THE UNIVERSITY OF MELBOURNE

27 June 2017

Ms Erin Gough
NSW Law Reform Commission
email: nsw-lrc@justice.nsw.gov.au

Review of laws relating to beneficiaries of trusts

Dear Ms Gough,

You have invited preliminary submissions regarding whether to adopt the proposals in the Victorian Law Reform Commission's Report on Trading Trusts – Oppression Remedies, Report (2015); and whether to reform beneficiaries' indemnities.

We attach to this letter the text of a submission made by two of us (Professors Bant and Harding) in respect of the Victorian Law Reform Commission consultation on Trading Trusts: Oppression Remedies, which was considered but not ultimately accepted by the VLRC. We continue to hold the views there expressed, however having now had the benefit of examining the VLRC's final report, we consider that it raises a very important and overarching set of issues that must be addressed in the general interests of coherence in the law of trusts and effective regulation of trading trusts in particular. These issues have not previously been addressed and need to be, as a matter of considerable urgency.

The short point is that trading trusts take the conception of the traditional (fixed and familial) trust and push it to breaking point, applying its structure, rules and normative foundations in circumstances far removed from their original sphere of operation. At these outer reaches, trust principles and regulating mechanisms are very poorly adapted to and, indeed, were never intended to operate on, the challenges posed by vehicles akin to trading trusts. This not only becomes apparent in the debate over oppression remedies (which, as we note below, derive from a corporate paradigm fundamentally at odds with traditional trust concepts and rationales) but in related areas such as third party creditors' rights of subrogation to trustees' rights of exoneration. Dr Allison Silink of UTS is currently undertaking important work in that regard and we highly commend her as a valuable source of insight on the related difficulties that arise from blithe use of trust concepts in what have become increasingly foreign and inapt contexts.

It is arguable that in many (and perhaps most) cases, trading trusts are used as a vehicle to have the benefits of corporate flexibility and asset protection, while wholly avoiding the accompanying corporate regulatory framework.[1] That is, the 'trust' structure is simply a formality to avoid the regulatory incidents of what is in substance corporate activity. In that context, piecemeal legislative reform to provide protection to beneficiaries of trading trusts simply invites introduction of foreign conceptions and

[1] An example of that framework is the strict limits on how assets can be removed from corporations. In addition to the voidable transaction rules there is the requirement in the *Corporations Act 2001* (Cth) s 254T that dividends must not be declared unless the company is has a solvent balance sheet, the dividend is fair and reasonable to all shareholders and the dividend would not materially prejudice creditors. Contravention is an offence that carries a penalty of up to 100 penalty units or 2 years imprisonment (Sch 3 item 83). In contrast, a corporation acting as a trustee has a great deal of freedom in distributing assets that it holds on trust without having to satisfy this test.

MELBOURNE LAW SCHOOL
The University of Melbourne | Victoria 3010 | AUSTRALIA
Phone: [redacted] Email: [redacted]

considerations arising from corporations law into the law of trusts proper, while failing to address the real need to grapple directly with the critical problem – the development of a novel hybrid institution that melds trust and corporate structures and that avoids regulation through either body of law.

In light of this, it is apparent that what is required is not ad hoc and piecemeal reform, focussing on only particular aspects of this larger problem, but rather bespoke and holistic regulation of trading trusts that is adapted and appropriate to the particular legal, social and economic challenges they pose. Superannuation trusts and managed investment schemes are the subject of specific legislative regulation and it is arguable that trading trusts should likewise be brought under a firm and coherent regulatory regime. For example, limiting the liability of investors in managed investment schemes can be justified because it is part of a holistic regime that requires the operators of the schemes to have independent financial means.[2] Overall, regulation of trading trusts should clarify how the interests of trading trust investors, creditors and managers are balanced,[3] and whether that balance is different from that adopted in Commonwealth corporations law. Relevant differences between the two might appear in: equity funding requirements, voidable transaction laws, insolvent trading principles, the liability of directors for actions that materially prejudice creditors, liability of those with effective control over trustee corporations, and the availability of criminal penalties for directors engaging in similar behaviour. Limiting reform to one issue – beneficiaries' liability – would be counter-productive.

The second, more significant, danger of the current approach to law reform is that, not only will it fail to provide effective and consistent regulation of trading trusts, but that principles and approaches adapted in the trading trusts context will leach into and undermine the law of trusts proper. Again, a good example of where this has already started to occur is in the context of third party creditors' rights of subrogation to trustees' rights of exoneration, where some scholars have argued (contrary, it is suggested, to the principled genesis of the right) that the trustees' right is conferred for the benefit of those third party creditors, an argument developed from the trading trust context and with the aim of addressing particular issues relevant in that field. If accepted, it would introduce significant incoherence in the law of express trusts proper, a point that Dr Silink is currently exploring in important new research highly relevant to this Commission's enquiries.

In concluding this brief submission, we note that the VLRC effectively adopted the submissions of scholars such as Professor Conaglen that the adoption of the oppression remedies under the Corporations Law framework was appropriate because, adopting a 'functional' analysis, trading trusts are indistinguishable for practical purposes from corporations. At 1.29, Professor Conaglen is quoted as stating:

Where the business is organised as a corporation, it has been thought fit to provide the courts with power to correct oppressive conduct (in ss 232-234 of the Corporations Act). Functionally speaking, the equity owners of a business should be in no worse position for having chosen to arrange their business affairs through a different legal structure, be it a trust or some other legal arrangement. If, as a matter of legislative policy, it is important

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[2] ASIC, Licensing: Financial Requirements, RG 166, 1 July 2015, Appendix 2 <http://www.asic.gov.au/regulatory-resources/find-a-document/regulatory-guides/rg-166-licensing-financial-requirements/>

[3] See Robert Flannigan, 'The Political Path to Limited Liability in Business Trusts' [2006] 31 Advocates Quarterly 257, 259-63.

for the courts to be able to rectify oppression between equity owners, it is arguable from a functional perspective that it should not matter which legal structure has been adopted.

We invite this Commission to press this point further: if trading trusts are simply corporations by another name, then an appropriate regulatory framework adapted to that reality should be used, rather than subverting the law of trusts to that purpose. If, on the other hand, trading trusts are truly trusts, then this necessitates distinct treatment and recognition of the fact that different legal institutions attract different legal consequences. We are less sure than is Professor Conaglen that there is any obvious injustice in visiting on those who invest in trading trusts as opposed to corporations the legal consequences of that choice: if the 'equity owners' of a trading trust have 'chosen to arrange their business affairs' through a trust structure rather than a corporate structure, the choice to take the benefits of that format may come with certain drawbacks, but that is the nature of the choice. If the problem is one of better investor education of the difference between trusts and corporations, that should be the focus of reform efforts. What should not be done is to collapse the normative and doctrinal differences between trusts and corporations, simply because equity owners who have sought to avoid corporate regulation also miss out on the protections that regulation confers.

We thank you for the opportunity to participate in this important review and welcome any further questions or comments regarding this submission.

Yours faithfully,

Professor Elise Bant
Mr Tobias Barkley
Professor Matthew Harding

Text of submission made to the Victorian Law Reform Commission on Trading Trusts and Oppression Remedies by Professors Bant and Harding, 17 July 2014

First, we would urge the Commission, in deciding the extent to which it is appropriate to regulate trusts in the same way as corporations, to consider the reasons for and against viewing trusts as distinct institutions serving values and aims that are different from those that underpin corporations. For instance, if the fundamental organising idea at the heart of the trust is a principle of settlor autonomy, then, all else being equal, there may be reasons to take a 'lighter touch' approach to the regulation of trusts than corporations, including in the matter of oppression remedies.

Secondly – and this point is related to our first point – we would reiterate the concerns expressed on 11 June 2014 as to the applicability of oppression remedies to discretionary trusts. It seems reasonable to assume that the core policy objective of oppression remedies is to protect the entitlements and voting power enjoyed by minority shareholders of corporations. In the case of unit trusts, where beneficiaries have entitlements (but not, we would note, voting power) it seems reasonable to pursue this policy objective to a degree. Matters are different in the case of discretionary trusts, where beneficiaries have neither entitlements nor voting power. If oppression remedies are to apply to discretionary trusts, this must be in the service of different policy objectives. In working out what these different policy objectives might be, one relevant consideration is the extent to which settlors of discretionary trusts value an institution that entails the relatively unfettered freedom of choice and action that the trustee of a discretionary trust enjoys. This question is not a legal one; it stands to be answered in light of empirical data. But if settlors of discretionary trusts do value such an institution, then fettering the discretion of the trustees of such trusts might frustrate the law's aim to facilitate settlor autonomy.

A third point relates to the question of how oppression remedies might be crafted in the setting of the Trustee Act, especially as they apply to discretionary trusts. It should not be assumed that just because the subject matter of such remedies will be trusts, courts should be given a wide-ranging and open-ended discretion in operating them. We would urge the Commission to give some thought to the extent to which legislative provisions might seek to guide and direct judicial application of any oppression remedies in the Trustee Act, so that those remedies can be administered in a predictable and transparent fashion. Here, possible models of appropriate legislation might be developed along the lines of the guiding criteria used to assist courts in determining unconscionable conduct under s 21 of the Australian Consumer Law

Thank you once again for the opportunity to participate in the consultation on these important reforms. Please do not hesitate to contact us if you would like to discuss this submission further.