THE TAX INSTITUTE

2018 National Superannuation Conference

Trends in Court Decisions Affecting Superannuation Funds

30 - 31 August 2018

The Langham, Melbourne

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1 Trends in court decisions

There have been no shortage of court decisions involving superannuation funds over the last year. Those selected in this paper are the decisions in *Mercer Superannuation (Australia) Limited v Billinghurst* [2017] FCAFC 201, *Carroll v United Super Pty Ltd* [2018] NSWSC 403, *Aussiegolfa Pty Ltd v Commissioner of Taxation* [2018] FCAFC 122 and *Cam & Bear Pty Ltd v McGoldrick* [2018] NSWCA 110. Brief mention is given to some others in the context of discussing these matters.

One trend that is apparent is that most of these decisions are decided by superior appellate courts; the NSW Court of Appeal, the Full Federal Court and in one instance a special leave application to the High Court (with the prospect of a second a real possibility in the *Aussiegolfa* matter). These matters did not settle; they involved protracted and keenly contested litigation. Accordingly, the conclusion that the issues raised by these matters are of importance is irresistible.

Before considering the issues raised by these decisions, it is timely to note that the superannuation industry is under the microscope in the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. In that regard, it is apt to recall the observation made earlier this month by Michael Hodge QC, counsel assisting the Royal Commission. He stated as follows:

> "Trustees are surrounded by temptation: to preference in the interests of their sponsoring organisations; to act in the interests of other parts of their corporate group; to choose profit over the interests of members; to establish structures that consign to others the responsibility for the fund and thereby relieve the trustee of visibility of anything that might be troubling. Their duties oblige them to resist all of these temptations".[1]

The duty to resist temptation, preference and the choice of profit over the interests of members is immediately apparent in the decisions in *Mercer* and *Carroll*. In these matters, the High Court's dicta in *Finch v Telstra Super Pty Ltd* (2010) 242 CLR 254 that the duty of superannuation trustees to properly inform themselves is more "intense" in superannuation trusts looms large.

One important trend emanating from the decisions in *Mercer* and *Carroll* is the emphasis by the courts for trustees of superannuation funds to comply with their duties as trustees. A critical requirement in that regard is the need for trustees of superannuation funds to place emphasis on the covenants in s 52(2) of the *Superannuation Industry (Supervision) Act* 1993 (**SIS Act**) in terms of how decisions are made. That is, the need of trustees of superannuation funds to act in the best interests of beneficiaries and to give priority to the interests of the beneficiaries where there is a conflict of interest. Indeed, the presence of a conflict of interest proved insurmountable in *Mercer*.

Other trends apparent from the *Mercer* and *Carroll* decisions are the emphasis given by the courts to act in good faith, the duty to consider all material available to the trustee and the duty to make proper inquiries (including further inquirers where appropriate). It was the failure of the trustee in *Carroll* to

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[1] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, 6 August 2018, transcript P-4163.

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perform most of these duties that resulted in the fund and insurer being unsuccessful in the NSW Supreme Court.

Fundamentally, the message from *Mercer* and *Carroll* and in the background, *Finch*, is that trustees of superannuation funds need to comply with their duties as trustees. They should expect that courts will enforce them rigorously. In this regard, trustees need to have fair and reasonable processes in place for how they make decisions; the Full Court in *Mercer* observed that there is no “hermetically sealed boundary” between process and outcome.

Not all of the decisions discussed in this paper go to the duties of trustees. There are regulatory cases decided every year, although the decision in *Aussiegolfa* (this matter may not be concluded) and its implications warrants a detailed discussion. Brief mention is also made of the regulatory issues contained in the AAT’s decision in *Hart v Commissioner of Taxation*.

Lastly, the unfortunate facts in *Cam & Bear* are a reminder that the superannuation industry is not immune from professional negligence claims. In my view, *Cam & Bear* is also a reminder of the perils of operating a self-managed superannuation fund (**SMSF**) generally.

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2 Trustee's calculation of lump sum pension not fair and reasonable: the decision in *Mercer v Billinghurst*

In December 2017, the Full Federal Court in *Mercer Superannuation (Australia) Limited v Billinghurst* [2017] FCAFC 201 dismissed an appeal by a trustee of a superannuation fund and concluded that the Superannuation Complaints Tribunal had addressed the correct question of whether the trustee's decision was fair and reasonable.

There are to be no further instalments in this judicial odyssey - the trustee's application for special leave to appeal to the High Court was dismissed in June 2018.

2.1 Facts

In September 2000, the respondent (**Mr Billinghurst**) retired from his position as Managing Director of Grosvenor International Australia Pty Ltd (**Grosvenor**), a position he had held for over 16 years. He commenced receiving a lifetime pension from his original corporate superannuation fund.

In May 2006, the Trustee of Mercer Superannuation (Australia) Limited (the **Trustee**) and Grosvenor Australia Asset Management Pty Ltd, another company in the Grosvenor Group, entered into a participation agreement to establish an employer-sponsored superannuation plan (the **plan**) within the corporate division of a superannuation fund known as the Mercer Super Trust (the **Mercer Fund**). Around that time, the assets and members of the original fund (including Mr Billinghurst) were transferred to the Mercer Fund.

The terms of the plan provided that increases in the pension, including for cost of living, were at the discretion of the employer. In practice, in most years, the employer increased the amount of the pension to take into account (in part) changes in the consumer price index (**CPI**). In reports provided to the Trustee by the Plan Actuary for the 2007 to 2011 period, the Plan Actuary made an assumption that there would be discretionary increases in the pension in the future and in most reports, it was assumed that pensions would increase by 1.9% or 2.0% per annum.

In the 2011 year, Mr Billinghurst's was receiving an annual pension of $98,780.

In November 2011, Grosvenor advised the Trustee that it would cease to carry on business in Australia from 31 December 2011. In its letter, dated 15 November 2011 (the **November letter**) Grosvenor advised the Trustee that it intended to provide each pensioner "with a lump sum arrived on the basis of a "fair and reasonable valuation of their current entitlement, to allow, should the pensioner wish, the purchase of an annuity, which would maintain their current stream of income".

In the November letter, Grosvenor requested that the Trustee prepare calculations of the final transfer value. Its request noted that for pensioners, the transfer values in relation to the current pensioners should be determined by reference to the cost to each pensioner of purchasing an equivalent annuity. The letter stated that the equivalent annuity should be valued consistently with the current pension arrangements, namely the annuities will not increase in future years and should not be linked to CPI.

In December 2011, the Trustee wrote to Mr Billinghurst to the effect that one of the options it was considering was payment of a lump sum to him. The transfer value for Mr Billinghurst was $1,432,824.

In March 2012, Mr Billinghurst wrote to the Trustee complaining about the basis used to calculate the lump sum. His main complaints were:

- the discount rate had been based on the yield on 10 year government bonds at 29 August 2011 rather than at 31 December 2011 (the date as at which the pension was to be valued);
- no allowance had been made for future pension increases; and
- no provision had been made for expenses that would be incurred by Mr Billinghurst in administering the lump sum.

In March 2012, Mr Billinghurst received a lump sum payment from the Trustee of $1,432,824 as a rollover amount. In April 2012, the Trustee, having received further advice from the Plan Actuary, maintained that the lump sum amount was fair and reasonable.

Mr Billinghurst requested that his complaint be referred to the Trustee's Claims and Complaints Committee for reconsideration. Mr Billinghurst subsequently provided to the Trustee advice from another actuary, which valued the lump sum equivalent of the pension at $1,921,000, based on:

- a discount rate of 3.7% (based on the yield on 10 year government bonds at 31 December 2011);
- an allowance for future pension increases of 2%; and
- an allowance for expenses of administering the assets of $10,000 per year. The Committee decided to affirm the original decision.

In February 2013, Mr Billinghurst complained to the Superannuation Complaints Tribunal (**Tribunal**). Essentially, Mr Billinghurst took issue with the assumed rate of return adopted by the Trustee and that future expenses were not taken into account. Mr Billinghurst also contended that the Plan Actuary engaged by the Trustee had a conflict of interest because he had already advised the employer in relation to the calculations and termination of the plan.

2.2 The Superannuation Complaints Tribunal

The Tribunal is established by s 6 of the *Superannuation (Resolution of Complaints) Act* 1993. Pursuant to s 14, a person may make a complaint to the Tribunal that a decision by the trustee of a regulated superannuation fund, in relation to a particular member or a particular former member of the fund, is or was unfair or unreasonable. Section 37 sets out the Tribunal's powers when reviewing a decision of a trustee. Relevantly, ss 37(3) and 37(6) are in the following terms:

> (3) On reviewing the decision of a trustee, insurer or other decision-maker that is the subject of, or relevant to, a complaint under section 14, the Tribunal must make a determination in writing:

> (a) affirming the decision; or
>
> (b) remitting the matter to which the decision relates to the trustee, insurer or other decision-maker for reconsideration in accordance with the directions of the Tribunal; or
>
> (c) varying the decision; or
>
> (d) setting aside the decision and substituting a decision for the decision so set aside.
>
> …
>
> (6) The Tribunal must affirm a decision referred to under subsection (3) if it is satisfied that the decision, in its operation in relation to:
>
> (a) the complainant; and
>
> (b) so far as concerns a complaint regarding the payment of a death benefit—any person (other than the complainant, a trustee, insurer or decision-maker) who:
>
> (i) has become a party to the complaint; and
>
> (ii) has an interest in the death benefit or claims to be, or to be entitled to benefits through, a person having an interest in the death benefit;
>
> was fair and reasonable in the circumstances.

The Tribunal agreed with Mr Billinghurst's submissions. On 29 December 2015, it determined that it was not satisfied that the Trustee's decision in relation to the calculation of the amount of the lump sum payable to Mr Billinghurst was fair and reasonable in the circumstances.

The Tribunal found that in determining the lump sum equivalent of Mr Bilinghurst's pension, the Trustee and Committee had applied the wrong test; the Trustee had applied a "fair and reasonable" test in making the calculation. Rather, the Trustee was required to apply the covenant in s 52(2)(c) and 52(2) of the SIS Act and its prudential and fiduciary obligations under both the SIS Act and trust law. Section 52(2) relevantly provides:

> (2) The covenants referred to in subsection (1) include the following covenants by each trustee of the entity:
>
> ...
>
> (c) to perform the trustee's duties and exercise the trustee's powers in the best interests of the beneficiaries;
>
> ...

This meant that the Trustee had to act in the best interests of the beneficiaries in making the calculation. In particular, if there was any conflict between its duties to the beneficiaries and to anyone else, including itself, priority had to be given to the interests of the beneficiaries.

The Trustee concluded that there was a conflict of interest in the Plan Actuary advising both the employer and Trustee in relation to what was the lump sum equivalent of Mr Billinghurst's pension

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and, because of that conflict of interest, it was not appropriate for the Trustee, because of its fiduciary duties to Mr Billinghurst, to act on the advice and recommendations of an actuary who was also advising the employer. The fact it was common industry practice for the plan actuary to advise both the Trustee and employer did not make it correct practice.

The Tribunal determined to set aside the Trustee's decision and remit the matter to the Trustee for reconsideration by obtaining advice from an actuary, who does not have a conflict of interest, as to what the proper calculation is of the lump sum equivalent, or commutation value, of Mr Billinghurst's pension. The Tribunal further directed at [113]:

> "...The Trustee is to then calculate the lump sum payable to the Complainant, without acting on any directions or request by the Employer and by applying its prudential obligations and the covenants in s52(2) of the *Superannuation Industry (Supervision) Act 199*3 (Cth), including by making a determination that is in the best interests of the beneficiaries, including the Complainant, and in accordance with this determination of the Tribunal. In making the calculation, the Trustee will need to determine whether it is appropriate to make any allowance for future expenses".

2.3 The Federal Court

The Trustee appealed to the Federal Court. Moshinsky J dismissed the Trustee's appeal.

His Honour noted that the Tribunal stands in the shoes of the Trustee and determines, based on all the information before it, whether or not a decision taken by the Trustee was fair and reasonable in the circumstances: at [46]. His Honour concluded that the Tribunal addressed the correct question, namely whether the decision of the Trustee was fair and reasonable in the circumstances. In making its decision, the Trustee did not appear to have addressed what it would have considered to be the appropriate lump sum amount determined on a fair value basis free of (what it perceived to be) the constraints of what the employer had stated in the November letter. That is, the task for the Trustee, consistently with its duty to act in the best interests of the beneficiaries, was to determine, on a fair value basis, the lump sum equivalent of Mr Billinghurst's pension.

The court rejected the Trustee's contention that the Tribunal failed to have regard to the fact that the decision concerned the distribution of the plan's assets on termination of the plan, and that there was a limited amount available to be distributed between members. Moshinsky J did not accept the premise that there was a finite pool of funds. Rather, his Honour found it was open to the Trustee to seek additional funds from the employer if the Trustee formed the view that the lump sum amount, determined on a fair value basis, was greater than that originally calculated by the plan actuary. Indeed, in that scenario, it was the duty of the Trustee (given its obligation to act in the best interests of the beneficiaries) to take all available steps to have the employer make good the shortfall.

The Trustee had also submitted that if the amount distributed to Mr Billinghurst was increased, the amount available for distribution to other members would be decreased. Moshinsky J concluded that this failed to have regard to the priority accorded to current pensions under the fund rules. That is, in any event, even if payment of a larger amount did decrease the amount available for other members, this would be consistent with the order of priority in the rules to pensions being provided from the plan that commenced payment before the termination date.

Lastly, Moshinsky J concluded that it was open to the Tribunal to conclude that the Trustee's decision was not fair and reasonable in circumstances where the Trustee relied on the advice of an actuary who had advised the employer about the same subject-matter: at [118]. He found that although it may be assumed the employer had an interest in treating employees and former employees fairly, it also had an interest in minimising its financial exposure to the plan including on termination of the plan. It was obvious that the adoption by the Trustee of the plan actuary's valuation may have significantly impacted the Trustee's decision as to the amount of the lump sum.

The court concluded that for all of these reasons, it was open for the Tribunal to reach the conclusion it did.

2.4 The Full Court

The Trustee appealed to the Full Court. A majority of the Full Court (Flick and Kerr JJ) dismissed the Trustee's appeal. Pagone J dissented.

The majority rejected the submission that Moshinsky J had erred in not finding that the Tribunal had misunderstood its statutory task. Contrary to what was argued by the Trustee, the majority found that Moshinsky J was "expressly mindful" that the expression "decision was fair and reasonable" were directed to whether the actual decision, rather than the process which led to it was fair and reasonable: at [34]. As the majority stated at [38]:

> "The Tribunal's and his Honour's findings that the Trustee had acted on the basis of a flawed process that had taken no account of the potential value of subsequent increases in Mr Billinghurst's pension that was to be commuted to a lump sum logically were capable of supporting a conclusion that the outcome had been unfair. That was the Tribunal's conclusion. There is, and can be, no hermetically sealed boundary between process and outcome".

The Trustee also contended that it was not entitled to demand or require any further funds from Grosvenor. This was on the basis that, having regard to the November letter, Grosvenor had exercised its termination rights under the plan. On the basis of exercising that right, it became the duty of the Trustee to "redeem all of the Units attributable to the Plan and apply the Plan's assets" in the order of priority specified by the plan. It was inherent in this submission, that it would have been open to Grosvenor when it had exercised its termination right to have left the Trustee substantially short of funds even to meet the limited obligations to the beneficiaries it had accepted on advice from the Plan Actuary, and that that would be "fair and reasonable".

This submission was rejected by a majority of the Court. The majority shared Moshinsky J's views that Grosvenor would have been obliged to put the Trustee in funds sufficient to meet any shortfall for an objectively fair valuation of the beneficiaries' entitlements on termination of the plan. As the majority stated at [56]:

> "It is a most unattractive proposition that Grosvenor would have had no responsibility to ensure that the Trustee was provided with sufficient funds for that purpose".

The majority concluded that Grosvenor's obligations to provide for a defined benefit pension had not been reduced by the arrangements it later made. In any event, the covenants imposed by s 52(2)(d) would have obliged the Trustee to ask Grosvenor to make an additional voluntary contribution to allow it to commute Mr Billinghurst's pension entitlements to a lump sum if the funds available both from the

redemption of units attributable to the plan and the additional contribution Grosvenor had committed to make in November 2011 were insufficient for that purpose.

The minority judgment (Pagone J) concluded that the appeal should be allowed. The main point of difference with the majority was Pagone J's conclusion that there was no basis upon which the Trustee could require any further contribution to be made by the Trustee. This was because the effect of the November letter was to terminate, reduce or suspend its obligation or agreement to contribute in respect of some or all members. On that basis, the Trustee was required to adjust contributions and to apply the assets available to the Trustee, redeem all the units and apply the plan's assets in order provided by the rules of the fund. Although the Trustee had obligations pursuant to s 52(2)(d) of the SIS Act, those obligations were to be met in accordance with the rules of the fund. The fact of termination, reduction or suspension pursuant to the letter of 15 November 2011 was one of the circumstances to be taken into account in determining whether the Trustee's decision was fair and reasonable.

2.5 Special leave application

Special leave was refused by the High Court on 18 May 2018. The application was granted a hearing (not dealt with on the papers) before Nettle and Gordon JJ.

Central to the Trustee's application for special leave was the submission that an employer may come under an obligation to make contributions beyond the governing rules of the plan because of the covenants contained in s 52(2). This would result in an "unquantifiable future and contingent obligation" which, it was argued, was a matter of public importance for which leave should be granted.

The High Court's conclusion that the matter before it turned on the construction of the particular deed in question and was not susceptible to wider application was fatal to the Trustee's application for special leave. The Court was also not persuaded that the decision of the Full Court contained sufficient doubt to warrant special leave.

2.6 Key messages

It is clear that the majority judgment of the Full Court is the applicable law. Several points should be noted.

It is vital that trustees of superannuation make decisions free of any conflict of interest. In *Mercer*, having the same actuary for the employer and the fund created an insurmountable obstacle for the Trustee throughout the four stages of litigation. Regard on this point should be give to the judgment of Moshinsky J.

Mercer is not the only decision to have considered conflicts of interest recently. In *Ainsworth v Davern* [2018] VSC 80, the Supreme Court of Victoria (McMillan J) removed a trustee of a SMSF following the death of the sole member and appointed two independent trustees until a dispute about the validity of the SMSF deed was resolved. As her Honour stated at [18]:

> "The legal principles concerning the removal of a trustee are well established. Where there is a conflict between interest and duty, it is in the interests of all that the fund be administered by independent trustees. The appointment of independent trustees will provide an independent view *untainted by conflict of interest*" [emphasis added].

The decision in *Mercer* is the latest in several cases that have emphasised the primacy of the best interests covenant: see *Commonwealth Bank Officers Superannuation Corporation Pty Ltd v Beck* (2016) 334 ALR 692; *Manglicmot v Commonwealth Bank Officers Superannuation Corporation Pty Ltd* [2011] NSWCA 204 and *Finch v Telstra Super Pty Ltd* [2010] HCA36. The SCT articulated that in determining the lump sum equivalent of Mr Billinghurst's pension, the Trustee had applied the wrong test and the SCT seized on the words in s 52(2)(c) of the SIS Act "to perform the trustee's duties and exercise the trustee's powers in the *best interests of the beneficiaries*" [emphasis added]. The SCT's conclusions remained undisturbed throughout the successive appeals.

The decision is a useful reminder of the operation of merits review in the Tribunal. In the Full Court, the Trustee argued that Moshinsky J at first instance should have found that the Tribunal had misconceived its duty as that of reviewing the process adopted by the Trustee rather than performing its legal task of considering whether there had been any unfairness or unreasonableness in the decision itself.

Moshinsky J and the majority in the Full Court were clear that the Tribunal addressed the correct question, namely whether the actual decision of the Trustee was fair and reasonable in the circumstances. However, the circumstances which may make a decision of a trustee unfair or unreasonable are many and varied and a narrow approach should not be adopted as to what may constitute unfairness or unreasonableness in decision: Moshinksy J at [19]. Further, unfairness or unreasonableness in process may, in an appropriate case, lead to unfairness or unreasonableness in decision. As the majority in the Full Court remarked, there was no "hermetically sealed boundary" between process and outcome: at [38].

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3 Trustee's decision making process inadequate and breach of duty: *Carroll v United Super Pty Ltd*

In *Carroll v United Super Pty Ltd* [2018] NSWSC 403, the plaintiff was successful in challenging the Trustee's decision that he was not Totally and Permanently Disabled (**TPD**) under the policy and deed. Rather than remitting the matter to the insurer for reconsideration, the Supreme Court of NSW (Slattery J) conducted its own assessment and concluded that Mr Carroll was TPD and ordered the insurer pay him $104,000.

3.1 Facts

Mr Carroll was self-employed as a builder in Tasmania until March 2012. He became a member of the industry superannuation fund, Construction and Building Union Superannuation Fund (the **Fund**), in June 1988. United Super Pty Ltd is the trustee (the **Trustee**) of the Fund. It exercises its functions pursuant to the CBUS Trust Deed (the **deed**) that constitutes the Fund. Hannover Life was United Super's group insurer.

Mr Carroll claimed he ceased work as a consequence of pain caused by a hip condition (bilateral hip dysplasia). It was not disputed that he remained continuously unemployed for 3 months from March to June 2012.

Mr Carroll contended that he was TPD from June 2012 within the provisions of Hannover's insurance policy. In December 2012, he claimed payment of a benefit of $104,000 from the Trustee on account of his claimed TPD. The Trustee referred Mr Carroll's claim to Hannover for determination. Both the Trustee and Hannover declined to accept the claim.

In September 2014, Mr Carroll bought proceedings in the Supreme Court of NSW against both the Trustee (first defendant) and Hannover (second defendant), challenging their decisions to decline his claim.

The relevant part of the insurance policy applicable to Mr Carroll was in the following terms:

> "Total and Permanent Disablement means with respect to an *Insured Person*, who as at the *Date of Disablement* is covered under *The Policy* for *Total and Permanent Disablement*, that they meet one or more of the following Parts as outlined in clause 2.2:
>
> …
>
> Part 2 – Unlikely to Return to Work:
>
> The *Insured Person* is unable to follow their usual occupation by reason of *Illness* or *Injury* for 3 consecutive months and in our opinion, after consideration of medical or other evidence satisfactory to us, is unlikely ever to be able to

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> engage in any *Regular Remuneration Work* for which the *Insured Person* is reasonably fitted by education, training or experience."

In issue was whether Mr Carroll satisfied the policy requirement that he is "unlikely ever to be able to engage in any Regular Remuneration Work for which he is reasonably fitted by education, training or experience".

In a letter denying Mr Carroll's claim, the Trustee stated that Mr Carroll did not answer the description of TPD as (at [55]):

> "… you are fit for sedentary type work, such as that of a project manager, although the evidence does not support that you are capable of returning to your role as a builder".

The Trustee and Hannover organised surveillance of Mr Carroll. An investigation report resulting from surveillance dated 15 November 2012 recorded three separate periods of surveillance which showed Mr Carroll entering, driving and alighting from a motor vehicle, undertaking shopping and walking up steps and climbing a ladder at one point.

A working document which preceded the Trustee's decision by some three months contained an opinion section. In that section were opinions from two Orthopaedic Consultants who, in addition to noting that Mr Carroll was not fit to return to work as a builder, opined that he could work as an estimator or project manager.

Hannover's internal assessments also proved instructive. One assessment stated at [64]:

> "The member clearly has stated that he has continued to engaged in low impact activities such as swimming, bicycle riding, walking and golf. Notably the activity of golf does requiring a pivoting of the hips, and as such demonstrates that the member's restriction is not as severe as the member would like us to believe. Bicycle riding would similarly also impact on hip movement and require a period of a prolong seated position…"

Mr Carroll's statement in a note to the Trustee that "I'm relying on this payout from Cbus (Hannover) to assist me in obtaining new hips sooner rather than later as I can't afford full hospital cover" was construed by Hannover as being "strongly financially driven or motivated".

Mr Carroll had a right total hip replacement in February 2015. Since then his left hip had become symptomatic. By the time of the trial he had become a possible candidate for left total hip replacement, but that surgery had not yet taken place.

From early 2015 the plaintiff had some involvement (the precise level of which was disputed) in a small importing business owned by his wife.

3.2 Applicable legal principles

The decision in *Carroll* provides a useful reminder of the principles applicable to superannuation trusts. In applying the High Court's seminal decision in *Finch v Telstra Super Pty Ltd* (2010) 242 CLR 254, a trustee:

- has a duty to apply a trust fund, such as the Fund, in accordance with the trust deed, in this case the deed; and

- is also required to act in good faith, on a real and genuine consideration of the material before it, for the purpose for which it was conferred, for sound reasons where the trustee has disclosed reasons, although the trustee is not obliged to give reasons for its decision.

The Court in *Carroll* referred to the dicta of the High Court in *Finch* that decisions of such a Trustee may be reviewable for want of "properly informed consideration" and that the duty of trustees to properly inform themselves is more "intense" in superannuation trusts in the form of the deed than in trusts of the *Karger v Paul* [1984] VR 161 type. As the High Court noted in *Finch* at [66]:

> "It is extremely important to the beneficiaries of superannuation trusts that where they are entitled to benefits, those benefits be paid".

The general rule where a trustee has failed to discharge its duties in considering a member's claim is to refer the matter back to the trustee for reconsideration. However, if the Court vitiates an insurer's decision upon breach of an insurer's duty of utmost good faith and embarks on a second stage inquiry, and on that inquiry finds that the plaintiff is totally and permanently disabled within the policy definition, there may be no further work for the trustee to perform and no need to remit the matter to the trustee for further consideration

The insurer's duty of utmost good faith in dealing with a claim is broader than the implied term obliging the insurer to act reasonably and applies to all aspects of the claims handling process. It requires the insurer to form the opinion itself and to act with the utmost good faith in doing so and it is not sufficient that some other insurer acting reasonably could have reached the conclusion that it did. It follows that the insurer should give reasons for its decision.

3.3 Decision

Mr Carroll was successful in challenging the Trustee's decision. He submitted that the Trustee did not turn its mind to whether sedentary work was within Mr Carroll's education, training or experience and was realistically available to him. In substance, this was a submission that the Trustee failed in its duty to give real and genuine consideration to the material before it on the issue of whether sedentary work was within Mr Carroll's education, training and experience and was realistically available to him. In particular, the working documents before the Court acknowledged that a "vocational assessment" would have made for a more complete assessment": at [125].

This was accepted by the Court. Slattery J found that the only evidence of the Trustee's reasons for the 16 September 2013 decision was the Trustee's letter of that date itself. That letter only contained one sentence that qualifies as a reason for decision: "In particular it was noted that you are fit for sedentary type work, such as that of a project manager....". The limited reasons given in the letter itself were not a sufficient basis to infer the Trustee did not exercise its discretion in good faith, for the purpose for which it was conferred, or without real and genuine consideration. However, the court found that the June 2013 working document and the presence, or absence, of other documents on the Trustee's file were nevertheless evidence of the process the Trustee undertook, or failed to undertake, in making its decision: at [131].

The court concluded that measured against the standard set out in *Finch* (above), the Trustee's decision-making process was inadequate and was a breach of the duty it owed to Mr Carroll. The

court inferred a vocational assessment was not obtained and concluded that the Trustee, by its working document, recognised that such an assessment was potentially relevant to its decision: at [133]. The Trustee's failure to seek the missing vocational material amounted to a breach of the Trustee's duty. The court also concluded that the Trustee did not give real and genuine consideration as to whether the work Mr Carroll could allegedly perform as an "estimator" or a "project manager" was realistically available to him.

Mr Carroll also submitted that there was no evidence available to Hannover to allow it to conclude that Mr Carroll could have continued managing his own business with him "undertaking the lighter non-manual aspects such as quoting, estimating or supervision of sub-contractors, together with any necessary administration tasks". Mr Carroll also submitted that Hannover made no attempt to enquire of him whether such a scenario was a viable way of operating his self-employed business, prior to expressing the opinion that he had continuing capacity for self-employment. The court accepted these submissions and concluded that this reasoning should have been put to Mr Carroll for his specific comment before Hannover sought to rely upon it. For these reasons, the Court concluded that Hannover's decisions should be vitiated. The decisions were based upon a process that involved a breach of Hannover's duty of utmost good faith and a breach of its duty to act reasonably in forming an opinion about Mr Carroll's TPD status.

Having concluded that the plaintiff was successful in challenging both the Trustee's and Hannover's decision, the court, rather than remitting the matter, proceeded to a second stage inquiry and assessed for itself whether Mr Carroll was TPD within the policy as at the time for assessment. That it did so was partly a response to the submission made by the defendants that there was no utility in conducting a second stage inquiry since the Court must come to the same conclusion as Hannover already has.

In relation to whether Mr Carroll was TPD, the real questions for consideration were: whether Mr Carroll is "unlikely ever", to be able to engage in "regular remuneration work", for which he is "reasonably fitted education training or experience". The court found that the two forms of work which he could undertake based on his education, training or experience were precluded for different reasons. Estimating and project management work was not wholly sedentary and would require visits to work sites. Slattery J accepted the medical evidence that Mr Carroll's physical incapacity meant he was unfit for such physical work. His Honour accepted that although Mr Carroll had technically successful hip replacement surgery, he nevertheless had a "relatively poor outcome": at [230]. In relation to running small family businesses, this was "casual work or other work of an intermittent nature", which did not qualify as regular remuneration work.

The court accordingly found that Mr Carroll was TPD and ordered that Hannover pay him $104,000. The court also ordered that the defendants pay 80% of Mr Carroll's costs, on an ordinary basis.[2]

[2] The reason the defendants were not ordered to pay all of the plaintiff's costs was because the court accepted that the plaintiff's conduct, including late service of an affidavit, had lengthened the hearing and led to a disorderly trial: at *Carroll v United Super Pty Ltd (No. 2)* NSWSC 1101 at [14], [28].

4 In-house assets, sole purpose and the decision in *Aussiegolfa*

The prevalence of SMSF's across the Australian commercial and investment landscape will be known to most of you. Indeed, figures released by the Australian Prudential Regulation Authority show that there are almost 600,000 SMSFs managing $696.7bn in assets as at 30 June 2017.

Two of the most important pillars of the SIS Act are that the fund does not breach the "in-house assets rule" and satisfies the "sole purpose test". In a test case, *Aussiegolfa Pty Ltd (Trustee) v Commissioner of Taxation* [2018] FCAFC 122, the Full Federal Court, in August 2018, found that the applicant, Aussiegolfa had breached the in-house asset rules but did not breach the sole purpose test. There are few decisions on either issue and the decision of the Full Court is significant. This space should be watched to see if a special leave application to the High Court is made.

4.1 The SMSF, DomaCom and student accommodation

Aussiegolfa Pty Ltd (**Aussiegolfa**) is the trustee of the Benson Family Superannuation Fund (the **Benson Fund**), a complying SMSF. Christopher Benson is the sole member of the fund. Since January 2015, he had been employed as the Victorian State Manager of DomaCom Australia Ltd (**DomaCom**). DomaCom holds an Australian Financial Services Licence issued by the ASIC and managed the DomaCom fund, a managed investment scheme to provide investors the opportunity to invest in fractional interests in property.

In July 2015, Christopher Benson, his mother and sister decided to invest in a student accommodation complex in Burwood, Victoria through DomaCom. A sub-fund of DomaCom was created to acquire the student apartment. Following its application to invest in the DomaCom fund in late March 2015, Aussiegolfa paid $28,080 for the acquisition of 28,080, $1 units in a sub-fund. This money was initially held in a cash pool. In July and August 2015, the funds contributed by Aussiegolfa were applied towards the acquisition of units in the DomaCom sub-fund (the **sub-fund**) that had acquired the student accommodation.

In August 2015, the custodian of the DomaCom fund entered into an exclusive leasing and managing authority with a student housing authority for the leasing of the property. The first two tenant were persons unknown and unrelated to Mr Benson. In April 2017, the student housing authority agreed to lease the apartment to Mr Benson's daughter, Emma with the lease commencing in February 2018. At the time, Emma was a full time student studying primary teaching at Swinburne University.

The Commissioner contended that the in-house asset rules and sole purpose test had been breached. In May 2017, Aussiegolfa sought to challenge that view by seeking declarations in the Federal Court. On 3 July 2017, the Commissioner made a determination under s 71(4) of the SIS Act that the units held by Aussiegolfa in the sub-fund are to be treated as an investment in a related trust of the Benson Fund. A prerequisite for making this determination is that the requisite loan, investment

or asset is not an in-house asset. Aussiegolfa also sought review of the determination made by the Commissioner in the AAT.[3]

A regulated superannuation fund is generally restricted from having more than 5% of the total market value of its assets invested in in-house assets. An "in-house asset" is defined in s 71 of the SIS Act to include (unless an exception applies):

- a loan to, or investment in, a "related party" of the fund;
- an investment in a "related trust" of the fund; and
- an asset of the fund subject to a lease or lease arrangement with a "related party" of the fund.

Aussiegolfa contended that the investment was in the DomaCom fund, not the sub-fund created and that the 5% limit for in-house assets was not breached. Aussiegolfa also argued that the DomaCom fund is a widely held unit trust and that consequently, Aussiegolfa's investment in it fell within the exemption in s 71(1)(h) of the SIS Act (an investment in a widely held unit trust).

4.2 At first instance

The debate about whether the in-house asset rules had been breached was a dispute about the identity of the investment and whether the sub-fund was a separate trust. The Court at first instance (Pagone J) found that the relevant investment was in the sub-fund. The responsible entity had separate fiduciary obligations to the unit holders of the sub-fund. Each sub-fund related to an identifiable item of property which was held by the trustee on trust pursuant to the specific terms of the constitution referable to that asset. Only the unit holders of the sub-fund were entitled to the capital relating to the property.

The conclusion that the sub-fund is a separate trust carried the consequence that it was not a widely held unit trust for the purposes of s 71(1)(h). Aussiegolfa's investment in DomaCom represented 7.83% of its assets and accordingly breached the 5% in-house assets rule.

The Commissioner also contended that the sole purpose test had been breached. The sole purpose test is contained in s 62 of the SIS Act and goes to the very core of the SIS Act. It provides that a regulated (complying) superannuation fund must be maintained solely for one of the legislated core purposes which can be in conjunction with any approved ancillary purposes. In essence, it requires that the fund be maintained for the sole purpose of providing retirement benefits to its members, or their dependents if a member dies before retirement. As Pagone J stated at [31]:

> "A high standard was adopted by s 62 of the SIS Act as an important pillar to ensure that self managed superannuation funds achieve the objectives of providing retirement benefits and not current day use or benefits".

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[3] In the AAT proceeding, the Commissioner's determination under s 71(4)(b) was set aside on the basis of the finding in the Federal Court that the investment was an in-house asset – which meant that the condition necessary for the Commissioner to make the determination under s 71(4) was absent: see *Aussiegolfa Pty Ltd as trustee of the Benson Family Superannuation Fund and Commissioner of Taxation* [2017] AATA 3013, DP Pagone.

The Commissioner contended that neither the core purposes nor the ancillary purposes include the provision of leased premises of an asset of a superannuation fund to a daughter of a member of a superannuation fund.

The Court stated that whether the sole purpose test continues to be satisfied was a question of fact and that where words as “exclusively”, “solely” or “only” are present in a statutory requirement, they prevent use for any other purpose, however minor, which is collateral or independent as distinguished from incidental to the stipulated use: at [29]. The inquiry into purpose was not an inquiry into motive but into the “end sought to be accomplished”: at [29].

The Court found the evidence was that the purpose of the investment in student housing through DomaCom was in part, to provide housing to Mr Benson’s daughter. That Mr Benson had admitted that the use of the property was to test the related party use of residential property within SMSF’s created a “factual difficulty” for Aussiegolfa: at [30].

Although Pagone J found the reasoning in the well-known “Swiss Chalet” case (*Case 43/95* [1995] ATC 374) to be “apt and broadly applicable”, his Honour, by way of obiter, noted that there may be circumstances in which a lease to a related party would not breach the sole purpose test. Pagone J was emphatic that the facts before the court did not fall into that category because a purpose of the investment was to provide accommodation to Mr Benson’s daughter: at [31]. This collateral purpose was not amongst the core or ancillary purposes enshrined in s 62.

4.3 The appeal

Aussiegolfa appealed from the decision of Pagone J at first instance. The Commissioner appealed from the decision of the AAT.[4] The two appeals were heard together.

The Full Court (Besanko, Moshinsky and Steward JJ) allowed the appeal in part. The court upheld Pagone J’s finding that the relevant investment was the units in the sub-fund which was a separate trust from the DomaCom Fund. In that regard, the sub-fund was a related trust under s 10(1) of the SIS Act and was not a widely held unit trust for the purposes of s 71(1)(h). This aspect of the decision was decided by reference to the general law conceptions of a trust; it was not suggested that the word “trust” had a special meaning for the purposes of s 71(1)(h). The Court found at [149] that when the Constitution was considered together with the Product Disclosure Statement:

> “one is left with the clear and unmistakable impression that there was an intention to create a distinct trust in association with the Burwood Sub-Fund units and that this intention was effective”.

Accordingly, the Court found that Pagone J was correct to conclude that there was a distinct trust associated with the sub-fund units and that the units held by Aussiegolfa in the sub-fund was an investment in a related trust.

Having made this finding, the Full Court dismissed the Commissioner’s appeal from the AAT decision: at [180].

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[4] The AAT appeal was effectively contingent on Aussiegolfa succeeding on the in-house asset issue in the Full Court.

4.3.1 Sole purpose test

In particular, it is the Court's finding on the sole purpose test that will attract interest. It was of significance to the Full Court that the lease to Mr Bensons' daughter had not commenced at the time the investment was made. The Court found that there was no evidence to support the proposition that a purpose of Aussiegolfa in acquiring the units in DomaCom was to provide accommodation to Mr Benson's daughter. In so far as Pagone J found that there was such a purpose, that finding could not stand.

Given this error, it was necessary to consider afresh whether the Benson Fund could be maintained other than for core purposes or for core and ancillary purposes. Importantly, the court found that it would not. Central to the Court's reasoning was that although the proposed lease would be to Mr Benson's daughter, it would be at market rent. As Moshinsky J stated at [177]:

> "… there does not appear to be any financial or other non-incidental benefit to be obtained by Ms Benson by leasing this property rather than another; nor does there appear to be any financial or other non-incidental benefit to be obtained by Mr Benson by the property being leased to his daughter rather than another tenant. It is true that Ms Benson would obtain a benefit in the sense that she obtains accommodation. But in circumstances where this is obtained at market rent, it does not appear to be a relevant benefit for present purposes".

His Honour made it clear this finding was dependent on the facts and circumstances of the case and that the situation would be different if the lease was not at market rent. If the lease was not at market rent, an inference would probably readily be drawn that the fund was being maintained for a collateral purpose, namely to provide discounted accommodation to a relative of a member of the fund, contrary to the sole purpose test.

Steward J agreed with Moshinsky J, although he wrote a separate judgment given the importance of the matters raised: at [184]. Construing s 62 as imposing a "strict standard" or a "high standard" was not of assistance. At the time the investment was made, there was no plan to lease the property to Mr Benson's daughter. She became the third tenant in February 2018 and contracted to pay the same rent as the previous tenant. As a student, the property was convenient to her for the purpose of travelling to university. There was nothing about her that rendered her an unsuitable tenant. In the circumstances, Steward J concluded at [237] that:

> "… the personality of the tenant is irrelevant to the Fund's ability to meet its core and ancillary purposes, as defined by s 62 of the SIS Act"

and at [241]:

> "… the continued payment by the daughter of market rent did not diminish or threaten the capacity of the Benson Fund to provide superannuation benefits to its members in the future. It continued to receive the same return from this investment".

The court acknowledged that Ms Benson did derive a benefit from the arrangement. However, this was not a relevant benefit. Any comfort or convenience from the arrangement by reason of the relationship between father and daughter was a "merely incidental" benefit: at [177]. This conclusion

was not impacted by the fact that Mr Benson submitted the application for lease on his daughter's behalf or agreed to act as guarantor of her obligations under the lease. Nor was it impacted by the fact that Mr Benson wished to test the ability for residential properties held by SMSF's to be used by related parties; this went to motive rather than purpose. Accordingly, the Court found that the Benson Fund would be maintained solely for the core or core and ancillary purposes by the proposed lease.

The court accordingly made a declaration that the leasing of the property by DomaCom Fund to Mr Benson's daughter would not cause Aussiegolfa to breach the sole purpose test. The proceeding was otherwise dismissed.

4.4 Messages

The decision in *Aussiegolfa* is significant in several respects. It must be stated that the trip through the courts may not be over; I expect (but do not know) that consideration would be given to a special leave application (by either or both parties). My views below are accordingly premised on that caveat.

In terms of the sole purpose test, in my view, the decision of the Full Court lends support to a substantive economic approach being applied in terms of whether an investment offends the sole purpose test. What was important to the Full Court was the ability of the Benson Fund, through the contemplated investment, to meet the core/ancillary purpose of the sole purpose test. As Steward J remarked, in the circumstances before the Court, the personality of the tenant was irrelevant to the ability of the Benson Fund to meet its core/ancillary purposes. The decision of the Full Court shows a willingness to look past incidental or ancillary outcomes where the investment is otherwise prudent and on market value terms. Conversely, as Steward J observed at [231(f)], the inference of the existence of a collateral purpose would be more readily justified where a rental property was leased to a relative for peppercorn rent.

However, the fine print of the Full Court's decision should be read before applying its reasoning on purpose too liberally. Moshinsky and Steward J both found that when the investment in DomaCom was made, there was no plan to lease the property to Mr Benson's daughter at [233]. That plan emerged some years later (and the majority noted that "purpose" in the context of s 62 looks to the objects of act on a yearly basis). The Court did find that when the plan did emerge, no collateral purpose existed of conferring a benefit on Mr Benson's daughter. However, it does leave open the question whether the decision might have been different if the plan to benefit Mr Benson's daughter was apparent from the outset.

It is worth noting that the Commissioner recently had success in arguing that the sole purpose test had been breached in *Hart and FCT* [2018] AATA 1267. In *Hart*, the AAT (Fice SM) upheld the Commissioner's decision to disqualify a person from acting as an SMSF trustee on the grounds that he was not a fit and proper person to do so and for numerous breaches of the SIS Act. The breaches were several and serious. They included (but were not limited to):

- failure to lodge annual returns on time;
- payment of benefits to member when no condition of release was satisfied;
- the acquisition of shares in a Philippines company on non-arm's length terms in breach of s 109 of the SIS Act; and
- the acquisition of real estate from related parties.

The breaches resulted in almost all of the funds (which totalled $600,000) in the SMSF disappearing. Amongst its reasoning, the Tribunal found that the sole purpose test had been breached.

Finally, a further word of caution. Even if the decision of the Full Court survives an appeal to the High Court and remains the law, there are other arrows in the Commissioner's quiver other than the sole purpose test, with which he can attack SMSF's. The Full Court confirmed that the in-house asset provisions were breached (although note the exemption for business real property in s 71(1)(g)); this remains a provision of key importance for SMSF transactions. Further, a host of other restrictions remain, including the prohibition on purchasing assets from related parties, providing financial assistance to a member/relative of member of the fund and with some exceptions, borrowing money.

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5 SMSF auditors in the headlights – beware of professional negligence (and regulatory) claims

The decision in *Cam & Bear Pty Ltd v McGoldrick* [2018] NSWCA 110 will send shivers to auditors of superannuation funds and their insurers.

Cam & Bear Pty Ltd is the trustee of the Lance Bear Superannuation Fund (the **Fund**). This self-managed superannuation fund was established in about 1985 for the benefit of Dr Lance Bear, a dermatologist, and his wife, Ms Jennifer Campbell. The directors of the trustee were Dr Bear and Ms Campbell. Mr John McGoldrick, the respondent, was an accountant who audited the accounts of the Fund, including for the financial years ended 30 June 2003 to 2007.

This appeal arose out of a claim for damages for negligence and misleading and deceptive conduct brought by Cam & Bear against Mr McGoldrick. It was alleged that Mr McGoldrick had breached his duty of care and engaged in misleading and deceptive conduct: first, by failing to qualify the audit reports as to the possibility that those assets described in the Fund's financial statements as "cash" may not be recoverable, they being in fact unsecured loans to a company associated with Dr Bear's friend, Mr Anthony Lewis; and, secondly, by including in the audit reports a statement to the effect that the financial statements "presented fairly...the financial position of the Fund and the results of its operations and its cashflows".

5.1 Friends and SMSF's…

Dr Bear and Mr Anthony Lewis were friends from school. Their families lived in the same suburb, socialised regularly and holidayed together. As Dr Bear's medical practice became busy, he desired that someone else manage and administer the Fund. For some years an entity called Austrust Ltd did so, on Mr Lewis' recommendation.

Mr Lewis conducted a finance business, Lewis Securities Pty Ltd (**Lewis Securities**). In 1996, Mr Lewis suggested that Dr Bear could move the Fund over to him and that his company, Lewis Securities could manage the investments and that Databank Investment Services Pty Limited (Databank) could do the administration. Mr Lewis informed Dr Bear that he (Mr Lewis) owned 35% of Databank. This occurred and from 1996, Dr Bear paid contributions to the Fund by drawing a cheque in which the payee was Lewis Securities. Dr Bear would deliver the cheque to Mr Lewis' home during his evening walk (a regular habit) and do so with words to the effect:

> "Here's some money for the Super Fund."

Between 1996 until 2008, Dr Bear made about 8 to 10 payments per year. He understood that the Fund consisted of cash amounts and shares. This understanding was obtained by and from conversations with Mr Lewis as well as from reading some of the documents such as balance sheets relating to the Fund. Dr Bear gave evidence that in about 2005, he wanted he wanted cash to comprise a greater proportion of the Fund's assets because he wanted to "make sure that [he] had

something to fall back on in the event of a market crash" and "wanted to have a reserve in the Fund in lieu of having a life insurance policy".

Dr Bear was also informed that one of Mr Lewis' companies was LSL Holdings and he understood that LSL Holdings was holding the cash amounts for the Fund. At no time did Mr Lewis or anyone else, at least prior to late 2008, tell Dr Bear that the money or some of the money that was contributed to the Fund was being used for unsecured loans. Nor did Dr Bear understand, from any entry in the documentation that there were unsecured loans between Lewis Securities and LSL Holdings or any other company. Dr Bear's evidence was that he was clear that he did not want, at any time, any of the money in the Fund to be used for an unsecured loan.

Each year Mr McGoldrick signed and certified the audit reports, without qualification. They stated that the financial statements fairly reflected the financial position of the Fund. These forms, together with ATO forms, were sent to Dr Bear's home. At no stage did Mr McGoldrick have any direct communication with Dr Bear.

The financial accounts that Dr Bear received were in a similar form year to year. In particular, the Statement of Financial Position, under the heading "Other Assets" contained the descriptions "Cash – LSL Holdings (Lance)" and "Cash – LSL Holdings (Jenny)". Each account had an auditor's note in the following terms:

> "**9. Reconciliation of Cash**
>
> For the purpose of the statement of cash flows, cash includes cash on hand and in banks. Cash at the end of the reporting period as shown in the statement of cash flows is reconciled to the related item in the Statement of Financial Position or Statement of Net Assets as follows …".

Dr Bear's evidence was that he knew that moneys in his Fund had been transferred from Lewis Securities to LSL Holdings, which paid a higher rate of interest. His evidence was that he believed that the reference to "Cash – LSL Holdings (Lance) referred to cash held by LSL Holdings. He never saw any statement for LSL Holding (and did not ask to see them).

Dr Bear's evidence was that his practice was to scan the audited reports but that at no time did he notice any special warning or see anything that was cause for concern. He assumed everything was in order with his Fund and continued to make contributions.

Dr Bear came to understand that everything was not in order with his Fund. In July 2008, Dr Bear agreed to commence a combined medical practice with another dermatologist. The establishment of the new medical practice required some capital cost.

On about 22 September 2008 Dr Bear told Mr Lewis that he wished to withdraw cash from the Fund. Mr Lewis attempted to dissuade him from taking this course and told him "It's not a good idea to withdraw cash for the Fund" and that he was better off "developing the Fund". However, Dr Bear insisted on the cash. The cash requested was not provided and on 29 October 2008, Lewis Securities and LSL Holdings were placed into voluntary administration. They were placed into liquidation in February 2009.

Mr McGoldrick gave evidence of the steps he took to audit the Fund's financial statements. He said that he queried with Mr Lewis the description of the amounts held on the Fund's behalf by LSL

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Holdings as “cash”. He said that Mr Lewis led him to believe that Dr Bear and Ms Campbell were “happy with the Fund’s financial reports describing the monies in the LSL Holdings account that way”. Mr McGoldrick gave evidence that he accepted the description of the relevant assets as “cash” because he believed that the assets comprised funds on deposit with LSL Holdings repayable at call and that LSL Holdings was backed by Lewis Securities which was a non-bank financial institution.

5.2 Decision at first instance

A seven day hearing in the Supreme Court of NSW ensued. Expert auditing and accounting evidence was given. Rothman J in the Supreme Court of NSW found that Mr McGoldrick had been negligent and engaged in misleading and deceptive conduct. In particular, Rothman J found that the experts agreed that a competent auditor would have requested and reviewed the financial reports of LSL Holdings and communicated to the trustee any concerns that resulted. His Honour found that, based on agreement amongst the experts, the definition of “cash” in Note 9 of the Fund financial statements did not have the qualities described by the term “cash”.

However, Rothman found that the auditor’s conduct had not caused any loss to the appellant. The basis for this finding was that in cross examination, Dr Bear accepted that it would have made no difference to him, in terms of his investment policy, if, instead of the description ‘Cash’, the accounts had said ‘Loan to LSL Holdings’. As His Honour stated (at [212]):

> “In other words, the level of trust reposed in Mr Lewis prior to 2008, together with the conceded lack of understanding as to the difference between the description ‘Cash - LSL Holdings’ and ‘Loans - LSL Holdings’ leads to the necessary conclusion that the misdescription in the financial statements was not the cause, nor a contributing factor, to the losses incurred. Rather, it seems, the losses were occasioned by an inappropriate level of trust in Mr Lewis, an inappropriate arms’ length relationship between the Trustee and Mr Lewis, which trust was misplaced and/or abused.”

Cam & Bear appealed.

5.3 The appeal

The appeal (McColl AP, Macfarlan and White JA) was allowed and Cam & Bear was awarded damages for its loss, less a deduction of 10% for its contributory negligence. The Court of Appeal accepted that Rothman J had not erred in how it construed Dr Bear’s admission that it would not have made any difference to him if the relevant assets in the financial statements had been described as “Loans to LSL Holdings” rather than as “Cash to LSL Holdings”.

However, the Court of Appeal also found that there was a “critical assumption” missing from the questions put to Dr Bear in cross examination. It was not put to Dr Bear that there it would have made no difference to him if Mr McGoldrick had informed him, by qualification of his audit certificate that there were doubts about the recoverability of the loans to which the items described as “cash” referred. Dr Bear had given affidavit evidence that if he had been “made aware that the ‘cash’ reported in the financial statements either was not held as cash or was in the form of *an unsecured loan that may not be able to be repaid*” he would have promptly arranged for steps to be taken to get the money back [emphasis added]. This was not contradicted or challenged in cross examination.

Accordingly, Dr Bear's evidence was accepted and the court found that Cam & Bear had proved breaches of duty that caused it to continue to make payments to LSL Holdings that it would otherwise not have made.

In adjudicating Mr McGoldrick's claim for contributory negligence, the court found that McGoldrick's negligence was of "significantly greater importance" than the "low level negligence" of Cam & Bear: at [90]. It was accepted that Dr Bear was not a sophisticated or experienced investor. Mr McGoldrick on the other hand was (at [88]):

> "a very experienced accountant and auditor who was engaged for the purpose of protecting the Fund and its trustee against financial risks that included the very type of risk that eventuated, namely that loans forming part of the Fund's assets might not be recoverable because of the poor financial position of the debtors".

The court found it was "much less clear" that the loss would have been avoided if the Cam & Bear's negligence had not occurred than if Mr McGoldrick's negligence had not occurred. Responsibility for the loss was apportioned 10% to Cam & Bear and 90% to McGoldrick.

Quantification of loss was remitted to the Common Law Division for completion.

5.4 Messages

The immediate message of the *Cam & Bear* decision is that fund auditors and accountants will need to examine what purports to be "cash" held by an SMSF and if necessary, through other entities, in more detail to make sure "cash" is in fact cash or a cash equivalent. In that regard, on 29 June 2018, APRA issued a letter to all RSE licensees stating that it had identified examples in the industry where 'cash' investment options appear to include exposure to underlying investments that would not generally be considered cash or cash-like in nature. The letter states as follows:

> "Under the reasonable expectations principles as set out in SPS 530 Investment Governance APRA considers that a superannuation fund member would understand that exposure to a 'cash' investment option or product will be readily accessible (for withdrawal or transfer) without change in value. This aligns with APRA's definition of cash under Superannuation Reporting Standard (SRS) 530 Investments (drawn from AASB 107) which states that 'cash':
>
> 'Represents cash on hand and demand deposits, as well as cash equivalents. Cash equivalents represent short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.'
>
> Assets that APRA has observed forming part of cash options' underlying investments include asset-backed and mortgage-backed securities, commercial bonds and hybrid debt instruments, credit-default swaps, loans and other credit instruments. These assets do not typically exhibit the characteristics necessary to be considered as cash or cash equivalent".

The decision in *Cam & Bear* also demonstrates that auditors and accountants will need to pay more attention to the wording and descriptions used in the accounts they prepare and audit reports.

Cam & Bear confirms that the superannuation industry is not immune from professional negligence actions and is illustrative of the potential perils of running an SMSF.

Finally, in addition to professional negligence claims, it is prudent to remember that auditors can face regulatory claims for breaching requirements in the SIS Act. The AAT, in *Whittle and ASIC* [2018] AATA 1861 affirmed a decision by ASIC to disqualify an approved SMSF auditor for failing to comply with the auditor impendence requirements by auditing the SMSF's of close family members. The AAT ruled that the auditor independence breaches were a "very serious matter" that continued over 9 and 6 years for the respective funds.

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