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Clarifying the treatment of trusts under insolvency law

1 Introduction

1 This submission responds to the consultation paper published by the Commonwealth Treasury (***Treasury***) on 15 October 2021 entitled *Clarifying the treatment of trusts under insolvency law* (***Consultation Paper***).

2 As one of the largest restructuring and insolvency practices in Australia, Allens has significant experience in advising financial institutions, insolvency practitioners and creditors in relation to a range of corporate insolvencies involving trading trusts and managed investment schemes (***MIS***). Significantly, Allens acted for a number of stakeholders in the agribusiness MIS collapses following the Global Financial Crisis (***GFC***) including the Great Southern Group, Willmott Forests Limited, and Timbercorp Limited Group.

3 This submission employs the following structure:

(a) Section 2 makes some preliminary comments on the apparent focus of the Consultation Paper;

(b) Section 3 contains a discussion of some general concepts in relation to 'insolvent trusts'; and

(c) Section 4 contains our responses to the specific consultation questions posed by Treasury, having regard to the matters identified in Sections 2 and 3.

2 Focus of the Consultation Paper

4 Treasury has identified the treatment of trusts under corporate insolvency law as an area for improvement in the context of exploring further insolvency reforms. The Consultation Paper refers to building on the progress of the small business reforms implemented on 1 January 2021, '*ensuring more companies can benefit from improvements to insolvency law.*'[1] As a result, it appears that Treasury is focused on small business trading trusts, which constitute the majority of trading trusts in Australia.

[1] Treasury, *Clarifying the Treatment of Trusts under Insolvency Law* (Consultation Paper, 15 October 2021) 2 (***Consultation Paper***).

5 Recent data from the Australian Taxation Office (***ATO***) discloses that there were 907,914 trusts operating in Australia in the 2018-19 income year. The majority (96%) of these either reported no income or were classified as 'micro' trusts, with an income of less than $2 million. A further 26,647 trusts were classified by the ATO as 'small', reporting an income of between $2 million and $10 million.

6 However, there were also a significant number of medium to large trusts that earned income during that period. The 2018-19 taxation income data recorded the existence of 4,551 'medium' trusts with an income of between $10 and $100 million, 186 'large' trusts with an income of between $100 million and $250 million, and 60 'very large' trusts with an income in excess of $250 million.[2] While it is not possible to determine from the publicly disclosed taxation data how many of these trusts were trading trusts administered by corporate trustees, the data demonstrates that trusts are used extensively in commercial life by both small and large enterprises.

7 Accordingly, while it appears that statutory reforms clarifying the treatment of corporate trading trusts will predominantly impact micro and small trusts with corporate trustees, it is important for Treasury to bear in mind that any legislative reform also has the potential to capture sophisticated funds structured as trusts with significant equity under management. These include registered management investment schemes (***RMIS***), real estate investment trusts (***REITs***) and superannuation trusts which pool investor funds for investment. As at 30 September 2021, managed investment trusts (***MITs***) (including superannuation funds) represented $4,390.3 billion funds under management.[3]

8 Large scale investment funds commonly feature complicated structures that combine elements of company, trust and contract law, which increases the complexity of legal issues arising n insolvency and winding up. They may be actively managed, or constitute passive investments. In the case of REITs, it is common for entities to be stapled, meaning that the securities of two or more entities can only be traded together (eg, one unit in a trust with one share in a company).

9 Further, in the case of large investment funds, it is common for the corporate trustee (which is often a professional provider of trustee services) to act as trustee of multiple trusts. Accordingly, in implementing any statutory reforms, it is important to avoid treating the financial circumstances of a particular trust as the same as the financial circumstances of its trustee (even though this may often be the case in practice for small trading trusts). This takes us to the next preliminary issue.

3 The concept of an 'insolvent trust'

10 Modern commercial 'trading trusts' often function similarly to a corporation. They are capable of operating a business under an ABN, incurring tax liabilities, entering into commercial transactions conducted in the name of the corporate trustee, incurring significant debts, and raising funding from investors who obtain a unitholding or proportional interest in the equity of the trust property.

11 However, a trust is not a legal entity. Rather, as the Consultation Paper states, it is a set of obligations and duties imposed on a person or a company acting as a trustee in respect of property held on behalf of the beneficiaries of the trust.[4] Accordingly, a person or an entity who acts as a trustee is personally liable for all debts and liabilities incurred in operating the business on behalf of

[2] We note that the publicly available taxation data does not distinguish between individual and corporate trustees and fund managers. See further 'Trust Statistics', Australian Taxation Office (Database, 8 September 2021) <https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Taxation-statistics/Taxation-statistics-2018-19/?page=10>. However, the Consultation Paper states that taxation data from 2018-19 shows that there were over 630,000 trusts with a corporate trustee, and that around 313,000 of these trusts were 'trading trusts'.

[3] Managed Funds, Australia, *Australian Bureau of Statistics* (Web Page) <https://www.abs.gov.au/statistics/economy/finance/managed-funds-australia/latest-release>.

[4] Consultation Paper (n 1) 4.

the corporate trading trust.[5] For this reason, it is commonplace to incorporate a company with nominal capital to act as a trustee to limit this liability.

12 Accordingly, while a trustee or a responsible entity may become insolvent, it is a legal fiction to refer to an 'insolvent trust' or an 'insolvent RMIS'[6] within the meaning of the *Corporations Act 2001* (Cth) (the ***Act***) (notwithstanding that the courts have accepted the use of this nomenclature in the context of applications involving the winding up of RMIS under Chapter 5C of the Act).[7]

13 The expression 'insolvent trust' intermingles two distinct concepts: the separate legal personhood of the corporate trustee holding the assets on trust, and the economic entity that is the trust fund or scheme. The current statutory framework only recognises the corporate trustee in the context of an insolvent winding up, and it is only when the corporate trustee becomes insolvent that the provisions of Chapter 5 of the Act are enlivened.

14 A trust or a scheme cannot itself be placed into voluntary administration or liquidation under the Act.[8] The expression 'insolvent trust' is a convenient shorthand that has been understood to refer to a financially unviable trust fund or scheme. When considered this way, insolvency in the context of a corporate trading trust may play out in a number of different ways (adopting the taxonomy and descriptions developed by Dr Nuncio D'Angelo[9]):

(a) **an insolvent corporate trustee and an insolvent (financially unviable) trust fund**: the corporate trustee is insolvent and the trust fund is not viable in the sense that the trustee is not able to discharge trust debts and meet trust liabilities as and when they fall due from the trust income or assets. For example, the trust income from the operating activities of the trust is insufficient to pay the operating expenses of the business conducted by the trust. This scenario appears to be the primary focus of the Consultation Paper (***Scenario One***);

(b) **an insolvent corporate trustee but a solvent (financially viable) trust fund**: the corporate trustee is insolvent, but the debts and liabilities that it is has incurred as trustee can be fully met from the trust fund assets (***Scenario Two***); and

(c) **a solvent corporate trustee but an insolvent (financially unviable) trust fund:** the trust assets are insufficient to meet the trust debts incurred in the operation of the trust business. However, the corporate trustee has effective limitations of liability in place,[10] and it remains able to pay debts incurred in its personal (rather than trustee) capacity as and when they fall due. As Dr D'Angelo notes, a trustee cannot be insolvent in its capacity as a trustee while being solvent in its personal capacity (or vice versa).[11] (***Scenario Three***).

15 In responding to the Consultation Questions, we emphasise that it is important to draw a distinction between the legal entity, being the corporate trustee and the economic entity, being the trust, scheme or fund.

16 We support legislative reform focussed on insolvent corporate trustees in order to clarify (among other things):

(a) the powers of external administrators appointed to insolvent corporate trustees to administer and sell trust assets;

(b) the circumstances in which an insolvent company may be removed as trustee of the trust; and

[5] Australian Law Reform Commission, *General Insolvency Inquiry* (Report No 45, 1988) (the ***Harmer Report***) 108.
[6] Nuncio D'Angelo, 'When Is a Trustee or Responsible Entity Insolvent? Can a Trust or Managed Investment Scheme Be "Insolvent"?' (2011) 39 *Australian Business Law Review* 95, 95.
[7] Ibid 97.
[8] Ibid 101.
[9] Ibid 103–104.
[10] Namely, the trust creditors' recourse against the trustee is limited to the extent of the trustee's indemnity against the trust fund.
[11] D'Angelo (n 6) 101.

(c) the priority of trust and non-trust (or different-trust) creditors, and the appropriate principles to be applied in distributing trust property to creditors.

17 However, in our view, Treasury would need to carefully consider whether there should be a comprehensive statutory winding up regime for 'insolvent trusts' as distinct economic entities. This would be a substantial change to the existing law which generally requires the trustee to wind up such trusts having regard to the provisions of the relevant trust deed or constitution.

18 We acknowledge that there may be benefits in having an express, consistent winding up regime for 'insolvent trusts' particularly in complex cases, having regard to the legal and operational issues arising from the agribusiness RMIS insolvencies following the GFC. However, the impacts of such a change may be far-reaching and we consider there ought to be broader consultation, particularly with fund managers, fund lawyers and other sector participants, before proposing any draft legislation to this effect.

4 Response to the Consultation Questions

19 Our response to the specific Consultation Questions posed by Treasury are set out below.

Consultation Question	Response
Question 1: *Should the corporate insolvency framework be amended so that it expressly provides for the external administration of insolvent trusts with a corporate trustee? If so, what external administration processes should the amendments apply to?*	The question as phrased raises the prospect of both an insolvent corporate trustee and an insolvent trust as a distinct economic entity. We have addressed each scenario in turn. ***Insolvent trustee*** The corporate insolvency framework should be amended so that it expressly addresses issues that commonly arise in the context of the external administration of a corporate trustee. Those issues include (among other things): (a) the powers of external administrators appointed to insolvent corporate trustees to administer and sell trust assets and exercise trust powers, including carrying on any business; (b) the right of the external administrator to be paid its remuneration and expenses from trust assets, and whether any priority exists between the external administrator's personal remuneration and its right of indemnity in respect of unpaid trust debts (that indemnity being the only source of recourse for trust creditors); (c) the circumstances in which an insolvent company may be removed as trustee of the trust or stripped of its powers; (d) in the case of the replacement of a trustee, the respective rights of recoupment and reimbursement and control of trust assets of the former trustee and the replacement trustee;[12]

[12] Diccon Loxton, 'In with the Old, Out with the New? The Rights of a Replaced Trustee Against its Successor, and the Characterisation of Trustees' Proprietary Rights of Indemnity' (2017) 45 *Australian Business Law Review* 285.
The difficulties that arise in this context are illustrated in the decision of *Pitard Consortium Pty Ltd v Les Denny Pty Ltd* [2019] VSC 614, which considered whether a former trustee's equitable lien conferred a right of possession of trust property as against a new trustee. Justice McDonald acknowledged there was conflicting authority on this point, ultimately holding that the plaintiff companies, being the replacement corporate trustees, were entitled to an order vesting trustee property. However, the orders were subject to:

Consultation Question	Response
	(e) the priority of trust and non-trust (or different-trust) creditors, and the appropriate principles to be applied in distributing trust property to creditors; (f) the circumstances in which trust property is to be regarded as 'property of the company' for the purposes of certain insolvency provisions of the Act; (g) the ability of secured creditors with security over the whole or substantially the whole of trust assets to enforce that security interest despite the appointment of voluntary administrators to the trustee or the ipso facto provisions of the Act; (h) the treatment of exclusion or exoneration clauses in trust deeds in the event of the insolvency of the corporate trustee, and whether those clauses should be void against the external administrator; (i) the priority of duties of an external administrator appointed to a corporate trustee, noting the administrator's statutory and fiduciary duties to the general creditors of the corporate trustee, their general law duties to the trust creditors and the beneficiaries of the trust, and the administrator's personal interest in having their remuneration met from trust property; and (j) the applicability of the voidable transaction regime to transactions conducted by a corporate trustee acting in its trustee capacity. Further, it should also be made clear that, in the voluntary administration of a corporate trustee, a deed of company arrangement can be used to restructure trust assets and trust creditors with respect to a particular trust and/or with respect to any non-trust assets and creditors who have recourse to those non-trust assets. ***'Insolvent trust'*** We consider that the corporate insolvency framework should not be extended to 'insolvent trusts' as a distinct economic entity (as opposed to insolvent trustees) without first engaging in broader consultation given that this would represent a significant departure from the existing law, which would require broad-based input from stakeholders. There may be benefits in having an express regime that creates a statutory procedure for the winding up or administration of an 'insolvent trust' given that the procedures contained in the

(a) the former corporate trustees' equitable liens in respect of liabilities for which they were entitled to be indemnified; and (b) undertakings provided by the plaintiffs to the defendants which ensured that the value of the trust property would not be diminished.

Consultation Question	Response
	constituent trust documents are frequently inadequate in this regard. This was particularly evident following the GFC and the collapse of a number of agribusiness RMIS. While the court has the power to direct a responsible entity where it 'thinks it is just and equitable to do so', there is no express power to wind up an insolvent scheme in the Act.[13] Further, the relevant provisions contained in Part 5C.9 of the Act are broad and partly depend on the adequacy of the winding up provisions contained in the MIS constitution.[14] It would also be necessary to consider how the provisions in Part 5C.9 in respect of the winding up of a MIS would interact with the comprehensive powers of external administration contained in Chapter 5 of the Act, which have wide application. We note that the Corporations and Markets Advisory Committee has given detailed consideration to these issues in the context of financially distressed MIS in their 2012 report and 2014 discussion paper.[15] In practice, our experience is that the majority of insolvencies involving trusts have to date fallen within Scenario One (insolvent trustee and 'insolvent trust'), rather than Scenario Three (solvent trustee and 'insolvent trust'). Nevertheless it is conceivable that Scenario Three may become more common as professional trustees and responsible entities engage in risk-taking activities or borrow funds in accordance with their mandates or instructions., In those circumstances, the particular trusts may become 'insolvent' however, due to limitation of liability clauses, the trustee or responsible entity is not insolvent. In our experience, all professional trustees and responsible entities vigorously and rigorously insist on having such clauses in all contracts that they enter into in such capacities. It is also common for such professionals to act in relation to many trusts. In relation to Scenario One, we consider that the amendments proposed above will address most issues that arise in insolvencies relating to trusts without creating additional complexities or conflicts that might arise if there were to be separate but concurrent insolvency administrations of both the trustee and the 'trust'. For example, if there were to be concurrent regimes, it would be necessary to consider issues such as the following: • assuming trust creditors participate and prove directly in the 'trust insolvency', does this mean that they no longer have

[13] See further the discussion in Nuncio D'Angelo, *Transacting with Trusts and Trustees* (LexisNexis, 2020) [10.62]–[10.81], and sections 601NA, 601ND and 601NF of the *Corporations Act 2001* (Cth). The courts have considered that insolvency is a valid reason to order the winding up of a MIS on the 'just and equitable' ground contained in s 601ND(1)(a) of the *Corporations Act 2001* (Cth).

[14] For example, section 601NF(1) provides only that:

> The Court may, by order, appoint a person to take responsibility for ensuring a registered scheme is wound up in accordance with its constitution and any orders under subsection (2) if the Court thinks it necessary to do so (including for the reason that the responsible entity has ceased to exist or is not properly discharging its obligations in relation to the winding up).

[15] Corporations and Markets Advisory Committee (***CAMAC***), *Management Investment Schemes* (Report, July 2012) ch 7; CAMAC, *The Establishment and Operation of Managed Investment Schemes* (Discussion Paper, March 2014).

Consultation Question	Response
	rights against the trustee (except to the extent they have personal claims against the trustee if any after limitation of liability clauses), and that the trustee no longer holds its right of indemnity in respect of its right of exoneration but would continue to hold its right of indemnity in respect of its right of reimbursement? Further, would the trustee have to prove for that claim in the 'trust insolvency' and would its claim have priority? • should the same or different external administrators be appointed to the trustee and the 'trust' and how should any conflicts be managed? However, in the case of Scenario Three, as noted above, we acknowledge that there may be benefits in having an express regime for the winding up or administration of 'insolvent trusts', including the availability of deeds of company arrangement as a restructuring mechanism.
Question 2: *What benefits would a legislative framework deliver?*	A legislative framework governing the external administration of insolvent corporate trustees would provide clarity and certainty for key stakeholders including insolvency practitioners, trust creditors, trust beneficiaries, employees and trade suppliers. It would also reduce the need for court applications (eg, in relation to the distribution of trust funds and the relative priority of trust, non-trust and different trust creditors or appointing the company's liquidator as a receiver of trust assets), thereby preserving the trust funds available for distribution to creditors and (to the extent that there are surplus funds) to beneficiaries. In the absence of an express legislative framework, courts have often struggled to provide clear and consistent guidance in this area, which often does not find direct analogy in company law.
Question 3: *Is there potential for detrimental or unforeseen impacts if the statutory regime is extended?*	Given the complexity of the subject matter and the range of trust structures that could potentially be caught by any amended legislation, stakeholders need an adequate consultation period and sufficient time with the draft legislation before any reforms are implemented. For example, as described in our answer to Question 8 below, there are numerous considerations and potential drafting complexities in implementing a new statutory priority regime for trust and non-trust creditors, which is only one element of the reforms that are proposed. The outcome of the consideration of these priority issues will impact, not only the procedures for the external administration of a trustee, but also potentially the risk profile for investors in and

Consultation Question	Response
	financiers of trusts, such as MITs, RMIS and REITS (particularly where multiple trusts are administered by a single trustee).
Question 4: *Should legislation expressly set out when a trust is deemed to be insolvent?*	The answer to this question depends on whether the proposed legislative reforms will extend only to insolvent corporate trustees, or also to 'insolvent trusts' as separate economic entities. In the case of the former option, we do not consider that a definition is required. In the case of the latter option, a definition will be necessary. This is because under the general law, a trust cannot be or become insolvent as it does not have separate legal personhood. A statutory definition will be necessary to establish uniformly when a trust, as an economic entity, is considered to be insolvent.
Question 5: *What is the most appropriate way to prescribe when a trust is taken to be insolvent?*	As a starting proposition, we do not support the creation of a statutory regime that treats trusts as separate economic entities in insolvency without broader consultation. If the legislative reforms only extend to insolvent corporate trustees, then we do not consider that any statutory definition or criteria is required in addition to section 95A of the Act. We consider that the reference in section 95A to payment of 'the person's debts' includes debts incurred by a corporate trustee whether in its personal capacity or in its capacity as trustee.[16] However, if the legislative reforms are intended to govern 'insolvent trusts' as a separate economic entity, it will be necessary to describe when a trust (at the fund, as opposed to trustee, level) is solvent and insolvent. To this end, we refer to our comments at paragraph 14 above, and the taxonomy set out by Dr Nuncio D'Angelo in his article, 'When Is a Trustee or Responsible Entity Insolvent? Can a Trust or Managed Investment Scheme Be "Insolvent"?'.[17] We also refer to the definition of insolvency proposed by Dr D'Angelo in *Transacting with Trusts and Trustees*,[18] which is congruent with section 95A of the Act and adopts a cash flow test of insolvency focused on the ability of the trust assets to support payment of the trust debts as and when they fall due.[19] Fundamentally, a trust fund should be considered insolvent or financially unviable (in the sense that it is endemically illiquid) when the trust assets are insufficient to meet the trust debts and liabilities as and when they fall due. This will also enable courts to draw on

[16] The extent to which trust liabilities need to be taken into account in assessing solvency can be complicated by the existence of limitation of liability clauses.
[17] D'Angelo, 'When Is a Trustee of a Responsible Entity Insolvent?' (n 6) 103–104.
[18] D'Angelo, *Transacting with Trusts and Trustees* (n 13) [10.82]–[10.93].
[19] D'Angelo, *Transacting with Trusts and Trustees* (n 13) [10.84]–[10.88].

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<tr><th>Consultation Question</th><th>Response</th></tr>
<tr><td></td><td>the extensive body of case law considering the concept of insolvency in the context of non-trustee companies.

To this end, we support the following definition proposed by Dr D'Angelo to the extent any legislative reform proposes to govern insolvent trusts:

A trust is solvent if, and only if, the trustee is able to pay all trust debts as and when they become due and payable out of trust assets and (where it is obliged to do so) its own assets.

A trust which is not solvent is insolvent.

A debt of a trustee is a 'trust debt' if the trustee is entitled to apply the assets of that trust to pay it (even if it also obliged to pay it out of its own assets), disregarding for the purposes of this definition any application of the clear accounts rule.</td></tr>
<tr><td>Question 6: Should the power of an insolvency practitioner to administer the trust assets and liabilities be expressly provided for in legislation?</td><td>Yes, subject to the following considerations.

Having regard to the scenarios described in paragraph 14:

• in the case of Scenario One, where there is an insolvent trustee and an insolvent trust, it is sensible for the same insolvency practitioner to administer the assets of the trust and to have express power to do so similar to its powers to deal with personal assets, and to exercise the corporations rights and powers as trustee (subject always to ongoing court supervision and the ability of the parties to apply to the court). This will avoid the time and expense involved in making an application to the court regarding the administration of trust assets or to have the insolvency practitioner appointed a receiver of trust assets;

• in the case of Scenario Two, where there is an insolvent trustee and a solvent trust fund, we again consider that the insolvency practitioner ought to have the power to administer the assets of the trust including the power to carry on the business and other activities of the trust so the trust can continue. However, the usual step taken by trust beneficiaries in such a scenario would be to remove the insolvent trustee and replace it with a new solvent trustee which can continue to administer the solvent trust. This raises the question of ejectment clauses, the ipso facto regime (which is discussed further below), the ability of secured creditors to enforce over the whole or substantially the whole of the trust assets, and the respective rights of recoupment and reimbursement and control of trust assets of the former trustee and the replacement trustee;

• in the case of Scenario Three, where there is a solvent corporate trustee and an 'insolvent trust', the insolvency provisions of Chapter 5 of the Act will not be triggered.</td></tr>
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Consultation Question	Response
	Rather, this scenario will involve winding up the fund in accordance with the funds' constituent documents. However, as noted in our answer to Question 1 above, these provisions are often inadequate and difficulties can result from the absence of an express statutory regime governing the termination and winding up of a trust or a scheme.
Question 7: *Should the law provide that, subject to a contrary order by a court, the same insolvency practitioner may administer both the company, and the assets and liabilities attributable to any trusts for which the company is trustee?*	Yes, see the response to Question 6 above. The law should clarify that the insolvency practitioner on behalf of the corporate trustee can administer the trust, including selling the assets of the trust and meeting the liabilities of the trust from trust property. As noted above, we do not presently propose there should be a separate regime that would treat insolvent trust funds as separate economic entities. Therefore, in terms of Scenario One (insolvent trustee and 'insolvent trust'), providing that the insolvency practitioner appointed to the corporate trustee is empowered to administer the related trust fund and exercise relevant powers, this would remove any need to enact two separate regimes (and potentially appoint two separate insolvency practitioners) in respect of both the trustee, and separately the trust fund administered by the corporate trustee.

Question 8: *Should the affairs of a trustee company and each trust it administers be resolved separately in external administration?*	As noted above, at present we only recommend provisions dealing with insolvent corporate trustees, not a separate administration regime for 'insolvent trusts'. If this were the position adopted by Treasury then it would be the same insolvency practitioner administering the affairs of the company and each trust for which it acts as trustee, albeit taking account of the separate position of trust assets and creditors.
	
	However, from the perspective of maintaining the separate *economic* interests of trusts, trustees and trust creditors, the following considerations are important (and are raised in other parts of this submission):
	
	• there should be clarification of the general view of current common law, namely confirming that:
	    • trust assets should generally only be available for priority creditors of the trustee and trust creditors to the extent of the trustee's right of exoneration;
	    • trust assets should be available for all creditors to the extent of the trustee's right of reimbursement for past expenditure as trustee and its remuneration;
	    • non-trust assets should be available for non-trust creditors and, subject to any limitation of liability clauses with particular creditors, trust creditors;

Consultation Question	Response
	• there needs to be a separate accounting for any external administrator's expenses and remuneration in dealing with trust and non-trust assets, and a regime for allocation where this cannot be done; • there needs to be clarity regarding when trust property is to be regarded as 'property of the company' for the purposes of certain insolvency provisions of the Act.
Question 9: *Should there be a statutory order of priority in the winding up of a trust?*	Again, it is necessary to distinguish between the winding up of a trust (which is raised in the question) and the winding up of a corporate trustee. In the winding up of a trust, the distribution of trust assets is generally governed by the provisions of the trust deed or constitution. As noted in the answer to Question 1, there may be benefits in having an express regime that creates a statutory procedure for the winding up or administration of an 'insolvent trust' given that the procedures contained in the constituent trust documents are frequently inadequate in this regard, and in particular do not provide any order of priority among trust creditors. However, we consider that this would require specific consultation with stakeholders, including fund managers, fund lawyers and other sector participants (to the extent that this has not already occurred). Regarding the winding up of a corporate trustee, we agree that there should be statutory clarification of the order of priority of distribution of the company's assets, including the proceeds of its right of indemnity in respect of trust assets, to creditors – that is, both trust creditors and non-trust creditors. In this respect, it is important to recognise that what is often referred to as a 'right of indemnity' is actually two separate rights: (1) a *right of reimbursement* for past expenditure by the trustee out of its own pocket; and (2) a *right of exoneration* against liabilities properly incurred as trustee. It is the right of exoneration which is for the particular benefit of trust creditors. While this issue has partly been settled by the *Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth*[20] decision, legislative reform remains necessary to address complex issues including the existence of multiple trusts with the same corporate trustee and the apportionment of costs in that circumstance (and the extension of the right of indemnity to the costs of winding up the trustee company).

[20] (2019) 268 CLR 524 (***Carter Holt***). The corporate trustee which was the subject of the *Carter Holt* decision, Amerind Pty Ltd, carried on a manufacturing and distribution business solely in its capacity as trustee of the relevant trading trust. It held no assets in its own right, and its liabilities were all incurred as trustee of the trust. Accordingly, it had only trust creditors and no general creditors, and there was only one trust to be administered, not multiple trusts . Chief Justice Kiefel, Keane and Edelman JJ acknowledged at [56]:

> This appeal was concerned only with two related issues of basic principle. Further issues may arise that need not be resolved on this appeal. For instance, questions might arise about the correct order of priority between trust creditors after payment of the priority debts. Or questions might arise about the marshalling of claims where a creditor has access to more than one fund…

<table>
<tr><th>Consultation Question</th><th>Response</th></tr>
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<tr><td>Question 10: Should a statutory order of priority replicate the regime for companies? Do additional factors need to be considered where a corporate trust structure is involved?</td><td>To the extent that the reforms are confined to the treatment of insolvent corporate trustees, we consider that it would be appropriate for any statutory order of priority enacted in respect of corporate trustees to be congruent with the current statutory order of priority for companies.

However, additional factors will need to be considered where a corporate trust structure is involved, including clarifying how any priority regime applies to trust creditors, non-trust creditors and different trust creditors. Whilst any priority regime should apply consistently to insolvent companies and insolvent corporate trustees, as far as possible each pool of assets and each class of creditors should be dealt with separately.

For example, in legislating a priority regime it would be necessary to consider (among other things):
appropriate drafting to implement or clarify the general view of the current common law, namely confirming that:
trust assets should generally only be available for priority creditors of the trustee and trust creditors to the extent of the trustee's right of exoneration;
trust assets should be available for all creditors to the extent of the trustee's right of reimbursement for past expenditure as trustee and its remuneration;
non-trust assets should be available for non-trust creditors and, subject to any limitation of liability clauses with particular creditors, trust creditors;
where there are multiple trusts or where the trustee acts in a personal and a trustee capacity, how to apportion trust creditor claims among the different trusts or capacities (where the contracting capacity is not expressly specified). For example, where employees have provided services to multiple trusts, or to the company in both its trustee and personal capacity, should the employee claims be apportioned equally across the funds, on a proportional basis, or using some other concept;
the treatment of any shortfall where the assets of one trust are inadequate to meet creditor claims, and whether those priority claims should be recoverable from other trust assets (to the extent there are multiple trusts, or trust and non-trust asset pools). Taking the above example of employee claims, if the assets of one fund are insufficient to meet the amount of the employee claims that were apportioned to that trust, should the employees suffer that loss or should they be entitled to claim on another fund?</td></tr>
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Consultation Question	Response
	Any legislative reform addressing the priority of trust creditors is also an opportunity to consider the prejudice occasioned to trust creditors when a corporate trustee acts in breach of trust and impairs its indemnity, leaving innocent trust creditors without any right of subrogation to the trustee's indemnity (and therefore no recourse to trust assets). Parliament should provide the extent to which creditors should be entitled to receive payment from the proceeds of trust assets in that circumstance.
Question 11: *Should there be additional limits on the enforceability of ejection clauses and/or clauses that seek to limit a trustee's right to indemnity, in situations involving insolvency or external administration?*	***Trustee ejectment clauses*** Trustee ejectment clauses dealing with the automatic removal or right to replace a trustee upon the occurrence of an insolvency event are not an excluded right for the purposes of the ipso facto provisions of the Act. Nor are provisions which may reduce the trustee's power to deal with trust assets and carry on business or other activities. Accordingly, any consideration of the insolvency regime to insolvent corporate trustees will need to expressly include the application of the ipso facto regimes in this context. The ipso facto provisions as currently drafted will not apply to all external administrations of corporate trustees or all trust instruments. For example, insolvent corporate trustees that go directly into liquidation and trust deeds that were executed prior to 1 July 2018 will be excluded from the existing ipso facto regime. However, we do not consider that it will necessarily be possible to have a uniform approach to the effect that trustee ejectment clauses should have no effect in all circumstances involving a trust. In both Scenario One and Scenario Two, if a corporate trustee is ejected, it becomes a bare trustee with limited power to deal with trust assets. It should retain full power to deal with trust assets and administer the trust. In Scenario One, where the trust is also insolvent, the trust assets are being effectively held for the benefit of trust creditors, and beneficiaries cease to have any real interest. Further it is highly unlikely that anyone would be willing to take it on as a replacement trustee. And even if one was, the complexities of determining the relevant position of old and new trustees would inevitably eat into the pool available for creditors. Finally all trust and non-trust assets are in the hands of the one external administrator administering the trustee corporation. We consider that, in relation to Scenario One, trustee ejectment clauses purporting to remove or limit an insolvent company as trustee should have no effect. Accordingly, the trustee should only be replaced by an order of the court or for a court to order replacement.

Consultation Question	Response
	However, the position in relation to Scenario Two is more complex. In that circumstance, while the corporate trustee is insolvent, the trust fund remains viable. The beneficiaries may want the trust to continue and want a new trustee, not one in the hands of an external administrator. Pending replacement, however, the trust needs to be administered and continue. Therefore, we suggest that in Scenario Two, the ejectment or limitation should be similarly restricted with a carve-out where a new trustee is appointed and takes over the trust. As suggested above, the position as between old and new trustees and their creditors should be clarified. In Scenario Three, where there is a solvent trustee, but an insolvent trust, the issue does not arise. ***Limitation of indemnity clauses*** We agree with the Harmer Report recommendation that clauses in a trust deed that purport to exclude a corporate trustee's right of indemnity should be void against a liquidator (but only to the extent of the right of exoneration). We also consider this recommendation should extend to limitation of liability clauses, and to other forms of insolvency practitioner including voluntary administrators and receivers and managers. A trust creditor's ability to recover from the trust assets is solely reliant on this indemnity.
Question 12: *What would be the impacts of any such limits?*	We refer to our answer in Question 11 above.
Question 13: *Are there any other issues that need to be considered in light of the questions above?*	As noted above, the corporate insolvency framework should be amended so that it expressly addresses the circumstances in which trust property is to be regarded as 'property of the company' for the purposes of certain insolvency provisions of the Act, and should generally include trust property to the extent of the right of indemnity, except as mentioned below. This will help clarify when external administrators are entitled to deal with and sell trust assets, which should remove the need for external administrators to approach the court for directions in this regard. It would also help clarify the operation of other important provisions of the Act, for example whether trust property is to be taken into account when determining whether a secured creditor holds security over the whole or substantially the whole of the corporate trustee's property for the purposes of section 441A of the Act and the ipso facto provisions. In this regard, we consider that trust assets should be included when considering the extent of a secured creditor's security.

Consultation Question	Response
	However, we also consider that a secured creditor should be able to enforce its rights in respect of trust property where either: • the corporation's business is being a trustee and the secured creditor can carry on that business upon enforcement; or • the secured creditor holds security over all or substantially all of the trust assets of a particular trust. It is common for such security to be taken, and as a policy matter, the secured creditor should be able to take over that particular trust's business (even where the secured creditor may not hold security over all or substantially all of the corporate trustee's assets, for example where the corporate trustee has significant personal assets, or where it is the corporate trustee of multiple trusts).
Question 14: *What is the most appropriate model by which a statutory regime could be expressed in the legislation?*	The reforms should be confined to the treatment of insolvent corporate trustees. We do not support the creation of a new regime that would treat trust funds as separate economic entities without further consideration, except as stated above. Any amendments addressing the position of insolvent corporate trustees should be made to the existing regime contained in Chapter 5 the Act. Ideally this would be in the form of amendments to existing sections and, to the extent necessary, the introduction of a new Division, but not the creation of separate schedules or rules.

We would welcome the opportunity to discuss the matters raised in this submission further. If you have any queries, please contact Matthew Whittle or Lucinda O'Dwyer.

Yours sincerely

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