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In re MANISTY'S SETTLEMENT

MANISTY AND ANOTHER *v.* MANISTY AND OTHERS

[1972 M. No. 5414]

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1973 March 6, 7; May 2 Templeman J

Power of Appointment—Intermediate power—Excepted class specified—Power to add to beneficiaries any person, corporation or charity—Whether power void for uncertainty

Applied. In re Hay's Settlement Trusts **[1982] 1 W.L.R. 202**

C

By a deed executed on December 8, 1971, a settlor conferred on his trustees power to apply the trust funds for the benefit of a class of beneficiaries, namely his infant children, his future children and remoter issue, and his two brothers and their future issue born before a closing date defined by clause 1 as the expiry of 79 years from the date of the settlement. By clause 1 it was provided that "every person who is for the time being a member of the excepted class shall be excluded from the class of beneficiaries." The original excepted class included the

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settlor, his wife for the time being, or any other person or his spouse settling property on the trusts of the settlement. Clause 4 (*a*) (iii) empowered the trustees (if they included at least one trustee who was not a beneficiary) at their absolute discretion to declare that any person, corporation or charity other than a member of the excepted class or trustee be included in the class of beneficiaries, provided that the deed should not take effect until it had been indorsed on the

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settlement. In December 1972, by a deed of declaration, a memorandum of which was indorsed on the settlement, the trustees added to the class of beneficiaries the settlor's mother and any person who should for the time being be the settlor's widow.

On a summons to determine whether the power conferred on the trustees to add to the class of beneficiaries was valid or void for uncertainty or otherwise:—

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Held, (1) that the settlor was not precluded by the doctrine of non-delegation from conferring an intermediate power on the trustees because a settlor could create powers of disposition exercisable by individuals or trustees without infringing the rule against delegation (post, pp. 21H—22A).

In re Abrahams' Will Trusts [1969] 1 Ch. 463 and *In re Park* [1932] 1 Ch. 580 applied.

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(2) That the conduct and duties of trustees of an intermediate power which prescribed the ambit of the power by classifying excepted persons were similar to the conduct and duties of trustees of a special power which prescribed the ambit of the power by classifying beneficiaries and provided that the definition of the excepted class was certain and the trustees could establish with certainty whether any given individual was or was not a member of the class, the mere width of the intermediate power did not make it impossible

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for the trustees to exercise the power or prevent the court from determining whether the trustees were in breach of their

[Reported by MRS. L. GAYNOR STOTT, Barrister-at-Law]

duty to administer; that therefore the power conferred on the trustees to add to the class of the beneficiaries and the exercise thereof by the deed of declaration were valid (post, pp. 22F–G, 26D–E).

In re Gulbenkian's Settlements [1970] A.C. 508, H.L.(E.); *In re Baden's Deed Trusts* [1971] A.C. 424, H.L.(E.) and *In re Baden's Deed Trusts* (*No.* 2) [1973] Ch. 9, C.A. applied.

In re Gestetner Settlement [1953] Ch. 672 considered.

The following cases are referred to in the judgment:

Abrahams' Will Trusts, In re [1969] 1 Ch. 463; [1967] 3 W.L.R. 1198; [1967] 2 All E.R. 1175.

Baden's Deed Trusts, In re [1967] 1 W.L.R. 1457; [1967] 3 All E.R. 159; [1969] 2 Ch. 388; [1969] 3 W.L.R. 12; [1969] 1 All E.R. 1016, C.A.; [1971] A.C. 424; [1970] 2 W.L.R. 1110; [1970] 2 All E.R. 228, H.L.(E.).

Baden's Deed Trusts (*No.* 2), *In re* [1972] Ch. 607; [1971] 3 W.L.R. 475; [1971] 3 All E.R. 985; [1973] Ch. 9; [1972] 3 W.L.R. 250; [1972] 2 All E.R. 1304, C.A.

Blausten v. *Inland Revenue Commissioners* [1971] 1 W.L.R. 1696; [1971] 3 All E.R. 1085; [1972] Ch. 256; [1972] 2 W.L.R. 376; [1972] 1 All E.R. 41; 47 T.C. 542, C.A.

Gestetner Settlement, In re [1953] Ch. 672; [1953] 2 W.L.R. 1033; [1953] 1 All E.R. 1150.

Gulbenkian's Settlements, In re [1968] Ch. 126; [1967] 3 W.L.R. 1112; [1967] 3 All E.R. 15, C.A.; [1970] A.C. 508; [1968] 3 W.L.R. 1127; [1968] 3 All E.R. 785, H.L.(E.).

Morice v. *Bishop of Durham* (1805) 10 Ves.Jun. 522.

Park, In re [1932] 1 Ch. 580.

The following additional cases were cited in argument:

Astor's Settlement Trusts, In re [1952] Ch. 534; [1952] 1 All E.R. 1067.

Jones, In re [1945] Ch. 105.

ORIGINATING SUMMONS

By a settlement dated December 20, 1971, the settlor, Edward Alexander Manisty, the first defendant, appointed his brother Henry Francis Manisty and Mark Rider Cheyne, the two plaintiffs, to be the first trustees of the settlement. By clause 4 (*a*) (i) read with clause 15, he gave the trustees for the time being power at their absolute discretion to pay, apply, appoint or settle the trust funds for the benefit of any of the beneficiaries, provided that the trustees included at least one trustee who was not a beneficiary. The power was exercisable during a perpetuity period, that is, until the expiration of 79 years from the execution of the settlement or such earlier date as the trustees should declare. The original beneficiaries were the settlor's two infant children, the fourth and fifth defendants, the future children and remoter issue of the settlor born before the closing date, the settlor's two brothers, Michael Christopher Manisty, the sixth defendant, who took no part in the proceedings, and Henry Herbert Manisty, the first plaintiff. The second defendant was the settlor's wife, Dinah Manisty, and the third defendant, his mother, Charlotte Stevens.

By a summons dated December 18, 1972, the plaintiffs applied to the court to determine (a) whether the power conferred on the trustees by

clause 4 (*a*) (iii) of the settlement to add to the class of beneficiaries was valid or void for uncertainty or otherwise, and, if the power was valid, whether a deed of declaration of December 8, 1972, a memorandum of which was indorsed on the settlement on December 11, 1972, operated to add the settlor's mother and any widow of the settlor to the class of beneficiaries.

C. H. McCall for the trustees. The trustees sought the determination of the court on the question as to whether the power was valid so that they might know whether the exercise of it was, or was not, of any effect. The trustees had made an appointment under their power but had been advised that in the light of Buckley L.J.'s judgment in *Blausten* v. *Inland Revenue Commissioners* [1972] Ch. 256, 271, they could not regard the validity of their power as being beyond doubt.

R. Cozens-Hardy Horne for the first, second, third and sixth defendants. Clause 4 of the settlement gives a mere power to the trustees and has no element of uncertainty. A settlor is not precluded by the doctrine of non delegation from conferring an intermediate power on the trustees. It is equivalent to giving a general power of appointment to the trustees and, when they come to consider the exercise of that power, they apply the test laid down in *In re Gestetner Settlement* [1953] Ch. 672; *In re Gulbenkian's Settlements* [1970] A.C. 508 and *In re Baden's Deed Trusts* [1971] A.C. 424.

In *In re Abrahams' Will Trusts* [1969] 1 Ch. 463, 474, Cross J. considered *In re Park* [1932] 1 Ch. 580 and decided that an intermediate power exercisable by trustees was valid.

Buckley L.J.'s dictum in *Blausten* v. *Inland Revenue Commissioners* [1972] Ch. 256, 271, is merely a dictum. In the case of a power it is only necessary for the trustees to know whether a particular individual does or does not come within the ambit of the power: see *In re Gulbenkian's Settlements* [1970] A.C. 508 and *In re Baden's Deed Trusts* [1971] A.C. 424. Applying that principle to the present case, the definition of the excepted class being certain, it follows that there is no uncertainty about the power.

J. Bradburn for the fourth and fifth defendants. A trust, in order to be valid must have three certainties: certainty of words, subject matter and objects. It must also be capable of control by the court: *per* Lord Eldon L.C. in *Morice* v. *Bishop of Durham* (1805) 10 Ves.Jun. 522, 539, quoted by Roxburgh J. in *In re Astor's Settlement Trusts* [1952] Ch. 534, 547–548, which decided that Lord Eldon L.C.'s test was as applicable to deeds as to wills.

Except within defined limits it is not permissible for a testator or settlor to delegate to another the choice of the objects of a trust. One obvious exception is a trust for charitable objects or purposes where the selection may be delegated to others, whether it be a specified individual or trustees for the time being. Another exception is where there is a trust for objects certain but it is made defeasible by the exercise of a power of appointment conferred on an individual: see *In re Park* [1932] 1 Ch. 580.

In the present case, the power is conferred not on an individual but on the trustees for the time being or their delegates, over a period of possibly 79 years. This is not permissible because *In re Gulbenkian's Settlements* [1970] A.C. 508 and *In re Baden's Deed Trusts* [1971] A.C. 424 do not conclusively answer the present problem because in each of those cases, the class of objects (albeit a very wide one) was defined, so that anything said about the test, whether for a trust or a power or a trust-power, being the ability to say with certainty that any given individual was or was not a member of the class must be read against that background. In the present case the problem is the prior question whether there is a class of objects at all or are the possible objects so hopelessly widely stated, in effect "all the world except a specified few," that the trustees cannot possibly consider in any sensible manner whether or not, or how to exercise the power.

Although this is a power which the trustees are not obliged to exercise at all, the trustees (as distinct from an individual) are under a duty to consider whether or not to exercise it: see *per* Lord Reid in *In re Gulbenkian's Settlements* [1970] A.C. 508, 518; and *per* Lord Wilberforce in *In re Baden's Deed Trusts* [1971] A.C. 424, 449, 456. In order that the trustees may be enabled to perform that duty there must be some "metes and bounds" limiting the field of consideration. There must be "something like a class": see *per* Lord Wilberforce in *In re Baden* [1971] A.C. 424, 457. The relevant parts of the argument of Mr. J. E. Vinelott Q.C. and Mr. Stephen Oliver and of Buckley L.J. in *Blausten* v. *Inland Revenue Commissioners* [1972] Ch. 256, 265–266, 271–273 are adopted.

Cur. adv. vult.

May 2. TEMPLEMAN J. read the following judgment. This summons challenges the validity of a power conferred on trustees to nominate and add to a class of beneficiaries.

By the settlement dated December 20, 1971, the settlor, who is the first defendant, appointed his brother Henry and a chartered accountant, who are the two plaintiffs, to be the first trustees, and by clause 4, read with clause 15, conferred on the trustees for the time being, provided that they include at least one trustee who is not a beneficiary, power at their absolute discretion to pay, apply, appoint or settle the trust funds for the benefit of any of the beneficiaries. The power is exercisable during a perpetuity period, that is to say, until the closing date defined by clause 1 as the date of the expiry of the period of 79 years from the execution of the settlement, or such earlier date as the trustees declare. The original beneficiaries were defined by clause 1 as the two existing infant children of the settlor, the future children and remoter issue of the settlor born before the closing date, the settlor's two brothers, Michael and Henry, and their children and remoter issue born before the closing date. It was provided that "every person who is for the time being a member of the excepted class shall be excluded from the class of beneficiaries."

The original excepted class defined by clause 1 comprised the settlor, the wife for the time being of the settlor, any other person or corporation settling property on the trusts of the settlement and the spouse of any

such other settlor. Clause 4, as limited by clause 15, also authorised the trustees, if they include at least one trustee who is not a beneficiary, to delete any person or corporation from the beneficiaries, to add any person, corporation or class to the excepted class and at their absolute discretion to exercise the power which is now challenged, and which, comprising clause 4 (*a*) (iii), reads as follows:

> "Power by any deed or deeds revocable or irrevocable to declare that any person or persons corporation or corporations or charity or charities (other than a person or corporation who shall for the time being be a member of the excepted class or one of the trustees) shall thenceforth and for such period as shall be specified in such deed or deeds (not extending beyond the closing date) be included in the class of beneficiaries hereinbefore defined provided always that any such deed shall not take effect unless and until the same (or a memorandum stating the effect thereof) has been endorsed on this settlement."

Subject to the powers of disposition conferred on the trustees, and to a trust for accumulation for 21 years, the trust funds, which in the first instance consisted of policies of assurance on the life of the settlor, were settled by clause 3 (2) on such of the children of the existing children of the settlor as shall be living on the closing date, or shall previously attain the age of 21 years, or if there shall be no such grandchildren of the settlor then by clause 3 (3) on such of the existing children as attain 21.

By a deed of declaration dated December 8, 1972, a memorandum of which was endorsed on the settlement and dated December 11, 1972, the trustees, who included one person who was not a beneficiary, added to the beneficiaries the mother of the settlor and any person who shall for the time being be the widow of the settlor. The settlor's wife, who may become his widow, and the settlor's mother are the second and third defendants and appear by Mr. Cozens-Hardy Horne to uphold the validity of the power to add beneficiaries and the validity of the deed of declaration which exercised that power.

The settlor's two existing infant children are the fourth and fifth defendants and they appear by Mr. Bradburn to argue in the interests of all the original beneficiaries that the power to add further beneficiaries is invalid and the deed of declaration is ineffective. The sixth defendant is Michael, the brother of the settlor, and has taken no part in the argument.

The power to add beneficiaries and to benefit the persons so added is exercisable in favour of anyone in the world except the settlor, his wife, the other members of the excepted class for the time being and the trustees, other than the settlor's brother Henry who was one of the original beneficiaries. This is not a general power exercisable in favour of anyone, nor a special power exercisable in favour of a class, but an intermediate power exercisable in favour of anyone, with certain exceptions.

Mr. Bradburn submits that an intermediate power cannot be conferred on trustees because of principles of non-delegation and uncertainty. The argument based on the principle of non-delegation stems from the proposition that a testator must not delegate to other persons the right to make a will for him. It is, however, established by authority that a testator, and a fortiori a settlor, may create powers of disposition exercisable by

individuals or by trustees without thereby infringing any rule against delegation. If delegation is the vice then delegation to an individual is as bad as delegation to a trustee. But in *In re Park* [1932] 1 Ch. 580, Clauson J. held valid an intermediate power conferred by a testator on an individual to appoint to anyone in the world, except the doneee of the power. If delegation is the vice then delegation to trustees by means of a special power is as bad as delegation to trustees by means of an intermediate power. But in *In re Gulbenkian's Settlements* [1970] A.C. 508 the House of Lords held valid a special power conferred by a settlor on trustees to benefit the settlor's son and his associates. To make assurance double sure, in *In re Abrahams' Will Trusts* [1969] 1 Ch. 463, 474–476, Cross J. held valid an intermediate power conferred by a testator on trustees to appoint to anyone in the world except the trustees, and he expressly rejected the argument based on the principle of non-delegation. I conclude that the settlor in the present case was not precluded by the doctrine of non-delegation from conferring an intermediate power on his trustees.

The argument based on uncertainty is that the trustees are under a duty to consider from time to time whether and how to exercise their powers, and that they cannot perform that duty, and a court cannot judge the performance of that duty, if the power is too wide. An intermediate power, it is said, is wider than any special power and is practically unlimited, and is therefore too wide, uncertain and invalid.

Invalidity, based on uncertainty, was the subject of *In re Gulbenkian's Settlements* [1970] A.C. 508 relating to special powers in favour of a class, and *In re Baden's Deed Trusts* [1971] A.C. 424, known as *Baden* (*No.* 1), relating to discretionary trusts in favour of a class. Those authorities establish that such a power or trust is valid if it can be said with certainty that any given individual is or is not a member of the class. The principle of the rule thus established does not strike down an intermediate power provided that, having regard to the definition of excepted persons, it can be said with certainty that any given individual is or is not an object of the power. The principle for which Mr. Horne contends may be adopted from the summary of the effect of *In re Gulbenkian's Settlements* to be found in the dissenting speech of Lord Guest in *Baden* (*No.* 1) [1971] A.C. 424 where he said, at p. 445: "In the case of a power it is only necessary for the trustees to know whether a particular individual does or does not come within the ambit of the power." Mr. Horne says, applying that principle to the present case, the definition of excepted class being certain, it follows that there is no uncertainty about the power.

The cases of *Gulbenkian* and *Baden* (*No.* 1) also establish, or rather reiterate, the rule that trustees of a power must consider from time to time whether and how to exercise the power, for in the words of Lord Reid in *Gulbenkian* [1970] A.C. 508, 518:

> "A settlor or testator who entrusts a power to his trustees must be relying on them in their fiduciary capacity so they cannot simply push aside the power and refuse to consider whether it ought in their judgment to be exercised. And they cannot give money to a person who is not within the classes of persons designated by the settlor: the construction of the power is for the court."

A In *Baden* (*No.* 1) [1971] A.C. 424, 449, Lord Wilberforce, referring to special powers, suggested that

> "Any trustee would surely make it his duty to know what is the permissible area of selection and then consider responsibly, in individual cases, whether a contemplated beneficiary was within the power and whether, in relation to other possible claimants, a particular grant was appropriate."

B He added, at p. 457, referring to special powers and to discretionary trusts in favour of a class that "in each case the trustees ought to make such a survey of the range of objects or possible beneficiaries as will enable them to carry out their fiduciary duty."

It is said that if a power is too wide the trustees cannot perform the C duty reiterated in *Gulbenkian* and *Baden* (*No.* 1) of considering from time to time whether and how to exercise the power and the court cannot determine whether or not the trustees are in breach of their duty. In my judgment, however, the mere width of a power cannot make it impossible for trustees to perform their duty nor prevent the court from determining whether the trustees are in breach.

In *In re Gestetner Settlement* [1953] Ch. 672 the trustees were D given the power set forth at p. 674, exercisable in favour of a class which excluded the settlor, his wife and the trustees and comprised four named individuals, the living and future descendants of the settlor's father and of an uncle of the settlor, the spouses, widows and widowers of those individuals and descendants, five named charitable bodies, former employees of the settlor or his wife and the widows and widowers of former employees E of the settlor or his wife and any person who was for the time being a director or employee or former director or employee or the wife or husband or widow or widower of a former director or employee of Gestetner Ltd. or of any company of which the directors for the time being included any one or more of the persons who were for the time being directors of Gestetner Ltd. This was a special power exercisable over an enormous class, and the great majority of beneficiaries by number and category F will never learn that they are objects of the power or fall to be considered by the trustees. If a director of Gestetner Ltd. became a director of Woolworth or Unilever there would be added to the class of beneficiaries shop assistants throughout England and workers throughout the world. *Gestetner* was approved in *Gulbenkian* and does not exhaust the ingenuity of settlors in creating classes and numbers of beneficiaries of G immeasurable width.

The argument that a discretionary trust in favour of a recognised class can be too wide was considered in *In re Baden's Deed Trusts* (*No.* 2) [1972] Ch. 607, a case known as *Baden* (*No.* 2), and a decision which for present purposes must apply to special powers as well as to discretionary trusts. In *Baden* (*No.* 2) it was submitted that a discretionary trust exer-H cisable in favour of employees and former employees of a company and their relatives and dependants was void for uncertainty because it did not satisfy the test suggested at p. 620 of the judgment of Brightman J., namely, that such a trust is

"invalid if the class is so large or arbitrary that the trustees cannot reasonably estimate the membership, or know how to set about instituting inquiries which will reveal the membership, including the membership of its subclasses or categories, and if the trustees cannot therefore properly discharge their duty to consider how the fund should be divided between the subclasses or categories, and what further inquiries they should make."

The suggested test only serves to illustrate how impossible it is to define the circumstances in which a recognised class may be said to be too wide. Brightman J. rejected the test and held that the discretionary trust was valid, applying only the test established in *Baden* (*No.* 1) that a trust in favour of a recognised class is valid if it can be said with certainty that any given individual is or is not a member of the class. The decision of Brightman J. in *Baden* (*No.* 2) was affirmed by the Court of Appeal [1973] Ch. 9. I conclude from *Gestetner*, *Gulbenkian* and the two *Baden* cases that a power cannot be uncertain merely because it is wide in ambit.

An alternative argument against the validity of an intermediate power conferred on trustees is that a power which is not confined to individuals or to classes recognised by the court is too vague. An intermediate power which does not attempt to classify the beneficiaries but only specifies or classifies excepted persons is therefore, it is said, too vague. It is admitted that it may be difficult to define or describe those classes which would not be recognised by the court, and are therefore also too vague, but the example suggested by Lord Wilberforce in *Baden* (*No.* 1) [1971] A.C. 424, 457 of "all the residents of Greater London" is given as an instance of a class which would not be so recognised. The submission that an intermediate power is too vague because the beneficiaries are not limited to specified individuals or recognised classes is in the final analysis based on the same reasoning as the attack on wide discretionary trusts which was rejected in *Baden* (*No.* 2) [1972] Ch. 607. The argument is that an intermediate power where the beneficiaries are not limited to specified individuals or recognised classes precludes the trustees from considering in a sensible manner whether and how to exercise the power, and prevents the court from judging whether the trustees have surveyed the field of objects and have properly considered whether and how to exercise the power.

Implicit in this argument are two assertions, first, that the terms of a special power in favour of recognised classes necessarily provide some guidance to the trustees with regard to the proper mode of considering how to exercise the power, and secondly, that the terms of a special power in favour of recognised classes enable the court to judge whether the trustees are in breach of their duty. In my judgment neither assertion is well founded. Some powers may give an indication of the expectations of the settlor. In *Gulbenkian* [1970] A.C. 508 it was plain that the trustees were expected to have regard to the best interests of Mr. Nubar Gulbenkian. There are similar powers where all the beneficiaries are equal but some are more equal than others. But in *Gestetner* [1953] Ch. 672 it was impossible to derive any assistance from the terms of the power, save that the trustees, it could be assumed, were expected to have regard to the considerations which might move the settlor to confer bounty on the beneficiaries. A similar expectation may be implied from an intermediate power,

A and in the present case, if the settlement is read as a whole, expectations of the settlor are not difficult to discern. In *Gestetner* the terms of the power did not in themselves indicate how employees were to be compared with relations, charities, individuals and other classes of beneficiaries. The terms of the power in themselves did not indicate whether and on what grounds one employee might be considered, whether by reference to services rendered to Gestetner Ltd. or to the settlor or by reference to age, health B or any other criterion. The terms of the power did not in themselves indicate whether and on what grounds one relation out of many was to be considered, whether by reference to his proximity to the settlor, poverty, educational requirements or any other circumstances. The terms of a special power do not necessarily indicate in themselves how the trustees are to consider the exercise of the power. That consideration is confided C to the absolute discretion of the trustees.

The court cannot insist on any particular consideration being given by the trustees to the exercise of the power. If a settlor creates a power exercisable in favour of his issue, his relations and the employees of his company, the trustees may in practice for many years hold regular meetings, study the terms of the power and the other provisions of the settlement, examine the accounts and either decide not to exercise the power or to D exercise it only in favour, for example, of the children of the settlor. During that period the existence of the power may not be disclosed to any relation or employee and the trustees may not seek or receive any information concerning the circumstances of any relation or employee. In my judgment it cannot be said that the trustees in those circumstances have committed a breach of trust and that they ought to have advertised the power or looked E beyond the persons who are most likely to be the objects of the bounty of the settlor. The trustees are, of course, at liberty to make further inquiries, but cannot be compelled to do so at the behest of any beneficiary. The court cannot judge the adequacy of the consideration given by the trustees to the exercise of the power, and it cannot insist on the trustees applying a particular principle or any principle in reaching a decision.

F If a person within the ambit of the power is aware of its existence he can require the trustees to consider exercising the power and in particular to consider a request on his part for the power to be exercised in his favour. The trustees must consider this request, and if they decline to do so or can be proved to have omitted to do so, then the aggrieved person may apply to the court which may remove the trustees and appoint others in their place. This, as I understand it, is the only right and only remedy of any G object of the power: see, for example, *In re Gestetner Settlement* [1953] Ch. 672, where Harman J. said, at p. 688, that the trustees

> "are not entitled entirely to release the power. That means that they are bound, as I see it, to consider at all times during which the trust is to continue whether or no they are to distribute any and if so what part of the fund and, if so, to whom they should distribute it. To H that extent, I have no doubt that there is a duty on these trustees: a member of the specified class might, if he could show that the trustees had deliberately refused to consider any question at all as to the want or suitability of any member of the class, procure their

> removal; . . . . there is no obligation on the trustees to do more than consider—from time to time, I suppose—the merits of such persons of the specified class as are known to them and, if they think fit, to give them something. The settlor had good reason, I have no doubt, to trust the persons whom he appointed trustees; but I cannot see here that there is such a duty as makes it essential for these trustees, before parting with any income or capital, to survey the whole field, and to consider whether A is more deserving of bounty than B. That is a task which was and which must have been known to the settlor to be impossible, having regard to the ramifications of the persons who might become members of this class."

Similarly, in the case of an intermediate power the settlor has no doubt good reason to trust the persons whom he appoints trustees. In my judgment the reasoning is parallel.

The court may also be persuaded to intervene if the trustees act "capriciously," that is to say, act for reasons which I apprehend could be said to be irrational, perverse or irrelevant to any sensible expectation of the settlor; for example, if they chose a beneficiary by height or complexion or by the irrelevant fact that he was a resident of Greater London. A special power does not show the trustees how to consider the exercise of the power in a sensible manner and does not by its terms enable the court to judge whether the power is being considered in a proper manner. The conduct and duties of trustees of an intermediate power, and the rights and remedies of any person who wishes the power to be exercised in his favour, are precisely similar to the conduct and duties of trustees of special powers and the rights and remedies of any person who wishes a special power to be exercised in his favour. In practice, the considerations which weigh with the trustees will be no different from the considerations which will weigh with the trustees of a wide special power. In both cases reasonable trustees will endeavour, no doubt, to give effect to the intention of the settlor in making the settlement and will derive that intention not from the terms of the power necessarily or exclusively, but from all the terms of the settlement, the surrounding circumstances and their individual knowledge acquired or inherited. In both cases the trustees have an absolute discretion and cannot be obliged to take any form of action, save to consider the exercise of the power and a request from a person who is within the ambit of the power. In practice, requests to trustees armed with an intermediate power are unlikely to come from anyone who has no claim on the bounty of the settlor. In practice, requests to trustees armed with a special power in favour, for example, of issue, relations and employees of a company are unlikely to come from anyone who has no claim on the bounty of the settlor, or has no plausible grounds for being given a benefit from property derived from the settlor. The only difference between an intermediate power and a special power for present purposes is that a settlor by means of a special power cannot be certain that he has armed his trustees against all developments and contingencies. A settlor who creates a special power exercisable in favour of issue, relations and employees may later regret that the trustees have no power to benefit adopted issue, widows and other persons outside the ambit of the power. Hence the recent popularity, as I am informed,

of intermediate powers which arm the trustees with a weapon which will enable them to consider all developments, and all future mishaps and disasters.

Logically, in my judgment, there is no reason to bless a special power which prescribes the ambit of the power by classifying beneficiaries and at the same time to outlaw an intermediate power which prescribes the ambit of the power by classifying excepted persons. It may well be that there are some classes of special power which will not be recognised by the court, but this possibility does not affect the validity of intermediate powers. The objection to the capricious exercise of a power may well extend to the creation of a capricious power. A power to benefit "residents of Greater London" is capricious because the terms of the power negative any sensible intention on the part of the settlor. If the settlor intended and expected the trustees would have regard to persons with some claim on his bounty or some interest in an institution favoured by the settlor, or if the settlor had any other sensible intention or expectation, he would not have required the trustees to consider only an accidental conglomeration of persons who have no discernible link with the settlor or with any institution. A capricious power negatives a sensible consideration by the trustees of the exercise of the power. But a wide power, be it special or intermediate, does not negative or prohibit a sensible approach by the trustees to the consideration and exercise of their powers.

If there is no logical objection to intermediate powers it remains to be considered whether the authorities, for historical or other reasons, forbid the conferment of intermediate powers on trustees. In *Morice* v. *Bishop of Durham* (1805) 10 Ves.Jun. 522 a trust for "such objects of benevolence and liberality as the trustee in his own discretion shall most approve" was held to be invalid and Lord Eldon L.C. said, at p. 539:

> "As it is a maxim, that the execution of a trust shall be under the control of the court, it must be of such a nature, that it can be under that control; so that the administration of it can be reviewed by the court; or, if the trustee dies, the court itself can execute the trust: a trust therefore, which, in case of mal-administration could be reformed; and a due administration directed; and then, unless the subject and the objects can be ascertained, upon principles, familiar in other cases, it must be decided, that the court can neither reform mal-administration, nor direct a due administration."

The decision in that case does not touch the present controversy. In a trust where the objects are described by vague adjectives such as "benevolent" and "liberal" the trust breaks the rule that the trustees and the court must be able to determine with certainty whether a particular individual or a particular object is within the ambit of the power. Nor does an intermediate power break the principles laid down by Lord Eldon L.C. in the passage which I have read because, in relation to a power exercisable by the trustees at their absolute discretion, the only "control" exercisable by the court is the removal of the trustees, and the only "due administration" which can be "directed" is an order requiring the trustees to consider the exercise of the power, and in particular a request from a person within the ambit of

the power. This control and direction may be exercised by the court in relation to a power, whether special or intermediate.

In *In re Park* [1932] 1 Ch. 580 Clauson J. held that an intermediate power exercisable by an individual was valid, but, he said, at p. 583:

> "It is clearly settled that if a testator creates a trust he must mark out the metes and bounds which are to fetter the trustees or, as has been said, the trust must not be too vague for the court to enforce, and that is why a gift to trustees for such purposes as they may in their discretion think fit is an invalid trust; there are no metes and bounds within which the trust can be defined, and unless the trust can be defined the court cannot enforce it."

If the object of metes and bounds is to enable the trustees and the court to determine whether an individual is or is not a beneficiary then an intermediate power satisfies that test. If the requirement of certainty is the same as that mentioned by Lord Eldon L.C. in *Morice* v. *Bishop of Durham* (1805) 10 Ves.Jun. 522, this passage from the judgment of Clauson J. does not affect powers, whether special or intermediate, where the only "enforcement" allowed to the court is enforcement of the right of any person within the ambit of the power to require the trustees to consider the exercise of the power and his request. If the passage means more than this, it nevertheless does not in terms apply to powers, and even in relation to trusts may be required to be reconsidered in the light of the consequences of the decision of the majority of the House of Lords in *Baden (No. 1)* [1971] A.C. 424.

In *In re Abrahams' Will Trusts* [1969] 1 Ch. 463, 474, Cross J. considered *In re Park* [1932] 1 Ch. 580 and decided that an intermediate power exercisable by trustees was valid. Mr. Bradburn points out that *In re Abrahams' Will Trusts* was decided before the decision of the House of Lords in *In re Gulbenkian's Settlements* [1970] A.C. 508, but it is plain that the judgment of Cross J. is not inconsistent with *Gulbenkian* and he discussed the nature of a power and the duty of the trustees in words which anticipated both *Gulbenkian* and *Baden*. Cross J. said [1969] 1 Ch. 463, 474:

> "It is not a trust imposed on them; it is a mere power. Of course it is a fiduciary power given to them in their capacity of trustees and they could not release it. They must retain it unless and until they exercise it, and consider from time to time whether they ought to exercise it."

The judge clearly did not envisage that the trustees' function, to which he alluded in terms anticipating *Gulbenkian* and *Baden* would be difficult or impossible for trustees to carry out in connection with an intermediate power, and clearly did not envisage that the court would find any difficulty in carrying out its limited function with regard to the exercise by the trustees of powers.

In *Baden (No. 1)* [1971] A.C. 424, Lord Wilberforce, at p. 457, referred first to "linguistic or semantic uncertainty which, if unresolved by the court, renders the gift void" and secondly to "the difficulty of ascertaining the existence or whereabouts of members of the class, a matter

with which the court can appropriately deal on an application for directions." Then he said:

> "There may be a third case where the meaning of the words used is clear but the definition of beneficiaries is so hopelessly wide as not to form 'anything like a class' so that the trust is administratively unworkable or in Lord Eldon L.C.'s words one that cannot be executed,"

B

and he cited *Morice* v. *Bishop of Durham*, 10 Ves.Jun. 522, 527. He continued:

> "I hesitate to give examples for they may prejudice future cases, but perhaps 'all the residents of Greater London' will serve. I do not think that a discretionary trust for 'relatives' even of a living person falls within this category."

C

In these guarded terms Lord Wilberforce appears to refer to trusts which may have to be executed and administered by the court and not to powers where the court has a very much more limited function. Moreover, a capricious power exercisable in favour of "residents of Greater London" may, as I have already outlined, well be uncertain. The settlor neither gives the trustees an unlimited power which they can exercise sensibly, nor a power limited to what may be described a "sensible" class, but a power limited to a class, membership of which is accidental and irrelevant to any settled purpose or to any method of limiting or selecting beneficiaries.

D

Finally, in *Blausten* v. *Inland Revenue Commissioners* [1972] Ch. 256 there are passages beginning at p. 271, which are admittedly obiter to the decision of Buckley L.J. in which the Lord Justice accepted the validity of an intermediate power exercisable by trustees with the consent of the settlor but was clearly not disposed to accept the validity of an intermediate power exercisable by trustees at their sole discretion. The full consequences and implications of *In re Gestetner Settlement* [1953] Ch. 672, *In re Gulbenkian's Settlements* [1970] A.C. 508 and the two *Baden* cases [1971] A.C. 424, (*No.* 2) [1973] Ch. 9 do not, however, appear to have been fully explored for the assistance of Buckley L.J. and that is not surprising in view of the fact that the Court of Appeal reached its conclusions on grounds which did not involve a final pronouncement on the validity of intermediate powers.

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In the result, I conclude that I am not constrained by authority to strike down a power which a settlor, disposing of his own property under skilled advice, wishes to confer on his trustees.

G

Declaration accordingly.

Solicitors: *Stephenson, Harwood & Tatham.*

H

uncertainty in the subject matter of a trust being part of the payments made to the respondent by third parties, the trust arising as those payments were received by the respondent.[87] Further, the fact that extensive analysis was required to determine the true construction of the clause did not result in uncertainty.[88]

In a strongly criticised decision,[89] the English Court of Appeal held it was effective for the owner of a parcel of 950 shares in a private company to declare a trust of 5% of those shares without otherwise specifying those of the parcel of shares to which the trust attached.[90] Directions by a testator to a legatee 'to consider my near relations'[91] 'as I should consider them myself or to reward my old tenants and servants'[92] according to their deserts have been held to be void for uncertainty as to the property to be bound by the trust. A direction or request that a donee 'make ample provisions' for a third party created no trust in favour of the latter,[93] but a direction to receive a 'reasonable income' was sufficiently certain.[94]

Even property which is incapable of assignment, such as a contract involving personal skill or confidence, may be held on trust.[95]

Certainty as to the Object of the Trust

[524] The objects of a private trust must be identified with sufficient certainty, failing which the trust will be invalid.[96] The requisite level of certainty depends on whether the trustees are obliged to distribute to a class of beneficiaries (a *fixed* trust), or have a discretion to select beneficiaries within a class to whom distributions are to be made (a *discretionary* trust).

[525] In the case of a fixed trust, the objects must be defined with sufficient precision to satisfy "list certainty". That will occur if it is possible for the trustees, or the court in their stead, to identify all of the beneficiaries. In *Kinsela v Caldwell*[97] the High Court said "it is sufficient that the provisions of the trust ensure that upon that date the beneficiaries can be ascertained with certainty".[98] Stronger statements, to the effect that complete identification is not merely sufficient but necessary, may be found in the authorities, reasoning that it is a breach of trust in such a case merely to divide the fund up among those present.[99]

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87. See Ch 6 'Express Trusts — Complete Consitution of Consideration'.
88. See (2000) 202 CLR 588 at [13]–[25] especially at [15]; 171 ALR 568, citing *Upper Hunter County District Council v Australian Chilling and Freezing Co Ltd* (1968) 118 CLR 429 at 436–437.
89. Hayton, 'Uncertainty and Subject-Matter of Trusts' (1994) 110 *LQR* 335, and see *Re Harvard Securities Ltd* [1997] 2 BCLC 369 at 381–385, ultimately holding that English and Australian law diverged in this respect.
90. *Hunter v Moss* [1994] 3 All ER 215; [1994] 1 WLR 452.
91. *Sale v Moore* (1827) 1 Sim 534; 57 ER 678.
92. *Knight v Knight* (1840) 3 Beav 148 at 177–178; 49 ER 58 at 69–70.
93. *Winch v Brutton* (1844) 14 Sim 379; 60 ER 404; *Re Bond* (1876) 4 Ch D 238. See, however, *Broad v Bevan* (1823) 1 Russ 517n; 38 ER 198; *Re Moore* (1886) 54 LT 231.
94. *Re Golay's Will Trusts* [1965] 2 All ER 660; [1965] 1 WLR 969.
95. *Don King Inc v Warren* [2000] Ch 291 at 320–1; [1998] 2 All ER 608 at 633–634; *McGowan v Commissioner of Stamp Duties* [2002] 2 Qd R 499 at [14].
96. See Emery (1982) 98 *LQR* 551, and Creighton (2000) 22 *Syd Law Rev* 93.
97. (1975) 132 CLR 458 at 461; 5 ALR 337 at 339.
98. Cf Matthews (1984) 48 *Conv* 22 but see Martin (1984) 48 *Conv* 304; Hayton (1984) 48 *Conv* 307.
99. *Re Gulbenkian's Settlement Trusts* [1970] AC 508 at 524; [1968] 3 All ER 785 at 792–793; *McPhail v Doulton* [1971] AC 424 at 453–4; [1970] 2 All ER 228 at 244; *Re Beckbessinger* [1993] 2 NZLR 362 at 369–70; *Commissioner of State Revenue v Viewbank Properties Pty Ltd* (2004) 55 ATR 501 at [20]–[21].

Provided no perpetuity is involved, it is not necessary that the class be known prior to the date of distribution; it is sufficient that on that date they can be ascertained with certainty.[100] Indeed, what is required is that the court be satisfied that "a complete list of the beneficiaries could probably be compiled".[101] However, in *West v Weston*, confronted with evidence that it was more probable than not that there were unidentified members of a large class of beneficiaries of a fixed trust in favour of "the issue living at my death of my four grandparents", Young J proposed and applied a modification of the rule, namely, that "the rule will be satisfied if, within a reasonable time after the gift comes into effect, the court can be satisfied on the balance of probabilities that the substantial majority of the beneficiaries have been ascertained and that no reasonable inquiries could be made which would improve the situation".[102] That modification is inconsistent with the tenor of what the High Court said in *Kinsela v Caldwell*, extracted above, which is to be taken as affirming the conventional test, rather than admitting the possibility that some lesser test might also suffice.[103]

[526] Mere difficulty in ascertaining the identity of the members of the class does not render the trust invalid; courts are accustomed to resolving such evidentiary difficulties.[104] However, the position is different if there is conceptual uncertainty. Thus a trust for distribution in equal shares to "my old friends" would be uncertain, in the absence of it being admissibly demonstrated that those words had a precisely defined meaning.[105]

[527] In the case of a *discretionary* trust, the objects must be defined with sufficient certainty to satisfy "criterion certainty", and, perhaps, there may in addition be a "loose class" or "administrative workability" requirement.[106] In *McPhail v Doulton*[107] a majority of the House of Lords discarded the former rule (list certainty) and held that "the test for the validity of trust powers ought to be similar to that accepted by this House in *Re Gulbenkian's Settlements* for [non-trust] powers, namely, that the trust is valid if it can be said with certainty that any given individual is or is not a member of the class." Thus it is not necessary to identify every member of the class, and mere evidentiary difficulties in respect of some members do not prevent validity, although conceptual certainty (which can be elusive) is required.[108]

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100. *Kinsela v Caldwell* (1975) 132 CLR 458 at 461; 5 ALR 337 at 339; *Spotlight Stores Pty Ltd v Federal Commissioner of Taxation* (2004) 55 ATR 745 at [48].
101. *Re Saxone Shoe Co Ltd's Trust Deed* [1962] 2 All ER 904 at 913; [1962] 1 WLR 943 at 955, not following *Re Eden* [1957] 2 All ER 430; [1957] 1 WLR 788.
102. (1998) 44 NSWLR 657 at 461.
103. See Creighton, (2000) 22 *Syd Law Rev* 93 at 97–98; validity might still have been achieved on orthodox principles had the evidence permitted a finding as to the maximum number of beneficiaries, thereby permitting a partial distribution and paying the balance into court: see *Re Gulbenkian's Settlement Trusts* [1970] AC 508 at 524; [1968] 3 All ER 785 at 793.
104. See, for example, *Re Coxen* [1948] Ch 747 at 759–760; [1948] 2 All ER 492 at 501–502; *Re Baden (No 2)* [1973] Ch 9 at 29; [1972] 2 All ER 1304 at 1309.
105. *Re Gulbenkian's Settlement Trusts* [1970] AC 508 at 524; [1968] 3 All ER 785 at 792; *McPhail v Doulton* [1971] AC 424 at 457; [1970] 2 All ER 228 at 247.
106. See [528].
107. [1971] AC 424; [1970] 2 All ER 228.
108. See *Re Baden (No 2)* [1973] Ch 9; [1972] 2 All ER 1304.

McPhail v Doulton provoked intense controversy at the time,[109] and left open the question of its applicability in Australia. It has now come to be regularly applied in Australia and New Zealand,[110] and should be taken to represent the law.

[528] In *McPhail v Doulton*, Lord Wilberforce also suggested that trust powers had to satisfy an additional requirement: that they form a 'loose class'.[111] His Lordship envisaged a case where 'the meaning of the words used is clear' (that is, criterion certainty exists) 'but the definition of beneficiaries is so hopelessly wide as not to form 'anything like a class' so that the trust is administratively unworkable or ... one that cannot be executed.'[112] His Lordship suggested that a trust power in favour of 'all the residents of Greater London might well fail on this ground'. Although his Lordship did not advance any reasons to justify this view, there is much to justify it both on authority and in principle. As far as authority goes, trust powers in favour of anyone, or anyone but the trustees, have always been held bad.[113] As far as principle is concerned, unless there is some requirement of class certainty it is not easy to see how any person at all would have sufficient locus standi to enforce the trust; if the chosen class were impossibly wide, it would seem absurd that merely anyone could institute equity proceedings seeking to compel the trustee to exercise the trust power.[114] In *Blausten v IRC*[115] the Court of Appeal, dealing with a mere power, not a trust power, held that, in any event, class certainty did exist; and, of the judges who heard that case, Buckley LJ was of the view that Lord Wilberforce's requirement of 'class certainty' applied equally to trust powers and to mere powers. This line of reasoning has been cogently attacked[116] as importing into the requirements for the validity of mere powers a test which properly belongs only to trust powers. Then, in *Re Manisty's Settlement*[117] Templeman J (correctly, it is submitted) declined to follow the application by Buckley LJ of the requirement of class certainty to mere powers. That case concerned a settlement enabling a trustee to appoint to a class of beneficiaries; which also provided for the exclusion of certain persons from that class; and which provided that the trustees were empowered at their absolute discretion to declare that any person, corporation or charity (other than a trustee or a member of the excluded class) be included in the class of beneficiaries. His Lordship pointed out that there was, in the case of mere powers (and, manifestly, it was a case of a mere power not a trust power) no authority compelling the importation of the requirement of class certainty; and

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109. Thus, for example, Crane (1970) 34 *Conv* 287 described it as "revolutionary"; see also paras [252]–[257] of the 6th edition of this work.
110. *Horan v James* [1982] 2 NSWLR 376; *McCracken v Attorney-General* [1995] 1 VR 67 at 71; *Herdegen v Federal Commissioner of Taxation* (1988) 84 ALR 271 at 277; *Re Blyth* [1997] 2 Qd R 567; *Re Beckbessinger* [1993] 2 NZLR 362 at 369.
111. [1971] AC 424 at 457; [1970] 2 All ER 228 at 247.
112. At 457; 247.
113. See *Neo v Neo* (1875) LR 6 CP 381; *Re Carville* [1937] 4 All ER 464; *Re Chapman* [1922] 1 Ch 287; *Re Pugh* [1967] 3 All ER 337; [1967] 1 WLR 1262; *Re Bourk* [1907] VLR 171; *Re Dwyer* [1916] VLR 114; *Re White* [1963] NZLR 788; *Re Hollole* [1945] VLR 295.
114. In *R v District Auditor; ex parte West Yorkshire Metropolitan County Council* (1986) 26 RVR 24 (noted Harpum (1986) 45 *CLJ* 391 and see Hardcastle (1990) 54 *Conv* 24), a trust for the benefit of "any or all or some of the inhabitants of the Country of West Yorkshire" was held invalid for administrative unworkability.
115. [1972] Ch 256; [1972] 1 All ER 41.
116. By (among others) Hardingham in (1975) 46 *ALJ* 293.
117. [1974] Ch 72; [1973] 2 All ER 1203.

that on principle such a requirement ought not be imported. In the case of mere powers, no question can ever arise of a member of the class of beneficiaries enforcing any trust, and the duty of the donee of the power to consider and investigate does not require or make necessary that the objects of the power should constitute any sort of class, loose or otherwise. Templeman J's decision was followed by Sir Robert Megarry V-C in *Re Hay's Settlement Trusts*.[118]

But all this leaves undecided the major problem, namely, what did Lord Wilberforce mean by 'a loose class'? He surely did not mean that all 'beneficiaries' of a trust power have to have a common characteristic; partly because that would mean one could never have a hybrid trust power, as opposed to a special trust power, and partly because such a trust would reimport into trust powers the very sort of test which the majority of the House of Lords in *McPhail v Doulton*[119] found unacceptable. It is respectfully suggested that all his Lordship should be taken to have meant is that 'the range' (of beneficiaries) 'constitutes a readily identifiable, numerically and geographically discrete grouping'.[120] However, one commentator[121] after a review of the authorities and academic writing concludes that the juridical basis for the 'workability criterion' remains nebulous but, surprisingly, says that this 'need not trouble us unduly' because the concept 'should not be hedged around with theoretical strictures' and that because many settlements 'fulfil important socio-welfare functions' the court should be left 'to devote its scarce resources thereto without being sidetracked by the whimsical and unworkable'.

[529] If a trust fails for want of certainty of object, the property is held on resulting trust for the settlor (or, if dead, the residuary beneficiaries under the settlor's will). If however a trust fails *both* for uncertainty of intention and for uncertainty of object, then the person to whom the property has been given will retain it unfettered by any trust.[122] Thus, where a testator gave property to a donee and expressed a desire, in language leaving it uncertain whether a trust was intended, that the donee would distribute it as he thought would be most agreeable to the testator's wishes, it was held that the donee was entitled to the property absolutely.[123]

118. [1981] 3 All ER 786; [1982] 1 WLR 202.
119. [1970] AC 508; [1968] 3 All ER 785.
120. Hardingham in (1975) 49 *ALJ* 7. The requirement appears in England to have been applied only in one case, *R v District Auditor, Ex parte West Yorkshire Metropolitan County Council* (1986) 26 RVR 24, noted Harpum [1986] *CLJ* 391.
121. Hardcastle, 'Administrative Unworkability — A Reassessment of an Abiding Problem' (1990) 54 *Conv* 24 at 33.
122. *Sale v Moore* (1827) 1 Sim 534; 57 ER 678.
123. *Stead v Mellor* (1877) 5 Ch D 225. But see also *Thomson v Shakespear* (1860) 1 De GF & J 399; 45 ER 413; *In the Will of Bourk* [1907] VLR 171; *Re Dwyer* [1916] VLR 114.

DOUBLE TAXATION TAXES ON INCOME

CONVENTION BETWEEN THE UNITED STATES OF AMERICA AND AUSTRALIA

Convention signed at Sydney August 6, 1982;
Transmitted by the President of the United States of America to the Senate September 14, 1982 (Treaty Doc. No.97-28, 97th Cong., 2d Sess.);
Reported favorably by the Senate Committee on Foreign Relations July 11, 1983 (S. Ex. Rept. No.98-16, 98th Cong., 1st Sess.);
Advice and consent to ratification by the Senate July 27, 1983;
Ratified by the President August 23, 1983;
Ratified by Australia October 19, 1983;
Ratifications exchanged at Washington October 31, 1983;
Proclaimed by the President December 5, 1983;
Entered into force October 31, 1983.

GENERAL EFFECTIVE DATE UNDER ARTICLE 28: 1 DECEMBER 1983

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TAX CONVENTION WITH AUSTRALIA

MESSAGE

FROM

THE PRESIDENT OF THE UNITED STATES

TRANSMITTING

THE CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF AUSTRALIA FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME, SIGNED AT SYDNEY ON AUGUST 6, 1982

LETTER OF SUBMITTAL

DEPARTMENT OF STATE,
Washington, August 17, 1982.

THE PRESIDENT,
The White House.

THE PRESIDENT: I have the honor to submit to you, with a view to its transmission to the Senate for advice and consent to ratification, the Convention between the Government of the United States of America and the Government of Australia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, signed at Sydney on August 6, 1982.

The Convention is based to a large extent on the United States draft model income tax convention published by the Department of the Treasury in June 1981 and the OECD model published in January 1977. It takes into account changes in the income tax laws and tax treaty policies of the two countries.

With respect to taxes on investment income, the Convention provides that the tax at source may not exceed 15 percent on dividends and 10 percent on interest and royalties.

At the request of the United States, the Convention includes a provision permitting either Contracting State to tax gains derived by a resident of the other State on the disposition of an interest in real property located in the first State.

In addition, the Convention allows the taxation of business profits in certain cases beyond those covered in the United States model by providing a somewhat broader definition of the term "permanent establishment." For example, a building site becomes a permanent establishment if it exists for more than 9 months (rather than the 12 months stipulated in the United States model) and supervisory activities carried on in connection with a building site for more than 9 out of 24 months constitute a permanent establishment. The use of a rig or ship for 6 out of 24 months in connection with the exploration or extraction of natural resources also constitutes a permanent establishment.

The rules governing the taxation of remuneration for personal services are similar to those of other United States tax treaties.

The Convention introduces a new article on nondiscrimination not found in the existing convention. This article, by its terms, will not apply to income tax laws reasonably designed to prevent the avoidance or evasion of taxes, or to tax provisions which are in force on the date of signature of the Convention (or subsequently enacted, but substantially similar in general purpose or intent to those already in force). Except for provisions in force on the date of signature, the nondiscrimination article will apply even to the above types of tax provisions, however, where such provisions (other than ones in international agreements) discriminate between citizens or residents of the other Contracting State and those of any third State. If either country considers that taxation measures adopted by the other country infringe upon these principles, the competent authorities of the two countries will endeavor to resolve the issue.

The Convention will enter into force upon the exchange of instruments of ratification and its provisions will take effect as of the first day of the second month following that date. The 1953 convention will cease to apply when the new Convention takes effect.

A technical memorandum explaining in detail the provisions of the Convention is being prepared by the Department of the Treasury and will be submitted to the Senate Committee on Foreign Relations.

The Department of the Treasury, with the cooperation of the Department of State, was primarily responsible for the negotiation of the Convention. It has the approval of both Departments.

Respectfully submitted,

GEORGE P. SHULTZ.

LETTER OF TRANSMITTAL

THE WHITE HOUSE, *September 14, 1982.*

To the Senate o/ the United States:

I transmit herewith, for Senate advice and consent to ratification, the Convention between the Government of the United States of America and the Government of Australia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income signed at Sydney on August 6, 1982. I also transmit the report of the Department of State on the Convention.

The Convention, based on the OECD and draft United States model income tax conventions, takes into account changes in the income tax laws and tax treaty policies of the two countries. It provides limits on the tax at source with respect to taxes on investment income and provides rules for the taxation of capital gains, business profits, personal service income and other income. It also specifies the method used to avoid double taxation and provides for administrative cooperation between the tax officials of the two countries to avoid double taxation and prevent fiscal evasion.

I recommend that the Senate give early and favorable consideration to the Convention and give advice and consent to its ratification.

RONALD REAGAN.

BY THE PRESIDENT OF THE UNITED STATES OF AMERICA

A PROCLAMATION

CONSIDERING THAT:

The Convention between the Government of the United States of America and the Government of Australia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income was signed at Sydney on August 6, 1982, the text of which is hereto annexed;

The Senate of the United States of America by its resolution of July 27, 1983, two-thirds of the Senators present concurring therein, gave its advice and consent to ratification of the Convention;

The Convention was ratified by the President of the United States of America on August 23, 1983, in pursuance of the advice and consent of the Senate, and was ratified on the part of Australia;

The instruments of ratification of the Convention were exchanged at Washington on October 31, 1983, and accordingly the Convention entered into force on October 31, 1983, its provisions to have effect as specified in Article 28;

NOW, THEREFORE, I, Ronald Reagan, President of the United States of America, proclaim and make public the Convention to the end that it be observed and fulfilled with good faith on and after October 31, 1983, by the United States of America and by the citizens of the United States of America and all other persons subject to the jurisdiction thereof.

IN TESTIMONY WHEREOF, I have signed this proclamation and caused the Seal of the United States of America to be affixed.

DONE at the city of Washington this fifth day of December in the year of our Lord one thousand nine hundred eighty-three and of the Independence of the United States of America the two hundred eighth.

By the President:
RONALD REAGAN

GEORGE P. SHULTZ
Secretary of State

CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF AUSTRALIA FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME

The Government of the United States of America and the Government of Australia.

Desiring to conclude a Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income,

Have agreed as follows:

ARTICLE 1
Personal Scope

(1) Except as otherwise provided in this Convention, this Convention shall apply to persons who are residents of one or both of the Contracting States.

(2) This Convention shall not restrict in any manner any exclusion, exemption, deduction, rebate, credit or other allowance accorded from time to time:

(a) by the laws of either Contracting State; or

(b) by any other agreement between the Contracting States.

(3) Notwithstanding any provision of this Convention, except paragraph (4) of this Article, a Contracting State may tax its residents (as determined under Article 4 (Residence)) and individuals electing under its domestic law to be taxed as residents of that state, and by reason of citizenship may tax its citizens, as if this Convention had not entered into force. For this purpose, the term "citizen" shall, with respect to United States source income according to United States law relating to United States tax, include a former citizen whose loss of citizenship had as one of its principal purposes the avoidance of tax, but only for a period of 10 years following such loss.

(4) The provisions of paragraph (3) shall not affect:

(a) the benefits conferred by a Contracting State under paragraph (2) of Article 9 (Associated Enterprises), paragraph (2) or (6) of Article 18 (Pensions, Annuities, Alimony and Child Support), Article 22 (Relief from Double Taxation), 23 (Non-Discrimination), 24 (Mutual Agreement Procedure) or paragraph (1) of Article 27 (Miscellaneous); or

(b) the benefits conferred by a Contracting State under Article 19 (Governmental Remuneration), 20 (Students) or 26 (Diplomatic and Consular Privileges) upon individuals who are neither citizens of, nor have immigrant status in, that State (in the case of benefits conferred by the United States), or who are not ordinarily resident in that State (in the case of benefits conferred by Australia).

ARTICLE 2
Taxes Covered

(1) The existing taxes to which this Convention shall apply are:

(a) in the United States: the Federal income taxes imposed by the Internal Revenue Code, but excluding the accumulated earnings tax and the personal holding company tax; and

(b) in Australia; the Australian income tax, including the additional tax upon the undistributed amount of the distributable income of a private company.

(2) This Convention shall also apply to any identical or substantially similar taxes which are imposed by either Contracting State after the date of signature of this Convention in addition to, or in place of, the existing taxes. At the end of each calendar year, the competent authority of each Contracting State shall notify the competent authority of the other Contracting State of any substantial changes which have been made during that year in the laws of his State relating to the taxes to which this Convention applies or in the official interpretation of those laws or of this Convention.

ARTICLE 3

General Definitions

(1) For the purposes of this convention, unless the context otherwise requires:

(a) the term "person" includes an individual, an estate of a deceased individual, a trust, a partnership, a company and any other body of persons;

(b) the term “company” means any body corporate or any entity which is treated as a company or a body corporate for tax purposes;

(c) the terms "enterprise of one of the Contracting States" and "enterprise of the other Contracting State" mean an enterprise carried on by a resident of Australia or an enterprise carried on by a resident of the United States, as the context requires;

(d) the term “international traffic” means any transport by a ship or aircraft, except where such transport is solely between places within a Contracting State;

(e) the term “competent authority” means:

(i) in the case of the United States: the Secretary of the Treasury or his delegate; and

(ii) in the case of Australia: the Commissioner of Taxation or his authorized representative;

(f) the terms “Contracting State”, “one of the Contracting States” and “the other Contracting State” mean the United States or Australia, as the context requires;

(g) (i) the term "United States corporation" means a corporation which, under United States law relating to United States tax, is a domestic corporation or an unincorporated entity treated as a domestic corporation, and which is not, under the law of Australia relating to Australian tax, a resident of Australia; and

(ii) the term “Australian corporation” means a company, as defined under the law of Australia relating to Australian tax, which, under that law, is a resident of Australia, and which is not, under United States law relating to United States tax, a domestic corporation or an unincorporated entity treated as a domestic corporation;

(h) the term "State" means any National State, whether or not one of the Contracting States;

(i) the term “United State tax” means tax imposed by the United States to which this Convention applies by virtue of Article 2 (Taxes Covered) and the term “Australian tax” means tax imposed by Australia to which this Convention applies by virtue of Article 2 (Taxes Covered), but neither term includes any amount which represents a penalty or interest imposed under the law of either Contracting State relating to United States tax or Australian tax;

(j) (i) The term “United States” means the United States of America; and

(ii) when used in a geographical sense, the term “United States” means the states thereof and the District of Columbia and also includes:

(A) the territorial waters thereof; and

(B) the sea-bed and subsoil of the submarine areas adjacent to the coast thereof, but beyond the territorial waters, over which the United States exercises rights, in accordance with international law, for purposes of exploration for, or exploitation of, the natural resources of those areas;

(k) the term "Australia" means the Commonwealth of Australia and, when used in a geographical sense, includes:

(i) the Territory of Norfolk Island;

(ii) the Territory of Christmas Island;

(iii) the Territory of Cocos (Keeling) Islands;

(iv) the Territory of Ashmore and Cartier Islands;

(v) the Coral Sea Islands Territory; and

(vi) any area adjacent to the territorial limits of Australia or of the said Territories in respect of which there is for the time being in force, consistently with international law, a law of Australia or of a State or part of Australia or of a Territory aforesaid dealing with the exploitation of any of the natural resources of the sea-bed and subsoil of the continental shelf;

(l) the term "resident of one of the Contracting States" and "resident of the other Contracting State" mean a resident of Australia or a resident of the United States, as the context requires.

(2) As regards the application of this Convention by one of the Contracting States, any term not defined herein shall, unless the context otherwise requires, have the meaning which it has under the laws of that State relating to the taxes to which this Convention applies.

ARTICLE 4
Residence

(1) For the purposes of this Convention:

(a) a person is a resident of Australia if the person is:

(i) an Australian corporation; or

(ii) any other person (except a company as defined under the law of Australia relating to Australian tax) who, under that law, is a resident of Australia, provided that, in relation to any income, a person who:

(iii) is subject to Australian tax on income which is from sources in Australia; or

(iv) is a partnership, an estate of a deceased individual or a trust (other than a trust that is a provident, benefit, superannuation or retirement fund, or that is established for public charitable purposes or for the purpose of enabling scientific research to be conducted by or in conjunction with a public university or public hospital, the income of which is exempt from tax under the law of Australia relating to Australian tax),

shall not be treated as a resident of Australia except to the extent that the income is subject to Australian tax as the income of a resident, either in the hands of that person or in the hands of a partner of beneficiary, or, if that income is exempt from Australian tax, is so exempt solely because it is subject to United States tax; and

(b) a person is a resident of the United States if the person is:

(i) a United States corporation; or

(ii) any other person (except a corporation or unincorporated entity treated as a corporation for United States tax purposes) resident in the United States for purposes of its tax, provided that, in relation to any income derived by a partnership, an estate of a deceased individual or a trust, such person shall not be treated as a resident of the United States except to the extent that the income is subject to United States tax as the income of a resident, either in its hands or in the hands of a partner or beneficiary, or, if that income is exempt from United States tax, is exempt other than because such person, partner or beneficiary is not a United States person according to United States law relating to United States tax.

(2) Where by application of paragraph (1) an individual is a resident of both Contracting States, he shall be deemed to be a resident of the State:

(a) in which he maintain his permanent home;

(b) if the provisions of sub-paragraph (a) do not apply, in which he has an habitual abode if he has his permanent home in both Contracting States or in neither of the Contracting States; or

(c) if the provisions of sub-paragraphs (a) and (b) do not apply, with which his personal and economic relations are closer if he has an habitual abode in both Contracting States or in neither of the Contracting States.

(3) For the purposes of this paragraph, in determining an individual's permanent home, regard shall be given to the place where the individual dwells with his family, and in determining the Contracting State with which an individual's personal and economic relations are closer, regard shall be given to his citizenship (if he is a citizen of one of the Contracting States).

An individual who is deemed to be a resident of one of the Contracting States for any year of income, or taxable year, as the case may be by reason of the provisions of paragraph (2) shall, for all purposes of this Convention, be deemed to be a resident only of that State for such year.

ARTICLE 5
Permanent Establishment

(1) For the purpose of this Convention, the term "permanent establishment" means a fixed place of business through the business of an enterprise is wholly or partly carried on.

(2) The term "permanent establishment" shall include especially:

(a) a place of management;

(b) a branch;

(c) an office;

(d) a factory;

(e) a workshop;

(f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources;

(g) an agricultural, pastoral or forestry property;

(h) a building site or construction, assembly or installation project which exists for more than 9 months; and

(i) an installation, drilling rig or ship that, for an aggregate period of at least 6 months in any 24 month period, is used by an enterprise of one of the Contracting States in the other Contracting State for dredging or for or in connection with the exploration or exploitation of natural resources of the sea-bed and subsoil.

(3) Notwithstanding paragraphs (1) and (2), an enterprise of one of the Contracting States shall not be regarded as having a permanent establishment solely as a result of one or more of the following:

(a) the use of facilities for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;

(b) the maintenance of a stock of goods or merchandise belonging to the enterprise for the purpose of storage, display or delivery;

(c) the maintenance of a stock of goods or merchandise belonging to the enterprise for the purpose of processing by another enterprise;

(d) the maintenance of a fixed place of business for the purpose of purchasing goods or merchandise, or for collecting information, for the enterprise;

(e) the maintenance of a fixed place of business for the purpose of activities which have a preparatory or auxiliary character, such as advertising or scientific research, for the enterprise;

(f) the maintenance of a building site or construction, assembly or installation project which does not exist for more than 9 months; or

(g) the use by that enterprise in the other Contracting State, of an installation, drilling rig or ship for dredging, or for or in connection with the exploration or exploitation of natural resources of the sea-bed and subsoil, provided that such use is not for an aggregate period of at least 6 months in any 24 month period.

(4) Notwithstanding paragraphs (1) and (2), an enterprise of one of the Contracting States shall be deemed to have a permanent establishment in the other Contracting State if:

(a) it carries on business in that other State through a person, other than an agent of independent status to whom paragraph (5) applies, who has authority to conclude contracts on behalf of that enterprise and habitually exercises that authority in that other State, unless the activities of such person are limited to those mentioned in paragraph (3) which, if exercised through a fixed place of business, would not make that fixed place of business a permanent establishment under the provisions of that paragraph;

(b) it maintains substantial equipment for rental or other purposes within that other State (excluding equipment let under a hire-purchase agreement) for a period of more than 12 months;

(c) it engages in supervisory activities in that other State for more than 9 months in any 24 month period in connection with a building site or construction, assembly or installation project in that other State; or

(d) it has goods or merchandise belonging to it that:

(i) were purchased by it in that other State, and not subjected to prior substantial processing outside that other State; or

(ii) were produced by it or on its behalf in that other State, and are, after such purchase or production, subjected to substantial processing in that other State by an enterprise where either enterprise participates directly or indirectly in the management, control or capital of the other enterprise, or where the same persons participate directly or indirectly in the management, control or capital of both enterprises.

(5) An enterprise of one of the Contracting States shall not be deemed to have a permanent establishment in the other Contracting State merely because that enterprise carries on business in that other State through a broker, general commission agent, or any other agent of independent status, where such broker or agent is acting in the ordinary course of his business as a broker, general commission agent or other agent of independent status.

(6) The fact that a company which is a resident of one of the Contracting States controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other.

(7) The principles set forth in the preceding paragraphs of this Article shall be applied in determining for purposes of this Convention whether there is a permanent establishment in a State other than one of the Contracting States and whether an enterprise other than an enterprise of one of the Contracting States has a permanent establishment in one of the Contracting States.

ARTICLE 6
Income from Real Property

(1) Income from real property may be taxed by the Contracting State in which such real property is situated.

(2) For the purposes of this Convention:

(i) a leasehold interest in land, whether or not improved, shall be regarded as real property situated where the land to which the interest relates is situated; and

(ii) rights to exploit or to explore for natural resources shall be regarded as real property situated where the natural resources are situated or sought.

ARTICLE 7
Business Profits

(1) The business profits of an enterprise of one of the Contracting States shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the business profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.

(2) Subject to the provisions of paragraph (3), where an enterprise of one the Contracting States carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the business profits which it might be expected to make if it were a distinct and independent enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment or with other enterprises with which it deals.

(3) In the determination of the business profits of a permanent establishment, there shall be allowed as deductions expenses which are reasonably connected with the profits (including executive and general administrative expenses) and which would be deductible if the permanent establishment were an independent entity which paid those expenses, whether incurred in the Contracting State in which the permanent establishment is situated or elsewhere.

(4) No business profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise.

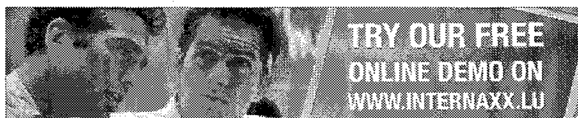
(5) For the purposes of the preceding paragraphs of this Article, the business profits to be attributed to the permanent establishment shall be determined by the same method year by year unless there is good and sufficient reason to the contrary.

(6) Where business profits include items of income which are dealt with separately in other Articles of this Convention, then the provisions of those Articles shall not be affected by the provisions of this Article.

(7) Nothing in this Article shall affect the application of any law of a Contracting State relating to the determination of the tax liability of a person in cases where the information available to the competent authority of that State is inadequate to determine the profits to be attributed to a permanent establishment, provided that, on the basis of the available information, the determination of the profits of the permanent establishment is consistent with the principles stated in this Article.

(8) Nothing in this Article shall in a Contracting State prevent the operation in that State of its law relating specifically to the taxation of any person who carries on the business of any form of insurance (as long as that law as in effect on the date of signature of this Convention is not varied otherwise than in minor respects so as not to affect its general character).

ARTICLE 8
Shipping and Air Transport



Hong Kong: Double Tax Treaties

BACK TO HONG KONG INFORMATION: BUSINESS, TAXATION AND OFFSHORE

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- HONG KONG TAXATION
- HONG KONG DIRECT CORPORATE TAXATION
- HONG KONG PERSONAL TAXATION
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Hong Kong Double Tax Treaties

Until June 2001, the territory had no comprehensive double taxation agreements in place. Since under the "territorial principle" only Hong Kong source income is taxable the double taxation of income does not usually occur thereby obviating the need for double taxation treaties. However the government is now entering an increasing number of tax treaties of various types. Under article 151 of the Basic Law the territory can negotiate its own double taxation treaties independently of China using the abbreviation Hong Kong, China. The territory is not able to take advantage of any double taxation treaties which China may enter into because only mainland taxes are mentioned in these treaties. Nor will China impose the terms of any double taxation treaties on the territory given that under articles 106-108 of the Basic Law it guaranteed Hong Kong the right to maintain an independent taxation system free of interference from the mainland until the year 2047.

Legislation which came into operation in March 2010 allows Hong Kong to enter into comprehensive DTAs, incorporating the Organisation for Economic Cooperation and Development (OECD) international standard on exchange of information.

In April 2010, Commissioner of Inland Revenue, Chu Yam-yuen, said that Hong Kong has entered a "new phase" in supporting the international effort to enhance tax transparency, and its next hurdle would be to sign at least twelve comprehensive double taxation agreements (DTAs).

There had been some concern within Hong Kong that the territory may become 'black listed' by the OECD, or be on the receiving end of sanctions for failing to implement the internationally-agreed standard on tax transparency and information exchange confirmed at the April 2009 G20 Summit in London. Secretary for Financial Services and the Treasury, Professor K C Chan assured lawmakers in May 2010 however, that the OECD had in fact commended Hong Kong's efforts to comply with these international standards.

In September 2012, the Inland Revenue Commissioner said that Hong Kong has taken "remarkable steps forward" in establishing its international tax treaty network since the amendment to the Inland Revenue Ordinance in March 2010, and since then, the tax treaty network of Hong Kong has expanded rapidly. As at March 31, 2012, Hong Kong had signed a total of 23 comprehensive double taxation agreements, of which 17 were in force by that date.

As at September 7, 2012, comprehensive double taxation avoidance treaties had been concluded between Hong Kong and the following countries (with 'in force' dates):

- Austria (January 1, 2011)
- Belgium (July 7, 2004)
- Brunei (December 19, 2010)
- Czech Republic (January 24, 2012)
- France (January 1, 2011)
- Hungary (February 23, 2011)
- Indonesia (March 28, 2012)

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BY KITTY MIV, EDITOR

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2008 ATC ¶20-051

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Federal Court, Sydney,

10 October 2008

Income tax — Capital gains tax — Capital gain on sale by Swiss resident company of shares in an Australian company — Whether Australia denied the right to tax gain by Swiss-Australia double taxation agreement — General principles of interpretation of double tax treaties — Application of Taxation Ruling TR 2001/12 — Whether the term "the Australian income tax" covers taxation of capital gains (Art 2) — Ambit of business profits (Art 7) and alienation of capital assets (Art 13) provisions — Income Tax Assessment Act 1997 , Pt 3-1 — International Tax Agreements Act 1953 , Sch 15.

The taxpayer company was incorporated in Switzerland. At all material times it was a resident of Switzerland and had Virgin Group Investments Ltd ("VGIL") as its ultimate holding company. At all material times its activities were, for the purposes of the DTA between Australia and Switzerland, an enterprise and it did not have, or carry on business through, a permanent establishment in Australia.

[8675]

On or about 30 June 2003 the taxpayer acquired from Cricket SA 1,448,120 ordinary shares in Virgin Blue Holdings Ltd ("VBHL") in consideration of A$320,595,232 (ie the Australian dollar equivalent to the amount in Swiss Francs). At the time, the ultimate holding company of both VBHL and Cricket was VGIL. On 27 October 2003 VBHL effected a 1:120 share split, thereby increasing the number of VBHL shares held by the taxpayer to 173,774,400.

On 4 November 2003 the taxpayer sold 21,721,626 of the VBHL shares ("the first tranche") to Cricket in consideration of $40,116,732. The taxpayer made a gain of $1,375,100 on the sale. On 8 December 2003 VBHL conducted an off-market buy-back of 7,031,176 ordinary shares of VBHL from the taxpayer, resulting in a loss to the taxpayer of $4,208,737. On 15 December 2003 the taxpayer sold 123,196,853 of the VBHL shares ("the second tranche") as part of an initial public offering of VBHL shares. The taxpayer received consideration of $277,192,919 for that disposal.

On 14 December 2005 the Commissioner issued to the taxpayer an assessment for the year ended 31 March 2004 (in lieu of the year ended 30 June 2004) in which $59,076,246 was included in its assessable income, being the amount of a net capital gain said to have been derived on the sale of the first tranche (ie $1,375,100) and second tranche (ie $57,701,146) of the VBHL shares.

However in August 2007 the Commissioner issued an amended assessment for the same year, including an amount of $192,746,072 (after deducting the capital loss of $4,208,737 on the buy-back) instead of $57,701,146. The gain made from the sale of the first tranche (ie $1,375,100), was also disregarded by reason of a rollover. The taxpayer objected to the amended assessment, the Commissioner disallowed the objection and the taxpayer appealed.

The issue before the Federal Court was whether Australia was denied the right to tax the amount of $192,746,072 by reason of the provisions of the double tax agreement (DTA) between Australia and

Switzerland, which was given effect in Australia by s 11E and Sch 15 to the *International Tax Agreements Act 1953*.

The Commissioner maintained the position adopted in Taxation Ruling TR 2001/12, ie that Australia's right to tax gains taxable in Australia exclusively under the CGT regime was not limited by pre-CGT treaties such as the Swiss DTA. To that end he argued that:

(i) CGT did not come within the meaning of the term "the Australian income tax" in Art 2(1)(a) of the Swiss DTA; nor was it a "substantially similar tax" within the meaning of that term in Art 2(2)
(ii) Art 7(1) of the Swiss DTA, in denying Australia the right to tax the profits of a Swiss enterprise in the circumstances of the present case, only applied to revenue profits; it did not limit the taxation of capital gains which were not revenue profits
(iii) Art 13(3) of the Swiss DTA, by reason of its reference to "income from the alienation of capital assets" manifested an intention that it was not to apply to capital gains which were not income.

The taxpayer's position was that the term "the Australian income tax" was ambulatory rather than static, this being manifest in the text of the DTA itself. Furthermore, from the time of the inception of income tax in Australia, the term had always been more than a tax on income. Alternatively, if CGT was not part of "the Australian income tax", it was substantially similar to it.

[8676]

Held: appeal allowed.

1. The better and preferred approach to interpreting the meaning and scope of the term "the Australian income tax" in Art 2(1)(a) was that it was ambulatory and not static. However, this did not strictly need to be decided because, at the time of the conclusion of the Swiss DTA, the term already accommodated and encompassed the taxation of capital gains. Although capital gains were not yet taxed on the comprehensive basis that came with the introduction of Pt IIIA into the Income Tax Assessment Act 1936, the income tax assessed under that Act accommodated and encompassed the assessment of capital gains as income, the assessment of capital receipts as income and the assessment of notional amounts as income just as much as it accommodated and encompassed the assessment of income according to ordinary concepts. It followed that tax on the amount of $192,746,072 was within the term "the Australian income tax" in Art 2(1)(a) of the Swiss DTA and was therefore tax to which the Swiss DTA applied.

2. Obiter: While a tax on capital gains under the regime introduced by Pt IIIA may be properly characterised as a "tax on property", and while income tax generally cannot be characterised as such a tax, it did not follow that the tax on capital gains under the Pt IIIA regime was not "substantially similar" to "the Australian income tax". The current operative provision now did exactly what its predecessors did: it statutorily assimilated a gain to income.

3. The Commissioner's position that the existence of Art 13 of the Swiss DTA indicated that Art 7 was only concerned with revenue profits of an enterprise could not be accepted. On the High Court authority of *Thiel* v *FC of T* 90 ATC 4717, Art 7(1) of the Swiss DTA denied Australia the right to tax the amount in question.

4. Obiter: In regard to Art 13(3), the word "income" in the phrase "income from the alienation of capital assets of an enterprise" could not be confined to "income according to ordinary concepts", otherwise there would be no work for the provision. Hence if Art 7(1) of the Swiss DTA did not apply to deny Australia the right to tax the amount then Art 13(3) did.

[*Headnote by Heidi Maguire*]

TF Bathurst QC and AH Slater QC with AJ Payne and JO Hmelnitsky for the taxpayer.

BJ Sullivan SC with TM Thawley for the Commissioner.

International Tax Update: Tax cases

21 May 2009

Undershaft (No 1) Limited v Federal Commissioner of Taxation: non-resident capital gains and pre-CGT Tax Treaties

Following the Virgin Holdings decision discussed in the December 2008 edition of this Update, the Federal Court handed down its decision in *Undershaft (No 1) Limited v FCT*.

The case concerned the disposal in late 2000 of shares in two Australian subsidiaries as part of a group reorganisation of the Aviva group. The parties made capital gains of approximately A$273 million (by CGNU Holdings (Australia) Ltd – a company resident in the UK) and A$108 million (by Norwich Union Overseas Holdings BV – a company resident in the Netherlands) respectively. The court had to consider whether the relevant pre-CGT treaties allocated taxing rights over the capital gains arising from each of the sales.

The Australian Taxation Office argued that:

- capital gains were outside the scope of taxes covered by both the UK and the Netherlands treaties since these treaties were concerned with the Commonwealth income tax
- Australia's income tax and Australia's capital gains tax are not a substantially similar tax
- the Business Profits Article applies only to revenue profits and does not allocate taxing rights in respect of capital gains
- a static interpretation should be applied in respect of the reference to the Commonwealth income tax so that it referred to the Commonwealth taxes that existed at the date of signing and since there was no CGT at this date the treaty did not allocate taxing rights in respect of capital gains.

The taxpayer's submissions in summary were as follows:

- that capital gains tax was included in the scope of taxes covered under each treaty – namely Commonwealth income tax and the Australian income tax
- alternatively, capital gains were a substantially similar tax that should be within the scope of taxes covered under each of the treaties
- an ambulatory approach and not a static approach was required when interpreting Australia's treaties.

The Australian Taxation Office lost on all four of its submissions. The Court followed *Virgin Holdings* and held that the term 'income taxes' in both the UK and the Netherlands treaties included CGT. The business profits article therefore applied to the relevant capital gain to give exclusive taxing rights to those countries. This was in part, at least in respect of the Netherlands treaty, because Australia's capital gains tax was not enacted as a separate tax.

The December 2008 edition of this Update discussed the case of *Virgin Holdings SA v FCT* concerning whether or not Australia's right to tax capital gains is limited by pre-CGT treaties because Australia's pre-CGT treaties do not distribute taxing rights over capital gains.

The Australian Taxation Office had previously appealed against the decision in *Virgin Holdings SA v FCT* to the Full Federal Court. This was not surprising, given the amount of tax involved and the potential revenue leakage. However, the Australian Taxation Office has discontinued the appeal.

The Australian Taxation Office has not yet appealed the *Undershaft* decision. The reasons for this have not been made clear.

Treasury estimated in 2002 that there was potential revenue of A$100 million annually at risk if the Australian Taxation Office's view was incorrect. This estimate was made before the comprehensive rewrite of Australia's CGT laws for non-residents in 2006.

These decisions represent authority that Australia's pre-CGT treaties do apply to allocate taxing rights over capital gains. They also remove the arguments underpinning the Australian Taxation Office's ruling on this issue (Taxation Ruling TR 2001/11).

Presumably, the Australian Taxation Office will release a Decision Impact Statement giving taxpayers guidance on their interpretation of the judgments or withdraw their ruling.

[¶986-606] Like a Virgin — touched for the second time: Undershaft No 1 Ltd v FC of T; Undershaft No 2 BV v FC of T

http://prod.resource.wkasiapacific.com/resource/scion/document/default/io1464705sl207117050

Last reviewed: 20 February 2009

The Commissioner has again failed to convince the Federal Court that double tax agreements (DTAs) entered into with the UK and the Netherlands did not preclude Australia from taxing capital gains made by non-resident companies (*Undershaft No 1 Ltd* v *FC of T*; *Undershaft No 2 BV* v *FC of T* 2009 ATC ¶20-091).

In allowing the taxpayers' objections against the Commissioner's assessments that sought to tax such capital gains, Lindgren J lent tacit approval to the recent decision in *Virgin Holdings SA* v *FC of T* 2008 ATC ¶20-051 (¶986-558), but independently reached his own conclusions on issues common to both sets of proceedings before him.

Facts

These were two proceedings heard together, with the issue in each proceeding being whether income tax was not payable on the amount of a capital gain by reason of the operation of a DTA, and specifically by reason of the business profits articles in each. In the first proceeding, the relevant DTA was between Australia and the UK (as at 2001); in the second proceeding it was between Australia and the Netherlands.

The two proceedings resulted from a merger in December 2000 of the businesses of CGU Insurance Australia Ltd (CGUIA) and Norwich Union Australia Ltd (NUA). All of the shares in those two companies were sold by their respective parent companies, the present taxpayers, to a company then known as CGNU Australia Holdings Ltd. It was those sales that gave rise to the capital gains.

Each taxpayer filed an income tax return for the year ended 30 June 2001 that did not include its capital gain as assessable income. The Commissioner issued notices of assessment including the net capital gains, to which each taxpayer objected. The Commissioner disallowed the taxpayers' objections and the taxpayers appealed to the Federal Court.

The parties agreed that each taxpayer was a resident of either the UK or the Netherlands, that each taxpayer was not a resident of Australia for the purposes of the ITAA 1936 nor carried on business through a permanent establishment in Australia, and that the sums of $273m and $108.5m made by the first and second taxpayer respectively from the sale of the shares were on capital account and not income.

The taxpayers contended that the tax that would otherwise have been imposed by Australia on their capital gains fell within the expressions "the Commonwealth income tax" in the UK DTA or "the Australian income tax" in the Netherlands DTA or, if it did not do so, within the expression "substantially similar tax", and was therefore within the scope of the DTAs. Conversely, the Commissioner contended that it did not fall within such expressions and that therefore the tax that would have been imposed on the capital gain by Australia was outside the scope of the DTAs.

The taxpayers also contended that each capital gain fell within the relevant "Business Profits Article" of each DTA, while the Commissioner contended that each did not. In this regard, the Commissioner submitted that in denying Australia the right to tax the industrial or commercial profits of a UK enterprise, UK DTA Art 5 applied only to revenue profits; it did not deny the power to tax capital gains that were not revenue profits, since capital gains, not being income from the conduct of a trade or business, did not fall within the exhaustive definition of "industrial or commercial profits" given in Art 5(7). The Commissioner also sought to rely on Netherlands DTA Art 13, said to be a "code" that dealt comprehensively with capital gains, to reinforce the notion that Art 7 of that DTA was confined in its operation to revenue profits.

The Commissioner also submitted in the first proceeding that Virgin Holdings was distinguishable (because of differences in terminology in the relevant DTAs and because the UK DTA was entered into before s

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26AAA was inserted into the ITAA 1936) and, in both proceedings, that Lindgren J was not obliged by considerations of comity to follow the *Virgin Holdings case*.

Decision

At the outset, Lindgren J found that *Virgin Holdings* was not distinguishable. After noting that he was not bound to follow *Virgin Holdings* (it being a decision of co-ordinate authority), Lindgren J commented that it would be a most unwelcome irony if single judges of the Federal Court did not respect the strong desirability of consistency in their decision making. Assuming *Virgin Holdings* was indistinguishable, it was thus to be followed unless considered to be clearly wrong or plainly wrong (which he did not consider it to be).

In considering the merits of the arguments, Lindgren J said that it could not be accepted that the expression "the Commonwealth income tax" in the UK DTA referred, in 1967, to the income tax that was notionally imposed on only those categories of income brought to tax by the ITAA 1936 that merited the description "income according to ordinary concepts" or "income on revenue account", and that omitted all other categories of income that were brought to tax by the same income tax statute. The Commissioner's argument that the expression had a "static" (as against "ambulatory") meaning was also to be rejected.

The expression "the Commonwealth income tax" was the tax for the assessment of which the ITAA 1936 (or its successor, the ITAA 1997) provided or might provide at any time and from time to time. It followed that the amendment to the ITAA 1936 by the introduction of the Pt IIIA regime in 1986 formed, at the time when the taxpayer in the first proceeding made its capital gain, part of the Commonwealth income tax and was therefore a tax covered by the UK DTA. Even if wrong in thinking that the tax introduced on the tax base as enlarged by the Pt IIIA regime fell within the notion of "the Commonwealth income tax", nonetheless it was a tax substantially similar to that tax and was therefore one of the taxes covered by the UK DTA.

Lindgren J also rejected the Commissioner's submission that the expressions "industrial or commercial profits" in UK DTA Art 5 or "business profits" in Netherlands DTA Art 7 referred only to revenue profits. None of the arguments put forward suggested that the contracting states did not intend to adopt the expansive notion of income that underlay ITAA 1936.

As there was no substance in the difference between the expressions "the Commonwealth income tax" and "the Australian income tax", the Commissioner's argument that the taxation of capital gains under the Pt IIIA regime was not caught by the Netherlands DTA Art 2(1)(a) was also to be rejected. Both UK DTA Art 5 and Netherlands DTA Art 7 operated to deny Australia the right to tax the capital gain of either taxpayer and, in regard to the latter, Art 13 did not alter that effect. The appeal was to be allowed in both proceedings.

Court ref: [2009] FCA 41 (Lindgren J), 3 February 2009, Sydney.

See FITR ¶167-000, ¶649-010.

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Taxman shifts on float cash

The Age Feb 10, 2011

By **BEN BUTLER**

THE war between the Tax Office and private equity firms over whether they should pay tax in Australia may be nearing an end after a shift in the ATO's position.

The dispute flared in 2009 when the ATO tried to stop $1.4 billion raised in the float of Myer leaving the country — but failed because the money had already disappeared overseas.

ATO deputy chief tax counsel Des Maloney said yesterday the ATO did not want to gouge private equity but wanted to make sure profits were being properly taxed somewhere in the world.

The ATO now wants private equity firms to tell it who their ultimate investors are so it can work out whether tax should be paid in Australia or in their home country.

Private equity firms have consistently said most of their investors are American and, because of a treaty between Australia and the US, should pay tax in their home country rather than here.

Speaking at a Taxation Institute of Australia breakfast yesterday, Mr Maloney, who wrote a series of controversial ATO rulings on private equity, including two that were applied to the Myer deal, said he hoped to have firms reporting the identities of their clients to the ATO within months.

"That's your get-out-of-jail free thing, isn't it?" Mr Maloney told the audience of tax professionals.

"Hopefully, if what's been put to us is right, the money should be able to leave Australia tax free."

But Mr Maloney blasted the "European dogleg" structure used by Texan private equity outfit TPG in the Myer float.

That deal's proceeds were funnelled from a Dutch company into a Luxembourg company, to take advantage of a tax treaty between the two countries, before being passed on to the investors through a partnership registered in a tax haven, the Cayman Islands.

"The proposition has been put to us that this is just a structure that's common, it's not there for Australian tax purposes," Mr Maloney said.

"My response to that is that just because it's common practice doesn't mean it's tax effective.

"I think you'll find the reasons, at least in terms of the information that's put to us, is that it's got more to do with tax planning than anything else.

Continued Page 2

NB

Tax Office shift signals war with private equity may be near an end

From Page 1

"There is no activity in the Netherlands or in Luxembourg.

"I've asked the question 100 times and no one's been able to tell us what's going on.

"What does the Dutch company do? Are there any staff? What else does it do? The reality is it does nothing.

"There's no funds going near the Netherlands, that's for sure."

And he had little sympathy for American investors whose attempts to arrange their affairs to minimise US tax leads them into trouble with the ATO.

"That's the business of US residents and their revenue agency, but if that structuring creates an Australian tax problem, well, so be it," he said.

"We're not in the business of ignoring the Australian tax position just because there's an overarching treaty between Australia and the country of residence of certain investors. US tax planning might dictate certain structuring but if that doesn't suit the Australian system, well, bad luck."

Speaking to BusinessDay after the breakfast, Mr Maloney said the ATO was talking with the industry about how much information private equity funds held about their investors. "You've got to remember it's called private equity because it's a private investing arrangement and the organisers of funds know very well who are the investors in those funds," he said.

"I don't imagine it's going to be too problematic."

The CER Agreement and Trans-Tasman Securities Regulation: Part 1

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Introduction

In domestic law, we expect nations to pursue their national interests. So, for example, New Zealand has a strong national interest in the quality of its securities regulation regime.[1] A robust securities regulation regime gives confidence to all investors, protects consumers and may attract foreign investment.[2] Similar considerations apply to Australia although that country is more ambitious in its goals.

Australia wants to become a global financial services centre and sees its "best of breed" regulatory regime as a means to achieve that end.[3] To this extent, Australia and New Zealand are competitors. There are, however, countervailing pressures to the creation of laws that are purely in the national interest. Australia and New Zealand are trading nations operating in global markets exposed to the influences of globalisation.[4]

Whatever globalisation connotes, it is apt to describe the erosion and irrelevance of national borders in markets that can be truly described as global, such as securities markets.[5] Thus, while New Zealand crafts securities laws that protect domestic consumers, it is mindful of the benefits of cross-border trading and integration in capital markets and the need for co-operation and co-ordination. It is especially aware of the advantages of co-ordinating New Zealand and Australian securities law[6] pursuant to the 2000 MOU.[7]

This article considers one particular aspect of the Closer Economic Relations Agreement (CER) between Australia and New Zealand—the inter-governmental project to co-ordinate business laws in the two countries. The project finds its present expression in the 2000 MOU which replaced the earlier Memorandum of Understanding between the Government of New Zealand and the Government of Australia on Harmonisation of Business Law signed on July 1, 1988 (the 1988 MOU).[8] Intuitively, this project is commendable; there are obvious advantages in aligning the business laws of trading partners. However, there are at least four key problems with this effort to co-ordinate Australian and New Zealand business laws.

First, strictly speaking, both MOUs are non-binding and declaratory only; the obligation imposed is simply to consult and keep informed—there is no enforcement mechanism. Thus, clause 9 of the 1988 MOU contains an obligation to keep informed and consult and clauses 10–12 of the 2000 MOU are similar. From a private lawyer's perspective, the mutual obligations are lower than those contained in a commercial Heads of Agreement.[9]

Secondly, the shift from the over-reaching term, "harmonisation", in the 1988 MOU to the term "co-ordination" in the 2000 MOU encapsulates a further problem. Whatever "harmonisation" means, it works best when there is full economic union and there is no full economic union between Australia and New Zealand.[10] To this extent, "co-ordination" is the default option where full economic union is neither present nor immediately feasible and, in practice, its operation seems bound to be fragmentary. Here, the best options are mutual recognition regimes.[11]

* *Thanks to Professor James D. Cox of Duke University School of Law for insightful comments on an earlier version of this manuscript. This article draws on my paper in (2004) 21 Law in Context.*

1. Gordon Walker, "The New Zealand National Interest in Securities Regulation" [1992] J.I.B.L. 452.
2. New Zealand Ministry of Economic Development, *Review of the Functions of the Securities Commission and Takeovers Panel* (Ministry of Economic Development, Wellington, 2001), p.17.
3. Axiss Australia, *Australia—A Global Financial Services Centre* (2004), available at *www.axiss.com.au*.
4. Gordon Walker and Mark Fox, "Globalisation: Meanings and Implications" in G. Walker, ed., *Securities Regulation in Australia and New Zealand* (Lawbook Co, Sydney, 1998), pp.3–32; Dick Bryan and Michael Rafferty, *The Global Economy in Australia* (Allen & Unwin, Sydney, 1999). Compare earlier discussions on the meaning of "internationalisation". See Robert P. Austin, "Regulatory Principles and the internationalization of Securities Markets" (1987) 50 (3) *Law and Contemporary Problems* 221 at 223 *et seq.*
5. Walker and Fox, n.4 above, p.6.
6. New Zealand Ministry of Economic Development, *Review of the Functions of the Securities Commission and Takeovers Panel* (Ministry of Economic Development, Wellington, 2001), pp.19–21.
7. The 2000 MOU is available at *www.mfat.govt.nz/foreign/regions/australia/tradeeconomic/austlaw.html*.
8. The 1988 MOU is available at *www.dfat.gov.au/geo/new_zealand/anz_cer/anz_cer.html*.
9. As we shall see, however, such "soft law" can have "hard law" outcomes. For a discussion of the hard/soft law distinction, see Kenneth Abbott and Duncan Snidal, "Hard and Soft Law in International Governance" (2000) 54(3) *International Organization* 421–456. In this author's view, the increasing influence of soft law (non-binding international law) on hard law (domestic legislation) since the mid-1990s is a result of globalisation.
10. Niamh Moloney, *EU Securities Regulation* (Oxford University Press, 2002), pp.62 *et seq.*
11. The US literature on securities regulation is particularly rich on this subject. See Hal Scott, "Internationalisation of Primary Public Securities Markets" (2000) 63 (3) *Law and Contemporary Problems* 71 at 81 *et seq.*, for a discussion of various types of mutual recognition regimes in the context of primary public securities markets.

Thirdly, co-ordination will always be difficult where (notwithstanding common origins of the legal system) it is sought between a Westminster system (New Zealand) and a federal system of government (Australia) where legislative responsibilities are allocated between a federal government and the states. This is because it may not be readily feasible for the federal government to take the lead on a matter that is within the powers of the states (for example, personal property securities).

Fourthly, the economic predicates are suspect.[12] According to the 2000 MOU, co-ordination of business law can facilitate the wider goal of a closer economic relationship between Australia and New Zealand by reducing transaction costs, lessening compliance costs and increasing competition. The first part of this assertion seems obvious; the latter part, less so. While there is intuitive appeal in the latter desiderata and the outcomes are desirable, there is little or no empirical evidence to support them.

The first major conclusion of this article is that the business law co-ordination project is best viewed as a "declaratory signal"—another symbol of the mutual desire that the CER relationship should move to the next stage of deeper economic integration. Indeed, on March 24, 2004, New Zealand Finance Minister, Dr Michael Cullen, expressed the view that Australia and New Zealand should have a single economic market within five years.[13] This view was reaffirmed at the inaugural Australia-New Zealand Leadership Forum at Government House, Wellington in May 2004.[14] Because New Zealand has more to gain than Australia from such a process, it should come as no surprise that the prime impetus for the business law co-ordination project comes from New Zealand.[15]

This leads to the second main conclusion: the business law co-ordination project is less about co-ordination *per se* than a conscious alignment of parts of New Zealand's business laws with those of Australia in order to facilitate a single market. This increasing "Australianisation" of New Zealand business law is most evident in the area of securities regulation.[16]

There is substantial evidence to support the view that political and business leaders on both sides of the Tasman want a fully integrated trans-Tasman economy.[17] First, surveys undertaken by Professor Catley in 2000 found a strong majority of New Zealand politicians thought CER had not gone far enough and a single economic union would benefit both countries (although New Zealand had more to gain than Australia).[18] In the Catley surveys, views of Australian politicians were overwhelmingly supportive of a single economic union[19] as were elite opinions in New Zealand.[20]

Secondly, in 2002, the Foreign Affairs, Defence and Trade Committee of the New Zealand Parliament published a report that recommended an Australia New Zealand Economic Community (ANZEC).[21] The response of the New Zealand Government was not fully supportive of ANZEC but it did issue a set of encouraging signals. For example, it stated that the New Zealand Government would continue to co-ordinate its business related legislation more closely with Australia unless there was a convincing case this would not be in New Zealand's economic interests.[22]

Thirdly, a positive report to the Australia New Zealand Business Council in August 2003 assessed the benefits of moving to a borderless market to be in the order of NZ$256 to NZ$576 million.[23] Fourthly, at the twentieth anniversary ministerial discussions on CER held at the Stamford Plaza in Double Bay, Sydney, in September 2003, the talks assumed a single economic market at some time in the future.[24]

Finally, a report prepared by the Law and Economics Consulting Group and ACIL Tasman for the Ministry of Economic Development in May 2004 entitled, *New Zealand—Australia Economic Interdependence*, as well as the inaugural Australia–New Zealand Leadership Forum meeting in the same month reached similar conclusions.[25]

12. *e.g.* it may well suit commercial actors to have regulatory differences in each jurisdiction thereby enabling regulatory arbitrage.
13. Megan Neil, "Cullen sees union after five years", *Australian Financial Review*, March 25, 2004, p.13; Michael Cullen, "Address to Deutsche Investor Forum" (March 2004), 8. Available at *www.beehive.govt.nz*.
14. Rowan Callick, "Push for Closer Ties with NZ", *Australian Financial Review*, May 17, 2004, p.8.
15. See Colin James, "Eye-to-Eye on CER", *New Zealand Management*, October 2003, p.26. (New Zealand must make the running on CER. CER is now the key instrument of economic integration with Australia.) New Zealand has undertaken the major conceptual work on the business law co-ordination project, see David Goddard, "Business Laws and Regulatory Institutions: Mechanisms for CER Co-ordination" in Arthur Grimes, Lydia Wevers and Ginny Sullivan, eds, *States of Mind: Australia and New Zealand 1901–2001* (Victoria University of Wellington, Institute of Policy Studies, 2002), p.179.
16. Gordon Walker, "Securities Regulation Reform in New Zealand: Australian Rules OK?" (2003) 21 C. & S.L.J. 533; Shelley Griffiths, "Aussie Rules 'Reform' of New Zealand Securities Law" (2004) 22 C. & S.L.J. 73.
17. Neil, n.13 above.
18. Bob Catley, *Waltzing with Matilda: Should New Zealand join Australia?* (Dark Horse Publishing, Wellington, 2001), pp.193–194.
19. *ibid.*, p.199.
20. *ibid.*, p.205.
21. New Zealand Foreign Affairs, Defence and Trade Committee, *Inquiry into New Zealand's Economic and Trade Relationship with Australia* (Wellington, 2002), p.4.
22. New Zealand Ministry of Foreign Affairs and Trade, Australia Division, *Government Response to the Report of the Foreign Affairs, Defence and Trade Committee into New Zealand's Economic and Trade Relationship with Australia* (Wellington, 2003). Available at *www.mft.govt.nz/foreign/regions/australia/working/committeereport.html*.
23. New Zealand Institute of Economic Research Report to Australia New Zealand Business Council Inc., *Stepping towards a Borderless Market? The Future of the trans-Tasman Market* (NZIER, Wellington, 2003), p.iv.
24. Greg Ansley, "Australia rules in bid for CER uniformity" *New Zealand Herald*, September 3, 2003.
25. Law and Economic Consulting Group and ACIL Tasman, *New Zealand—Australia Economic Interdependence* (ACIL Tasman and LECG Asia Pacific, Wellington, 2004). Available at the New Zealand Ministry of Economic Development website.

Subsequent analysis begins with a brief interpretation of the Australia–New Zealand relationship before moving to consider the CER Arrangement, the place of the business law co-ordination project within that arrangement, and, the evolution of trans-Tasman securities regulation.

1901: A Strategic Inflection Point

The "strategic inflection point" in the Australia–New Zealand relationship is the establishment of the Commonwealth of Australia in 1901 by the federation of the six Australian colonies.[26] At the time, the colony of New Zealand was invited to join the Commonwealth of Australia but did not do so.[27] A provision for New Zealand to join the Commonwealth of Australia still appears in the Commonwealth of Australia Constitution Act 1900 but it is very unlikely that it will be exercised for domestic political reasons.

The federation of the Australian colonies was a strategic inflection point in the Australia-New Zealand relationship because prior to that time there was no such thing as "New Zealand" or "Australia" as we know them today; there were simply seven British colonies (the so-called "seven sisters") situated in the South Pacific—Queensland, New South Wales, Victoria, South Australia, Western Australia, Tasmania and New Zealand.

Prior to federation, there was extensive trade and movement of peoples between the seven colonies[28] and the governing law in all colonies flowed from a common British origin (so-called "*ersatz* harmonisation"). If New Zealand had joined the Commonwealth of Australia then—obviously—this discussion would be about Australian inter-state trade and commerce.

Professor James Belich, author of a leading history of New Zealand, has considered the position of New Zealand before and after federation in Australia.[29] He states:

> [B]efore 1901, New Zealand was part of "Australia", to the extent that any such thing existed. In a sense, non-federation was, by default, a declaration of independence, or at least a transfer of dependence. It also meant that, on 1 January 1901, New Zealand suddenly became small ... Until 1901, there was no such thing as a formal Australia; and to the extent that it existed informally ... New Zealand was as much a part of it as any. New Zealand not only failed to join something new in 1901; it abandoned something old—the Tasman world.[30]

It is important to grasp the implications of "New Zealand becoming small". Belich again:

> Before 1901, New Zealand was not small in its local context. It ranked third of the seven colonies in population and production, and it was closer to the big two, Victoria and New South Wales, than to the small four ... On 1 January 1901, New Zealand suddenly shrank to about a quarter of its previous size. From an association of equals, or one dominated by a big three that included New Zealand, it became very much the junior partner in Australasia. The seven sisters had become two, and one was pretty big ... "Greater Britain" and the merged Tasman world both substantially ended in 1901 and, for the New Zealanders who made the decision not to federate, their demise was predictable.[31]

To draw this point out by a degree of exaggeration we can say that prior to federation each country was part of the other's internal markets. While there were some tariff barriers, "Australasia was to some extent a single market for goods as well as labour".[32]

By contrast, after federation the Australian export market for New Zealand collapsed from around 14 to 5 per cent and remained at that level until the late 1960s.[33] This decline in trans-Tasman trade was not an issue while Britain remained New Zealand's major export market. In 1973, however, Britain joined the European Economic Community (EEC), an event that symbolised a gradual economic disconnection between New Zealand and Britain. For example, Belich notes that between 1965 and 1989, "the proportion of New Zealand's exports taken by Britain dropped from over 50 to 7 per cent—a revolution in terms of trade".[34] New Zealand's response to Britain's joining the EEC is telling; it largely comprised "unabashed appeals to sympathy and sentiment".[35]

Another critical event was the ANZUS crisis of the late 1980s (prompted by New Zealand's anti-nuclear stance and the bombing of the *Rainbow Warrior* by France), which fractured New Zealand's defence arrangements with Britain and the United States and left Australia as New Zealand's only ally. As stated, however, trade between Australia and New Zealand began to pick up a few years after the New Zealand and Australia Free Trade Agreement of 1965 (NAFTA).[36]

The CER Arrangement of 1983, an Australian initiative, provided a boost to this process such that by 1990 the proportion of New Zealand exports to Australia had reached 20 per cent. Today, Australia remains New Zealand's largest trading partner.

26. The phrase "strategic inflection point" was coined by Andrew Grove, CEO of Intel, to describe the point in the business lifecycle where a curve stops curving in one direction and starts curving in another. The old strategic picture dissolves and gives way to the new. If the point is missed, the business declines. See Robert Heller, *Andrew Grove* (Dorling Kindersley, London, 2001), pp.72–79.
27. John Farrar, "Harmonisation of Business Law between Australia and New Zealand" (1989) 19 V.U.W.L.R. 438–439.
28. James Belich, *Making Peoples* (Penguin Books, Auckland, 1996), Ch.5; Denis McLean. *The Prickly Pair: Making Nationalism in Australia and New Zealand* (Otago University Press, Dunedin, 2003), p.46; Shaun Goldfinch, "Taking each other for granted", *Australian Financial Review*, March 5, 2004, p.11.
29. James Belich, *Paradise Reforged* (Penguin Books, Auckland, 2001), pp.48 *et seq.*
30. *ibid.*, pp.46–48.
31. *ibid.*, pp.51–52.
32. *ibid.*, p.49.
33. *ibid.*, p.52.
34. *ibid.*, p.426.
35. Belich documents some of this pathetic special pleading. Query the extent to which this attitude informs the present New Zealand stance towards Australia. *Ibid.*, p.433.
36. Farrar, n.27 above, at 440–441.

Consider now the consequences of New Zealand "becoming small" after 1901. Relative size is the key factor in the New Zealand-Australia trade relationship. Thus, consequences of New Zealand's failure to federate can be seen in the various statistics. Some indicative comparative data is provided by Australia's Department of Foreign Affairs and Trade (DFAT) on its web page dedicated to celebrating 20 years of CER.[37] For example:

- In 2001, New Zealand ranked fifth in Australia's top 10 merchandise export destinations and Australia ranked first in New Zealand's top 10 merchandise export destinations.
- In 2001, New Zealand ranked sixth in Australia's top 10 merchandise import sources and Australia ranked first in New Zealand's top 10 merchandise import sources.
- In 2001, New Zealand ranked ninth amongst foreign investors in Australia and Australia ranked first amongst foreign investors in New Zealand.
- As of 2001, the Gross Domestic Product (GDP) of New Zealand (compared with the Gross State Product of the Australian States and Territories) ranked it fourth after NSW, Victoria and Queensland. The GDP of New Zealand, however, is greater than the respective equivalents in Western Australia, South Australia, the ACT, Tasmania and the Northern Territory.
- As of 2002, the GDP of Australia, New Zealand and the ASEAN economies ranked (respectively and approximately) as follows: Australia, US$400 billion; Indonesia, US$175 billion; Thailand, US$125 billion; Malaysia, US$98 billion; Singapore, US$96 billion; The Philippines, US$95 billion; New Zealand, US$52 billion; Vietnam, US$30 billion followed by Burma (Myanmar), Brunei, Cambodia and Laos (the Lao PDR).
- More than 450,000 New Zealanders reside in Australia and about 50,000 Australians live in New Zealand. New Zealand has provided the largest source of recent long-term settlers in Australia.

We can construct a simple picture from the above and other well-known data. New Zealand has a population of approximately 4 million. The Australian population is about 20 million. 1,200 miles of sea separate Australia and New Zealand. Australia is the most important economic relationship for New Zealand. New Zealand is not the most important economic relationship for Australia.

When New Zealand looks to the eastern seaboard of Australia, it sees three Australian states (Victoria, New South Wales and Queensland) each of which has a larger economy than New Zealand. The net result is that Australia is much more important to New Zealand than New Zealand is to Australia.

It follows that New Zealand is more likely to emphasise and place weight on the relationship between the two countries. New Zealand needs Australia but the converse does not hold good. A New Zealand political commentator, Colin James, puts it this way:

> When Australia thinks about itself, New Zealand doesn't figure. When New Zealand thinks about itself, it cannot ignore Australia ... Australia is New Zealand's most important relationship; for Australia the most important relationship is with the United States. Almost every aspect of the Australia-New Zealand relationship is important to New Zealand but the reverse is not the case ... It is likely that the onus will always be on New Zealand to take the policy initiatives ...[38]

For the types of reasons identified by Colin James, it is suggested that, more than 100 years after federation in Australia, the CER Agreement is leading New Zealand to another strategic inflection point—one that may ultimately result in economic union with Australia.

The CER Agreement

The Australia New Zealand Closer Economic Relations Trade Agreement (CER Treaty) is a bilateral treaty between the governments of Australia and New Zealand, which took effect on January 1, 1983.[39] It replaced the New Zealand Australia Free Trade Agreement (NAFTA) that had come into effect on January 1, 1966.

The CER Treaty is a regional free trade agreement.[40] It is permitted under Art.XXIV of the General Agreement on Tariffs and Trade 1947 (GATT). Under Art.XXIV of GATT, customs unions and free trade area agreements are a permitted exception to the cardinal principle of non-discrimination because it is recognised that such agreements have the potential to further economic integration without necessarily adversely affecting the interests of third parties.[41]

The CER Treaty is simultaneously the central enabling document for the free trade agreement between Australia and New Zealand and the umbrella agreement for a range of downstream agreements and other documents that better implement the CER Treaty.[42] Collectively, these agreements and documents are known as the CER Agreement.

As stated, the prime focus of this article is on one of the downstream documents—the Memorandum

37. See *www.dfat.gov.au/geo/new_zealand*.

38. Colin James, "An Ethnic Accident" in Grimes, Wevers and Sullivan, n.15 above, pp.312–313.
39. For background documentation, see Australian Department of Foreign Affairs and Trade and New Zealand Ministry of Foreign Affairs and Trade, *The Negotiation of the Australia New Zealand Closer Economic Relations Trade Agreement 1983* (Commonwealth of Australia, Canberra, 2003).
40. CER Arts 1(b) and 2. Available at *www.mfat.govt.nz*.
41. Raj Bhala, *International Trade Law: Theory and Practice* (2nd ed., Mathew Bender, Massachusetts, 2000), p.619; John Mo, *International Commercial Law* (2nd ed., Butterworths, Sydney, 2000), p.653.
42. These are listed in Peter Lloyd, "Completing CER" in Grimes, Wevers and Sullivan, n.15 above, p.153.

Table 1: Stages of deepening regional integration

Depth of integration	Trade liberalization	Common commercial policy	Free movement of factors	Common monetary and fiscal policy	Common government
Free trade agreement	Yes				
Customs union	Yes	Yes			
Common market	Yes	Yes	Yes		
Economic union	Yes	Yes	Yes	Yes	
Political union	Yes	Yes	Yes	Yes	Yes

of Understanding Between the Government of New Zealand and the Government of Australia on Coordination of Business Law signed on August 31, 2000.

The CER Agreement is primarily a regional free trade agreement (RFTA). Its history and success can be tracked through the series of articles and book chapters written by Professor Peter Lloyd.[43] A World Trade Organisation (WTO) review of the CER Agreement in 2000 found that the CER Agreement had "fulfilled entirely its objective of free trade in goods and extended its coverage to provide for close to free trade in services ... [I]t has greatly deepened the integration of the economies of the two countries through ... agreements relating to harmonisation of standards, mutual recognition and conformity assessment procedure."[44] It is important to appreciate that RFTAs are, generally speaking, the first stage in a sequenced process of deepening economic integration.

In this regard, consider Table 1, above, reproduced from Gavin and Van Langenhove.[45]

If we look closely at Table 1, we can see that CER has not progressed much beyond an RFTA. A common commercial policy is stage two in the sequence contemplated above but this is not what the 1988 MOU or the 2000 MOU are designed to achieve because there is no common commercial policy. At best, these MOUs are precursors to such a policy.

43. Peter Lloyd, *The Future of CER* (Victoria University Press for the Institute of Policy Studies, Wellington, 1991); Peter Lloyd, *Completing CER* (CEDA, Melbourne, 1997) and Peter Lloyd, "Completing CER" in Grimes, Wevers and Sullivan, n.15 above.

44. Gary Sampson, "The Closer Economic Relations Agreement between Australia and New Zealand" in Gary Sampson and Stephen Woolcock, eds, *Regionalism, Multilateralism, and Economic Integration: The Recent Experience* (United Nations University Press, Japan, 2003), p.202.

45. Brigid Gavin and Luk Van Langenhove, "Trade in a World of Regions" in Sampson and Woolcock, *ibid.*, p.279.

The 1988 MOU

The superseded 1988 MOU was the subject of a "stocktaking" review by Professor Farrar in 1989.[46] By way of background, Art.5 of the 1988 MOU committed both governments to examine the scope for harmonisation of business laws and regulatory practices in accordance with a programme to be established. Article 8 said that effective harmonisation does not require replication of laws. Article 9 stated that each government will keep the other informed of proposed reforms in the business law area and, where feasible and appropriate, will consult on the harmonisation of the laws in question.

Professor Farrar's article reproduces the 1988 MOU and then proceeds to scrutinise each of the areas of law selected (for example, companies, securities and futures laws; personal property securities laws, etc.), noting existing differences in national laws. Looking to the immediate future, Farrar thought it surprising that little that New Zealand had done since the 1988 MOU came into force was in compliance with its obligations and objectives.[47] He then stated:

> CER, and particularly the [1988 MOU], necessitate a reorientation of thinking. Each partner must consider the law of the other when contemplating reform of areas covered by CER. This at least seems to be the position of the Department of Justice and the Ministry of Commerce in New Zealand. I suspect that the position of the Law Commission may be different—its mandate is to consider objectively what is the best model and to look at Australian law as part of the total mix.[48]

These comments touch on an important issue. As stated in the introduction to this article, in the area of domestic law nations *ex ante* pursue their national interest. Thus, the mandate of a body such as the New Zealand Law Reform Commission (NZLRC) is to seek out best practice in a particular area regardless of whether any resultant legislation conforms to Australian federal law.

46. Farrar, n.27 above, at 435.

47. *ibid.*, at 460.

48. *ibid.*, at 461.

To this extent, there were always going to be significant "carve outs" from both MOUs. The most obvious of these is the New Zealand Companies Act 1993. In 1986, the Minister of Justice asked the NZLRC to report on the form of a new Companies Act to replace the Companies Act 1955. The NZLRC produced two reports.[49] After major revisions, the draft Act produced by the Law Commission was passed in late 1993. For the first time, English models were abandoned. New Zealand, contrary to the spirit of the 1988 MOU, did not follow Australian federal law. Instead, the Companies Act 1993 was based on a Canadian model, the Business Corporations Act, which in turn was based on the corporate law statute of the State of New York.[50]

A similar point can be made in relation to the New Zealand Personal Property Securities Act 1999 (PPSA), which came into effect on May 1, 2002.[51] Here, the cognate Australian legislation is state and territory, not federal legislation. As early as 1970, Reisenfeld had commented on the "quagmire" of chattels securities in New Zealand and that criticism could easily have been extended to Australia.[52]

In 1987–88, Professor Farrar urged for reform in New Zealand on North American and Canadian models. The resultant PPSA is modelled on the Saskatchewan Personal Property Security Act 1993. The extant Australian state and territory laws are similar to the New Zealand law pre-PPSA.[53] Professor David Allan has described them as "horrific".[54]

In terms of the provisions of the 1988 and 2000 MOUs, commentators have stated that either the PPSA is a contravention of the spirit of CER[55] or a spur to Australia to enact similar legislation.[56] Both views are tenable (the latter is to be preferred) and highlight the difficulty of co-ordination when one party operates within a federal framework.

Despite the carve-outs noted above, business law "harmonisation" achievements under the rubric of the 1988 MOU were significant and included legislation to abolish anti-dumping measures in favour of competition laws to cover anti-competitive conduct affecting trans-Tasman trade in goods, other amendments to competition law, innovations in litigation procedure, reciprocal enforcement of judgments and the like.[57]

The 2000 MOU

Background: conceptual work by David Goddard Q.C. and the NZIER

The 2000 MOU clearly shows the influence of the work of David Goddard Q.C. and the New Zealand Institute of Economic Research (NZIER). For this reason, it is useful to contextualise the 2000 MOU by a discussion of the key report by Goddard and the NZIER entitled, *CER: Business Law Co-ordination Potential*.[58]

The report begins with the observation that there is a range of business law activities that one state may seek to co-ordinate with others. Co-ordination is preferred to harmonisation in order to "emphasise that we are not just concerned with substantive law, or with whether or not the texts of two countries laws should be the same".[59] The report identifies a number of mechanisms for co-ordination including:

- adoption of identical rules, administered by a single shared institution;
- recognition of decisions made in the other state, under that state's rules, by that state's institutions;
- adopting similar or identical rules, administered by different institutions;
- agreeing which state's rules will apply in specific circumstances, and that law being applied by both state's institutions;
- a single institution administering different laws, but aiming to achieve consistency in their interpretation and application;
- collaboration between institutions, such as information sharing; and
- co-operation in making information accessible across borders, where public access to information is part of the administration of the relevant law (such as registries).[60]

The report argued the initial focus should be on recognition of regulatory outcomes (mutual recognition regimes) where states agree on which state's institutions will be competent to deal with a particular issue and then each state recognises that institution's decisions. This approach builds on the

49. NZLRC, *Company Law: Reform and Restatement* (NZLRC, Wellington, 1989) and NZLRC, *Company Law Reform: Transition and Revision* (NZLRC, Wellington, 1990).
50. Dale Oesterle, "Why have a Companies Act?" in Gordon Walker and Brent Fisse, eds, *Securities Regulation in Australia and New Zealand* (Oxford University Press, Auckland, 1994), p.313.
51. Linda Widdup and Laurie Mayne, *Personal Property Securities Act: A Conceptual Approach* (Butterworths, Wellington, 2000); Malcolm McKinnon, "UNCITRAL Receivables Convention: The Possibility of Trans-Tasman Harmonisation" (2003) 34 V.U.W.L.R. 524–525.
52. S. Reisenfeld, *The Quagmire of Chattels Security in New Zealand* (New Zealand Legal Research Foundation, Auckland, 1970).
53. Paul Latimer, *Australian Business Law* (CCH Australia, Sydney, 2004), pp.829–908.
54. David Allan, "Personal Property Security—A Long, Long Trail A-Winding" (1999) 11 Bond L.R. 181.
55. Bob Duggan, "PPSA—The Price of Certainty" [2000] N.Z.L.J. 241.
56. Allan, n.54 above, at 184.
57. Kerrin Vautier, James Farmer and Robert Baxt, *CER and Business Competition* (CCH NZ, Auckland, 1990); Australian Law Reform Commission, *Legal Risk in International Transactions* (AGPS, Canberra, 1996), pp.72–73; David Goddard, *Making Business Law: The CER Dimension* (1999). Available at *www.med.govt.nz.*
58. David Goddard and NZIER, *CER: Business Law Co-ordination Potential: Discussion Paper* (Wellington, August 1999).
59. *ibid.*, p.2.
60. *ibid.*

Trans-Tasman Mutual Recognition Arrangement (TTMRA) between Australia and New Zealand signed in 1996.

Under the TTMRA, a good legally able to be sold in one country may be legally sold in the other country and a person entitled to practise a profession in one country is entitled to practise the equivalent in the other country.[61]

Mutual recognition regimes are a useful alternative to the adoption of common (harmonised) standards.[62] Each country retains its own standards but mutual recognition removes barriers to trade between them. A good example is provided in the area of securities regulation in relation to issues of securities.

The Securities Act (Australian Issuers) Exemption Notice 2002 (SR2002/314 which expires on September 30, 2007) made under the Securities Act 1978 (NZ) provides a mechanism for Australian issuers seeking an exemption from the prospectus registration requirements of the Securities Act. In a similar manner, Australia operates a mutual recognition regime that can recognise a New Zealand registered prospectus for the purposes of the Australian Corporations Act 2001 (Cth).[63] These examples indicate that mutual recognition of regulatory outcomes is a useful, low cost co-ordination mechanism.

The matter is more complicated where the subject of co-ordination involves mandatory standards because "states normally require a minimum level of consistency in minimum standards as the basis for mutual recognition".[64] The choice here is broadly between "global" or "localised" solutions.

A "global" solution might involve two states opting into an international solution such as an international agreement or a model law. So, for example, cross-border insolvency law reform in New Zealand will be addressed through the adoption of the UNICITRAL Model Law.[65] However, while a global, multilateral solution may be optimal it will often be slower and more expensive to implement. Hence, if co-ordination is desirable, it is thought that the presumption should be in favour of CER co-ordination except where a multilateral initiative is in progress and there is a reasonable likelihood of that initiative bearing fruit.

Goddard and the NZIER identify a set of principles in order to ascertain areas where co-ordination might be useful.[66] These are discussed below.

First principle: one firm, one issue—one regulator, one set of rules

This is the mutual recognition solution. One institution in each jurisdiction is responsible for determining a particular issue in respect of a given firm. So, for example, the New Zealand Registrar of Companies (not the Securities Commission) is responsible for the registration of prospectuses. Once the prospectus is registered under New Zealand law, that determination would be recognised in New Zealand and Australia (ASIC Policy Statement 56: PS59.192 and ASIC Policy Statement 72: PS72.73–75).

As the authors note, this is the basis of TTRMA for goods but not for services and further comment that this approach "would have a dramatic impact if applied to services generally, and to financial markets".[67]

There has been some progress on this front since the Goddard/NZIER report was published. In November 2002, the Australian Securities and Investment Commission (ASIC) released its *Principles for cross border financial services regulation*.[68] ASIC uses these principles to guide its policy and decision-making as to whether, for example, to recognise a foreign regulatory regime or regulator.

Principle 1 states that ASIC recognises foreign regulatory regimes that are "sufficiently equivalent" to the Australian regulatory regime in relation to the degree of investor protection, market integrity and reduction of systemic risk they achieve.

Principle 2 states that ASIC gives the fullest possible recognition to "sufficiently equivalent" foreign regulatory regimes. The equivalence principles are set out in Principles 7 to 10. ASIC will treat a foreign regime as equivalent to the Australian regime if it satisfies these Principles (such as consistency with *IOSCO, Objectives and Principles of Securities Regulation*).

It is these Principles that inform subsequent ASIC Policy Statements released following the Financial Services Reform Act 2001 (Cth) (FSRA)[69] in effect as of March 11, 2004 such as ASIC Policy Statement 176—Licensing: Discretionary Powers—wholesale foreign financial services providers (issued September 12, 2003) and ASIC Policy Statement 177—Australian market licences: Overseas operators (issued October 30, 2003).

Second principle: can this issue be effectively regulated domestically—if not is there a multilateral solution? Will it work? At what cost?

Here, the focus is on positive and negative externalities and the limits of regulatory reach in the electronic age. As to the latter point, Goddard and the NZIER comment that it is "increasingly illusory to

61. Commonwealth of Australia Productivity Commission, *Evaluation of Mutual Recognition Schemes*, (Productivity Commission, Canberra, 2003).

62. There is an extensive academic literature on mutual recognition regimes in the USA. See Hal Scott, "Internationalisation of Primary Public Securities Markets" (2000) 63 (3) *Law and Contemporary Problems* 71.

63. ASIC Policy Statement 56, ASIC Policy Statement 72 and ASIC Policy Statement 178. See also ASIC Class Order CO 00/177.

64. Scott, n.62 above.

65. Hon. Lianne Dalziel, "Strengthened securities trading law", Press Release of July 24, 2003 (*www.sec-com.govt.nz*).

66. Goddard and NZIER, n.58 above, p.6.

67. *ibid.*

68. ASIC, *Principles for cross border financial services regulation: Making the regulatory environment work in a cross border environment* (November 2002). Available from the ASIC website.

69. CCH Australia, *The Financial Services Regime* (CCH Australia, Sydney, 2003); Sharon Horgan, *Horgan's Law of Financial Services* (Lawbook, Sydney, 2003).

believe that domestic law can effectively regulate activities like financial services, or gambling".[70]

This proposition is well understood internationally.[71] The Wallis Report[72] that led to the new financial services regime in Australia is largely predicated on this perception, as is Australia's response to the information economy.[73]

Thus, intangibles such as securities, which are susceptible to electronic trading, are items that are difficult to regulate comprehensively on a domestic basis and are good candidates for co-ordination. An example is internet offerings of securities (see ASIC Policy Statement 141—*Offers of Securities on the Internet*).

Third principle: commerce is not fundamentally different in Australia and New Zealand—is there a good reason for the law on this issue to be different?

The focus here is on common laws to reduce the costs of making and interpreting laws and thereby achieve network externalities. Recall the earlier discussion of company and personal property security law reform in New Zealand; in the case of the PPSA there were compelling reasons why the pre-existing New Zealand law should be replaced and, in an ideal universe, the Australian states and territories should follow.

In the case of the Companies Act 1993 (NZ), we have a new statute based on a Canadian model. There is room, however, for selective alignment with Australia. Chapter 2E of the Corporations Act 2001 (Cth), dealing with related party transactions is an example.

Fourth principle: would it be more efficient to combine these institutions? Or is information exchange sufficient?

There is some scope for combining institutions to achieve economies of scope and scale. Goddard and NZIER suggest that one Patent Registry for Australia and New Zealand may be possible. Where the underlying laws are different (for example, company law), information exchange is the preferred solution. An example is provided by the 1994 MOU between the Australian Securities Commission and the Securities Commission of New Zealand.

Constraints, competing policy goals and cost/benefit analysis

The four principles outlined above are used to select candidates for co-ordination. Once this is done, countervailing arguments are considered. This issue will be returned to in Part 2 of the article in a discussion of transaction costs.

Applying the principles—a non-exhaustive list of candidates

Using the above criteria, Goddard and NZIER identified the following "candidates for co-ordination":

- offers of securities to the public;
- company registration;
- registers for patents and trade marks;
- insolvency; and
- provision of legal services.

In Part 2 of this article, we will examine why New Zealand will increasingly seek to adopt Australian law and the "Australianisation" of New Zealand business law in the area of securities regulation.

70. Goddard and NZIER, n.58 above, p.6.
71. Peter Dicken, *Global Shift* (4th ed., Guilford Press, New York, 2003), pp.85–121.
72. Commonwealth of Australia, *Final Report of the Financial System Inquiry* (AGPS, Canberra, 1997), Chs 2 and 4.
73. Gordon Walker, "Strategy as Law: Australia's Strategic Architecture for the Information Economy" (1999) 18 C. &

The CER Agreement and Trans-Tasman Securities Regulation: Part 2

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Introduction

The CER Treaty is simultaneously a Regional Free Trade Agreement between Australia and New Zealand and the umbrella agreement for a range of downstream arrangements that better implement the CER Treaty. One of the downstream arrangements is the Memorandum of Understanding between the Government of New Zealand and the Government of Australia on Co-ordination of Business Law signed in August 2000 (the 2000 MOU). The 2000 MOU is now being employed to implement trans-Tasman mutual recognition of offers of securities and managed investment scheme interests. Part 1 of this article (appearing in the previous issue of this journal) considered the background to this initiative, the trade relationship between Australia and New Zealand, the CER Agreement, the precursor to the 2000 MOU, and, conceptual work preceding the 2000 MOU. Part 2 of the article now examines why New Zealand will increasingly seek to adopt Australian law and the "Australianisation" of New Zealand business law in the area of securities regulation.

The 2000 MOU: Why New Zealand Will Increasingly Seek to Adopt Australian Business Law

In general, the language of the 2000 MOU follows closely the Goddard/NZIER report—sometimes verbatim. The focus now is on co-ordination (not harmonisation) of business law in order to deepen the CER Agreement. The predicate for the project is awareness that "existing laws and regulatory practices *may* impede the development of trans-Tasman business activity" (clause 3) and further co-ordination will minimise such impediments.

Closely following Goddard's own work, clause 4 of the 2000 MOU states:

> An array of approaches exists to achieve the goal of increased coordination in business law. Both governments recognise that one single approach would not be suitable for every area, that coordination is multifaceted and does not necessarily mean the adoption of identical laws, but rather finding a way to deal with any differences so they do not create barriers to trade and investment. In working towards greater coordination, the efforts of both governments will focus on reducing transaction costs, lessening compliance costs and uncertainty, and increasing competition.

Thus, while existing business laws *may* impede business activity, a range of approaches can be used to address this problem with the goal of reducing transaction costs, lessening compliance costs and uncertainty and increasing competition.

In 1990, Dr James Farmer Q.C.—perhaps the first "harmonisation sceptic"—addressed some of these issues when discussing the 1988 MOU.[1] His key points were that the quality of domestic laws should not be compromised and the case for harmonisation was assumed rather than established by rational debate or analysis.[2] He stated:

> [T]he committee acknowledged that differences in business laws did not in truth create impediments to trade at all. That is, they did not prevent or obstruct business between Australia and New Zealand in the sense that tariffs and other border controls had done before the reforms implemented by CER. Rather, the trade impediment was identified as being simply one of higher transaction and compliance costs arising out of regulatory regimes, which were not entirely compatible.[3]

These remarks by Farmer Q.C. serve as a cue to consider more closely the transaction cost rationale for the co-ordination project. Such an examination does not appear to have been undertaken previously.

The starting point, of course, is the work of Ronald Coase.[4] Briefly stated, the "Coase Theorem" (to use Stigler's expression) holds that, in a world of zero transaction costs, any initial definition of rights will lead to an efficient outcome. This is said to be because, in a world of zero transaction costs, market transactions will lead to efficient outcomes. However, inefficient transactions do occur in fact and the reason is transaction costs. Carl Dahlman summarised the concept of transaction costs by describing them as "search and information costs, bargaining and decision costs, policing and enforcement costs".[5]

1. James Farmer, "The Harmonisation of Australian and New Zealand Business Laws" in Kerrin Vautier, James Farmer and Robert Baxt, *CER and Business Competition* (CCH NZ, Auckland, 1990), p.45.
2. *ibid.* pp.46–49.
3. *ibid.* p.49.
4. Ronald Coase, *The Firm, the Market and the Law* (University of Chicago Press, 1990).
5. Carl Dahlman, "The Problem of Externality" (1979) 22 (1) *Journal of Law and Economics* 148.

To these items, we must add "compliance costs", namely, the costs to a firm of complying with the laws and regulations affecting the market it trades in. To this extent, compliance costs are part of transaction costs and can be subsumed into them. Clearly, compliance and transaction costs are lower and there will be fewer externalities when there is agreement on minimum standards in business laws in each jurisdiction.

It is useful, however, to keep the two types of costs distinct because compliance costs, it is suggested, are the salient transaction cost. Transaction costs are ubiquitous. For business within Australia and New Zealand and for business between Australia and New Zealand, there is no such thing as a world of zero transaction costs.

Consider now Dahlman's definition of transaction costs in the context of trans-Tasman trade. The question we are asking here is whether—in principle and in the absence of any comprehensive evidence—there is any great cost differential between trans-Tasman trade and inter-state trade in terms of transaction costs.

Another way of framing this question is to ask whether there is any great difference between New Zealand-New South Wales (NSW) trade and NSW-Western Australian trade (where the tyranny of distance is a common factor in both types of trade). The following propositions seem sustainable.

First, we observe that the advent of internet technology has reduced the costs of trans-Tasman search and information costs. Where internet use is insufficient, the cost of agents or personal visits will be about the same as the intra-Australian equivalent.

Secondly, bargaining and decision costs are broadly the same. Thirdly, policing and enforcement costs are similar.[6] The conclusion is that transaction costs in trans-Tasman trade are not especially higher than the inter-state equivalent within Australia but compliance costs may impose a higher burden.

The next question is whether supposed higher compliance costs impose an unjustifiable burden on trans-Tasman trade. Ideally, the answer to this question would be provided by empirical evidence tracking a set of trans-Tasman trade transactions and quantifying the added costs imposed by any additional regulatory burden.[7]

An intuitive answer, however, is that the added costs are not onerous, may in fact be *de minimis*, are capable of being priced into the transaction, and, do not justify any great expenditure of taxpayer's money to benefit a small proportion of business actors where it is possible to "contract around" (via forum selection clauses and other devices) any perceived disadvantages.

In this regard, none of the case studies[8] in trans-Tasman business produced in 2003 by Australia's Department of Foreign Affairs and Trade (DFAT) make any mention of adverse compliance costs.[9] This may be because trans-Tasman trade related compliance costs are primarily addressed in tailored (or customised) contract(s) and these can be characterised as "one off" costs.[10]

If the above analysis holds, then the key focus in trans-Tasman business law co-ordination is not on compliance costs in trans-Tasman trade but on compliance costs *within* the particular jurisdiction. On this view, the trans-Tasman business law co-ordination project needs to be recalibrated to focus on reducing compliance costs within the particular jurisdiction. For example, Australia should focus on reducing compliance costs associated with its new financial services regime.

Both Australia and New Zealand are interested in reducing compliance costs within their own borders. In New Zealand, the principal mechanism is the use of regulatory impact statements (RIS) and business compliance cost statements (BCCS). From April 1, 2001, all policy proposals submitted to Cabinet in New Zealand that require a RIS and have compliance cost implications for business must include a BCCS in the RIS.[11]

In Australia, the Office of Regulation Review (ORR) is the institution responsible for monitoring compliance cost issues.[12] However, when preparing an Australian RIS no account is taken of the terms of the MOUs under scrutiny. So, for example, there is no mention of the 1988 MOU in the Australian ORR, *A Guide to Regulation*.[13]

We return now to the terms of the 2000 MOU. The work programme for co-ordination of business law specified in the 2000 MOU is as follows:

- cross-recognition of companies;
- greater compatibility in disclosure regimes in relation to financial products;
- cross-border insolvency;
- mutual recognition of stock markets;
- intellectual property;
- information sharing;
- electronic transactions;
- competition law.

There is a stocktake on most of these issues in Part Five of *States of Mind: Australia and New Zealand*

6. Assuming reciprocal enforcement of judgments and the use of forum selection clauses.
7. This suggests an interesting research project opportunity.
8. Commonwealth of Australia, Department of Foreign Affairs and Trade, *Case Studies in Trans-Tasman Business* (*www.dfat.gov.au/geo/new_zealand/anz_cer_20years/case_studies.htm*).
9. Australian Department of Foreign Affairs and Trade and New Zealand Ministry of Foreign Affairs and Trade, *The Negotiation of the Australia New Zealand Closer Economic Relations Trade Agreement 1983* (Commonwealth of Australia, Canberra, 2003).
10. More realistically, it may also be because the most meaningful compliance costs for trans-Tasman business do not relate to trade as such but to carrying on business in the other jurisdiction and to this extent are "hidden" in the sense that they are those incurred by, for example, an entity controlled by a New Zealand company carrying on business within Australia where compliance costs overall are higher than in New Zealand.
11. See *www.med.govt.nz/buslt/compliance.html.*
12. See *www.pc.gov.au/orr/role.html.*
13. Office of Regulation Review, *A Guide to Regulation* (2nd ed., AGPS, Canberra, 1998).

1901–2001.[14] An official pronouncement on progress under the 2000 MOU is the Joint Statement by Hon. Lianne Dalziel and Hon. Helen Coonan dated August 28, 2003.[15] The statement claims significant progress on the business law co-ordination project in the areas of competition law, securities markets, accounting standards, and, trans-Tasman insolvencies.

Significantly, the New Zealand Ministry of Foreign Affairs and Trade (MFAT) has stated: "New Zealand has moved or is moving towards Australian business law in a number of areas".[16] The areas identified were competition law, electronic transactions, takeovers, insider trading, continuous disclosure, director's disclosure of share dealings and insolvency laws. At this point, therefore, we can identify a second key characteristic of the business law project.

Earlier, it was claimed that the project was largely declaratory of a desire for closer economic union and the principal impetus came from New Zealand. It is now suggested that there is good evidence that the co-ordination project mostly involves New Zealand adopting Australian law and, to this extent, the trajectory of the co-ordination project is one way. Subsequent discussion will focus on securities regulation.

The "Australianisation" of New Zealand Business Law: Securities Regulation

Co-ordination in the realm of securities markets is the salient example of an area where the principles of the 2000 MOU are being actively pursued from the New Zealand end. This is confirmed in policy statements of the New Zealand Government.[17] In July 2003, the Ministry of Commerce made explicit reference to these principles when announcing further reform to New Zealand's securities regulation regime including the proposed reform of New Zealand's insider trading provisions along Australian lines.[18] We also see these principles directly addressed in, for example, s.19A(2)(i) of the Securities Markets Act 1988 (NZ) and s.24 of the Takeovers Act 1993 (NZ).[19]

In a Media Statement dated July 24, 2003, the Hon. Lianne Dalziel, then New Zealand's Commerce Minister, announced proposals to strengthen New Zealand's secondary market regulation.[20] According to the Media Statement, a Securities Trading Law Review and a Securities Trading Law Reform Bill would be released in 2003–04 for comment.[21] The new Bill will introduce:

- a new insider-trading regime similar to Australia;
- more prohibitions on market manipulation;
- amendments to the law relating to investment advisers;
- increased penalties for violating secondary market regulation;
- fine-tuning the substantial security holder disclosure regime, and,
- improvements to the application of secondary market regulation.

The Media Statement contains a hyperlink through to the website of the Ministry of Economic Development where the Cabinet papers relating to these proposals are cached.[22] The substantive documents[23] are prefaced by an overview document entitled, *Review of Securities Trading Law*. The overview document and the Cabinet Paper entitled *Review of Securities Trading Law: Overview and Application Issues* by the Hon. Lianne Dalziel provide us with a much clearer view of the New Zealand Government's overall plan for securities regulation reform.

It is now plain that the Labour Party-led coalition Government in New Zealand has embarked on the most comprehensive reform of securities regulation in over a decade. The four-step reform agenda presents a striking contrast to the inaction of the National Government in this area during the 1990s.

The key document is the Hon. Lianne Dalziel, *Review of Securities Trading Law: Overview and Application Issues*[24] addressed to the Chair of the Cabinet Economic Review Committee. Part of this document states as follows:

> The government has identified as one of its key objectives promoting confidence in the New Zealand market. This objective involves strengthening the regulatory framework in order to encourage investment and enhance the performance of the New Zealand market. In order to achieve this objective a four-step programme of

14. Arthur Grimes, Lydia Wevers and Ginny Sullivan, eds, *States of Mind: Australia and New Zealand 1901–2001* (Victoria University of Wellington, Institute of Policy Studies, 2002). See also the CER Backgrounder at *www.mfat.govt.nz*.
15. *Joint Statement by Hon Lianne Dalziel and Senator the Hon Helen Coonan on Business Law Coordination Work Programme* dated August 28, 2003 (*www.mfat.govt.nz*).
16. New Zealand Ministry of Foreign Affairs and Trade, Australia Division, *Update of Business Law* (*www.mfat.govt.nz*).
17. *e.g.* in March and May 2003, the New Zealand Government stated that it was committed to further co-ordination of business laws of the two economies: see *Australian Financial Review*, March 12, 2003, p.3; May 22, 2003, p.14.
18. Hon. Lianne Dalziel, "Strengthened securities trading law", Press Release of July 24, 2003 (*www.sec-com.govt.nz*).
19. They are also reflected in the appointment of the Australian commercial lawyer, Dennis Byrne, to the Takeovers Panel and of Australian Jane Diplock, AO, as Chairman of the Securities Commission. (Prior to her appointment to the Securities Commission, Jane Diplock was the Australian Investments and Securities Commission's (ASIC) National Director Infrastructure and Strategic Planning and New South Wales Regional Commissioner.)
20. n.18 above.
21. As of September 2004, these documents had not been released.
22. See *www.med.govt.nz/buslet/bus_pol/bus_law/securities/index.html* for downloadable copies of all documents.
23. Cabinet Papers; Regulatory Impact and Business Compliance Cost Statements; Discussion Documents and Media Statements.
24. Hon. Lianne Dalziel, *Review of Securities Trading Law: Overview and Application Issues* (Office of the Minster of Commerce, File No.RCP 3.3.4.4).

reform relating to securities law has been developed and has been in progress since 2000. This includes:

The introduction of the Takeovers Code: The Takeovers Code was implemented on 1 July 2001. The intention of the Code is to align our takeovers regime with international best practice, at the same time giving greater confidence to small and minority investors by providing them with fair and equal treatment and participation in takeover situations;

The Securities Markets and Institutions Bill: The Securities Amendment Act 2002 and the Securities Markets Amendment Act 2002 were passed on 1 December 2002 (these acts were the result of the Securities Markets and Institutions Bill). The purpose of the legislation was to promote confidence in the New Zealand market by increasing the effectiveness and efficiency of the law and regulatory institutions governing securities markets and aligning the law with international best practice;

The Review of Securities Trading Law [this refers to the three volumes of discussion documents on insider trading, market manipulation and penalties available at the Ministry of Economic Development website] and, The Review of the Securities Act 1978 and other issues: The substantive work on this review will be undertaken after the Review of Securities Trading Law is completed. The review will consider possible changes to the regulation of securities offerings, whether there should be licensing of financial intermediaries, reviews of the Unit Trusts Act and the provisions relating to contributory mortgages and other security law issues that are necessary to achieve a consistent and cohesive package of securities laws.[25]

The overt policy rationales for reforming securities regulation in New Zealand appear in the paragraph quoted above. Generally, however, they can be reduced to one overarching rationale—investor protection.

As argued elsewhere, the rationale for reform in New Zealand is best explained by the work of Rafael La Porta and colleagues.[26] The precise detail or shape of reform is best explained by an increasing New Zealand focus on the principles of the 2000 MOU. These desiderata are confirmed by recent reports of the policy position of the New Zealand Government.[27]

Recently, the New Zealand Exchange (NZX) adopted a continuous disclosure regime that closely resembles Australia.[28] The most striking example of this trend, however, is the proposed introduction of an insider-trading regime[29] and market manipulation[30] provisions that follow the Australian position.

The 1998 MOU and the Goddard/NZIER report listed fundraising as one area of potential harmonisation and co-ordination. The 2000 MOU talks about achieving greater compatibility in disclosure regimes in relation to financial products (the latter terminology anticipated the passage of the Financial Services Reform Act 2001 (Cth) (FSRA) in Australia.) It is important to appreciate that New Zealand and Australia have fundraising regimes that diverge in significant respects.

First, in New Zealand, s.33 of the Securities Act 1978 (NZ) prohibits the offering of a security "to the public" in the absence of a registered prospectus or an investment statement. Australia, however, has abandoned the "offer to the public" requirement. Thus, s.706 appearing in Ch.6D of the Corporations Act 2001 (Cth) states that an offer of securities for issue needs disclosure unless s.708 says otherwise. In this way, Australian law establishes a "bright line rule".

By contrast, New Zealand excluded offers as contained in s.3(2) of the Securities Act 1978 (NZ) (broadly, the types of offers contemplated in s.708 of the Corporations Act 2001) may be susceptible to subsequent challenge as constituting a public offer and hence requiring registration.[31]

Secondly, the prospectus content rules differ. In New Zealand, a registered prospectus requires the information prescribed in the Regulations to the Securities Act 1978 (NZ). In Australia, the general disclosure test that applies to most prospectuses is set out in s.710 of the Corporations Act 2001 (Cth). It states that a prospectus issued in connection with an offer of securities for subscription must include all the information that investors and their professional advisers would reasonably require to make an informed assessment of (a) the rights and liabilities attaching to the securities and (b) the assets and liabilities, financial position and performance, profits and losses and prospects of the company.

The requisite information must be included to the extent that it is reasonable for investors and their

25. *ibid.* para.7.

26. Gordon Walker, "Securities Regulation Reform in New Zealand: Australian Rules OK?" (2003) 21 C. & S.L.J. 536.

27. The New Zealand Minister of Finance, Hon. Michael Cullen, has stated that, as far as possible, common regulatory systems as between New Zealand and Australia are desirable: see David Bassanese, "Living History", *Australian Financial Review*, July 21, 2003, p.52; A. Wood, "To CER, with Love", *Weekend Australian*, March 15–16, 2003, p.29. Australia is the largest investor in New Zealand and Australia is the second largest destination for New Zealand investment. Total bilateral trade between Australia and New Zealand in 2002 was over AU$16.2 billion: *Australian Financial Review*, February 21, 2003, p.12.

28. See NZX LR 10.1.1 and compare ASX LR 3.1. Former lawyer, now ACT Party politician, Stephen Franks described the new NZX rules as "Australia-style hotpants". See *Australian Financial Review*, January 17, 2003, p.51.

29. See Hon. Lianne Dalziel, *Review of Securities Trading Law: Insider Trading* (Office of the Minister of Commerce, File No.RCP 3.3.4.4) addressed to the Chair of the Cabinet Economic Review Committee. Para.13 of this document states that, "the proposed insider trading regime is similar to that in the Australian *Corporations Act* 2001 ... The introduction of the insider trading regime would contribute to the closer coordination of New Zealand and Australian securities law." See also Shelley Griffiths, "Aussie Rules 'Reform' of New Zealand Securities Law" (2004) 22 C. & S.L.J. 73.

30. A key recommendation is to create an offence in relation to misleading and deceptive conduct relating to securities. Presumably, the proposed provisions would follow closely those contained in Pt 7.10 of the Corporations Act 2001 (Cth)—see especially ss.1041E and 1041H.

31. Peter Fitzsimons, "Public Offerings of Securities in New Zealand" in Gordon Walker, gen.ed. *Securities Regulation in Australia and New Zealand* (Lawbook Co, Sydney, 1998), p.352.

professional advisers to expect to find the information in the prospectus and only if the relevant person actually knows the information or in the circumstances ought reasonably to have obtained the information by making inquiries. The latter requirement imposes a due diligence obligation.

It is immediately apparent that the disclosure obligations imposed under Australian law are more onerous than the New Zealand equivalent. In turn, this raises questions about mutual recognition of registered prospectuses where disclosure standards are lower in one jurisdiction than in the other.

The solution appears obvious: New Zealand should abandon the "offer to the public" test for prospectus registration and follow the Australian practice. It is notorious that s.3 of the Securities Act 1978 (NZ) has been an unmitigated disaster and is long overdue for consignment to the boneyard. (Hong Kong and Malaysia have recently abandoned the public offer concept and Singapore is set to follow.)

Similarly, New Zealand prospectus content requirements should be aligned with Australia. The 2003 Dalziel and Coonan Joint Statement indicated that Australian and New Zealand officials had reached preliminary agreement on detailed proposals for mutual recognition of securities offerings. Prima facie, this is puzzling since—as we have seen—there are long-standing pre-existing arrangements for mutual recognition of securities offerings. This proposal, however, extends existing arrangements. The Joint Statement elaborates:

- under these proposals an issuer should be able to offer securities in both countries using a single disclosure document that satisfies the requirements of the home country and investors should be able to take action in the courts of either country;
- legislation will be required to implement the proposal in Australia and regulations will be required in New Zealand; and
- a joint discussion paper will be issued by November 30, 2003 and a finalised proposal should be ready by June 30, 2004.

New Zealand has established a mechanism to effect this proposal via legislation as a result of the Securities Act Amendment Act 2002 (NZ). It introduces, amongst other things, a new Pt 5, Subpts 1-4 to the Securities Act 1978 (NZ). The purposes of the new Pt 5 are fully stated in s.71 of the Act. However, one key purpose is to introduce recognition and application regimes that provide for exemptions from Pt 2 of the Act and Regulations so that foreign issuers may offer securities in New Zealand in accordance with the laws of their home countries.[32]

The Australian Treasury and the New Zealand Ministry of Economic Development produced a discussion paper on the above proposal. The discussion paper, *Trans-Tasman Mutual Recognition of Offers of Securities and Managed Investment Scheme Interests*, was released on May 18, 2004.[33]

In brief, the proposal is that the fundraising laws of the home jurisdiction will apply to offers made to investors in the host jurisdiction. In addition, however, parts of the law of the host jurisdiction will also apply. The way this scheme will operate can be illustrated by considering a prospectus offering in Australia.

- First, the Australian prospectus must comply with all applicable Australian laws (*i.e.* it must be a "regulated offer" in the home jurisdiction).
- Secondly, the Australian issuer opts in to the New Zealand mutual recognition regime by filing a notice that contains prescribed information in relation to the offer and the offeror with the Securities Commission in New Zealand.
- Thirdly, the Australian issuer undertakes to comply with the ongoing requirements of the mutual recognition regime. These will include conditions that the issuer will comply with Australian law and any ongoing requirements imposed by New Zealand. An issuer in breach of these ongoing requirements may be subject to suit by the Securities Commission in New Zealand.
- Further, an aggrieved investor may take action in either jurisdiction.

It is envisaged that the proposed arrangements will be effected by way of a treaty. Further submissions on the proposal were sought with a closing date of July 16, 2004.

In Part 1 of this article, it was asserted that in domestic law nations pursue their own interests. In the US context, Professor James D. Cox has stated:

> Incantations regarding the pre-eminence of U.S. capital markets and the rigors of its regulation are repeatedly joined as justifications for the status quo of U.S regulatory treatment of foreign issuers. Only isolated accommodations are made for foreign issuers and with the exception of Canadian issuers, all must abide by the same standards that pertain to U.S issuers.[34]

32. Norman Miller, "Cross-border coordination of securities market regulation—A New Zealand perspective" (paper presented in Sri Lanka, January 24, 2003). Available at *www.sec-com.govt.nz.*

33. Commonwealth of Australia, Department of the Treasury and New Zealand Government, Ministry of Economic Development, *Trans-Tasman Mutual Recognition of Offers of Securities and Managed Investment Schemes* (*www.med.govt.nz/buslt/bus_pol/bus_law/financial-markets.ttmr* and *www.treasury.gov.au/contentitem.asp*).

34. James Cox, "The Death of the Securities Regulator—Globalisation". Unpublished manuscript on file with author. In passing, note that the reference by Professor Cox to the position of Canadian issuers is a pointer to the multi-jurisdictional disclosure system (MJDS) adopted by the Securities and Exchange Commission (SEC) in 1991, which permits eligible Canadian issuers to satisfy SEC registration and reporting requirements by filing disclosure documents that satisfy Canadian requirements. At the same time, Canada undertook changes to its securities laws to permit US issuers to satisfy its laws by filing documents prepared in accordance with SEC requirements. The MJDS is presently the best analogy with the proposed Australia-New Zealand mutual recognition regime. For this reason, it deserves closer scrutiny by trans-Tasman policy-makers.

Leaving aside arguments for special treatment (*cf.* Canada and the United States) based on proximity and *de facto* economic integration, the main concern about the proposed mutual recognition regime is the extent to which Australia's interest in the pre-eminence of its securities regime—which has higher disclosure and reporting standards than New Zealand—is eroded or compromised by recognition of lower standards in New Zealand.

Thus, it is arguable that New Zealand prospectus disclosure and related standards need to be overhauled to align with those of Australia; otherwise, Australia will be recognising a lower standard of prospectus disclosure. For example, valuation of vendor consideration in a primary public offering is treated differently in Australia than in New Zealand. Again, if reciprocal access to the courts of the host country is to occur then presumably the remedies for defective disclosure must be the same.[35]

In short, the logic of this proposal points in one direction: New Zealand must adopt the Australian law.[36]

The 2000 MOU Work Programme for Co-ordination of Business Law also seeks to achieve greater compatibility in disclosure regimes in relation to "financial products". The new regime for financial products in Australia came as a result of the FSRA in 2001 and—as with the Companies Act 1993 and the Personal Property Securities Act 1999 in New Zealand—consideration of the principles of the 2000 MOU was non-existent in the preparation of this legislation.

The immediate prospects of New Zealand aligning with the FSRA regime in Australia are remote. New Ch.7 of the Corporations Act 2001 (Cth) was introduced by the FSRA and came into full effect on March 11, 2004. Chapter 7, Pt 7.9 now regulates the offer and sale of "financial products" other than securities.[37] It requires disclosure to investors by means of a Product Disclosure Statement (PDS).

The Australian regime goes much further than the New Zealand equivalent. This is because prospectus or investment statement disclosure in New Zealand flows—generally speaking—from the definition of a "security" in s.2D(1) of the Securities Act 1978 (NZ) and this definition is not as expansive as the definition of a financial product in s.763A(1) of the Corporations Act 2001 (Cth).

More pertinently, it is unarguable that the regulatory burden imposed on industry by the FSRA in Australia is high and ongoing.[38] It is unlikely that the New Zealand Government would seek to impose a similar regime on the industry in New Zealand.

Conclusion: A New Form of Path Dependency or One System, Two Countries?

The main conclusions on the business law co-ordination project are two-fold. First, the project is best viewed as a declaratory signal that New Zealand and Australia wish to move to closer economic union.[39] Secondly, the overall trajectory of the project—at least in the key area of securities regulation—is in one direction. Thus, New Zealand will increasingly adopt Australian law verbatim even if it is arguably sub-optimal as in the case of the Australian insider trading regime. On this view, we are witnessing a striking example of "soft law" (the 2000 MOU) leading to "hard law" outcomes.[40] This phenomenon is driven by globalisation.

The case for integration of trans-Tasman capital markets is not new.[41] In 2000 discussions were held between the New Zealand Stock Exchange (as it was then known) and the Australian Stock Exchange (ASX) regarding a possible merger.[42] The newly demutualised New Zealand Exchange (NZX) has produced revamped Listing Rules closely aligned with the ASX and the new continuous disclosure regime in the Securities Markets Act 2002 (NZ) follows its equivalent in the Corporations Act 2001 (Cth).

One view of the NZX reforms (in contrast to official versions of events), is that they were necessary to extract maximum value for the existing members (via shares issued to members on listing) and a required precursor to any subsequent merger negotiations with the demutualised ASX. In line with this analysis—as the NZX positions itself as an attractive merger prospect—we might expect further fine-tuning of the NZX Listing Rules, Business Rules and Conduct Rules to conform to ASX practice.

35. Consider here ss.728 and 729 of the Corporations Act 2001 (Cth) and compare the liability provisions under the Securities Act 1978 (NZ). At present, there is no liability in New Zealand for a misleading or deceptive statement in a prospectus in the Securities Act. Instead, litigants rely on s.9 of the Fair Trading Act 1986. See, *e.g. Jagwar Holdings v Julian* (1992) 6 N.Z.C.L.C. 68, 040.

36. This concern may be overstated. After all, in the case of reciprocal admission of lawyers, a New Zealand lawyer with no training in Australian law may be admitted in Australia. To this extent, there is a degree of "satisficing" in mutual recognition of professional qualifications and query whether a similar logic will apply in the area under scrutiny. ("Satisficing" is a practical alternative to attempting to optimise as a rule of conduct—see Oxford Dictionary of Economics).

37. As to the definition of "financial product", see Kevin Lewis, "When is a financial product not a financial product?" (2004) 22 (2) C. & S.L.J. 103.

38. Jemima Whyte, "Compliance costs top $100 million", *Australian Financial Review*, March 10, 2004, p.49.

39. In New Zealand, Treaty of Waitangi issues (relating to the special status of Maori in New Zealand) are often seen as an impediment to this process. In this regard, note that New Zealand Opposition Leader, Dr Brash, has stated an intention to reverse race-based legislation deriving from the Treaty if elected: see Rowan Callick, "Race play powers Brash to the front", *Australian Financial Review*, March 18, 2004, Special Report, p.10; Anon, "Uneasy Partners", *The Economist*, February 28, 2004, p.33.

40. Dinah Shelton, ed., *Commitment and Compliance: The Role of Non-Binding Norms in the International Legal System* (Oxford University Press, 2000).

41. Edna Carew, "Trans-Tasman Market Ties Gain Momentum", *Australian Capital Markets*, 1991–92, p.36.

42. Gordon Walker, "Securities Regulation Reform in New Zealand: Australian Rules OK?" (2003) 21 C. & S.L.J. 533.

How might we characterise the new "Australianisation" of New Zealand business law?[43] In company law and securities regulation, New Zealand followed the United Kingdom for most of its history and legislation was path-dependent.[44] In the period 1978–2002, we observe New Zealand crafting new legislation based on non-UK models. Since 2003, however, a new limited form of path dependency has emerged in New Zealand and the model is Australia. Is this a bad thing? Not necessarily.

There is a pragmatic spirit to the New Zealand approach. Recently, for example, we saw New Zealand and Australian state governments join together to attract biotechnology.[45] In much the same way, Deng Xiaoping reminds us: "It doesn't matter whether a cat is black or white as long as it catches mice".[46] And if pragmatism is the lodestar, the ultimate outcome for the Australia-New Zealand business law co-ordination project will be—to rephrase Deng Xiaoping on the relationship between China and Hong Kong—"one system, two countries".

43. One explanation is provided by Teubner's notion of a "legal irritant". Gunther Teubner, "Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Divergences" (1998) 61 M.L.R. 11.

44. Gordon Walker, "Reinterpreting New Zealand Securities Regulation" in Walker, gen.ed., n.31 above, p.88.

45. Morgan Mellish and Mark Ludlow, "Bio-Adversity is over as states bury the hatchet", *Australian Financial Review*, June 2, 2004, p.1. This event might be regarded as a precedent for the reform of personal property securities law in the Australian states.

46. Jim Rohwer, *Asia Rising* (Touchstone, New York, 1995), p.125.

Division 5A—Types of company

45A Proprietary companies

(1) A proprietary company is a company that is registered as, or converts to, a proprietary company under this Act.

Note 1: A proprietary company can be registered under section 118 or 601BD. A company can convert to a proprietary company under Part 2B.7.

Note 2: A proprietary company must:

- be limited by shares or be an unlimited company with a share capital
- have no more than 50 non-employee shareholders
- not do anything that would require disclosure to investors under Chapter 6D (except in limited circumstances).

(see section 113).

Small proprietary company

(2) A proprietary company is a small proprietary company for a financial year if it satisfies at least 2 of the following paragraphs:

(a) the consolidated revenue for the financial year of the company and the entities it controls (if any) is less than $25 million, or any other amount prescribed by the regulations for the purposes of this paragraph;

(b) the value of the consolidated gross assets at the end of the financial year of the company and the entities it controls (if any) is less than $12.5 million, or any other amount prescribed by the regulations for the purposes of this paragraph;

(c) the company and the entities it controls (if any) have fewer than 50, or any other number prescribed by the regulations for the purposes of this paragraph, employees at the end of the financial year.

Note: A small proprietary company generally has reduced financial reporting requirements (see subsection 292(2)).

Large proprietary company

(3) A proprietary company is a large proprietary company for a financial year if it satisfies at least 2 of the following paragraphs:

(a) the consolidated revenue for the financial year of the company and the entities it controls (if any) is $25 million, or any other amount prescribed by the regulations for the purposes of paragraph (2)(a), or more;

(b) the value of the consolidated gross assets at the end of the financial year of the company and the entities it controls (if any) is $12.5 million, or any other amount prescribed by the regulations for the purposes of paragraph (2)(b), or more;

(c) the company and the entities it controls (if any) have 50, or any other number prescribed by the regulations for the purposes of paragraph (2)(c), or more employees at the end of the financial year.

When a company controls an entity

(4) For the purposes of this section, the question whether a proprietary company controls an entity is to be decided in accordance with the accounting standards made for the purposes of paragraph 295(2)(b) (even if the standards do not otherwise apply to the company).

Counting employees

(5) In counting employees for the purposes of subsections (2) and (3), take part-time employees into account as an appropriate fraction of a full-time equivalent.

Accounting standards

(6) Consolidated revenue and the value of consolidated gross assets are to be calculated for the purposes of this section in accordance with accounting standards in force at the relevant time (even if the standard does not otherwise apply to the financial year of some or all of the companies concerned).

Chapter 2A—Registering a company

Part 2A.1—What companies can be registered

112 Types of companies

Types of companies

(1) The following types of companies can be registered under this Act:

Proprietary companies	Limited by shares
	Unlimited with share capital
Public companies	Limited by shares
	Limited by guarantee
	Unlimited with share capital
	No liability company

Note: Other types of companies that were previously allowed continue to exist under the Part 10.1 transitionals.

No liability companies

(2) A company may be registered as a no liability company only if:
- (a) the company has a share capital; and
- (b) the company's constitution states that its sole objects are mining purposes; and
- (c) the company has no contractual right under its constitution to recover calls made on its shares from a shareholder who fails to pay them.

Note 1: Section 9 defines ***mining purposes*** and ***minerals***.

Note 2: Special provisions on no liability companies are found in the provisions referred to in the following table:

No liability company provisions

item	topic	provisions
1	names	148, 156, 162
2	terms of issue of shares	254B

No liability company provisions		
item	**topic**	**provisions**
3	liability on partly-paid shares	254M
4	calls	254P-254R
5	winding up	477-478, 483, 514
6	registering a body as a company	610BA
7	transitional	the Part 10.1 transitionals

(3) A no liability company must not engage in activities that are outside its mining purposes objects.

(4) The directors of a no liability company must not:

(a) let the whole or proportion of a mine or claim on tribute; or

(b) make any contract for working any land on tribute;

unless:

(c) the letting or contract is approved by a special resolution; or

(d) no such letting or contract has been made within the period of 2 years immediately preceding the proposed letting or contract.

(5) An act or transaction is not invalid merely because of a contravention of subsection (3) or (4).

113 Proprietary companies

(1) A company must have no more than 50 non—employee shareholders if it is to:

(a) be registered as a proprietary company; or

(b) change to a proprietary company; or

(c) remain registered as a proprietary company.

Note: Proprietary companies have different financial reporting obligations depending on whether they are small proprietary companies or large proprietary companies (see section 45A and Part 2M.3).

(2) In applying subsection (1):

(a) count joint holders of a particular parcel of shares as 1 person; and

(b) an employee shareholder is:

(i) a shareholder who is an employee of the company or of a subsidiary of the company; or

(ii) a shareholder who was an employee of the company, or of a subsidiary of the company, when they became a shareholder.

(3) A proprietary company must not engage in any activity that would require disclosure to investors under Chapter 6D, except for an offer of its shares to:

(a) existing shareholders of the company; or

(b) employees of the company or of a subsidiary of the company.

(3A) An offence based on subsection (3) is an offence of strict liability.

Note: For ***strict liability***, see section 6.1 of the *Criminal Code*.

(4) An act or transaction is not invalid merely because of a contravention of subsection (3).

Note: If a proprietary company contravenes this section, ASIC may require it to change to a public company (see section 165).

114 Minimum of 1 member

A company needs to have at least 1 member.

115 Restrictions on size of partnerships and associations

(1) A person must not participate in the formation of a partnership or association that:

(a) has as an object gain for itself or for any of its members; and

(b) has more than 20 members;

unless the partnership or association is incorporated or formed under an Australian law.

Note: For the effect of a contravention of this section, see section 103.

(2) The regulations may specify a higher number that is higher than the number specified in paragraph (1)(b) for the purposes of the application of that paragraph to a particular kind of partnership or association.

(3) An offence based on subsection (1) is an offence of strict liability.

Note: For ***strict liability***, see section 6.1 of the *Criminal Code*.

Part 2A.2—How a company is registered

117 Applying for registration

Lodging application

(1) To register a company, a person must lodge an application with ASIC.

Note: For the types of companies that can be registered, see section 112.

Contents of the application

(2) The application must state the following:

(a) the type of company that is proposed to be registered under this Act;

(b) the company's proposed name (unless the ACN is to be used in its name);

(c) the name and address of each person who consents to become a member;

(d) the present given and family name, all former given and family names and the date and place of birth of each person who consents in writing to become a director;

(e) the present given and family name, all former given and family names and the date and place of birth of each person who consents in writing to become a company secretary;

(f) the address of each person who consents in writing to become a director or company secretary;

(g) the address of the company's proposed registered office;

(h) for a public company—the proposed opening hours of its registered office (if they are not the standard opening hours);

(j) the address of the company's proposed principal place of business (if it is not the address of the proposed registered office);

(k) for a company limited by shares or an unlimited company—the following:

(i) the number and class of shares each member agrees in writing to take up;

(ii) the amount (if any) each member agrees in writing to pay for each share;

(iia) whether the shares each member agrees in writing to take up will be fully paid on registration;

(iii) if that amount is not to be paid in full on registration—the amount (if any) each member agrees in writing to be unpaid on each share;

(iv) whether or not the shares each member agrees in writing to take up will be beneficially owned by the member on registration;

(l) for a public company that is limited by shares or is an unlimited company, if shares will be issued for non-cash consideration—the prescribed particulars about the issue of the shares, unless the shares will be issued under a written contract and a copy of the contract is lodged with the application;

(m) for a company limited by guarantee—the proposed amount of the guarantee that each member agrees to in writing;

(ma) whether or not, on registration, the company will have an ultimate holding company;

(mb) if, on registration, the company will have an ultimate holding company—the following:

(i) the name of the ultimate holding company;

(ii) if the ultimate holding company is registered in Australia—its ABN, ACN or ARBN;

(iii) if the ultimate holding company is not registered in Australia—the place at which it was incorporated or formed;

(n) the State or Territory in this jurisdiction in which the company is to be taken to be registered.

Note 1: Paragraph (b)—sections 147 and 152 deal with the availability and reservation of names.

Note 2: Paragraph (f)—the address that must be stated is usually the residential address, although an alternative address can sometimes be stated instead (see section 205D).

Note 3: Paragraph (g)—if the company is not to be the occupier of premises at the address of its registered office, the application must state that the occupier has consented to the address being specified in the application and has not withdrawn that consent (see section 100).

Note 4: Paragraph (h)—for ***standard opening hours***, see section 9.

(3) If the company is to be a public company and is to have a constitution on registration, a copy of the constitution must be lodged with the application.

(4) The application must be in the prescribed form.

(5) An applicant must have the consents and agreements referred to in subsection (2) when the application is lodged. After the company is registered, the applicant must give the consents and agreements to the company. The company must keep the consents and agreements.

(6) An offence based on subsection (5) is an offence of strict liability.

Note: For ***strict liability***, see section 6.1 of the *Criminal Code*.

118 ASIC gives company ACN, registers company and issues certificate

Registration

(1) If an application is lodged under section 117, ASIC may:

(a) give the company an ACN; and

(b) register the company; and

(c) issue a certificate that states:

(i) the company's name; and

(ii) the company's ACN; and

(iii) the company's type; and

(iv) that the company is registered as a company under this Act; and

(v) the State or Territory in this jurisdiction in which the company is taken to be registered; and

(vi) the date of registration.

Note: For the evidentiary value of a certificate of registration, see subsection 1274(7A).

ASIC must keep record of registration

(2) ASIC must keep a record of the registration. Subsections 1274(2) and (5) apply to the record as if it were a document lodged with ASIC.

119 Company comes into existence on registration

A company comes into existence as a body corporate at the beginning of the day on which it is registered. The company's name is the name specified in the certificate of registration.

Note: The company remains in existence until it is deregistered (see Chapter 5A).

119A Jurisdiction of incorporation and jurisdiction of registration

Jurisdiction in which company incorporated

(1) A company is incorporated in this jurisdiction.

Jurisdiction of registration

(2) A company is taken to be registered in:

(a) the State or Territory specified:

(i) in the application for the company's registration under paragraph 117(2)(n) (registration of company under this Part); or

(ii) in the application for the company's registration under paragraph 601BC(2)(o) (registration of registrable body as company under Part 5B.1); or

(b) the State or Territory in which the company is taken to be registered under paragraph 5H(4)(b) (registration of body as company on basis of State or Territory law).

This subsection has effect subject to subsection (3).

Note 1: ASIC must specify the State or Territory in which the company is taken to be registered in the company's certificate of registration (see paragraph 118(1)(c)(v) and 601BD(1)(c)(v)).

Note 2: The company's legal capacity and powers do not depend in any way on the particular State or Territory it is taken to be registered in (see section 124).

Note 3: A law of a State or Territory may impose obligations, or confer rights or powers, on a person by reference to the State or Territory in which a company is taken to be registered for the purposes of this Act. For example, a State or Territory law dealing with stamp duty on share transfers might impose duty on transfers of shares in companies that are taken to be registered in that State or Territory for the purposes of this Act.

(3) The State or Territory in which a company is taken to be registered changes to the State or Territory in this jurisdiction nominated by the company if:

(a) either:

(i) the relevant Minister of the State or Territory in which the company is taken to be registered before the change approves the change; or

(ii) the State in which the company is taken to be registered ceases to be a referring State; and

(b) the procedural requirements specified in the regulations are satisfied.

(4) A company continues to be registered under this Act even if the State in which the company is taken to be registered ceases to be a referring State.

120 Members, directors and company secretary of a company

(1) A person becomes a member, director or company secretary of a company on registration if the person is specified in the application with their consent as a proposed member, director or company secretary of the company.

(2) The shares to be taken up by the members as specified in the application are taken to be issued to the members on registration of the company.

Note: A member's name must be entered in the register of members (see section 169).

121 Registered office

The address specified in the application for registration for the company's proposed registered office becomes the address of the company's registered office on registration.

122 Expenses incurred in promoting and setting up company

The expenses incurred before registration in promoting and setting up a company may be paid out of the company's assets.