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Clarifying the treatment of trusts under insolvency law

I refer to the consultation paper *"Clarifying the treatment of trusts under insolvency law"* that was released by The Treasury on 15 October 2021 (**the Consultation Paper**).

I have had to consider issues relevant to the Consultation Paper extensively while practising as a lawyer, both when conducting litigation and when advising clients. Given my understanding of legal issues relevant to the Consultation Paper and the importance of the issues to all stakeholders, I have decided to make a submission.

I have practiced as a lawyer for over 25 years, corporate insolvency and litigation being my main specialisations. In addition to my time in private practice, I worked as a Senior Lawyer at ASIC as part of its Insolvency Practitioners and Liquidators Team from 2009 to 2013.

Summary of Submission

The Consultation Paper rightly identifies that Australia's current corporate insolvency laws don't expressly cover how business trust structures and businesses with a corporate trustee are dealt with during insolvency.

There is a clear need for law reform in respect of corporate insolvency and trusts. As identified in the Harmer Report 33 years ago, the companies legislation makes little to no provision for corporate trustees that become insolvent, it being appropriate that the principles for winding up apply to an insolvent corporate trustee.[1]

Given the popularity of trading trusts and the current challenges faced by insolvency practitioners when winding up corporate trustees, the Act should provide specifically

[1] Australian Law Reform Commission, *General Insolvency Inquiry*, (report 45 1988) (**Harmer Report**) [44]

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for the winding up of an insolvent corporation in its capacity as trustee of a trust or trusts.

As also identified in the Harmer Report, any changes in respect of the winding-up of corporate trustees must as far as possible be consistent with trust law.[2] The equitable principles that apply in respect of the winding-up of a corporate trustee vary greatly to the prescriptive rules-based approach to corporate winding up under the *Corporations Act 2001* (**Act**) and the *Corporations Regulations 2001* (**Regulations**). Recoupment, exoneration, subrogation and apportionment; these and other equitable principles are crucial to the winding up of an insolvent corporate trustee and it would be contrary to existing law, and in most cases unjust, to restrict their operation.

The Act can be easily amended to provide for the winding up of a company in its capacity as trustee of a trust or trusts when that company is already in external administration, the existing court-appointed receiver process in effect being simplified by the inclusion of a trust specific insolvency test and a just and equitable ground.

Amending the voluntary liquidation sections of the Act to provide for a voluntary winding up of an insolvent corporate trustee (in their capacity as trustee of a trust or trusts) is more difficult. Any amendments need to have regard to and protect the interests of both trust creditors and beneficiaries and must be in line with existing equitable principles.

The voluntary administration and small business restructuring parts of the Act do not sit easily with the equitable principles that apply in respect of the winding-up of an insolvent corporate trustees. In particular deeds of company arrangement (**DOCAs**) and restructuring plans are at odds with those principles and with the trust deed which specifies the trustee and beneficiary relationship. It is noticeable that Harmer Report does not refer to insolvent corporate trustees and restructuring, even though it resulted in Australia's voluntary administration laws.

Any amendments to the Act in respect of insolvent corporate trustees should be considered as part of a comprehensive review of the external administration parts of the Act and also the *Bankruptcy Act 1966* (Cth)(**Bankruptcy Act**). As identified by the relevant industry body, there is a need for a comprehensive review of Australia's personal and corporate insolvency laws to ensure they are simple, efficient and effective. Any corporate trustee insolvency and trust property insolvency amendments must be simple in their construction and efficient and effective in their operation, reducing complexity and inefficiency rather than adding to it.

Equitable principles relevant to insolvent corporate trustees

It is not possible to properly consider the issues identified in the Consultation Paper without having regard to each of the equitable principles that apply in respect of the

[2] Harmer Report above n 1 [44]

winding-up of corporate trustees and particularly in respect of a corporate trustee's right of indemnity.

Whether sourced in statute, as an express term in a trust deed or as an implied equitable term, a trustee has two rights of indemnity, being a right of recoupment and a right of exoneration.[3] The trustee also has an equitable lien which supports the rights of indemnity.[4]

The expressions "trust asset" (or "trust property") and "trust creditor" are also crucial when considering rights of indemnity, the expressions shorthand for, respectively, the rights held on trust by the trustee and those creditors of the trustee whose debts were properly incurred with authority in the course of the trust business.[5]

The rights of indemnity in respect of a corporate trustee and the main equitable principles relevant to that indemnity when the trustee is insolvent are as follows:

1. **Recoupment.** A trustee's right of indemnity includes a right to recoup money from trust assets in respect of liabilities that the trustee has previously discharged from their own funds. Trust funds that are received as a result of exercising a right of recoupment are available to meet both trust and non-trust creditors.[6]

2. **Exoneration.** In addition to a right of recoupment, a trustee's right of indemnity includes a right of exoneration, being the right to discharge trust liabilities directly from assets of the trust. Control of the rights of a trustee in relation to trust assets passes to a liquidator, a liquidator limited by the terms of the power of exoneration in the exercise of control over trust rights. The proprietary interest of the trustee in the trust fund is shaped by its purpose and origin in the trust relationship, to pay trust creditors in order for the trustee to exonerate itself from those debts, the limitation in respect of trust debts not precluding the relevant statutory priority rules.[7]

3. **Subrogation.** Trust creditors can enforce the power of exoneration by subrogating to the trustees' rights, with the creditor being no better off than the trustee. The exercise of the right of exoneration results in the transfer of trust assets directly to the trust creditors in payment of their debts, there being no beneficial receipt of funds that can be used to meet non-trust creditor claims. As all trust creditors have equal rights of subrogation to the right of exoneration and supporting lien, the payments to them following the exercise of the right of subrogation occur *pari passu*.[8]

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[3] *Carter Holt Harvey Woodproducts Australia Pty Ltd v The Commonwealth* [2019] HCA 20 [29] (**Amerind**),
[4] *Lane (trustee) in the matter of Lee (Bankrupt) v Deputy Commissioner of* Taxation [2017] FCA 953 [5] (**Lane**)
[5] Amerind above n 3 [24]
[6] Amerind above n 3 [34] Lane above n 4 [5]
[7] Amerind n 3 [34] [156], Lane above n 4 [5]
[8] Amerind n 3 [34], Lane n 4 [5]

4. **Exclusion of Trust Property**. It is an elementary and fundamental principle that in respect of trustee companies, distribution of trust property is precluded from distribution amongst creditors, there being an exclusion of property held on trust from the property of the trustee which applies to corporations.[9]

5. **Clear Accounts.** A trustee's right of indemnification is subject to a condition precedent that the trustee make good any loss caused to the estate. Where a trustee's entitlement to an indemnity for a liability properly incurred is subject to an account or liability for breach of trust, a balance is to be ascertained on the cross liabilities and the trustee is entitled to payment of any balance in his or her favour.[10]

6. **Cherry v Boultbee**. Where a trustee entitled to participate in a fund is also bound to contribute to the aid of that fund, he cannot participate till he fulfils his duty to contribute.[11]

7. **Hotchpot.** The hotchpot principle applies in respect of a distribution to trust creditors. Trust creditors must bring into account the amounts which they have received by the application of the right of exoneration, prior to participating in a distribution. Trust creditors must bring into hotchpot their dividends from the exercise of the right of exoneration against the property of the trust. The right is subject to their being one fund, the relevant maxim being equity is equality.[12]

8. ***Saunders v Vaultier***. Beneficiaries who are sui juris (of age) and have capacity can unanimously agree to terminate a trust and call for a distribution.[13]

In respect of the payment of the remuneration and expenses of a liquidator of a corporate trustee, the following principles are also relevant.

1. ***Universal Distributing*** **Lien.** In equity, an equitable lien arises in favour of a liquidator over the funds realised from the sale of company property for the costs they incur for the care, preservation and realisation of property prior to those otherwise interested in the fund.[14]

2. ***Berkeley Applegate*** **Principle.** Where a person seeks to enforce a claim to an equitable interest in property, the court has the discretion to require as a condition of giving effect to that equitable interest that an allowance is made for costs incurred and for skill and labour expended in connection with the administration of the property.[15]

3. **Apportionment**. Where a liquidator is administering through a company in respect of which they are a liquidator of more than one trust, the liquidator is

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[9] Amerind n 3 [26]
[10] *Australian Securities and Investments Commission v Letten & Ors* [2011] FCA 1420 [14][19]; *Park v Whyte* (No 3) [2017] QSC 230 (17 October 2017)
[11] *Cherry v Boultbee* [*1839*] *Eng R 1099*
[12] Lane above n 4 [5], *Commissioner of Taxation v Lane* FCAFC 184 [111] (**Lane Appeal**)
[13] *Saunders v Vaultier* (1841) 4 Beav 115
[14] *Universal Distributing Co Ltd (in liq)* [1933] HCA 2
[15] *Re Berkeley Applegate* (1989) Ch 32

not entitled to charge the beneficiaries of one trust with the costs and expenses incurred by another. However, where expenses are attributable to one or more trusts, the expenses must be apportioned between those trusts and where no apportionment is possible, a *pari passu* apportionment can take place.[16]

4. **General Liquidation work**. Where the company is the trustee of a trading trust and has no other activities, the liquidators are entitled to be paid their costs and expenses, whether for administering the trust assets or for "general litigation work" out of the trust assets. However, it has also been stated that where work done by a liquidator in relation to trust assets may properly be considered as having been done for the purposes of winding up the affairs of the company, any remuneration and expenses attributable to that work is to be paid out of the non-trust property and remuneration for work administering trust property might fall on the trust assets.[17]

The court also has general powers in respect of trusts based on its inherent equitable jurisdiction and under the State Trust Acts, including to appoint new trustees, to make vesting orders, to seek directions, to seek judicial advice, to protect trustees (including making a direction that bringing or defending proceedings is justified) and to provide for payment of remuneration and expenses.[18]

The need for simple, efficient and effective insolvency laws

As identified by the Australia Restructuring, Insolvency & Turnaround Association (**ARITA**), a comprehensive review of Australia's personal and corporate insolvency laws needs to be carried out to ensure those laws are simple, efficient and effective.[19]

Australia's corporate and personal insolvency laws are overly complex and voluminous. The external administration procedures set out in the Act are schemes of arrangement, receivers and other controllers, voluntary administrations, small business restructuring, court liquidations, members voluntary liquidations and creditors voluntary liquidations. This is in addition to bankruptcies, debt agreements and personal insolvency agreements as specified in the Bankruptcy Act.

A separate trust specific external administration procedure will just add to theexisting complexity. It won't simplify corporate insolvency laws. Law reform there needs to be minimal, being part of the existing external administration procedures as much as possible, rather than being an additional external administration procedure.

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[16] *Re Suco Gold Pty Ltd (in liq)*(1983) 33 SASR 99 at 110 (**Suco Gold**); Amerind above n 2 [169] to [172]

[17] *GB Nathan & Co Pty Ltd* (in Liquidation) (1991) 5 ACSR 673*; In the matter of AAA Financial Intelligence Ltd (in liquidation)* [2014]] NSWSC 1004 [13] (citing Suco Gold)

[18] Trustee Act 1925 (NSW), the Trustee Act1958 (Vic), the Trusts Act 1973 (Qld), Trustee Act 1936 (SA), Trustees Act 1962 (WA), the Trustee Act 1896 (Tas), Trustee Act 1980 (NT), Trustee Act 1925 (ACT) (**State Trust Acts**); Re Beddoe, Downes v Cottam [1893] 1 Ch 547 (CA) 557

[19] ARITA, *Financial Recovery 2020 An 8 Point Plan*, August 2019 p8

As identified in recent bankruptcy decisions, equitable issues apply equally in respect of bankruptcies.[20] Consideration of trust issues as part of a comprehensive review of both corporate and personal insolvencies will ensure that insolvency law as whole is simplified and that issues in respect of corporate insolvencies and trusts aren't dealt with in a stop gap fashion. Both corporate and personal insolvency law reform is required regarding trusts and there is a risk of greater complexity if those reforms aren't standardised or, ideally, included in one Act as part of a comprehensive insolvency law review.

A legislative framework for insolvent trusts

Should the corporate insolvency framework be amended so that it expressly provides for the external administration of insolvent trusts with a corporate trustee?

The Consultation Paper rightly identifies that where a company without a trust structure becomes insolvent, the company and its creditors have the benefit of the clear statutory regime established under the Act and that no such regime exists for insolvent corporate trust structures.

The problems associated with trading trusts and creditors' rights have long been identified, Professor Ford stating in 1981 that the fruit of the union between the law of trusts and the law of limited liability companies is a commercial monstrosity with considerable scope to frustrate creditors.[21] As identified in the Harmer Report seven years later there is a need for certainty in the event of an insolvency of a trading trust.

The need for law reform is beyond doubt. It is in the interests of creditors and also beneficiaries that either the Act or the state Trusts Acts provide for the winding up of a trustee in their capacity as trustee of a trust or trusts.

The right law reforms can reduce risk to trust creditors, non-trust creditors and external administrators while respecting the rights of beneficiaries and also reducing costs and complexity.

Still, as identified in the Harmer Report, although it seems appropriate that the principles for winding up should apply to an insolvent corporate trustee, consistency with the general principles of trust law must be maintained as far as possible.[22]

Any law reform in respect of corporate trustees must therefore tread lightly when it comes to existing trust law, maintaining the relevant equitable principles in respect of the winding-up of trusts. The need identified in the Harmer Report has just increased over the years, there being extensive authority in respect of a trustee's indemnity and

[20] Lane n 4, Lane Appeal n 12
[21] H.A. J Ford, *Trading Trusts and Creditors Rights*, Melbourne University Law Review [Vol 13 June 1981]
[22] Harmer Report n 1 [44]

lien and how it applies to trust creditors, non-trust creditors, and to costs and expense of liquidators.

The equitable principles relevant to personal insolvency are largely the same as those that apply in respect of corporate insolvency. By considering law reform in respect of personal insolvency at the same time as corporate insolvency law reform those principles can be preserved regardless of the form of insolvency rather than inconsistent personal and corporate insolvency provisions fettering those principles.

What external administration processes should the amendments apply to?

The simplest and safest option is to include a new section in the Act giving the court the power to appoint a liquidator to a company in its capacity as trustee, to wind up the trust or trusts the company is the trustee of when:

1. the company is already in external administration; and
2. the trust is insolvent based on a statutory definition of insolvency; or
3. it is otherwise just and equitable for the trust or trusts to be wound up (**Court Liquidator Amendments**).

Liquidators of corporate trustees, trust creditors and beneficiaries would have the power to apply for the order with all creditors, beneficiaries and trustees served or given notice of the application and having the right to appear on the hearing.

Difficulties in respect of dealing with trust assets during external administration are most often addressed by the court appointing of a receiver. A liquidator of a corporate trustee can apply to the court to be appointed the receiver of trust assets.[23] The Court Liquidator Amendments would however simplify a trust asset appointment, it possible to seek an order on that basis when either a court appoints a liquidator or after a liquidator is appointed voluntarily.

Any amendments to the voluntary liquidation sections of the Act need to protect both trust creditors and beneficiaries and make sure that relevant equitable principles aren't restricted. Possible amendments would be:

1. beneficiaries have the power, subject to there also being a separate corporate trustee voluntary liquidation appointment, to appoint a liquidator to wind up a trust or trusts. This would be based on a 75% majority of beneficiaries, being a power equivalent to that of members under section 491(1) of the Act. Alternatively, although not preferrable, the State Trust Acts would specify the beneficiary voluntary procedures with the creditors voluntary procedures in the Act.
2. If the corporate trustee and the trust or trusts being wound up are solvent then the declaration as to solvency in section 494 could provide specifically for the solvency of the trust or trusts based on a separate trust definition of insolvency (the declaration still given by the directors of the trustee company).

[23] *In the matter of Stansfield DIY Wealth Pty Limited (in liquidation)* [2014] NSWSC 1484

Alternatively, the declaration would need to be specified in the State Trust Acts, although this isn't preferrable as it would add to the complexity.

3. If the corporate trustee and the trust or trusts are insolvent, then there would be no declaration as to solvency. The liquidator would send a report as to affairs under section 497 that would relate to both the corporate trustee and the trust or trusts and include the names of the trust creditors.

4. Separate trust creditor and non-trust creditor meetings could be held subject to the appropriate creditor request. If there are multiple trusts separate trust creditor meetings could be held for each of those trusts (see s75.15 of the Insolvency Practice (Corporations) at Schedule 2 of the Act (**IPSC**)).

5. Separate trust creditor and non-trust creditor committees of the inspection could be formed (see Division 80 of the IPSC) (**Voluntary Liquidator Amendments**).

Giving beneficiaries the power to appoint the corporate trustee liquidator to wind up a trust or trusts (in effect appointing the liquidator to wind up the trust property) is consistent with the *Saunders v Vautier* principle*.* Beneficiaries have few powers, lacking the power of general meeting like members, the power to terminate is however one joint power they do have. The Voluntary Liquidator Amendments would be a codification of that power with the benefit of a 75% majority as opposed to the absolute agreement. Although beneficiaries' rights are the preserve of equity and the State Trusts Acts, given the connection to the corporate trustee, a beneficiary approval in the Act is reasonable.

Trust creditors would also be protected by the Voluntary Liquidator Amendments, having the right to call a separate creditor meeting. Their rights under the principles of exoneration and subrogation are dealt with separately.

There are clear difficulties in the voluntary administration and small business restructuring procedures in part 5.3A and Part 5.3B being amended to extend those external administrations to trust property. Corporate restructuring under those parts does not sit easily with the equitable principles relevant to the winding up of corporate trustees.

It is questionable whether the status of trust creditor claims, based on exoneration and subrogation, could be properly identified during a voluntary administration moratorium period and restructuring proposal period (let alone there being a taking of accounts with regard to the clear accounts and hotchpot rules) particularly when the purpose of those time periods is to propose a deed of company arrangement and restructuring plan.

Corporate trustee appointments frequently result in extensive investigations by insolvency practitioners to properly identify corporate and trust assets and how rights of recoupment, exoneration and subrogation should be dealt with. The adjudication and distribution process can also be drawn out, particularly if there is a need to consider subrogation, apportion funds and if equitable principles affect the amount of

a trust creditor distribution. It is difficult to see how those investigations and adjudications can be properly carried out during time-pressured voluntary administration and restructuring moratoriums, particularly if there is separate trust and non-trust creditor reports and separate voting.

What benefits would a legislative framework deliver?

The Voluntary and Court Liquidator Amendments would protect trust creditors, non-trust creditors and beneficiaries. They would also protect liquidators when they are dealing with trust assets.

Subject to the appropriate order or resolution, the right of a liquidator to deal with trust property would be established on appointment. Trust creditors exoneration and subrogation rights in respect of trust assets would be protected, the risk of commingling of trust and company assets greatly reduced. The liquidator also would not be at risk of dealing with property that it is not entitled to deal with, greatly mitigating their risk in respect of corporate trustee appointments.

Trust creditors and beneficiaries would have clear rights in respect of the winding-up process. The status of trust creditor claims would be determined based on statutory proof of debt procedures and established equitable principles of exoneration and subrogation. There would be safeguards built in for beneficiaries including them being able to voluntarily appoint a liquidator and them being on notice of a corporate trustee, trust property winding up application.

There would be significant costs savings in respect of the Voluntarily Liquidator Amendments. A liquidator could be appointed to a corporate trustee to wind up a trust or trusts by beneficiaries (consistent with equitable principles and a standard voluntary winding up). If a creditors meeting is not required the costs would be greatly reduced when compared to the existing court-appointed receiver procedure. Even with a creditors' meeting, the costs would be reduced, particularly when the cost of heavily contested corporate trustee liquidation and court-appointed receiver proceedings is considered.

Court Liquidator Amendments would also reduce costs, there could be one application to wind up a corporate trustee and the trust or trusts it is the trustee in respect of (whether on insolvency or just and equitable grounds). The powers and procedures in respect of the winding-up of trusts would be in the Act (with regard to equitable principles) rather than under bespoke orders. The appointment of a liquidator in respect of a corporate trustee would remove duplication and reduce costs with there still being the protection of a separate liquidator if required.

Is there potential for detrimental or unforeseen impacts if the statutory regime is extended?

The possible detriment in respect of the Court and Voluntary Liquidator Amendments would be if the act was inconsistent with rights of indemnity and related equitable principles. Still, as set out below, that risk is far less in respect of liquidation than

would be the case if there were voluntary administration or small business restructuring amendments.

1. **Beneficiaries**. The rights of beneficiaries could be compromised or excluded if the Court and Voluntary Liquidator Amendments are too prescriptive or inconsistent with equitable principles. The duties owed by a trustee to a beneficiary are fundamental to the concept of a trust. Australia's insolvency laws are creditor focused and, similar to a company member, the focus post amendments would be on the trust creditors, not beneficiaries. The creditor and committee meeting requirements in the Act are not easily modified to factor in beneficiaries or to include them in remuneration and other determinations. The position is even more complex for voluntary administrations and restructuring, creditor meetings and approvals difficult to modify to factor in beneficiary rights.

2. **Trust Deed.** The trust deed is crucial regarding the operation of a trust, formalising the powers of a trustee and how the trust is administered. There is therefore a risk that an external administrator appointed in respect of trust property will unreasonably affect the operation of the deed. Any restructuring amendments could result in a DOCA or plan that undermines the trust deed or is inconsistent with it. The Court and Voluntary Liquidator Amendments wouldn't result in the same inconsistencies. The liquidator role would be in respect of trust creditors with the beneficiaries being dealt with under the trust deed post a trust creditor adjudication and distribution.

3. **Trusts Act application and Equitable Jurisdiction**. The statutory power to seek directions under section 90-15 of the IPSC and the additional court directions powers in the Act should not restrict in any way the operation of the State Trust Acts and the Court's inherent equitable jurisdiction. Just because issues arise in respect of the liquidation, it doesn't result in the Act being the sole basis for resolving insolvent corporate trustee issues. The rights to apply for judicial advice and to seek Beddoe orders[24] in respect of proceedings in particular need to be preserved. That said, applications are frequently brought under the Act, Trusts Acts and in equity and there is no reason why that practice wouldn't continue.

4. **Lien and Indemnity.** The corporate trustees' lien and indemnity are unlikely to be fettered by the Act, the clear accounts rule and the rule in *Cherry v Boultbee* more likely to restrict its operation. However, if the voluntary administration laws were to be amended then the operation of the statutory lien and indemnity in the Act would need to be carefully considered.

5. **Recoupment and Exoneration Amounts**. Amounts received by a Liquidator based on the right of recoupment or exoneration will need to be clearly identified. If a liquidator receives recoupment funds then a distribution is likely to be to both trust and non-trust creditors. The requirement to correctly identify recoupment and exoneration amounts would be further complicated in respect

[24] Re Beddoe [1983] 1 Ch 547

of multiple trust appointments and the sporadic nature of the receipt of those amounts. Still, the making of separate orders or resolutions regarding a trust asset appointment would aid in correct receipting of those amounts (there being the power to appoint a separate trust property liquidator similar to a special purpose liquidator or separate court-appointed receiver). Even if one liquidator is acting, equitable principles would provide sufficient guidance rather than making overly prescriptive amendments to the Act and Regulation.

6. **Trust and non-trust creditor distributions.** Correctly dealing with recoupment and exoneration amounts during a voluntary administration or restructuring period would be difficult if there are restructuring amendments. Given the tight statutory periods, the nature of funds received and the nature of restructuring under a DOCA or plan, it would be challenging to investigate, consider and report on equitable principles and establish how they would affect a DOCA or restructuring plan distribution. The appointment of a corporate trustee liquidator and a trust property liquidator would not pose the same problems given the nature of a winding-up.

7. **Clear accounts, Cherry v Boultbee and Hotchpot**. A liquidator would need to investigate whether the trustee indemnity is subject to a counter liability based on the trustee's conduct or a duty to contribute to the fund. Those investigations are crucial to identify, in particular, trust creditor subrogation claims. This could result in the need for the taking of accounts if there is a counter liability including a possible court application. The existing liquidator investigation and reporting obligations are broad enough to cover this requirement. Likewise, any contribution that the trust company needs to make to the fund or exoneration amounts that trust creditors need to contribute to the fund needs to be accounted for. The tight periods for voluntary administration and restructuring would however pose difficulties with counter liability and contribution investigations, particularly if a formal taking of accounts is required. The focus is on maximising returns to creditors through flexible restructuring rather than waiting for exoneration amounts to be received and for contributions to be taken into account.

8. **Apportionment**. The Court and Voluntary Liquidator Amendments would provide for a liquidator appointment in respect of several trusts. There would in effect be a separate court order or beneficiary approval for each trust. It is also clear that a liquidator of an insolvent corporate trustee of multiple trusts should be viewed as holding multiple trusts each directed to different groups of creditors**.**[25] Issues in respect of apportionment of remuneration and expenses could be dealt with in orders ancillary to the appointment. Separate trust creditor approvals for each separate trust could also be sought in respect of the voluntary process and the remuneration and expenses pari passu apportionment dealt with in those resolutions. It is however difficult to see how

[25] Amerind n 3 [159]

voluntary administration and restructuring amendments could provide for such apportionments.

9. **General Liquidation Work.** Where the corporate trustee had multiple roles (both trustee and non-trustee based) and holds corporate funds then the statutory liquidation work remuneration and expenses would be determined by non-trust creditors. If an unfunded corporate trustee only ever acted in a trustee role, then remuneration and expenses for general or statutory liquidation work could be determined by trust creditors if there is one trust (or the trust creditors of each separate trust on a pari passu basis if there is more than one trust). The situation of an unfunded corporate trustee that also had other roles is more complex, consideration needing to be given to whether there is an overlap between general liquidation work and trust-specific work.[26]

10. **Universal Distributors and Berkley Applegate**. As is the case with a corporate trustee liquidator, a trust property liquidator could rely on those principles, particularly were the clear accounts rule and *Cherry v Boutlbee* fetter the trustee lien and indemnity (A court application not necessary to assert a *Universal Distributors* lien).

Complex trust amendments to the Act also possess a risk when it comes to the simplicity, efficiency and effectiveness of corporate insolvency laws. A new part of the Act specifically in respect of insolvent corporate trustees would make the Act more complex. It would just be further monolithic drafting when law simplification is required. There is also the additional risk of inconsistency between corporate and personal insolvency laws which could result in inconsistent application of general equitable principles.

Clarifying when a trust is taken to be insolvent

Should legislation expressly set out when a trust is deemed to be insolvent?

For the purposes of the Court and Voluntary Liquidator Amendments, a statutory definition of when a trust is deemed insolvent is a necessity. Although it is fiction to talk about an insolvent trust, consideration can be given to what is a financially unviable trust.[27] A statutory insolvency definition, although in some respects arbitrary, can identify what is a financially unviable trust.

If the court has a statutory power under the Act to appoint a liquidator that statutory definition in respect of a trust or trusts would need to be satisfied the same way that the corporate trustee's insolvency is satisfied on a winding-up hearing. Alternatively, if the company is wound up on just and equitable grounds then broad equitable principles could be applied to the trust property itself the same way they are applied in respect of the winding up of a corporate trustee.

[26] *Re French Caledonia Travel* (**French Caledonia**) [2003] NSWSC 1008 [212]
[27] The Honourable T F Bathhurst AC, 2021 Harold Ford Memorial Lecture, *Commercial Trusts and Liability of Beneficiaries: Are Commercial Trusts a Satisfactory Vehicle to be use in modern day Commerce*, 5 October 2021 (**Bathurst Speech**)

A statutory definition would also be crucial for a voluntary winding up, the declaration as to solvency and creditors reporting contingent on it.

What is the most appropriate way to prescribe when a trust is taken to be insolvent?

The focus of a statutory definition would be the assets of the trust and whether those assets are insufficient to support the trustees right to exoneration. Having regard to managed investment scheme commentary and definitions, the definition could be:

1. that the trustee has no funds to continue the management and administration of the trust and no reasonable prospect of getting in those funds; and
2. the liabilities referable to the trust cannot be met as they fall due from trust income or readily realisable assets; [28] and/or
3. that within three months before an application to wind up a company as trustee of a trust, execution or other process was issued on a judgment, decree or order obtained by the court (whether in Australia or not) in favour of a creditor and against the trustee in its capacity as trustee and execution has been returned unsatisfied.

Consideration could also be given to a presumption of insolvency based on a failure to maintain trust records.

Clarifying the role of the external administrator

Should the power of an insolvency practitioner to administer the trust assets and liabilities be expressly provided for in legislation?

In respect of the Court and Voluntary Liquidator Amendments, the liquidator of trust property would only be appointed by an order of the Court or by resolution of beneficiaries (followed by trust creditors). The liquidator would administer trust assets and liabilities given their appointment. Liquidators of corporate trustees receive recoupment amounts and pass on exoneration amounts without a separate court order, further legislative amendment not necessary given the role of a corporate trustee even when in external administration.

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?

The Court and Voluntary Liquidator Amendments would provide for the appointment of the liquidator, subject to the corporate trustee already being in liquidation.

The court and beneficiaries would retain the discretion to appoint the liquidator, being the corporate trustee liquidator or someone else. There are clear cost savings

[28] Bathurst Speech above n 27 and section 601ND of the Act

in having the same liquidator appointed and no doubt the court or beneficiaries would have regard to this, the exception being if there is a conflict of interest.

Distribution of assets

Should the affairs of a trustee company and each trust it administers be resolved separately in external administration?

If the Court and Voluntary Liquidator Amendments were made, it would be necessary to deal with trust administration and company administration separately for the following reasons:

1. The corporate trustee liquidation needs to be carried out separately as it relates to company creditors. Except for recoupment, adjudication of proofs of debt and payment of any dividend would be to those creditors under the Act. Remuneration and expenses in respect of the company liquidation would be approved by company creditors. In respect of recoupment, it could be dealt with by a *pari passu* apportionment between trust and non-trust creditors, with trust and non-trust creditors approving the distribution.

2. Corporate trustee work also needs to be carried out separately given the special nature of statutory liquidation or general liquidation work in respect of corporate trusts. If the corporate trustee conducts no other business and is unfunded then there may be a claim against trust property for those costs and expenses. The one caveat on that issue is that there may be the existence of an "overlap area" between the liquidator and trustee activities. Where a liquidator does work that would entitle them to both liquidator remuneration and recovery from trust assets, there may be two funds (the company and the trust) and contribution is made between them.[29]

3. Remuneration and expense claims from trust property will be simplified if work in respect of that trust or fund in question is carried out separately. This would allow remuneration and expense approval without having to apportion. It is however likely that some trust asset liquidator work will be for the benefit of all funds. That work will need to be recorded separately so that a *pari passu* apportionment can be arrived at for payment.

Regardless of the complexities that result from equitable apportionment and contribution, there is a need to separately administer corporate trustees and trusts as much as possible, the proviso being that creditors and beneficiaries should benefit from work in respect of all trusts through less duplication and lower liquidator costs and expenses.

Should there be a statutory order of priority in the winding up of a trust? 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?

[29] Bathurst Speech above n 27 and section 601ND of the Act

The application of the statutory priorities in section 556 of the Act in respect of the right of exoneration is now clearly settled.[30] Given the extensive authority and the way exoneration works, difficulties could arise if the section was replicated separately in respect of a trust property liquidator.

It is questionable whether trust creditors would be better protected by replicating section 556. Section 556 of the Act can be construed as if the liquidator of a corporate trustee held separate funds, each for different groups of creditors.[31] Any consequential amendments to the liquidator definitions to provide for trust property liquidations would need to preserve that construction.

Ejection and indemnity clauses

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? What would be the impacts of any such limits?

The Harmer report identifies that there should be limits on the power to remove a trustee in the event of insolvency. If a company is acting as the trustee of a trust and becomes subject to an application for winding up in insolvency, any provision in the trust instrument allowing for the removal of the company as trustee or the exercise of any power that allows for the removal of the company as trustee should have no effect.[32]

The reasoning in the Harmer Report applies just as much today as it did in 1988. It is also consistent with the ipso facto clause amendments to the Act. The corporate trustee and the trust it administers are closely intertwined and to seek to automatically end that relationship on the appointment of corporate trustee liquidator causes difficulties for both the corporate trustee and in respect of the administration of the trust.

The operation of the *Treasury Law Amendment (2017 Enterprise Incentives No. 2) Act 2018* (Cth) addresses ipso facto clauses in respect of corporate trustees in external administration, although further liquidator specific amendments may be required.

Other issues

Are there any other issues that need to be considered in light of the questions above?

In addition to the Court and Voluntary Liquidator Amendments identified, consequential amendments to the Act and Regulations would be required so that existing sections can operate in respect of a liquidator trust asset appointment.

[30] Amerind n 3
[31] Amerind n 3 [97]
[32] Harmer Report above n 1 [44]

1. The altering of the liquidator definition to include a liquidator of a corporate trustee appointed to wind up a trust or trusts would result in many of the sections applying in respect of a trust property liquidation.

2. The powers in sections 477 and 506 of the Act in respect of liquidators would need to provide for a trust asset liquidator. A liquidator definition change may suffice.

3. The report as to affairs in section 475 would include the affairs of the trust or trust a liquidator is appointed in respect of it.

4. Section 478 of the Act would need to provide for a list of beneficiaries to be prepared in respect of each of the trusts in respect of which the liquidator is appointed.

5. The release and termination of winding up powers in sections 480 to 482 would need to be extended to a liquidator of a trust or trusts and the stay of execution and stay of proceedings would apply to trust property if a trust property liquidator was appointed.

6. Section 483 of the Act would need to provide for the delivery of trust property to a trust property liquidator.

7. A special manager power in section 484 can apply to a corporate trustee liquidator. If there is a conflict of interest the corporate trustee liquidator could appoint a special manager rather than acting as liquidator of both the corporate trustee and the trust assets.

8. The books and records inspection power would include beneficiaries in respect of a trust property liquidation.

9. The remuneration determination provision in the IPSC would apply in respect of a court-appointed liquidator of a trust (provided creditors is defined as trust creditors). The review of remuneration determinations can include a beneficiary as “a person with a financial interest” in the external administration.

10. The IPSC would need to provide for a separate external administration account in respect of each trust being wound up and an annual administration return in respect of each trust. The power in section 70-15 of the IPSC would extend to trust audits.

11. The IPSC would need to provide for the appointment of committees of inspection of trust creditors for each trust.

12. The court powers to review an external administration in division 85 of the IPSC would extend to a trust asset liquidation. Beneficiaries would retain rights to apply to the court under that division being people with a financial interest, although non-court powers would only be exercised by trust creditors.

What is the most appropriate model by which a statutory regime could be expressed in the legislation?

The Act could be amended by one amending act that would include the Court and Voluntary Liquidator Amendments and also the consequential amendments. The amendments being to Chapter 5 of the Act, the IPSC and the Regulations.

A 12-month review of the operation of the amendments, and particularly the consequential amendments, would need to be carried out to assess their operation and any further consequences.

Closing Comment

Thank you for the opportunity to make a submission.

If you have any questions about the submission feel free to contact me on the email stated.

Yours Faithfully

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