NEW SOUTH WALES BAR ASSOCIATION

PRELIMINARY SUBMISSION TO NSW LAW REFORM COMMISSION: REVIEW OF LAWS RELATING TO BENEFICIARIES OF TRUSTS

1. This preliminary submission addresses the two topics identified in the email to stakeholders from the Law Reform and Sentencing Council Secretariat dated 12 May 2017.

2. The Bar Association would welcome an opportunity to provide more detailed submissions in respect of any consultation paper that is ultimately issued.

Limitation or removal of liability of beneficiaries of trusts in cases where the trustee fails to satisfy the obligations of the trust

3. It is necessary to distinguish two situations which raise potentially different considerations:

    a. the liability of beneficiaries to indemnify the trustee in respect of liabilities the trustee incurs in the conduct of the affairs of the trust; and

    b. the liability of beneficiaries to creditors of a trading trust for liabilities the trustee incurs in the conduct of the affairs of the trust.

4. In the first situation, liability is based on the principle in *Hardoon v Belilios* [1901] AC 118, according to which a beneficiary who is sui juris is personally bound to indemnify a trustee for liabilities properly incurred. The principle, which rests on the proposition that a beneficiary who gets the benefit of the trust property should bear its burden, applies in New South Wales: *Balkin v Peck* (1998) 43 NSWLR 706.

5. There is merit in exploring the desirability of abolishing or modifying this principle.

6. The principle in *Hardoon v Belilios* is rarely engaged and its bounds are uncertain. For instance:

    a. the principle does not apply to discretionary trusts;

    b. the principle can be limited or excluded, either expressly in the trust deed (*Hardoon v Belilios*) or by implication depending on the context (*Wise v Perpetual Trustee Co* [1903] AC 139);

    c. the decided cases do not generally apply the principle outside the context of a trading trust;

d. there is doubt as to whether the principle applies to beneficiaries who are not sui juris and to life tenants: see *Jacobs' Law of Trusts in Australia* (8th ed 2016) at [21-05]; *Balkin v Peck* (1998) 43 NSWLR 706 at 713;

e. in *Ron Kingham Real Estate Pty Ltd v Edgar* [1999] 2 Qd R 439 at 442, the Queensland Court of Appeal appeared to suggest that relevant to the engagement of the principle was the circumstance that the beneficiaries also controlled the corporate trustee. The basis for this is unclear.

7. It is common for solicitors drafting a trust deed of a trading trust to exclude the operation of the principle in *Hardoon v Belilios* by specifying that unitholders will have no liability to the trustee beyond any amount unpaid on their units.

8. One reason for considering abolition of the principle is that it would seem unjust that beneficiaries (who may not be aware they could be personally liable to the trustee for debts incurred by the trustee) should be liable simply because no one took the care to exclude the principle.

9. Any consultation on this issue should canvass the following matters:

a. the practical significance of the issue – that is, to what extent is liability for debts incurred by a trustee ever sheeted home to beneficiaries under the existing case law;

b. whether there is any flexibility in the case law *not* to apply the principle where it would appear unjust in all the circumstances to do so – for example, where the beneficiaries had no active involvement in the affairs of the trading trust. It is notable in this respect that in *Balkin v Peck* (1998) 43 NSWLR 706 at 712 the Court of Appeal emphasised the equitable foundations of the principle; and in *Ron Kingham Real Estate Pty Ltd v Edgar* [1999] 2 Qd R 439 at 442 the Queensland Court of Appeal pointed out that in the circumstances of that case it would be "against conscience" for the beneficiaries to retain the proceeds of their conduct;

c. if the principle were abolished or limited, are there alternative remedies sufficient to address a situation in which a beneficiary was involved in incurring a liability or liabilities of a trading trust. Some such remedies might include:

i. an action for breach of duty, where the beneficiary involved was also a director of the corporate trustee;

ii. impounding of the beneficiary's interest under s 86 of the *Trustee Act* or the general law on the basis that the beneficiary requested, instigated or consented to the incurring of the liability;

iii. the trustee's lien over trust assets. This may be of limited relevance given that the resort to the principle in *Hardoon v Belilios* is generally necessary

precisely because the trust assets are insufficient. However, there are circumstances in which the trustee can enforce its lien against beneficiaries to whom the trust property has been distributed: *Grizonic v Ranken* [2011] NSWSC 471 at [66] (Brereton J);

d. whether, if the principle is to survive, its operation should be restricted to trusts of particular kind and the preconditions to its engagement clarified.

10. The second situation which needs to be addressed by the present reference is the liability of beneficiaries to creditors of a trading trust for debts incurred by the trustee.

11. The circumstances in which such a liability might arise under the existing law are not obvious.

12. In D'Angelo, *Commercial Trusts* (2014) at [3.30]-[3.56] it is suggested that beneficiaries of a trading trust may be liable to creditors on the ground of an implied agency relationship. The thesis appears to be that, where a beneficiary controls the trustee, that circumstance – either alone or in combination with other circumstances – may provide a basis for finding that the trustee has incurred any liabilities as agent for the beneficiary in question. There do not appear to be any decided cases that support this theory. Unless further investigation reveals a real concern that beneficiaries may become liable to creditors on the basis of an implied agency theory, there would not seem to be a need to consider reform to the law on this basis.

13. One other potential source of liability to creditors arises from the possibility that creditors could be subrogated to the trustee's personal right of indemnity which arises under the principle in *Hardoon v Belilios*. This would enable creditors to sue beneficiaries directly. It is clear creditors can be subrogated to the trustee's proprietary right of indemnity by way of lien over the trust assets; but the case law concerning whether subrogation is available in respect of the trustee's personal right is less certain. The only Australian case which has upheld a right of subrogation in such a situation appears to be *Ron Kingham Real Estate Pty Ltd v Edgar* [1999] 2 Qd R 439 at 443-444; but see also *McLean v Burns Philp Trustee Co Pty Ltd* (1985) 2 NSWLR 623 at 640-641 where Young J assumed creditors could be subrogated to the trustee's personal right of indemnity. This potential source of liability would disappear if the principal in *Hardoon v Belilios* were abolished.

14. The Bar Association suggests that any consultation on this issue canvass the following:

a. the juristic basis on which beneficiaries of trading trusts could be liable to trust creditors under the existing law;

b. investigation of whether there are any instances in which beneficiaries of trading trusts have been found liable to trust creditors;

c. consideration of the sufficiency of other remedies creditors may have against a beneficiary who was involved in incurring liabilities of a trading trust;

d. whether, if the principle in *Hardoon v Belilios* is to survive, there is any justification for denying creditors the ability to be subrogated to trustee's personal right of indemnity which arises under that principle.

Whether New South Wales should adopt the recommendations of the Report, Trading Trusts – Oppression Remedies, January 2015, of the Victorian Law Reform Commission

15. The New South Wales Bar Association considers there is merit in the proposal to adopt the recommendations of the Victorian Law Reform Commission Report on Trading Trusts – Oppression Remedies, January 2015 ("Victorian Report").

16. In addition to the considerations canvassed in the Victorian Report, the Bar Association draws attention to the following matters.

17. First, the uncertainty concerning whether the oppression remedy in Part 2F.1 of the Corporations Act is available to beneficiaries of trading trusts with a corporate trustee is largely a product of New South Wales decisions suggesting the remedy is *not* available (see the cases discussed in the Victorian Report at 3.49-3.58). The broader approach adopted in some Victorian cases (discussed in the Victorian Report at 3.59-3.83) does not seem to have been followed in this State. That highlights the need for clarity to be brought to the issue in New South Wales.

18. Secondly, it seems likely that, as occurred in Victoria, there will be anecdotal evidence that the present state of the law causes hardship to family businesses and other small to medium sized business enterprises by (a) requiring the expenditure of extensive costs investigating possible ways of framing a claim in the absence of an oppression remedy and (b) causing oppressed unitholders to refrain from taking legal action or settle on unfavourable terms because of the absence of any clear oppression remedy (see Victorian Report at 1.27-1.28). This is especially so given the established line of New South Wales cases suggesting Part 2F.1 is not available to beneficiaries of trading trusts with a corporate trustee.

19. An important issue for consideration in the context of the present reference will be the extent to which practitioners in this State have experience of cases in which the likely absence of an oppression remedy has caused hardship to unitholders.

20. Thirdly, as in Victoria, there are limitations on the utility of remedies otherwise available to courts in this State to provide relief to beneficiaries from oppressive conduct in connection with the affairs of the trust. The alternative remedies and their limitations are canvassed in the Victorian Report in Chapter 4. For present purposes, it is worth noting that (as the Victorian Report acknowledges at 4.138) s 81 of the *Trustee Act* 1925 (NSW) carries limitations similar to those which apply to s 63 of the *Trustee Act* 1958 (Vic). Those limitations were emphasised recently in *Hancock v Reinhart* (2015) 106 ACSR 207 at

[186]-[193] where Brereton J (interpreting the equivalent provision in Western Australian legislation) pointed out that the section does not give the Court the ability to confer on a trustee a power of amendment of the trust deed.

21. Fourthly, it is desirable that the law on this matter be uniform across the country as far as is possible. If the NSW Law Reform Commission ultimately makes recommendations similar to those made in the Victorian Report, it will be important to ensure that any legislation resulting from these recommendations is, as far as possible, consistent with any legislation that is enacted in Victoria on the same topic.

22. The Bar Association otherwise supports consultation on this issue in a similar manner to that which occurred in Victoria. The consultation should involve the following topics:

    a. the adequacy of existing remedies for oppression available to beneficiaries of trading trusts;

    b. the types of trusts which should be subject to any statutory oppression remedy. In particular:

        i. whether it is appropriate to exclude certain trusts such as charitable trusts, managed investment schemes and superannuation trusts which are the subject of separate regulatory regimes;

        ii. whether it is appropriate to include discretionary trusts;

    c. who should have standing to seek a statutory oppression remedy in respect of a trading trust;

    d. what forms of relief should a court be empowered to give from oppression in the context of a trading trust;

    e. the relationship between any proposed statutory remedy and the existing powers of the courts under Part 2F.1 of the *Corporations Act*.

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