Part III—MIS as a commercially viable model and their marketing to retail investors

There were many shortcomings in the promotion of MIS to retail investors from the financial advisers who gave poor advice, the promoters of the schemes who appeared to downplay the risks inherent in the investment, the research houses that rated the schemes and the unfortunate lending practices which left many growers deeply in debt.

In this part of the report, the committee turns its attention to the commercial viability of some of the schemes, the business model and possible structural flaws, including whether they were Ponzi-like enterprises. The committee seeks to determine whether such schemes should have been marketed to retail investors in the first place.

Chapter 13

Business model—commercial viability

13.1 To this point in the report, the committee has focused on the financial advice aspect of MIS and particularly on the adequacy of the disclosure regime. In this chapter, the committee is primarily concerned with the performance of the schemes and the reasons for their ultimate failure. It considers factors that may have undermined the commercial viability of MIS schemes including high upfront expenses and the management and performance of the schemes.

Reasons for collapses

13.2 Some of the major organisations that gave evidence during the committee's inquiry attributed the collapse of the high profile agribusiness MIS to a number of reasons including:

- the global financial crisis (GFC);
- the 2007 taxation announcement (The ATO's change of interpretation in 2008 of the taxation arrangement for investments in non-forestry agribusiness MIS meant that investors in such schemes would no longer be able to claim upfront deductions for their contributions to the MIS on the basis that the investor was not 'carrying on a business'. In 2008, the Federal Court found that expenses were not of a capital nature and were, indeed, allowable deductions incurred in carrying on a business. Some claim that the delay in settling the test case created uncertainty in the market);[1]
- prevailing weather conditions including drought; and
- commodity prices.[2]

13.3 On the GFC, KordaMentha informed the committee that the effect of the GFC, which severely limited the availability of funds from the capital markets, and the higher than expected operating costs contributed significantly to the working

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1 The Hon Peter Dutton, Minister for Revenue and the Assistant Treasurer, Media release, No. 007, Tuesday, 6th February 2007, 'Non-Forestry Managed Investment Schemes', http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2007/007.htm&pageID=003&min=pcd&Year=&DocType=0 (accessed 21 November 2014). See Australian Forest Products Association, *Submission 126*, pp. 6–7.

2 See, for example, CPA, *Submission 142*, p. [1] and ANZ, *Submission 145*, paragraph 18. The ANZ referred to 'drought, a change in how some of these schemes were assessed by the Australian Tax Office (ATO) in 2007 (the ATO ruling was later overturned by the Courts), and the onset of the global financial crisis'.

capital shortfall facing the liquidators.[3] Many investors, however, were of the view that the GFC exposed inherent flaws in the structure of the schemes.

13.4 Notably, long before the MIS failures, people in the industry were raising concerns about the commercial robustness of the schemes. Looking back, many are now convinced that the schemes were flawed from the start. One investor stated:

> I suppose this outcome may not have been so hard to take mentally if there was a particular event that caused this outside of Timercorp's control but all of the evidence including Timbercorp's outsourced analysis on their structure pointed to the fact that it was a doomed company and investors would not see a return.[4]

13.5 From the committee's perspective, it is important to detail some of the concerns that were raised about the commercial viability of the MIS before their collapse because such assessments could not be interpreted with the benefit of hindsight. The committee has already touched on the poor performance of some schemes in the context of the discrepancy between expected yield rates given in prospectuses and PDSs and the actual poor returns. Importantly, however, below expected yields may also have signalled fundamental flaws in the business model and management of the schemes.

Schemes' performance

13.6 As early as the turn of the century concerns about the commercial soundness of MIS were surfacing. A 2000 report from the Rural Industries Research and Development Corporation (RIRDC), undertaken to assess the effect of public investment ventures largely tax-driven, noted two main risks associated with investment in agricultural investment ventures:

- investors may not receive the benefits as specified by the promoter—short-term taxation benefits are typically achieved by investors, but long-term capital gains or income are not; and
- the venture may collapse—cash flow problems are common among agricultural investment ventures, usually as a result of the promoter making inaccurate financial forecasts.[5]

13.7 After analysing 39 ventures, the study assessed the financial performance of most of these ventures as 'poor to average'. Among other things, it found:

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3 Additional information, KordaMentha, 4 December 2012, paragraphs 9 and 26.

4 Name withheld, *Submission 31*, p. [1].

5 See Tracy Bramwell and Peter Chudleigh, *The Impact of Tax Driven Financial Investment on New Industry Development*, A report for the Rural Industries Research and Development Corporation, RIRDC Publication No 00/14, RIRDC Project No AGT–3A, February 2000, p. 2, https://rirdc.infoservices.com.au/items/00-014, (accessed 5 December 2014).

- the physical performance (yields etc) for 19 ventures was rated with about 50 per cent of them rated very poorly—at least some physical output was achieved by most ventures;
- project management was assessed for 18 ventures, of which nearly 40 per cent were rated as being very poorly managed and the remainder as mainly satisfactorily managed; and
- the financial performance of 18 ventures was rated, with around 60 per cent rated as performing poorly financially—only three of 18 ventures were noted as performing at least satisfactorily.[6]

13.8 The committee reached similar conclusions about problems with overly optimistic projections. In its 2001 interim report on mass marketed tax effective schemes, the committee found that few schemes represented 'a good investment in the ordinary meaning of the term', and without the 'tax deductibility' factor, very few would have 'got off the ground'.[7]

13.9 Cornish Consultancy maintained that policy makers were well aware of the risks inherent in agribusiness MIS by 2006, yet, in its assessment, they 'chose not to close down these schemes', resulting in the tax payer and investors losing billions of dollars.[8] In 2005/06, two researchers found indications of plantations in some cases achieving growth rates—Mean Annual Increments—less than the rates suggested in the PDS for the hardwood plantation MIS. According to the research, in Victoria at least, there were 'identifiable instances of MIS plantations being established on land in rainfall areas of below 650mm p.a. which is the minimum feasible rainfall indicated in the PDS of the largest MIS operator'.[9]

13.10 Around the same time, researchers with RIRDC again questioned the commercial viability of some agribusiness MIS. They reported that along with other studies, their analysis suggested that the MIS sector (but not all MIS) continued 'to perform poorly with respect to realistic or actual rates of return versus projected

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6 Tracy Bramwell and Peter Chudleigh, *The Impact of Tax Driven Financial Investment on New Industry Development*, A report for the Rural Industries Research and Development Corporation, RIRDC Publication No 00/14, RIRDC Project No AGT–3A, February 2000, pp. 24–25.

7 Senate Economics References Committee, *Inquiry into mass marketed tax effective schemes and investor protection*, Interim report, June 2001, p. 2.

8 *Submission 60*, p. 3.

9 Patrick Mackarness and B Malcolm, 'Public policy and managed investment schemes for hardwood plantations', School of Agriculture and Food Systems, The University of Melbourne, *Extension Farming Systems Journal*, volume 2, No. 1, p. 106, https://www.csu.edu.au/__data/assets/pdf_file/0008/109547/EFS_Journal_v02_n01_10_Mackarness_and_Malcolm.pdf. One of their recommendations was to increase ASIC's powers and duties regarding agribusiness Product Disclosure Statements to include independent evaluation of MISs by experts who are not appointed by the Responsible Entity (see Lacey et al. 2006), p. 115.

rates'.[10] The researchers found that the performance of MIS could be expected to vary considerably, producing good and poor performers but it was likely that returns to investors would be 'less than satisfactory, with high commissions for marketing and profits to promoters being important factors'.[11] They argued:

> Product Rulings may have provided greater tax certainty for individual investors in projects but from the community's point of view, resources are wasted if investors are being encouraged to invest in non-commercial projects by optimistic forecasts and/or inadequate regulation. The beneficiaries, in these cases, are the promoters and managers.[12]

13.11 In its submission to the 2008 Review of Non-Forestry Managed Investment Schemes, the NFF referred to the RIRDC's suggestion that the overall MIS sector continued to perform poorly with respect to realistic or actual rates of return versus projected rates.[13]

13.12 Some submitters to this current inquiry also harboured serious doubts about the viability of agribusiness MIS well before their downfall. For example, CPA Australia informed the committee that it had long recognised the potential risks investors took when investing in agribusiness MIS. It indicated that it had been proactive in trying to ensure that investors were educated about the risks so that they could make informed decisions. For example, since early 2000 CPA Australia had issued a range of investor guidance, media articles and advertisements encouraging potential investors to seek professional advice on MIS before investing.[14]

13.13 Mr Tom Ellison noted that around 2004 when plantings and land acquisitions were at their peak:

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10 Rick Lacey, Alistair Watson and John Crase, *Economic effects of income-tax law on investments in Australian agriculture, with particular reference to new and emerging industries*, Rural Industries Research and Development Corporation, RIRDC Publication No 05/078, RIRDC Project No AWT–1A, January 2006, p. vii, https://rirdc.infoservices.com.au/items/05-078 (accessed 5 December 2014).

11 See, for example, Rick Lacey, Alistair Watson and John Crase, *Economic effects of income-tax law on investments in Australian agriculture with particular reference to new and emerging industries*, Rural Industries Research and Development Corporation, RIRDC Publication No 05/078, RIRDC Project No AWT–1A, January 2006, p. 44, https://rirdc.infoservices.com.au/items/05-078 (accessed 5 December 2014).

12 Rick Lacey, Alistair Watson and John Crase, *Economic effects of income-tax law on investments in Australian agriculture with particular reference to new and emerging industries,* Rural Industries Research and Development Corporation, RIRDC Publication No 05/078, RIRDC Project No AWT–1A, January 2006, p. 10, https://rirdc.infoservices.com.au/items/05-078 (accessed 5 December 2014).

13 Submission to the Review of Non-Forestry Managed Investment Schemes, 12 September 2008, p. 4, http://archive.treasury.gov.au/documents/1423/PDF/National_Farmers_Federation.PDF (accessed 23 November 2014).

14 *Submission 142*, p. [2].

> At the basic, fundamental economic level, paying three or four times the value of productive farmland to plant a commodity crop on should send warning bells, because commodities are low price and subject to huge variability and it is not normal to expect people to spend hundreds of millions of dollars buying land to facilitate that.[15]

13.14 Mr Sean Cadman from the Cadman and Norwood Environmental Consultancy suggested that when Timbercorp and Great Southern harvested their first plantations 'the unrealistic nature of the yield forecasts and returns to investors became apparent'. He argued that despite the disappointing results the schemes continued and additional changes to taxation arrangements 'actually made things worse'.[16]

13.15 Mr Samuel Paton, the Principal of Agribusiness Valuations Australia, indicated that in 2005 it was already clear to him that the structure of the schemes was 'doomed to fail and produce very poor outcomes for government (in terms of balance of payments offsets), investors, taxpayers etc'.[17]

13.16 Mr John Lawrence, an economist, tax accountant and more recently a public policy researcher, noted that one of the principal reasons for the failure was underperforming yields. He explained that 'the yields from crops planted over a 15-year period from 1994 were, on average, only about 60% of what was predicted by the respective PDS'. Mr Lawrence stated:

> Price increases failed to eventuate as predicted. Instead wood fibre followed the pattern experienced by every other bulk commodity over time where real price decreases are the norm.[18]

13.17 With regard to Great Southern, he noted that the projected yields for 55,000 hectares of trees from the 1998 to 2004 crops were predicted to be only 160 tonnes per hectare compared to the PDS predictions of 250 tonnes.[19] Referring to the suggestion that harvest yields could be reliably predicted after 4 years, he noted:

> If there was sufficient certainty that yields could be predicted after 4 years, enough to bring future commissions to account, the impending MIS crisis should have been obvious to insiders well before, particularly to foresters responsible for site selection. These same foresters however never wavered from their assessment that 250 tonnes was reasonably achievable despite overwhelming evidence to the contrary based on past actuals.[20]

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15 *Proof Committee Hansard*, 4 August 2015, p. 21.

16 *Submission 105*, p. [2].

17 *Submission 149*, p. 2.

18 *Submission 194*, p. 3

19 *Submission 194*, p. 5.

20 *Submission 194*, pp. 5–6.

13.18 In his words, the prediction 'was never downgraded despite repeated evidence to the contrary' and there was 'never enough suitable ground to grow what was promised'.[21] Importantly, he noted, however, that it was just not one project that fell short of expectations—'there was a consistent pattern'.[22] In summary, according to Mr Lawrence, MIS failed principally because they were 'duds'.[23]

13.19 According to a report tabled by Mr Peterson during a public hearing, returns from Timbercorp's 2006 and 2007 horticultural harvests were generally falling short of expectations.[24]

Poor management

13.20 In some cases, poor management was held to contribute to the disappointing performances. In 2011, the House of Representatives Standing Committee on Agriculture, Resources, Fisheries and Forestry expressed concern about the management of forestry MIS. At that time, a witness told the committee that the MIS regime had worked to put trees in the ground but not 'the right trees in the right ground' to meet actual needs.[25] A number of witnesses spoke of planting trees in the wrong locations—away from processing plants that did not allow 'leverage on existing infrastructure'. Others referred to planting the wrong species of tree.[26] As one witness stated:

> The MIS tax incentives drove a lot of money into plantations and it was like a gold rush. To get those trees in the ground by the end of June meant that the wrong species were planted in the wrong place at the wrong time. There was no prudent linkage to a productive outcome.[27]

21 *Proof Committee Hansard*, 5 August 2015, p. 1.

22 *Proof Committee Hansard*, 5 August 2015, p. 11.

23 *Submission 194*, p. 3.

24 Kylie Mastores to Sol Rabinowicz, Robert Hance et al, email, 14 May 2007, tabled document, 12 November 2014.

25 Mr Nick Roberts, the Australian Forest Products Association, in House of Representatives Standing Committee on Agriculture, Resources, Fisheries and Forestry, *Seeing the forest through the trees,* Inquiry into the future of the Australian Forestry Industry, November 2011, paragraph 5.47.

26 House of Representatives Standing Committee on Agriculture, Resources, Fisheries and Forestry, *Seeing the forest through the trees,* Inquiry into the future of the Australian Forestry Industry, November 2011, pp. 70–71.

27 House of Representatives Standing Committee on Agriculture, Resources, Fisheries and Forestry, *Seeing the forest through the trees,* Inquiry into the future of the Australian Forestry Industry, November 2011, p. 71. Councillor Lindsay Passfield, House of Representatives Standing Committee on Agriculture, Resources, Fisheries and Forestry, *Committee Hansard*, 1 September 2011, p. 18.

13.21 Citing the House of Representative committee's inquiry into the future of the Australian Forestry Industry, the Department of Agriculture noted the concerns about the suitability of the plantations established under MIS. The department stated:

> There is evidence that some MIS plantations were established in less than optimal locations. For example, in a few instances, there appears to have been poor consideration of the suitability of the species to the growing location, as well as the proximity of the wood resource to suitable markets or processing facilities.[28]

13.22 Planting trees and crops in unsuitable locations does not make commercial sense, but the evidence strongly suggested that the use of tax incentives drove this type of decision-making and the schemes ended up very much supply rather than demand driven.

Tax incentive—driver of uncommercial decisions

13.23 Indeed, many commentators associated with the industry saw the failure of the MIS industry as 'in some ways a reflection of the inherent problem of using tax inducements to fund industry'.

13.24 A 2006 RIRDC study observed that investors were paying substantial premiums through MIS marketing commissions and profits to be able to claim taxation deductions for their investments in MIS.[29] In 2009, the PJC heard a number of complaints about the potentially market distorting effects of the tax incentives available to agribusiness MIS investors. Evidence suggested that rather than investment flowing to commercial activities on the basis of profitability, tax incentives had generated an influx of investment to agribusiness MIS that would have been directed elsewhere had they not been available. Such incentives created an inefficient use of capital and an uneven playing field for traditional agricultural enterprises competing for scarce land, water and labour resources.[30]

13.25 While the tax incentives may have diverted investment away from other sectors in the economy into agribusiness MIS, they also had the potential of skewing investment towards the front end of the schemes.

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28 *Submission 135*, p. 7.

29 Rick Lacey, Alistair Watson and John Crase, *Economic effects of income-tax law on investments in Australian agriculture with particular reference to new and emerging industries,* Rural Industries Research and Development Corporation, RIRDC Publication No 05/078, RIRDC Project No AWT–1A, January 2006, p. 48.

30 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into aspects of agribusiness managed investment schemes*, September 2009, p. 17.

13.26 NewForests stated that the deductions became 'the goal', and the underlying investments 'a kind of by-product of the tax deduction'.[31] It stated further:

> While most of the MIS timber plantations in Australia were professionally established, the drive for land and planting deadlines pushed new plantations into areas of low rainfall, poor market access or areas of limited historical forestry experience. As MIS companies acquired extensive land banks with debt finance, the sector became overleveraged. The high costs of managing large numbers of retail clients, packaging and selling the products, and financing the whole cost base upfront, meant that the projects were commercially non-viable. So while the calamitous end of the MIS was unforeseen, many commentators felt it was overheated and due for some form of correction. Ultimately, the stress of the financial crisis led to a complete collapse of the industry.[32]

13.27 Evidence before this current inquiry similarly supported the contention that the tax deductions may have had unintended adverse consequences. The Tasmanian Farmers and Graziers Association (TFGA) noted that MIS generated investment was not based on sound long term strategic investment planning but primarily motivated by tax incentives, which caused significant distortions within the markets in which they operated.[33] The TFGA referred to the 'excessive haste' in implementing the schemes without any overlying strategy, which was executed in an ad hoc and detrimental way.[34] In its view, the MIS arrangements 'have clearly demonstrated that attempting to drive investment via tax incentives is a potentially risky strategy that often has unintended negative consequences'.[35]

13.28 Mr Richard Hooper, TFGA, informed the committee that the tax requirement encouraged a lot of forestry companies to 'get the money spent' and 'so they did unseasonal plantings and picked land that was never really suitable for trees'.[36] His colleague, Mr Nicholas Steel, acknowledged that the industry needed to attract capital and, while noting that MIS was a good tool, agreed with the view that the rules around it were not and had allowed the market to be distorted—'too many trees were planted, and planted in some of the wrong areas'.[37] Also, referring to the tax incentive, Mr Michael Hirst observed:

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31 NewForests, 'Rationalizing Timberland Managed Investment Schemes: The changing Landscape of Australia's Forestry Investment Sector', p. 4, http://www.newforests.com.au/wp-content/uploads/2014/09/Rationalizing-the-MIS-20140908.pdf (accessed 15 November 2014).

32 NewForests, 'Rationalizing Timberland Managed Investment Schemes: The changing Landscape of Australia's Forestry Investment Sector', p. 4, http://www.newforests.com.au/wp-content/uploads/2014/09/Rationalizing-the-MIS-20140908.pdf (accessed 15 November 2014).

33 *Submission 24*, p. 4.

34 *Submission 24*, p. 5.

35 *Submission 24*, p. 6.

36 *Proof Committee Hansard*, 5 August 2015, p. 16.

37 *Proof Committee Hansard*, 5 August 2015, p. 17.

> …as soon as you introduce the incentive to plant out as much as you can, because it emphasises the returns, you are going to run into problems because it entices greed and bad practices. So, in some manner, we have to have someone to say, 'No, the figures you quoted are not right,' or, 'No, that country is not suitable.' Maybe that is the way that there could be ethical planting, because, like I say, if you are doing it on commissions and on an amount of money per hectare, it is probably going to end in tears down the track.[38]

13.29 Similarly, Mr Lawrence drew attention to the effect of the tax incentives on decisions:

> Originally when managed investment scheme companies put out a product disclosure statement and they might have only planned to plant 5,000 hectares, they probably could have managed that. But there were a couple of peak years—2005–06 from memory—where sometimes they would be flooded with applications…I think in one instance one of the companies might have had over 20,000 hectares. There was a mad scramble for land, and that is when they started leasing land from farmers—increasingly so—because they had all this money and they could not hand it back. It was too good to be true, so they had to lease land from farmers.[39]

13.30 ASIC also noted that the availability of tax incentives for investment in forestry MIS 'may have encouraged levels of investment that may otherwise not have been achieved'.[40]

High upfront commissions and establishment costs

13.31 The poor performance may also be linked to the high upfront costs of the schemes that diverted funds away from the actual preparation for, and planting of, the trees or crops.

13.32 Earlier the committee referred to the high commissions paid to advisers. This practice not only had the potential to compromise the quality of advice but to reduce the funds available for the actual investment. Again, there were early warning signals of the risks that these high upfront expenses posed to the success of the schemes.

Early warnings

13.33 Well before the collapse of the major agribusiness MIS, commentators within the industry had voiced concerns about the tax incentive encouraging high upfront fees and other expenses and the effect on the commercial viability of agribusiness MIS. For example, such concerns were raised as early as 2001 during the committee's

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38 *Proof Committee Hansard*, 5 August 2015, p. 17.

39 *Proof Committee Hansard*, 5 August 2015, p. 8.

40 *Submission 34*, p. 11.

inquiry into tax effective schemes.[41] At that time, evidence before the committee noted, in regard to blue gum plantations, that some plantation companies charged investors an upfront fee in excess of over $9,090 per hectare. The Minority Report to the committee's final 2001 report observed that credible research from government agencies, such as the Department of Conservation and Land Management in Western Australia and academic departments such as ANU Forestry, showed that it should cost no more than about $3,000 (maximum) to establish one hectare of blue gums on leased land over a 10–12 year rotation period.[42]

13.34 Van Eyk, an investment research, advice and funds management company, told the committee in 2001 that it was inconceivable how any project, or any business, could expect to be successful when between 70 and 80 per cent of the funds invested were 'immediately diverted into what is basically non-productive expenditure'. It stated further that it was difficult to understand how 'both the ATO and ASIC rationalise such schemes to be "commercial ventures" on a pre-tax basis when such a high proportion of the funds are not in fact utilised in actually growing or producing the crop'.[43] In short, van Eyk argued that the majority of agribusiness schemes were likely to fail commercially because not enough of the funds raised were 'going into the ground'. It concluded that growers would 'gain no return on the investment and a potentially viable industry sector will be brought into disrepute'.[44]

13.35 At that time, witnesses from a range of agribusinesses disputed van Eyk's assessment. In particular, they rejected the claim that the agribusiness sector as a whole systematically overcharged for management fees and commissions. For example, Great Southern Plantations Ltd suggested that van Eyk did not sufficiently consider the whole life cycle of the businesses it criticised.[45] Mr John Young, then Chairman and Managing Director of Great Southern, said:

> They look at certain issues such as stumpage, which they have mentioned, and up-front establishment costs. What they do not look at is the long-term viability of the businesses, the cash flows and liquidity, the borrowing levels, the balance sheet, the whole box and dice. So we feel that their research is flawed in that regard…[46]

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41 Senate Economics References Committee, *Inquiry into mass marketed tax effective schemes and investor protection*, 2002, Minority Report, paragraph 1.130.

42 Senate Economics References Committee, *Inquiry into mass marketed tax effective schemes and investor protection*, 2002, Minority Report, paragraph 1.131.

43 Senate Economics References Committee, *Inquiry into mass marketed tax effective schemes and investor protection*, Final Report, February 2002, paragraph 4.52.

44 Senate Economics References Committee, *Inquiry into mass marketed tax effective schemes and investor protection*, Final Report, February 2002, paragraph 4.53.

45 Senate Economics References Committee, *Inquiry into mass marketed tax effective schemes and investor protection*, Final Report, February 2002, paragraph 4.55.

46 Senate Economics References Committee, *Inquiry into mass marketed tax effective schemes and investor protection*, Final Report, February 2002, paragraph 4.56.

13.36 Again in 2005/06, two researchers felt the need to highlight the fact that a substantial proportion of the initial investment in MIS went to activities other than the establishment costs of the plantation. They found:

> It costs around $1,600 per hectare to establish Blue Gums. This is a robust figure. The remaining $7,400 of the original $9,000 per hectare investment is devoted to other matters including prospectus costs, the purchase of land by the Responsible Entity, sometimes payments of commissions to the financial planners of the investors, and profit.[47]

13.37 In 2006, Mr David Cornish, then with MS&A, advisers to Australian agriculture, pointed to high upfront fees, noting:

> The promoters, such as Timbercorp and Great Southern, charge the investor (man in the street) substantial upfront fees to manage a timber lot on their behalf.[48]

13.38 In support of his argument, Mr Cornish cited evidence given by the ATO in 2001 to this committee, which suggested that 'in some cases the establishment and management fees may be artificially geared so that no matter what happens to the business itself, investors are guaranteed at least a 'tax profit' for their investment.[49] Moreover, he suggested that it was becoming obvious as the first schemes came to fruition that the actual returns were 'well below market expectation'.[50] According to Mr Cornish, the tax policies at the time meant that the promoter's profits were:

> …based purely on its ability to sell a scheme and capture upfront fees, not on how profitable that scheme is. **More importantly, the risk of failure of these schemes is jointly owned by the investor and the taxpayer. The promoter bears no financial risk if the project fails**.[51]

13.39 Mr Cornish argued that it was 'critical to understand that the investor only owns the trees'—that 'the promoter buys the land from the surplus generated from

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47 Patrick Mackarness and B Malcolm, 'Public policy and managed investment schemes for hardwood plantations', School of Agriculture and Food Systems, The University of Melbourne, *Extension Farming Systems Journal*, volume 2, number 1, p. 106.

48 Appendix one, 'MS&A submission on the proposed new taxation arrangements for investments in Forestry Managed Investment Schemes (MIS)', *Submission 60*, pp. 1, 6 and 8.

49 Appendix one, 'MS&A submission on the proposed new taxation arrangements for investments in Forestry Managed Investment Schemes (MIS)', *Submission 60*, p. 10 and Senate Economics References Committee, *Inquiry into mass marketed tax effective schemes and investor protection*, Final Report, February 2002, paragraph 4.54.

50 Appendix one, 'MS&A submission on the proposed new taxation arrangements for investments in Forestry Managed Investment Schemes (MIS)', *Submission 60*, p. 13.

51 Appendix one, 'MS&A submission on the proposed new taxation arrangements for investments in Forestry Managed Investment Schemes (MIS)', *Submission 60*, pp. 7–8 (emphasis in original).

these massive upfront fees charged to other schemes'.[52] In 2006, he maintained that proposed policy changes must be able to resolve the current failures of the MIS industry. In his assessment, these failures were:

- profiteering by promoters at the expense of the Australian taxpayer;
- asymmetric information—due to the lack of credible independent and transparent information on the profitability of the project; and
- the promoters' lack of accountability to achieve profitable outcomes for their investor clients.[53]

13.40 Concerns about the commercial viability of these schemes persisted. In 2008, Adviser Edge, an investment research house, referred to a review of many MIS, which suggested that high profit margins were being earned by managers in initial years. By 'high' Adviser Edge meant that the profit margins in some cases were particularly excessive 'to indicate that profit margins had been brought forward from later years into the initial year of the MIS project'. Adviser Edge considered that this aspect of the MIS regime was potentially one that needed to be addressed. Its research indicated that:

> …on average, 42% of application fees were attributable to agricultural operational expenses in FY 2007/08. This includes all non-forestry MIS projects assessed by Adviser Edge in FY2007/08 for which managers provided a break-down of the application fee. The median percentage of application fees attributable to direct operational expenses is slightly higher, with a total of 45%. This implies that, on average, 58% of all application fees for non-forestry MIS was attributed to adviser commissions, marketing, product development costs, administration, corporate overheads and manager profits.[54]

13.41 Referring to the upfront expenditure, Adviser Edge noted that the costs associated with administration and product development of MIS projects and adviser commissions were substantial:

> MIS managers receive a significant proportion of their profits as part of the initial application fee. The heavy weighting on the application fee reduces

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52 Appendix one, 'MS&A submission on the proposed new taxation arrangements for investments in Forestry Managed Investment Schemes (MIS)', *Submission 60*, pp. 1 and 8.

53 *Submission 60*, p. 10 and Appendix one, 'MS&A submission on the proposed new taxation arrangements for investments in Forestry Managed Investment Schemes (MIS)', p. 19 in *Submission 60*.

54 Submission to the Review of Non-Forestry Managed Investment Schemes, p. 12, http://archive.treasury.gov.au/documents/1423/PDF/Adviser_Edge.pdf (accessed 23 November 2014).

> the risk for the manager, and transfers the majority of production risk to the investor.[55]

13.42 Dr Judith Ajani submitted to the 2009 PJC's inquiry that an investigation of late 1990s hardwood plantation prospectus documents revealed a wide chasm between market outlook and actual market realities.[56] According to Dr Ajani:

> Before the MIS approach to growing wood, it cost around $2,000 to plant and manage a hectare of trees over a ten year rotation. Managed investment schemes more than quadrupled that cost. Neither wood prices nor plantation yields have increased anywhere near sufficient to offset this cost increase. The public purse is the biggest loser in this arrangement.[57]

13.43 Based on her research, Dr Ajani contended that far from being an attractive investment proposition, forestry MIS were 'never a commercially viable arrangement from the perspective of the so-called "investor"'.[58] The NFF informed the PJC that the decisions to invest in MIS were largely based on the tax deductibility of the investment rather than the promise of long term profitability. It argued that as a result of this measure:

> …MIS have traditionally been primarily focused on industries with a high proportion of up-front expenses, with little regard given to the output returns generated.[59]

13.44 The same concerns were repeated during this current inquiry. For example, Mr Bryant noted the high upfront fees including commissions paid to advisers (minimum ten per cent) and the salaries paid to the company's back room support staff. In regard to Timbercop, Mr Bryant noted that there were approximately 80 staff at its peak, a number of whom were on performance bonuses, which would take their six-figure base salaries even higher.[60] Mr Cornish, who had also registered his concerns in 2006, told the committee that:

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55 Submission to the Review of Non-Forestry Managed Investment Schemes, p. 12, http://archive.treasury.gov.au/documents/1423/PDF/Adviser_Edge.pdf (accessed 23 November 2014).

56 Submission to Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into aspects of agribusiness managed investment schemes*, included in *Submission* 26, p. 56.

57 Submission to Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into aspects of agribusiness managed investment schemes*, included in *Submission* 26, p. 56.

58 *Submission 26*, p. 1.

59 NFF, *Submission 22* to the Parliamentary Joint Committee on Corporations and Financial Services (PJCCFS), *Inquiry into aspects of agribusiness managed investment schemes*, p. 3; and New South Wales Farmers' Association, *Submission 52* to the PJCCFS inquiry into agribusiness MIS, pp. 5–6. It noted that that the commercial decision to invest in MIS was 'based on the immediate tax deductibility of the investment, rather than any dividend return or the entity's long term profitability' and investors 'lured by this incentive have forced a rapid expansion in the MIS sector'.

60 *Proof Committee Hansard*, 12 November 2014, p. 12.

> …current taxation policy significantly reduces the likelihood of the investor receiving an economic return, rather than if the taxation advantage was not available. This is simply due to the promoter exploiting the tax benefit and charging the investor well above the cost of operation, and the investor accepting it, given he/she can write it off as a tax deduction.[61]

13.45 In his view, taxation policy to support the forestry industry should be 'adjusted to promote long term profitable timber production and efficiency within the industry'. He referred to the UK industry, where the tax incentive was removed from the upfront deduction to a tax break on the final product. In his assessment, such a measure would produce several favourable consequences that, *inter alia*, include:

- removing the ability for an MIS promoter to profiteer at the expense of the Australian taxpayer;
- making schemes profit focused—currently MIS promoters make money out of how many hectares they plant not on how profitable that is; and
- encouraging 'best practice' forestry to ensure profitability is maximised.[62]

13.46 Mr Lawrence was also critical of the corporate model. He explained that in most instances the deferred fee model was used with varying upfront payments combined with varying commissions at harvest time. He then noted that only a small portion was spent on tree establishment with much of the remainder lent by the RE to the parent company. He also drew attention to:

- the ongoing costs, which required funds from the parent and, because they were greater than expected, generated cash flow problems;[63]
- the requirement for new sales to replenish the cash tin; and
- the back up cash inflow, which came from so called annuity income from growers repaying loans, but the increasing loan defaults over time resulted in a slowing of the cash inflow.

Overall, in his view, the model was 'vulnerable'.[64]

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61 *Submission 60*, p. 11.

62 *Submission 60*, p. 11.

63 According to Mr Lawrence, 'The underestimation of ongoing costs was highlighted when Gunns assumed management of Great Southern's MISs. The constitutions for each scheme were amended to increase the harvest commission by approximately 5% points for each estimated year until harvest. In other words, the newest project due to be harvested in 9 years time ended up with a harvest commission of over 50%. Growers can't make money on that basis'.

64 *Submission 194*, pp. 3–4.

Ponzi-like schemes

13.47 On reflection, some in the industry were of the view that the failure of some MIS was inevitable. In 2010, researchers from the Department of Finance, University of Melbourne, referred to Great Southern's decision 'to effectively ex post underwrite projected returns to investors in early schemes'. In their view, while this measure certainly placed the interests of the earlier investors first, it did so at the expense of those in later schemes.[65] They maintained:

> In principle, as long as the final year inflows are adequate, any combination of sources of funds is acceptable, and the lowest cost funding would appear optimal. However, if the approach used is that of creating new MIS to not only fund expenses of, but also provide unwarranted returns to, investors in earlier schemes, the structure has, at least, the appearance of a Ponzi scheme. Any subsidization of returns to investors in old schemes, motivated perhaps by a need to point to past investors returns to generate new interest, is not only inconsistent with the principle of scheme investors bearing the risk of their investment but exacerbates the risk of the RE becoming dependent on increasing growth in new MIS for survival. While not a Ponzi scheme per se, if promised returns to new scheme members are excessive, and returns provided to old scheme members are inflated relative to actual underlying returns, a Ponzi outcome of collapse is likely.[66]

13.48 The researchers explained further the effects of a company operating multiple schemes established at different points in time. In their assessment, using Great Southern as an example, two significant consequences flowed from this setup:

- The assets of any individual MIS are not fully quarantined and so are available for use in other schemes. The MIS investor has 'ownership' of a particular lot of trees or other plants, established when the scheme is set up. But the residual funds are deposited with the parent company GSL and thus, as a claim on the company's assets, co-mingled with those of other MIS (and other creditors) on the parent company. Indeed, GSL's revenue was dominated by new MIS subscriptions.
- Because the GSL business model was built on continuing and increasing creation of new MIS for a revenue stream and finance source, problems of attracting new investors could arise if returns on existing/maturing schemes were inadequate. Hence, incentives may have existed for GSL (or a subsidiary), as purchaser of harvests (for on-sale), to apply some new

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65 Christine Brown, Colm Trusler and Kevin Davis, 'Managed Investment Scheme Regulation: Lessons from the Great Southern Failure', 29 January 2010, p. 9, http://kevindavis.com.au/secondpages/workinprogress/Great_Southern_JASSA-v2-28-1-10-3.pdf (accessed 9 December 2014).

66 Christine Brown, Colm Trusler and Kevin Davis, 'Managed Investment Scheme Regulation: Lessons from the Great Southern Failure', 29 January 2010, p. 5. http://kevindavis.com.au/secondpages/workinprogress/Great_Southern_JASSA-v2-28-1-10-3.pdf (accessed 9 December 2014).

> investment inflows to subsidize returns to poorly performing old schemes in a 'quasi'-Ponzi' type structure.[67]

13.49 Some submitters shared this view that agribusiness MIS had the hallmarks of a Ponzi scheme. One financial adviser, who also questioned the viability and integrity of the schemes, stated that it was well known that many of the projects failed to perform to prospectus forecasts. To his mind, it appeared that there was no delineation of projects from one another with the result that in terms of cash flow:

> …the good subsidised the bad and the current subsidised the past.[68]

13.50 Arguably, in his opinion, the company was trading while insolvent.[69] Mr Cornish explained the Ponzi-like arrangement another way:

> The reality is that the whole structure of the business model of the promoter was based on getting that lump sum principal up top, and not how much money they make. The viability of Great Southern, Timbercorp and all those companies fell over when they could no longer get the next person into the scheme.[70]

13.51 Only after the collapses, did investors come to suspect that later schemes may well have been augmenting the returns of earlier underperforming ones. Mr David Lorimer spoke of being unaware that the funds he invested in one scheme were being used to prop up other schemes. In his words:

> This screams Ponzi scheme to me. I was always under the impression that each project was stand alone. I was obviously mistaken. (This point alone would have warned me off the schemes).[71]

13.52 One couple stated that the product disclosure statements/prospectuses highlighted individual project returns, which suggested that each project was independent. They argued, however, that in reality, 'if one project failed, this deficit would flow over and affect the profitable projects'.[72] In their words:

> We were also not aware that with this flawed business model, the viability of **OUR PROJECTS** was dependent on subsequent year's projects

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67 Christine Brown, Colm Trusler and Kevin Davis, 'Managed Investment Scheme Regulation: Lessons from the Great Southern Failure', 29 January, 2010, p. 7, http://kevindavis.com.au/secondpages/workinprogress/Great_Southern_JASSA-v2-28-1-10-3.pdf (accessed 9 December 2014).

68 Name withheld, *Submission 106*, p. 2. See, also, name withheld, *Supplementary Submission 52.1*, p. [1].

69 Name withheld, *Submission 106*, p. 2.

70 *Proof Committee Hansard*, 4 August 2015, p. 14.

71 *Submission 55*. See, also, name withheld, *Submission 97*, p. [2].

72 *Confidential Submission 36*, p. [4].

> attracting sufficient investments. If not, then our yearly funds would be directed to propping up other projects and keeping them above water.[73]

13.53 Supporting this view, one grower stated simply that the financial decision to use money from later projects to finance earlier ones was 'bad financial management and hence undermined the later projects'.[74] Another suggested that Timbercorp Forestry appeared to be a vehicle created to generate revenue for Timbercorp where the real money was in finance and commissions. In other words, the MIS was 'a scam not a scheme for investors'.[75] A submitter, who wanted his name withheld, shared this same conviction. He argued that, in effect, the directors were looking at ways to minimize 'harm to the sales of woodlots in the 2005 project by covering for the returns to investors in the 1994 project'. Put another way:

> …funds from the new investments were required to top up some of the early investments as the yields were not as advertised in the PDS. These reduced yields were never ever communicated to prospective investors in the 2005 and 2006 schemes. In the end approximately 18,480 investors bought into the two schemes, some made cash investments some borrowed to invest. Little did they know that their funds were going to be used to top up earlier projects and thus start the downward spiral.[76]

13.54 Convinced that funds were being funnelled to prop up earlier projects, he asked, was this not 'the modus operandi of a Ponzi scheme?'[77] Mr Mazzucato agreed, stating that from all appearance, Timbercorp was operating a Ponzi scheme. Put simply:

> The profits of the business did not cover the costs to the business. They required new investors to pay their obligations to their older investors.[78]

13.55 In his estimation, the financial planners and banks treated this 'as a feeding frenzy preying on unsuspecting and unsophisticated investors'.[79] Another couple stated:

> There was evidence that Great Southern was effectively a Ponzi scheme whereby new investors were providing returns to old, plus there were financial reports showing Great Southern was actually insolvent when the last lot of 2008 Grapevines were sold. Two of the directors had resigned in 2006 following the surfacing of such Ponzi scheme information.[80]

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73 *Confidential Submission 36*, p. [4] (emphasis in original).

74 *Confidential Submission 140*, p. 2.

75 Name withheld, *Submission 41*, p. 3.

76 Name withheld, *Submission 150*, p. [1].

77 Name withheld, *Submission 150*, p. [2].

78 Mr Peter Mazzucato, *Submission 40*, p. [2].

79 Mr Peter Mazzucato, *Submission 40*, p. [3].

80 Name withheld, *Submission 56*, pp. [3]–[4].

13.56 Also referring to Great Southern, Mr Lawrence noted:

> Great Southern propped up the returns of the first three crops that were harvested. They interposed a related entity to buy the crop at an inflated price so that the growers would end up with the return they promised. But, of the first crop Great Southern grew, they harvested only 123 tonnes when 250 was predicted. The next two were not as bad but they were well below predictions, and they kept it under double wraps.[81]

13.57 In his opinion, had the company not bolstered the returns of its early schemes from 2005 until 2007 and had people been more aware of the yields, then the schemes would have 'fallen over a lot earlier than they did'.[82]

13.58 Mr Michael Galvin, who was Counsel for the plaintiffs in the Great Southern proceedings, also commented on the subsidisation of earlier projects. He referred to Great Southern's efforts to conceal the fact that its wood lots from earlier schemes were not going to produce anywhere near the predicted 250 cubic metres per hectare and therefore not produce the anticipated returns for growers. He cited the first forestry project, the 1994 eucalypt project, which was due for harvest in 2004:

> When it became apparent that the yield from this project would fall well short of the expected yield, rather than declare that outcome to the market and suffer the adverse publicity, the management of Great Southern implemented a transaction by which a newly-formed entity—Great Southern Export Company—purchased the woodchips at an inflated price equal to the amount which would have been paid had the yield been as anticipated to investors.
>
> Plainly, the volume of yields in earlier projects was likely to have a direct impact on sales in new forestry projects. It was not in the interests of Great Southern's ongoing schemes and business for the investors in the '94 project to receive a return which was substantially less than had been anticipated. When it came to his attention, non-executive director Jeffrey Mews was troubled by the apparent use of Great Southern's own money to top up returns to the '94 project growers. He ultimately resigned over the issue. Similar topping-up of the '95 and '96 project returns occurred, though a lesser sum was paid to growers in the latter project.[83]

13.59 In his words, Great Southern was 'putting off the inevitable'.[84]

13.60 Many who invested in the later schemes were surprised to learn that their funds were not being used to plant their vines or trees and had 'no prospect of

81 *Proof Committee Hansard*, 5 August 2015, p. 10.

82 *Proof Committee Hansard*, 5 August 2015, p. 1.

83 *Proof Committee Hansard*, 6 August 2015, p. 30.

84 *Proof Committee Hansard*, 6 August 2015, p. 32.

producing an income to repay loans'.[85] This was particularly evident to growers who were encouraged to invest in 2008 just before Timbercorp's fall. As one grower stated:

> I invested mid to late 2008 which was shortly before the complete collapse of the company when they knew that this was inevitable but continued to dupe individuals into investing based on their lies.[86]

13.61 A couple in their mid 60s were advised to invest in Timbercorp in June 2008 and by April 2009 it was in liquidation. In their view, they should not have to pay back their loan as they were sold the investment 'when the company was in difficulties'.[87] Along the same lines, Miles and Marion Blackwell were convinced that, although Timbercorp took their money, their trees were never planted. They also labelled the scheme 'a scam' meant to draw in more investors to help pay out the earlier ones.[88]

13.62 An older couple stated that they had received nothing for their investments in 2006, 2007 and 2008, indicating further that in 2008 'the trees were never even planted'.[89] Yet another grower stated:

> I struggle to understand how a company can advertise an investment with great return, then before there is even a crop in the ground the whole project defaults but they still charge an annual management fee and interest charges on a project that did not even exist. Timbercorp sold something to people, they could not deliver the goods, so I see no reason why we should have to pay for something that does not exist.[90]

13.63 Investors who invested in Great Southern just before the company collapsed gave similar accounts. With the benefit of hindsight, they also formed the view that the schemes were flawed from the beginning, with some suggesting that it was a Ponzi scheme which engaged in 'unethical, unconscionable conduct'.[91] One such investor remarked:

> By purchasing some of the last vinelots in 2008 we may never know if our grapes were actually planted or not, but the MIS as a whole was destined to fail. GS was operating a Ponzi-like scheme, providing loans to investors and using money (provided by Bendigo Bank) to continue trading and selling schemes while never actually developing or in some cases even

85 Name withheld, *Submission 91*, p. [2].

86 Name withheld, *Submission 31*, p. [1].

87 Name withheld, *Submission 48*.

88 *Submission 173*.

89 Peter and Elaine Wilson, *Submission 49*.

90 Name withheld, *Submission 77*.

91 Name withheld, *Submission 52*, p. [1].

> planting the vinelots. It now seems that GS had sold such a loan to us and transferred it to Bendigo Bank just prior to its collapse.[92]

13.64 Two growers who also held positions in Timbercorp are well placed to shed some light on the extent to which the companies relied on new investors to keep earlier schemes afloat. Mr Bryant was one of growers who likened MIS to Ponzi schemes.[93] To his mind, the problems stemmed from the manner in which the products were sold, explaining:

> The corporate structures were built on revenue streams that relied wholly on investor income at the front end. No other revenue would come to that entity until they got a proportion of harvest proceeds at the back end. Both those arrangements are commercially acceptable but it is the amount of money that went to getting these products into the market, which was not covered by anything other than investors' money.[94]

13.65 According to Mr Bryant, Timbercorp and Great Southern's single, upfront payment model meant that if you paid $3,000 for a wood lot:

> …the money went into the company. There was no portion of that put aside for future maintenance of the plantation in the case of timber lots. When the music stopped there was no money left to continue the plantations to the end.[95]

13.66 Mr Byrant's reasoned that this reliance on a form of revenue, where the company depended on investors' money going into the project, was 'basically akin to a Ponzi scheme'.[96] He agreed that the signs of Timbercorp's failure were there and referred to revenue streams and the need to continue to attract increasing sales. In reference to Timbercorp, he observed:

> They were getting decreasing sales before the GFC happened. They had to achieve the yields on the crops to get the revenue streams that they had budgeted on getting and they needed the recipients of loans to keep paying the loans. Those three things were not happening. The yields were not happening; they were not getting increasing sales—they were getting decreasing sales; and they were getting an increasing number of people defaulting on their loans. So it would have still happened.[97]

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92 Name withheld, *Submission 91*, p. [1].

93 Mr Andrew Reibelt, *Submission 104*; name withheld, *Submission 150*, p.[1]; name withheld, *Submission 153*, p.[2]; Mr Mark Laszczuk, *Submission 157*; name withheld, *Submission* 167, p. [5].

94 *Proof Committee Hansard*, 12 November 2014, p. 11.

95 *Proof Committee Hansard*, 12 November 2014, p. 11.

96 *Proof Committee Hansard*, 12 November 2014, p. 11.

97 *Proof Committee Hansard*, 12 November 2014, p. 28.

13.67 Mr Peterson explained further that Timbercorp made its money through annuity style income, which included annual rent, management fees, percentage share of crop, interest on grower loans and other. He noted that at its height Timbercorp's loan book was half a billion dollars. He surmised that if Timbercorp were making three per cent on money they borrowed from ANZ, the amount would be substantial. In his opinion:

> The loan book, as with Great Southern, was a very, very important revenue driver of the business.[98]

13.68 According to Mr Peterson, however, in February 2007 the Timbercorp default loan book, or loans in arrears—growers not paying their loans—was a sizeable $24.5 million but on 12 July, five months later, it had doubled to $49 million.[99] Mr Peterson drew together all the warning signs emanating from Timbercorp—projects not performing to expectations; fall in annuity revenue; the shrinking loan book; and the loans in arrears.[100] According to Mr Peterson, Timbercorp was in real trouble without being able to sell annuity products in horticulture.[101] He contended:

> If the projects were not on track and you had used a cash flow to get there to build your investment model, you were in real trouble. Timbercorp did not give out adjusted cash flows on an annual basis to take into account these results for clients already in projects. So when the clients started seeing these results and emailing us asking what is going on, they realised they could not afford to keep on paying the project, that they had been misled in their view, and the default loan book increases but, worse for Timbercorp, growers were saying: 'We don't want to invest in anymore projects…That was reflected in 2008 when only $119 million of product was sold, but by that stage the wheels were off—projects were not delivering, there was pressure from the financiers, the government was saying, 'No more MIS.…It was clear what was happening in February 2008—you were in real trouble…these projects were not delivering, growers were in default and annuity income was in trouble. What was going to keep the company afloat?[102]

13.69 Noting that no projects were being sold in 2009, Mr Peterson asked, 'where was the income coming from to feed this beast?'[103]

13.70 No one disputed the proposition that the earlier schemes had failed to perform as expected. In 2007, Australian Agribusiness Group (AAG) produced the results of its research, which reported that Great Southern had completed harvests from its 1994

98 *Proof Committee Hansard*, 12 November 2014, p. 14.

99 *Proof Committee Hansard*, 12 November 2014, p. 15.

100 *Proof Committee Hansard*, 12 November 2014, pp. 17–19.

101 *Proof Committee Hansard*, 12 November 2014, p. 18.

102 *Proof Committee Hansard*, 12 November 2014, p. 19.

103 *Proof Committee Hansard*, 12 November 2014, p. 28.

and 1995 plantation projects achieving harvest volumes of 123 m^3/ha and 166 m^3/ha respectively. At that time, Great Southern advised that the lower than forecast yields were due to silvicultural issues, 'largely caused by specific site issues combined with below average rainfall conditions'.[104]

13.71 According to AAG's 2007 research report, Great Southern had, overtime, taken substantial action to address the problem of low yields, including better land selection, silvicultural practices and genetic improvements. It wrote that Great Southern believed firmly that the prices likely to be achieved for the projects due to be harvested over the coming few years were 'on track' to meet expectations.[105]

13.72 Hearing the Great Southern proceedings, Justice Croft also understood that in the ten years or so since the establishment of the 1994 plantations there had been a pronounced evolution in knowledge and experience in the forestry industry generally and in particular within Great Southern. According to Justice Croft:

> Much more was known empirically about the synergies and effects of soil depth, soil quality and annual rainfall on plantation growth. Consequently, in 2005 when Great Southern came to assess the productive capabilities of the land used in the 1994 plantations, those lands scored roughly half of the 250/m^3 they had originally been assessed at in 1994. I accept that the disparity between these 'scores' is a ready reflection of the significant evolution in the sophistication of plantation establishment and maintenance that had occurred during the decade or so since the 1994 plantations were established.[106]

13.73 Mr Galvin, who was Counsel for the plaintiffs in the Great Southern proceedings, had a different interpretation:

> I think, His Honour Justice Croft formed the view that there was a sufficient basis for distinguishing the earlier projects from the later projects, having regard to the improvements in silvicultural practices and seedling genetics. That is a view that would be open to debate, and was debated before His Honour. Ultimately, he determined that issue in favour of the defendants.
>
> Having said that, the evidence as I saw it was plainly that, if anything, the expected volumes were decreasing because the quality of the land that was being acquired for later projects was lesser. Land was becoming scarcer and

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104 Australian Agribusiness Group, *Great Southern 2008 Diversified Olive Income Project Retail Investment Research*, May 2007, updated July 2007, pp. B6–B7, https://www.accounting.eknowhow.com/johngrindal/files/0K9ZHF3I2K/AAG%20Research%20-%20Olives.pdf (7 September 2015).

105 Australian Agribusiness Group, *Great Southern 2008 Diversified Olive Income Project Retail Investment Research*, May 2007, updated July 2007, p. B7, https://www.accounting.eknowhow.com/johngrindal/files/0K9ZHF3I2K/AAG%20Research%20-%20Olives.pdf (7 September 2015).

106 Annexure, Clarke v Great Southern Pty Ltd (recs & mgrs apptd) (in liq) [2014] VSC 334 (25 July 2014) [36]–[37] to Clarke (as trustee of the Clarke Family Trust) v Great Southern Finance Pty Ltd (recs & mgrs apptd) (in liq) [2014] VSC 516.

> it was becoming far more expensive. They simply could not get the land they needed to meet the estimates that they had been promoting.[107]

13.74 Evidence before the committee strongly suggests that during the peak years of investment in agribusiness MIS, the need to spend money and the subsequent drive for land meant that increasingly land with poorer soils and lower rainfalls were being selected. Other management decisions such as planting the wrong species would likewise affect productivity. Also, given the high upfront costs—commissions, marketing, administration and corporate overheads—the revenue from new schemes may well have been a critical element in maintaining the earlier schemes.

13.75 In 2009, ASIC reasoned that, while agribusiness MIS did not share the characteristics of a Ponzi scheme, a business model that relied on receipts from application fees for revenue 'may be unstable if the flow of new MIS sales is interrupted'.[108] Reflecting on the commercial viability of these schemes, ASIC, more recently, informed the committee that:

> The collapse of a number of responsible entities of forestry schemes has highlighted issues with this type of investment and the way forestry schemes were promoted to investors. While a small number of responsible entities are still operating in this space, they do not appear to be reliant on the sale of managed investment schemes to fund their business operations in the same way as responsible entities such as Timbercorp Securities Limited and others.[109]

13.76 In ASIC's estimation:

> Where a responsible entity of a forestry scheme is reliant on scheme sales for a substantial part of revenue for working capital, an interruption to scheme sales revenue could have significant implications for the responsible entity, and its ability to fulfil its contractual obligations owed to growers. We have seen that where scheme sales reduce suddenly, some responsible entities have not had sufficient reserves to fulfil their obligations to growers.[110]

13.77 Interestingly, in respect of the commercial soundness of MIS, Justice Judd found in December 2010 that:

> Wherever ultimate responsibility for the collapses may reside, it is difficult to overlook structural flaws in the design and regulation of managed investment schemes. These flaws facilitated investment strategies, management practices and decisions, regulatory attitudes and revenue

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107 *Proof Committee Hansard*, 6 August 2015, pp. 32–33.

108 ASIC, Submission to the Parliamentary Joint Committee on Corporations and Financial Services' *Inquiry into Agribusiness Managed Investment Schemes*, July 2009, paragraphs 89–90.

109 *Submission 34*, paragraph 9.

110 *Submission 34*, paragraph 53.

> policies which together conspired to cause huge financial loss to investors, the revenue, banks and other financial institutions, and the communities in which the schemes were operated.
>
> Whenever an enterprise is designed and structured to depend upon third party financing of 'tax effective' investment as its primary source of revenue, failure is almost inevitable. The generation of such revenue can become the substitute business, with the primary production activity a mere adjunct, undertaken in order to satisfy criteria for the deductibility of invested funds. Such managed investment schemes should not be mistaken for real businesses.[111]

13.78 As noted earlier, investors assumed that their funds were to be used for their particular scheme, but this was not necessarily the case where the RE operated a number of MIS. A reliance on new schemes to subsidise, or in effect underwrite, earlier schemes where performance was below expectations showed a clear weakness in the MIS model. This arrangement not only exposed the MIS to cash flow problems and eventual failure but was inherently unfair to the newer investors whose interests were compromised by preferring the interests of earlier investors—not all investors were being treated equally.

Conclusion

13.79 There was not one single cause that led to the collapse of some high profile agribusiness MIS. A range of factors combined that made some of these schemes a high risk venture and prone to failure. They included high upfront costs—generous commissions to financial advisers, funds diverted from operation expenses into the general working capital of the parent company, excessive overspending on corporate overheads and marketing—poor management decisions regarding the planting and location of the schemes, a business structure that depended on new sales for cash flow, and the lag time between initial investment and dividends.

13.80 There is a compelling argument that such schemes should not have been marketed to retail investors. The committee finds it difficult to justify the expenses involved in some but not all schemes—overspending on commissions, administration and marketing. Indeed, it would appear that investors paid way too much for their agribusiness plot and too little of their initial outlay went on productive expenditure. Also, despite the suggested improvements in silvicultural practices and seedling genetics, the discrepancy between the projected rates of return and the actual yields cannot be ignored.

13.81 In the following chapter, the committee looks at the marketing and selling of high risk products to retail investors.

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111 Environinvest Ltd (No 4) [2010] VSC 549 (8 December 2010) [2]–[3]. Environinvest was an unlisted public company that promoted and managed investment schemes, including the establishment and management of eucalyptus plantations, in which members of the public were invited to participate.