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Dear Sir/ Madam,

Consultation: Clarifying the treatment of corporate trusts in insolvency

1. I am a practising barrister in New South Wales, having been called to the bar in 1997, and also senior lecturer at the University of Technology Sydney and in January 2022 I will relocate to Faculty of Law at the University of New South Wales. My practice, teaching and research expertise is in the field of equity and trusts and commercial law. I have a longstanding interest in both the doctrinal trusts law issues and questions of statutory interpretation of the Corporations Act that arise in relation to the commercial use of trusts under Australian law. I have published a number of academic articles[1] and presented at conferences and academic colloquia in relation to some of the matters the subject of this Consultation.

2. I make this submission on my own behalf and not on behalf of any institution or client. This submission is structured to respond broadly to the issues the subject of the Consultation Paper. In the **Summary and Recommendations** at para [65] below, specific answers to the Consultation Questions are offered where relevant to the content of the submission.

3. Before considering the issues raised in the questions, I note the following by way of context and general introduction to my view on the need for legislative reform.

Context to the insolvency of trading trusts

4. The trading trust operates through a corporate entity as trustee that rarely owns any assets beneficially. The wealth-generating asset pool that underpins the business of a trading trust is held on trust, so is *not* "property of the company" in this usual sense. It is well known that property held on trust does not form part of the "property of the company" within the meaning of the Act, despite the fact that the width of the definition of "property" in s 9 could in theory extend to it.[2] It is property owned legally but held for the benefit of

[1] Allison Silink, 'The Trustee's Indemnity as "Property of the Company" under the Corporations Act 2001(Cth): *Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth*' (2019) 30 *Journal of Banking and Finance Law and Practice* 272; Allison Silink, 'Trustee exoneration from trust assets – Out on a Limb? The tension between creditor expectations and the 'clear accounts rule' (2018) 12 *Journal of Equity* 58.

[2] In *Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth* (2019) 93 ALJR 807; [2019] HCA 20 ("*Amerind*") Kiefel CJ, Keane and Edelman JJ confirmed at [26]-[27] that trust assets are generally excluded from the statutory concepts of property of the company. The exclusion enshrined in express statutory provisions to this effect in s 116(2)(a) of the Bankruptcy Act 1966 (Cth), "applies by undisputed analogy in the case of corporations". Their Honours explained that the reason for this is that the liquidator's powers over property for the purposes of statutory distribution had always been concerned with "only those rights that 'enure in law' for the benefit of the 'personal estate' of the bankrupt or insolvent person". As the trustee "does not generally have any entitlement to deal with the rights held on trust for the trustee's own benefit", it follows that "rights held on trust were, and are, generally excluded from inclusion in the statutory concepts of the 'property' of the bankrupt or the 'property' of the insolvent company".

others and the company as trustee is subject to equitable obligations in its management and distribution.

5. The trustee's only proprietary interest in those assets is its equitable lien over them to the extent of its *right of indemnity*.[3] However it is misleading to speak of the trustee's proprietary interest in respect of its "right of indemnity" without recognising that the proprietary interest comprises two very different types of interest for insolvency purposes.

   5.1. *Right of recoupment:* The trustee has a proprietary interest in trust assets in respect of its right of *recoupment* to reimburse itself for trust liabilities that it has paid from its own pocket. These are funds that, once in the corporate trustee's hands, are unquestionably "property of the company" within the meaning of the Act. They are funds to which it is entitled beneficially; funds that it can freely (outside of insolvency) use for its own purposes, and are therefore available to be pooled for distribution its general unsecured creditors.

   5.2. *Right of exoneration:* The trustee also has a proprietary interest in trust assets in respect of its right of *exoneration* – to access trust funds or assets to pay to trust creditors in the discharge of unpaid, properly incured trust liabilities which the trustee has incurred personally in its capacity as the trustee of the trust ("property in respect of exoneration"). "Property in respect of exoneration" will never be available to the trustee to use for itself and so never bears the same character as "property of the company" that in insolvency is available for its general unsecured creditors. It can only accessed to be applied directly to the trust creditors. The value of these outstanding trust debts delimits the scope of the trustee's proprietary interest in respect of exoneration.

6. It is here that terminology and definitions can be fraught. Yes, the trustee's interest in trust assets in respect of the exoneration right is "*proprietary*": the cases have long acknowledged the trustee's lien as an equitable proprietary interest. But it is also well recognised that this proprietary interest is a uniquely limited form of proprietary interest. Crucially for insolvency purposes, it lacks the usual indicia of property which mean that, in the trustee's hands, the trustee would be entitled to use it, dispose of it, exclude others or retain it for its own purposes. Trust creditors have equitable rights of subrogation to this property. The acknowledged consequence is that these funds cannot be mixed with funds for distribution to general unsecured creditors of the company. Equitable principle, as confirmed by the High Court recently in *Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth* ("*Amerind*"),[4] demands that these funds are kept separate and available for trust creditors only.

7. As discussed below, because of these fundamental differences in the nature of the property the subject of the right of exoneration as compared with property of the company which it is free to use for its own purposes, the existing insolvency framework cannot (or cannot clearly) apply to property in respect of the right of exoneration. The only present alternative is in Equity, which does provide its own procedure for distribution to trust creditors.[5] However, Equity does not provide anything resembling the detailed statutory regime and procedures for the insolvency of corporate trustees, despite the fact that trusts are now being used on a wide scale as risk-taking commercial entities that are as prone to financial distress or failure as any other corporate entity.

8. There is widespread agreement that liquidators of companies acting as trustees of trading trusts *should* be in a position to manage the liquidation of a trust of which a company is

[3] There are many authorities discussing the nature of the trustee's right of indemnity but High Court authority includes *Octavo Investments Pty Ltd v Knight* (1979) 144 CLR 360; *Chief Commissioner of Stamp Duties (NSW) v Buckle* (1998) 192 CLR 226, 246 [50]; [1998] HCA 4; *Bruton Holdings Pty Ltd (in liq) v Federal Commissioner of Taxation* (2009) 239 CLR 346, 358–359; [2009] HCA 32. *Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth* (2019) 93 ALJR 807.

[4] *Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth* (2019) 93 ALJR 807; [2019] HCA 20.

[5] See for example, *Re Independent Contractor Services (Aust) Pty Ltd (in liq) (No 2)* (2016) 305 FLR 222, [25]; [2016] NSWSC 106.

trustee just as efficiently as the winding up of the company in its own right, and that priority creditors should be recognised in respect of the distribution of property in respect of the right of exoneration. However, the machinery is not presently there to do so under the provisions of Chapter 5.

9. The reason for this is probably explicable from the history of the introduction of insolvency law and in particular the introduction in the late nineteenth century of provisions recognising the priority of certain general unsecured creditors over the holder of a floating charge over the pool that would, but for the priority provisions, "scoop the pool" and prevent recovery by general unsecured creditors.[6] Comparable provisions were adopted in Australian companies legislation but despite amendment from time to time, they remain in substantially similar form to their initial enactment. These were enacted long before trading trusts began to be used in Australia from the 1970's giving rise to issues with respect to the rights of trust creditors as a separate class of creditor.

10. In the absence of dedicated reform to address trading trusts, courts have had to deal with many applications from creditors, receivers and managers and liquidators seeking guidance and resolution on matters of process and procedure, and clarification of substantive rights and obligations arising in the context of the liquidation or receivership of a corporate trustee. These have principally concerned whether or how the insolvency provisions of the *Corporations Act* can be applied to the circumstances of an insolvent corporate trustee.

11. The opportunity that this Consultation now provides for consideration of legislative reform to address the insolvency of trading trusts is welcomed by many, including this author.

The Consultation

12. The Consultation Paper notes that "[r]eforms to clarify the treatment of trusts under Australia's insolvency regime could help to reduce the cost and complexities associated with dealing with an insolvent business where a corporate trust is involved."

Would reforms achieve saving in cost and complexity?

13. There can be no question that reforms specifically directed to insolvent corporate trustees would achieve this. The present cost and complexity in dealing with the insolvency of corporate trustees is significant, burdensome and often wasteful of both scarce assets left to a corporate trustee in financial distress, and of creditor resources.

14. One example suffices to illustrate the difficulties with the present uncertainty as to whether, or how, the insolvency of a corporate trustee can be addressed under existing Corporations Law insolvency provisions. In *Re Enhill Pty Ltd*[7] in the context of an application for recovery of the liquidator's costs, expenses and entitlement to remuneration incurred in the winding up of the company, Lush J in the course of his reasons stated that 'the trustee's right of indemnity or lien is part of his "personal property"[8] and opined further that '[t]here is no reason of general application why this property should not, in the hands of the trustee in bankruptcy, be available to all creditors, both personal and trust.'[9]

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6 See discussion in *Korda v Silkchime Pty Ltd* (2010) 243 FLR 269, 279 [45]–[46]; [2010] WASC 155. *The Joint Stock Companies Act* 1844 (6 Geo IV, c 16) incorporated company that registered under its provisions, and then the Winding-Up Act of the same year regulated their winding up. However, following the result in *Salomon v Salomon & Co Ltd* [1896] UKHL 1, [1897] AC 22, the *Preferential Payments in Bankruptcy (AmeI s ndment) Act 1897* (UK) was enacted to provide that in the winding up of any company, certain preferential payments should, so far as the assets of the company available for distribution may be insufficient to meet them, have priority over the claims of holders of debentures under any floating charge created by the company, and shall be paid accordingly out of any property comprised in or subject to such charge. Australian statutory insolvency provisions which also descend from the same origin, presently embodied in ss 433(3) and 561 of the *Corporations Act*, have retained this priority for the claims of certain general creditors over the holder of a floating charge.

7 [1983] VR 561.

8 At 569.

9 Ibid 570.

15. Whilst the outcome addressed the practical difficulties facing a liquidator of an insolvent corporate trustee, this reasoning flew in the face of trust law under which the trustee's right of indemnity, to the extent of its right of exoneration from trust assets, is only available to it to pay trust creditors, not to augment its personal estate.

16. This decision gave rise to 35 years' worth of repeated applications to the court and challenges to the decision. Over 30 cases were litigated directly concerning the issues directly in the proceedings and legal databases record 56 cases that considered it prior to it culminating in complex and protracted litigation up to the High Court to resolve it in *Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth* ("Amerind").[10] In *Amerind* the High Court confirmed that property in respect of the trustee's right of exoneration cannot be made available to general unsecured creditors, holding *Re Enhill* to have been wrongly decided.

17. This substantial cost in legal advice and litigation, and unnecessary complexity in winding up could have been avoided entirely. The same year that *Re Enhill* was decided, 1983, terms of reference were given to the Australian Law Reform Commission on general issues relating to insolvency.[11] The ALRC's final report (Harmer Report)[12] made specific recommendations to deal with the very question that had been the subject of *Re Enhill* and *Amerind*. The Harmer Report recommended that company and trust property be kept separate and provided for an order of distribution from trust proceeds that included costs of the winding up to the extent that the assets of the company were insufficient.[13] Had the recommendations of the Harmer Report been enacted at the time, *Amerind* would never have been heard.

18. This is but one example. There are numerous other issues that have added cost and complexity to the winding up of a company that acts as trustee, including:

    18.1. applications to courts to clarify liquidators' powers sell trust property without the necessity of an application to court to be appointed as receiver of trust property of which the company is trustee,

    18.2. the extent to which provisions of the Act dealing with voidable payments apply to payments to trust creditors,

    18.3. the operation of so-called 'ejection clauses' where a trustee is removed and rights of the trustee to trust assets are more difficult to assert, and

    18.4. payment of liquidator's costs and remuneration.

19. It is respectfully submitted that the case for legislative change was already made by the Harmer Report in 1988. The issues referred to above are all aspects of the case made in that Report. The legislature has now been alive to the popularity of trading trusts as a commercial entity and to the unique issues that arise in their insolvency, for over three decades. Those issues remain as important now as they were then - if not more so, given the continued increase in the use of the trust for commercial purposes. Evans notes that in 2015-16, business income derived through trusts (over $368 billion) was *16.78 times* the 1989-90 trading trust income (over $22 billion) at the time the Harmer Report made its recommendations.[14]

20. The Australian trading trust has flourished with legislative sanction. At the heart of its rise since the 1970's have been unique tax advantages for taxation of trusts by comparison

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[10] *Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth* (2019) 93 ALJR 807; [2019] HCA 20.

[11] The Australian Law Reform Commission Discussion Paper No 32, 1987 Chapter 5 headed 'Corporate Trading Trusts' at [168]-[192] addressed this very question in relation to insolvent corporate trading trusts. The Law Reform Commission Report No 45 ("the Harmer Report") published the following year, made recommendations in very similar terms for legislative reform.

[12] The Law Reform Commission Report No 45, Commonwealth of Australia, 1988. ("the Harmer Report")

[13] Harmer Report, 117 at [265].

[14] Alex C Evans, 'Why We Use Private Trusts in Australia: The Income Tax Dimension Explained' (2019) 41 *Sydney Law Review* 217, 231.

with corporate taxation[15] that are not replicated in other common law countries. At all times it has been a policy decision for the legislature whether to condone this practice or restrict it through taxation legislation reform. Exactly 40 years ago, in 1981, Needham J observed that trading trusts were "no doubt entered into for taxation purposes" and questioned whether they "should be allowed to exist."[16] However, over half a century has passed since the rising use of trading trusts came onto the legislative radar and the legitimate taxation benefits available that sustain it remain in place with Government imprimatur.[17]

21. The trading trust is now deeply entrenched in both taxation law principles and practice, and in commercial practice. On current estimates, the Australian Taxation Office predicts that by 2022, over 1 million trusts will exist in Australia.[18] Of course, not all of these are trusts that trade. However, ATO statistics for the 2013-14 year confirm that based on that data, 73.2% of trusts in Australia are discretionary trusts that are engaged in either trading or investment activities, and 32.6% are classed as "trading trusts" engaged in business activities other than operating as investment vehicles.[19] Presently, trading trusts have more presence in taxation law[20] than under corporations law. "Trading trust" is a defined term under taxation law but not the *Corporations Act*. The ATO website currently notes that trusts are used "as a vehicle for business, investment and estate planning by various segments of Australian society", making this vehicle "*a defining feature* of the Australian economy." Yet there is no regime to manage their financial distress or insolvency when it occurs.[21]

Why legislative reform to the insolvency provisions of Corporations Act to provide for property in respect of a right of exoneration is necessary

22. The difference in the structure and operation of a trust as compared to a company, and the unique nature of the trustee's proprietary rights to trust assets in respect of its right of exoneration mean, in my view, that the existing provisions of chapter 5 of the Corporations Act cannot adequately address their insolvency. Consequently, legislative reform is

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[15] Trust income is not taxed at the trust level as a company is taxed, but in the beneficiary's hands, so at the marginal tax rate that applies to the beneficiary. Additionally, there is discounted capital gains treatment for trusts, and a further advantage in the treatment of franking credits that flow through to the beneficiary who is entitled to be refunded the difference between the level of company tax paid and the tax threshold of the beneficiary. Evans has noted that the rise of trust may be explained in the context of disadvantageous tax settings in the 70's and early 80's for private companies, including the fact that prior to the introduction of dividend imputation in 1987, private company income was taxed twice, and that private companies were subject to undistributed profits tax to prevent companies being used as a tax shelter, which most likely contributed to strategic advice to look at alternative structures like the trading trust. Even after the introduction of imputation, there were ongoing tax advantages to the trust: see Alex C Evans, 'Why We Use Private Trusts in Australia: The Income Tax Dimension Explained' (2019) 41 *Sydney Law Review* 217, 237-241.

[16] *Re Byrne Australia Pty Ltd* (1981) 1 NSWLR 394, 399.

[17] The Treasury Consultation Paper '*Modernising the taxation of trust income - options for reform*' published in November 2011, observed that, 'The Government is updating and rewriting the trust income tax provisions to increase certainty and reduce compliance costs for the many hundreds of thousands of taxpayers that use trusts. This is not a 'crack down' on the use of trusts. The Government considers that, where used appropriately, trusts are a legitimate structure through which Australians should be able to conduct their personal and business affairs — not a form of tax avoidance.' The statement by then Assistant Treasurer Bill Shorten noted that the consultation paper, '…also highlights a number of options for reform which will ensure that businesses and individuals can continue to use trusts, with confidence that the tax outcomes applying to their circumstances are fair and consistent, whilst ensuring the community that the use of trusts does not provide inappropriate opportunities to manipulate tax outcomes.'

[18] https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/General-research/Current-issues-with-trusts-and-the-tax-system/?anchor=fnb1-ref#fnb1-ref citing RMIT Report Executive Summary

[19] Statistics used in the report commissioned by the ATO from RMIT *Current Issues with Trusts and the Tax System* published in 2019 RMIT Report, 20. See definition of "trading trust" in s 102M of the Income Tax Assessment Act 1936.

[20] In particular the trust income tax provisions in Division 6 of Part III of the *Income Tax Assessment Act* 1936

[21] In 2019, the Australian Tax Office conducted an inquiry into taxation issues relating to trusts, particularly examining avoidance issues: Associate Professor Ashton da Silva, Professor John Glover, Dr Venkateshwaran Narayan, Dr My Nguyen, Associate Professor Kate Westberg, RMIT University, '*Current Issues with Trusts and the Tax System: Examining the operation and performance of the tax system in relation to trusts, with a particular focus on discretionary trusts linked to high net worth individuals'(2019) ("RMIT Report"), That research paper noted that the number of trusts grew by almost 700 percent between 1990 and 2014. 18.*

required to ensure that trading trusts in financial distress can be managed as efficiently as company insolvency and personal bankruptcy.

23. But for the implications of the decision of the Hight Court in *Amerind* (which is discussed below), it is submitted that the insolvency provisions of the Corporations Act assume that the company's *property* (and the phrase "property of the company" is used many times through Chapter 5) is property that the company has a beneficial interest in, that it could otherwise use for its own purposes to sell, grant interests in etc, but for the imposition of insolvency.

24. This proposition underpins much of the existing insolvency framework.

The features of current statutory insolvency

25. As I have discussed before,[22] the architecture of the existing insolvency regime has three essential features which are founded on this being the proper interpretation of the nature of "property of the company" in Chapter 5 insolvency:

    25.1. The first is that the distributable fund in a winding up has always been understood to be, and the Act is best interpreted as referring to, a *single pool* available to the whole body of the company's general unsecured creditors (among whom certain classes of creditor are afforded priority in the prescribed order).[23]

    25.2. Second, the distributable fund comprises that property of the company that is *capable* of distribution to the company's general body of unsecured creditors, which must mean property beneficially owned by the company and realisable for value (unlike the trustee's proprietary interest in trust assets in respect of the right of exoneration);[24] and

    25.3. Finally, any *surplus* of that pool of realised property of the company after distribution to the body of such general creditors, is required to be returned to the owners (or contributories) of the company – that is, its shareholders.[25]

26. In other words, the concept of "property of the company" in insolvency is more than the sum of its parts: it takes its meaning from this broader context and application within the Act.[25] This context leads to the interpretation of the Act such that only property satisfying the usual indicia of "property" - to use the property for its own purposes, to sell, encumber, grant rights in, or transfer – properly constitutes "property of the company" for insolvency purposes in the context of the Act.

27. A brief consideration of some of the provisions of the Act demonstrates that the existing provisions for the winding up of a company are premised on dealing with property that is beneficially owned by the company, and that these provisions cannot be given a sensible interpretation if applied to property that cannot be distributed to general unsecured creditors and where any residue is returnable to shareholders as contributories of the company.

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[22] Allison Silink, 'The Trustee's Indemnity as "Property of the Company" under the Corporations Act 2001(Cth): *Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth*' (2019) 30 *Journal of Banking and Finance Law and Practice* 272.

23 See, eg, Kristin Van Zweiten, *Goode, Principles of Corporate Insolvency* (Sweet & Maxwell, 2018) [2-04].

24 See, eg, Van Zweiten, n 22, 219 [6-09], where it is stated that, "where the right is truly non-transferable in the sense that it is of a kind having value only in the hands of the company in liquidation and cannot be sold or otherwise disposed for value, then it is not property for the purposes of the Insolvency Act 1986".

25 Discussed by Siopis J in *Jones v Matrix Partners Pty Ltd* (2018) 260 FCR 310[172]; [2018] FCAFC 40. [25] See, eg, *Nokes v Doncaster Amalgamated Collieries Ltd* [1940] AC 1014, 1051–1052 (Lord Porter).

Coherence in statutory interpretation – why the existing regime cannot apply readily to property in respect of the exoneration right

28. The inclusion of the trustee's interest in respect of its right of exoneration causes tension in the proper interpretation of existing provisions of Chapter 5 of the Corporations Act as the following sections demonstrate.

29. **Section 477(2)(c) – the liquidator's power to sell property of the company:** S 477(2)(c) provides that a liquidator of a company may "sell or otherwise dispose of, *in any manner,* all or any part of the property of the company." There is present uncertainty after *Amerind* as to whether a liquidator still needs an order of the court to sell trust assets to access the value of the trustee's lien. Even if it is legislated (as is widely supported) that a liquidator should have power to dispose of trust assets to have access to funds in right of the right of exoneration, there may be questions as to whether the words "in any manner" are appropriate for the disposition of trust assets. For example, a disposition of trust assets in exchange for shares in a body corporate to be held by members of the company (see s 507 below) would be a breach of trust. Trust assets can only be disposed of for payment to trust creditors for the discharge of trust liabilities.

30. **Section 501 - distribution of property of the company:** pursuant to s 501, when dealing with distribution of property of a company, the property of a company must, on its winding up, be applied in satisfaction of its liabilities equally and, subject to that application, must, unless the company's constitution otherwise provides, be distributed among the members according to their rights and interests in the company. As a matter of statutory construction, "must" is mandatory: the pool of "property of the company" – and this is treated in the singular as one body of property - must be applied *pro rata* in satisfaction of all "its liabilities" and, subject to that application, "must" be distributed to members. There is no provision for separate pools of types of creditor, or different types of liabilities, so that liabilities can be grouped, and some of its liabilities paid more or less depending upon which pool they are in. The Act otherwise makes no express provision for payment of *trust creditors* as it does for other priority creditors. To require trust creditors to be paid pro rata with general unsecured creditors from a common pool and surplus returned to members would constitute a breach of trust, and ignore well settled equitable principles.

31. **Section 507 – liquidator may sell property of the company in exchange for shares in body corporate of purchaser:** pursuant to s 507, where it is proposed to transfer or sell to a body corporate the whole or a part of the business or property of a company, the liquidator may with authority, enter into an arrangement in compensation for transfer or sale, whereby the liquidator receives shares debentures, policies or other interests for distribution among the members of the company, or where members participate in the profits or benefits of the purchasing body corporate. Yet none of this is dealing that is permissible with property in respect of the trustee's right of exoneration. Sale of trust property is not permissible in exchange for shares or other interests for members of the company in a purchasing entity. It is only permissible for the purpose of raising funds to pay trust creditors.

32. **Section 543 – investment of excess:** provides that whenever the cash balance standing to the credit of a company that is in the course of being wound up is in excess of the amount that, in the opinion of the committee of inspection, or, if there is no committee of inspection, of the liquidator, is required for the time being to answer demands in respect of the property of the company, the liquidator may in certain circumstances invest the sum or any part of the sum and interest forms part of the property of the company. However, proceeds of the trustee's right of exoneration may only be paid to trust creditors. It cannot be co-mingled with property of the company owned beneficially and invested on the name of the company, such that interest forms part of the property of the company. Again, this would constitute a breach of trust including in profiting from the office.

33. Section **544 Unclaimed money to be paid to ASIC:** Pursuant to this section after making a final distribution, an unclaimed money or undistributed amount arising from the property of the company is payable to ASIC. However money in respect of a right of exoneration

that is unclaimed, or a debt forgiven, must be returned to the corpus of the trust and held for beneficiaries.

34. **Section 555 - all debts and claims proved in a winding up rank equally**: This section provides that except as otherwise provided by the Act, all debts and claims proved in a winding up rank equally and, if the property of the company is insufficient to meet them in full, they must be paid proportionately. The only sensible meaning of s 555 is that the "property of the company" for the purposes of the Act (whatever that comprises) is pooled into a single fund to determine such equal shares of all general creditors. Once again, as there is no other provision in the act for trust creditors, this section of itself would require "all debts and claims" - inclusive arguably of claims of trust creditors - to rank equally, thereby mixing claims of trust creditors with those of general unsecured creditors. Yet cases have repeatedly held that trust property cannot be applied to meet the claims of general unsecured creditors.

35. As a matter of statutory interpretation, legislation is to be construed on the prima face basis that its provisions are intended to give effect to harmonious goals and the intention of the legislature is construed through the words in a statute.[26] It is submitted that the existing provisions of Chapter 5 do not accommodate the unique interest of a trustee in respect of a right of exoneration in trust assets. Legislation is not to be interpreted as altering common law doctrines without expressing that intention with 'irresistible clearness': *Potter v Minahan.*[27] There is nothing in the Act to indicate the intentional alteration or abrogation of equitable principles with respect to the limitations on the trustee's use of trust funds in discharge of its trust liabilities.

36. The Act is silent as to the insolvency of trading trusts (unlike taxation law which refers to it expressly) and silent as to the distribution of property other than to general unsecured creditors by the means provided.

37. It is submitted that, (contrary to the finding in *Amerind* discussed below in relation to sections 433/556), where the broader context Chapter 5 was not in issue, the better interpretation of Chapter 5 as a whole is that the Act simply does not provide for the distribution of an insolvent company's equitable proprietary interest in trust assets in respect of its right of exoneration. The existing provisions of the Act can only be sensibly interpreted to address property beneficially owned by the company. Specific legislative reform is required to provide liquidators with the power to deal with property in respect of a trustee's right of exoneration, and for the distribution of this property. This will avoid confusion in the application of existing provisions now well understood in relation to property beneficially owned by the company and distributable in a winding up to its general unsecured creditors.

Understanding the existing definition of "property" in context

38. Without appreciation of this context in the interpretation of "property of the company", the definition of "property" in s 9 of the Corporations Act is very broadly defined and could be argued to extend to the trustee's proprietary interest in trust assets in respect of its right of exoneration.[28] Section 9 is so broadly defined in fact, that it would, in theory, also encompass property owned by a trustee and held on trust, despite the fact that it is accepted that trust assets are *not* property of the company.[29] Therefore, a literal reading of s 9 has already been rejected, and as a matter of statutory interpretation, applying the modern approach to statutory interpretation of text, context and purpose,[30] coherence with

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[26] See generally *Project Blue Sky Inc v Australian Broadcasting Authority* (1998) 194 CLR 335.

[27] (1908) 7 CLR 277

[28] S 9 defines "property" to mean "any legal or equitable estate or interest (whether present or future and whether vested or contingent) in real or personal property of any description and includes a thing in action"

[29] *Amerind*, [26] (Kiefel CJ, Keane and Edelman JJ); [2019] HCA 20. Their Honours confirmed that trust assets are generally excluded from the statutory concepts of property of the company on the basis that the exclusion enshrined in express statutory provisions to this effect in s 116(2)(a) of the *Bankruptcy Act 1966* (Cth), "applies by undisputed analogy in the case of corporations".

[30] See for example *SZTAL v Minister for Immigration and Border Protection* (2017) 262 CLR 362; [2017] HCA 34.

other provisions of the Act requires the existing definition of "property" to be read in a manner that gives effect and meaning to the whole of the Act. The sections of the act referred to above would not bear a sensible meaning if applied to trust property.

39. Prior to *Amerind*, the meaning of property of the company in insolvency has been considered before. In *Nokes v Doncaster Amalgamated Collieries Ltd*,[31] the House of Lords had to construe what was essentially the same concept – the "real and personal property, and things in action of the company" – as it appeared in s 151 of the *Companies Act 1929* (UK) for the purposes of determining what was relevant property of the company in insolvency. The Act contained a similarly wide definition of property to s 9 of the *Corporations Act*.[32] Lord Porter observed:

> Having regard to these considerations I find myself thrown back upon a consideration of the meaning to be placed on the word "property" [in the section] .. In truth the word "property" is not a term of art but takes its meaning from its context and from its collocation in the document or Act of Parliament in which it is found and from the mischief with which that Act or document is intended to deal. … Sect 189 of the latter Act contains similar provisions. In neither case has it ever, so far as I know, been suggested that "property" included anything other than *property of which the company then in course of being wound up could dispose*.[33]

40. There has been academic commentary supporting this construction. Prior to the High Court's decision in *Amerind*, the authors Heydon and Leeming have previously observed, for example, that s 556 cannot apply in terms of the proceeds of realisation of a trustee's right of indemnity because the provision is "addressed only to distribution of assets beneficially owned by the company and available for division between general creditors."[34]

41. Property in respect of a right of exoneration which cannot be used in any way other than to pay to trust creditors, where any use for personal benefit would be a breach of trust, and where any residue must be held on trust held for beneficiaries of the trust, is not easily reconciled with the existing interpretation of "property of the company" or shoehorned into the existing statutory process and distributable pool comprised of "property of the company" discussed above.

42. The characteristics of the trustee's highly conditioned beneficial right or interest with respect to its right of exoneration are particularly apparent when the asset or its proceeds leave the trust account and are transferred into the trustee's own account. In *Re Suco Gold Pty Ltd (in liq)*, King CJ observed that "if [the trustee] takes trust property into his possession … that property retains its character as trust property and may be used only for the purpose of discharging the liabilities incurred in the performance of the trust".[35] This passage was cited with approval by Allsop CJ in *Jones v Matrix Partners Pty Ltd* ("*Killarnee")*,[36] and by Bell, Gageler and Nettle JJ in *Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth* ("*Amerind")*.[37] As D'Angelo has put it, the trustee "is little more than a conduit".[38] The trust property to which the beneficial interest attaches is not "owned" or enjoyed by the trustee in the same manner as a beneficial interest of a beneficiary under a fixed trust nor is it ever capable of being used for the trustee's purposes or benefit in the manner of property that it owns beneficially. Benefit to the trustee is only to be found in discharging it from liability that it incurred as trustee, not for its personal benefit.

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31 *Nokes v Doncaster Amalgamated Collieries Ltd* [1940] AC 1014.

32 *Companies Act 1929* (UK) s 154(4) provided that "in this section the expression 'property' includes property rights and powers of every description ..".

33 *Nokes v Doncaster Amalgamated Collieries Ltd* [1940] AC 1014, 1051–1052 (emphasis added).

34 JD Heydon and MJ Leeming, *Jacobs' Law of Trusts in Australia* (LexisNexis, 8th ed, 2016) 523 [21-15].

35 Re *Suco Gold Pty Ltd (in liq)* (1983) 33 SASR 99, 107–108.

36 *Jones v Matrix Partners Pty Ltd* (2018) 260 FCR 310, [100]–[101]; [2018] FCAFC 40.

37 *Amerind*, [92].

38 See Nuncio D'Angelo, *Commercial Trusts* (LexisNexis Australia, 2014), [5.123].

43. In *Amerind* the High Court confirmed orthodox doctrine that the only role of the proprietary interest in respect of a trustee's exoneration right is to preserve the priority of the trustee's access to the fund for use to pay its trust liabilities ahead of the determination and distribution of any interest of the beneficiaries.

44. However, the High Court also found that exoneration funds in respect of the trustee's right of exoneration constituted "property of the company" within the meaning of the Act so that in the circumstances of that case, the statutory distribution rules applied for the benefit of priority creditors (in that case, the Commonwealth Government).

45. If a statutory regime for the insolvency of trading trusts had existed at the time that proceedings in *Amerind* were brought which effectively mirrored the statutory scheme for distribution of property of the company of general unsecured creditors, the case would not have been heard, nor the outcome required. But when *Amerind* was heard, the only option to achieve the effect of priority distribution to trust creditors in a manner akin to unsecured priority creditors in a corporate insolvency was to find that the trustee's proprietary interest in trust funds was relevantly "property of the company" within the meaning of the Act as it applies to distribution to unsecured creditors.

46. For the reasons below, it is submitted that rather than leaving it to the courts to have to find judicial solutions to legislative gaps like the absence of a statutory priority regime, as was forced in *Amerind*, it would be appropriate to reverse the effect of *Amerind* and by legislative reform provide expressly for the insolvency of a corporate trustee and the distribution of trustee's interest in trust assets in respect of the right of exoneration.

The Effect of Hight Court in Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth ("Amerind")[39]

47. As mentioned above, the ratio of *Amerind* was that the trustee's proprietary interest in respect of its right of exoneration was found to be "property of the company" for the purpose of attracting the statutory priority rules in s 556/ 561.

48. A comprehensive analysis of the decision is beyond the scope of this submission and I have analysed it earlier.[40] However its findings are analysed briefly here to the extent that it bears on the scope of legislative reform that may be considered and whether it is suggested that the decision renders reform unnecessary.

49. *Amerind* was the vehicle that finally ventilated before the High Court in the context of receivership the question whether the trustee's equitable proprietary interest in trust assets in respect of its right to be exonerated from trust liabilities[41] is relevantly "property of the company" that is required to be distributed in accordance with the statutory priority regimes under ss 433(3) and 561/556 of the *Corporations Act*. A related question was whether, if the statutory regime applies, the claimants entitled to share in the distribution of that property include the corporate trustee's *general* creditors, or whether distribution is limited to the *trust* creditors. Accordingly, the task before the Court in *Amerind* was essentially one of statutory interpretation – construing the meaning of "property of the company" as the phrase appears in ss 433(3) and 556.

50. I do not repeat the facts that are well known and frequently analysed. In *Amerind*, the High Court confirmed that the trustee's interest in trust assets in respect of its right of exoneration was an equitable proprietary interest, described as a "lien" over trust asset and also described as a "beneficial" interest in the trust assets. However, this unique

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[39] *Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth* (2019) 93 ALJR 807; [2019] HCA 20.

[40] I discussed this case in more detail in Allison Silink, 'The Trustee's Indemnity as "Property of the Company" under the Corporations Act 2001(Cth): *Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth*' (2019) 30 *Journal of Banking and Finance Law and Practice* 272.

41 This equitable proprietary interest is part of and supports the trustee's right of indemnity, which comprises two limbs: a right of recoupment for debts, liabilities and expenses the trustee has already paid out of its own money; and a right of exoneration for unpaid debts, liabilities and expenses. This assumes that the debts, liabilities and expenses have been properly incurred and the trustee's account is clear – that is, it owes no obligation to restore or make good a loss to the fund arising from its own misconduct.

equitable interest was at all times limited by the equitable requirement that it can only be used to pay trust creditors so as to discharge trustee liabilities properly incurred in managing the business of the trust, and could not be used for the trustee's own purposes or mixed with funds for distribution to general unsecured creditors.

51. The critical question for present purposes is the basis upon which the Court found that the insolvency provisions of the Act apply.

52. As a preliminary matter, it is noteworthy that none of the considerations discussed above at [25]-[37] above in relation to the structure of statutory distribution of "property of the company" and return of residue to contributories, or coherence with other provisions of Chapter 5 of the Act were discussed in the Court's reasons for judgment.

53. The Court decided that trustee's interest in trust funds in respect of the right of exoneration were relevantly "property of the company" for the following reasons:

    53.1. Kiefel CJ, Keane and Edelman JJ reasoned that statutory distribution had always been concerned with "only those rights that 'enure in law' for the benefit of the 'personal estate' of the bankrupt or insolvent person",[42] "deriving any benefit" from the rights held on trust.[43] Their Honours considered the "benefit" to the trustee in using its rights to discharge trust liabilities constitutes such a right which enures to the benefit of the trustee.[102]

    53.2. Their Honours also found that: "[T]he proportionate payment requirement in s 555 is premised upon the extent to which the property of the company can "meet" those debts. *The intrinsic limit of the power of exoneration precludes it from being used to meet debts other than those incurred with authority for the conduct of the trust business*."[44] This interpretation of the scope of s 555 as respecting the limitation on the exoneration funds being available to "meet" particular creditors is novel. Section 555 simply enacts the principle for *pari passu* distribution if the property of the company is insufficient to meet claims in full subject to exceptions set out in the *Corporations Act*. The focus is on the insufficiency of the pool to "meet", or pay, all general creditors' claims, and the consequential mandate for rateable distribution.

    53.3. It is submitted that there is no basis in the section for empowering a liquidator to maintain separate statutory pools of distributable property of the company for different classes of creditor other than in the manner provided in Pt 5.6. Indeed, elsewhere in the Act where distributable property is to be reserved for a certain class of creditor and is not to form part of the distribution regime under s 556 – such as proceeds of contracts of reinsurance – specific provision has been made for those payments so that they do not form part of the fund distributable under s 556.[45] Their Honours did not give further reasons for reaching this conclusion and it was not addressed in either of the other judgments.

    53.4. Bell, Gageler and Nettle JJ reasoned that the property comprised in the circulating security asset was the inventory itself – the trust asset – not its right of indemnity.[110] Amerind's *right of indemnity* was itself not "property of the company" comprised in or subject to a circulating security interest granted by Amerind,[46] but that did not matter. Their Honours similarly held that even though the inventory was held on trust, that did not mean that to the extent of its beneficial interest, the trust asset could not be "property of the company" for the purposes of s 433(3).[47]

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42 *Amerind*, [27]–[28] (Kiefel CJ, Keane and Edelman JJ).

43 *Amerind*, [28].

44 *Ibid*, [44].

45 See, eg, *Corporations Act 2001* (Cth) s 562A.

46 *Amerind*, [86].

47 *Ibid*, [87].

53.5. Their Honours observed that the identification of the amounts that would be payable pursuant to s 556(1)(e) in the event of a winding up is informed by the legislative context in which s 556(1)(e) appears, noting in particular "the close juxtaposition" of s 556(1)(e) to both ss 555 and 561, and then concluded immediately following, that:

> In the winding up of a corporate trustee, the "property of the company" that is available for the payment of creditors includes so much of the trust assets as the company is entitled, in exercise of the company's right of indemnity as trustee, to apply in satisfaction of the claims of trust creditors.[48]

53.6. Their Honours observed that the trustee in bankruptcy or assignee takes the bankrupt's property *subject to equities*, but otherwise as property divisible among creditors. Their Honours deduced from this statement of principle that this "allows for the payment of creditors out of property held on trust to the extent that the bankrupt has a beneficial interest in the trust assets, and thus to the extent of the bankrupt's right of indemnity".[49] The position under the *Corporations Act* was comparable.[118] In other words, the "subject to equities" principle provides the reason why trust assets are *excluded* from the distributable pool: the trust property is subject to the beneficiaries' equity and the trustee holds no beneficial interest in it. However, any other beneficial interest of the trustee in the trust assets, such as that to support its indemnity, is property that falls *into* the pool.

53.7. However, there is a question that arises from the application of this principle. This is because the trustee's beneficial interest is *itself* arguably also property that is subject to an "equity" – the *equity of subrogation* that trust creditors have in the trustee's beneficial interest. Does the *subject to equities* principle not equally apply to this interest in the trustee's property so as to remove it from the distributable pool? This was not raised or discussed in the case but would appear to be arguable on the basis of the "subject to equities" principle recognised in this judgment.

54. In summary, the Court was unanimous in finding that as the receivers were appointed on behalf of the holders of debentures secured by a circulating security interest over the trust assets (including the inventory, the surplus of which was in issue) the preconditions to s 433(2) were met,[50] and s 433(3) operated on the trustee's proprietary interest in the trust fund and required the application of the statutory priority rules in s 433 to the receivership surplus.[51] As summarised by Bell, Gageler and Nettle JJ:

> In the winding up of a corporate trustee, the "property of the company" that is available for the payment of creditors includes so much of the trust assets as the company is entitled, in exercise of the company's right of indemnity as trustee, to apply in satisfaction of the claims of trust creditors.[52]

55. The outcome resolved previous uncertainty and accords with the recommendations of the Harmer Report that the distribution of the trustee's interest in trust assets ought to be regulated by statutory distribution rules. However, it is argued here that the Court's finding that the existing statutory framework applies expands the previous understanding of what constitutes an interest qualifying as "property of the company" and strains the conceptual structure of statutory distribution to accommodates the trustee's lien in respect of its right of exoneration.

56. So, for example, s 501 considered at [30] above must presumably now be read as follows:

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48 *Ibid*, [90].

49 *Ibid*, [94]

50 *Amerind*, [47] (Kiefel CJ, Keane and Edelman JJ)..

51 *Amerind*, [145].

52 *Amerind*, [90].

Distribution of Property of Company

Subject to the provisions of this Act as to preferential payments, the property of a company must, on its winding up, be applied in satisfaction of its liabilities equally [*although property comprising the beneficial interest in trust assets can only be applied as between trust creditors in satisfaction of trust liabilities*] and, subject to that application, must, unless the company's constitution otherwise provides, be distributed among the members according to their rights and interests in the company [*except for property of the company comprising a trustee's beneficial interest in trust assets in respect of its right of exoneration, any surplus of which cannot be distributed to members and must be returned to the trust fund, to be held for the benefit of the beneficiaries on the terms of the trust*].

57. This is a major reinterpretation of the otherwise clear words of the statute, but it would seem to be required to give effect to the ratio of *Amerind*.

58. To avoid this sort of complication in the interpretation of the existing provisions of the Act, it is submitted here that if legislative reform is considered to provide a more transparent means to achieve the desirable outcome of *Amerind*, one option that ought be considered is the reversal of *Amerind* to restore an understanding of "property of the company" as property distributable to general creditors and to provide separately for a parallel regime for the distribution of trust property to trust creditors.

Would extending the statutory definition of "property" to include the trustee's proprietary interest in trust assets in respect of its right of exoneration resolve the issue?

63. In my submission, addressing the needs for liquidators in managing the insolvency of a company acting as trustee and the distribution requirements of trust assets in respect of the exoneration right will not be resolved simply by an extension of the statutory definition of "property of the company" to encompass property in respect of a right of exoneration.

64. This would be to legislate the result in *Amerind.* This is a short way to create a priority waterfall for trust creditors, but does not respect the fundamental differences between, on the one hand, property beneficially owned by the company that is distributable to general creditors, and, on the other, property in respect of the company's right of exoneration from trust assets. Nor does it address the issues discussed above.

Summary and Recommendations

65. To summarise the submission made above, and where relevant, noting recommendations made referable to the specific Consultation Questions, it is submitted that the corporate insolvency framework should be amended to provide as follows:

A legislative framework for insolvent trusts

65.1. In answer to **Question 1**: the corporate insolvency framework should be amended so that it expressly provides for the external administration of insolvent corporate trustees and the trusts of which the company is trustee in specific provisions – or a separate part of Chapter 5. The provisions should apply to all administration processes that may arise in the administration of a company acting as trustee.

65.2. In answer to **Question 2**: the benefit of such a legislative framework would include (i) relieving insolvency practitioners of the burden of uncertainty in the extent to which existing provisions apply, (ii) avoiding the waste of scarce company resources in funding litigation for clarification from courts, and (iii) avoiding the tension in trying to shoehorn trust issues into the existing insolvency framework which on a proper interpretation applies to "property of the company" of which it has the right to

dispose and use for its own purposes, and not to its proprietary interest in trust assets which it can never use for its own purposes but which must be applied to trust liabilities.

65.3. In answer to **Question 3:** there is no potential for detriment or unforeseen impacts if the statutory regime is extended through dedicated provisions with respect to the trustee's interest in trust assets in respect of its right of exoneration. However, there is risk of inconsistency or tension in statutory interpretation if the trustee's proprietary interest is treated as "property of the company" to which the existing provisions of Chapter 5 apply with the meaning that is given to that phrase in the context of the Act, where those provisions permit dealing with the trustee's interest in a manner that offends the equitable principles which continue to apply to trust assets, (in particular, the restriction on any dealing with them other than their distribution to trust creditors).

Key design considerations for a legislative framework

Clarifying the role of the external administrator

65.4. In answer to **Question 6:** the power of an insolvency practitioner to administer the trust assets and liabilities of which a company is trustee, and the trustee's interest in trust assets in respect of its right of exoneration, should be expressly provided for without requiring separate application to the court for appointment as receiver.

65.5. Except where an existing statutory power would offend the principle that exoneration funds can only be paid to trust creditors, provide liquidators with the same powers and process in the winding up of a trading trust with a corporate trustee as is already provided for the winding up of the company and company assets.

65.6. In answer to **Question 7**: the law should provide that subject to a contrary order by a court, the same insolvency practitioner may administer both the company and the assets and liabilities of any trust or trusts of which the company is trustee. As long as each trust, its liabilities and funds representing the right of exoneration are treated as separate pools, there is no reason that one liquidator should not administer all the affairs of the company.

Distribution of assets

65.7. In answer to **Question 8**, provide for a separate statutory distributable fund of property representing the trustee's right of exoneration from trust assets for *each trust* in respect of which the company is trustee.

65.8. In answer to **Questions 9 and 10**, the same statutory order of priority in the winding up of a trust should apply for trust creditors as exists for general unsecured creditors in the distribution of a pool representing the trustee's right of exoneration from trust assets.

65.9. However, as discussed above, there are additional factors that need to be considered where a company acts as trustee, for example, it is not appropriate to provide, as s 501 provides in relation to the distribution of property of the company, that any residue is returned to contributories. Any unclaimed property in trust assets is held for beneficiaries and not returned to shareholders of the company.

Other issues

65.10. In answer to **Question 13:** whilst beyond the scope of this Consultation, there are other important reforms which might be considered for the regulation of corporate trustees which, if enacted, could avoid some of the complications of financial distress for the corporate trustee and trust creditors (who may not have been aware they were dealing with a trust). I do not address these specifically given the scope of this

Consultation however would support the broadening of the scope of the Consultation for this purpose.

65.11. In answer to **Question 14:** any model adopted for reform of the statutory regime should provide for:

65.11.1. A **definition** of "property in trust assets in respect of the trustee's right of exoneration" that is distinct from the existing definition of "property of the company" so as to reflect the fundamental difference between property that can only be applied in discharge of trust liabilities, and property that, but for insolvency, would be property that the company could use for its own purposes, any residue of which is returnable to contributories; and

65.11.2. The separate treatment of each trust in respect of which a company acted as trustee, and separate treatment of the corporate trustee's property in respect of the exoneration right (of each trust or trusts) from "property of the company" of which it has the right to dispose and use for its own interests and purposes.

I would be happy to discuss these matters further.

Yours sincerely,

Allison Silink

Dr Allison Silink

10 December 2021