Supreme Court
of New South Wales

Memorandum

To : Bathurst CJ

From : [redacted]

Date : 29 January 2018

Subject: **Laws Relating to Beneficiaries of Trusts – Consultation Paper**

NSW Law Reform Commission – Consultation Paper on Laws relating to Beneficiaries of Trusts

1. The two issues on which the Law Reform Commission is asked to report are:

   1.1 The liability of beneficiaries, as beneficiaries, to indemnify trustees or creditors when trustees fail to satisfy obligations of the trust, and

   1.2 Whether oppression remedies available under company law should be extended to beneficiaries of trading trusts.

Beneficiaries' personal liability to indemnify a trustee for obligations properly incurred by the trustee

2. It appears from paragraph 2.1 of the Consultation Paper that the issue of concern is that "… investors assume their liability is limited to the amount they invest (or agree to invest) in the venture …". At para 2.14 the Commission states that investors in public unit trusts assume that their liability is limited to the amount they invest in the same way that a shareholder is not liable to contribute if the company becomes insolvent. The identified concern is to

protect investors in public offered investment vehicles that are structured as trusts (para 2.23).

3. The Commission notes (at para 2.12) that "We understand the current practice is to insert provisions in the trust documents that purport to limit the liability of beneficiaries, but these provisions have never been tested …".

4. It is not correct to say that such provisions have never been tested. They were tested in *McLean v Burns Philp Trustee Co* (1985) 2 NSWLR 623 at 641 (Young J). The efficacy of such provisions has not been doubted. (*Chief Commissioner of State Revenue v CCM Holdings Trust Pty Ltd* [2014] NSWCA 42 at [72] per Gleeson JA citing *Hardoon v Belilios* [1901] AC 118 at 127; *RWG Management Ltd v Commissioner for Corporate Affairs* [1985] VR 385 at 394; *McLean v Burns Philp Trustee Co Pty Ltd*; *Causley v Countryside Pty Ltd (No 3)* (NSW Court of Appeal 2 September 1996, Unreported)).

5. Whether a trustee's right to indemnity out of trust assets can be excluded by the terms of the trust deed is undoubtedly a live question. But, so far as I am aware, there has never been any question that the trust deed cannot exclude the right of a trustee to be personally indemnified by the beneficiaries.

6. The Consultation Paper notes (at para 2.16) that the Ministerial Council for Companies and Securities preferred to rely on "administrative procedures designed to ensure full disclosure on the matter of unitholders' liability and the fact that there could be a clause excluding liability" and said (at 2.17) that the Ministerial Council's reasoning assumed that exclusion clauses were effective. In my view there is no reason to doubt that assumption.

7. In *Hardoon v Belilios* it was said that "the plainest principles of justice require that the cestui que trust who gets all the benefit of the property should bear its burden, unless he can shew some good reason why his trustee should bear them himself."

8. That principle is as good today as it was in 1901. There is no obvious reason that the beneficiary's interest should be preferred to that of a creditor. Investors in public investment vehicles that are structured by way of trusts can be effectively protected by a clause in the trust deed. Legislation is not needed to provide that protection. The Consultation Paper says (at 2.26):

> "The use of trusts is widespread. One example is the use by superannuation funds when they invest in major infrastructure projects. There would be a widespread loss of confidence in such structures if liability for such projects were to fall elsewhere than intended or expected."

9. It is surely unlikely that a superannuation fund investing in a major infrastructure project that involved the use of trusts would not ensure that the trust deed excluded a beneficiary's personal liability.

10. The Consultation Paper does not identify any specific case in which such protection has been found to be wanting.

11. More than 30 years has passed since the Ministerial Council for Companies and Securities decided not to proceed with the change in the Companies Amendment Bill 1985 (Cth) that included a provision for limited liability. The Consultation Paper does not identify any problem that has arisen from that decision.

12. At para 2.31 of the Consultation Paper it is said:

> "It is not clear that a provision in the trust instrument can effectively limit the liability of investors for all purposes, since it could be argued that the trustee was acting as agent for the beneficiaries (who would therefore be liable on that basis) or that creditors are nevertheless entitled to sue beneficiaries directly. Even if the law were clear that inserting an explicit provision in the trust instrument could limit liability, the effectiveness of the limitation would depend on drafting. Legislation would remove the risk posed either by poor drafting or the inadvertent omission of such a clause."

13. I disagree. It is quite clear that the relations between trustee and beneficiary on the one hand, and agent and principal on the other, are distinct. If the beneficiaries do appoint the trustee to act as agent for them, there is no

reason they should not be liable for the debts that their principal incurs. But they would not be liable merely by reason of the trust relationship if the trust deed so provided. Nor should a legislative provision that excluded a beneficiary's liability to indemnify a trustee exclude a beneficiary's liability as principal if a principal and agency relationship existed. The Commission's terms of reference required it to review and report only on the liability of beneficiaries, as beneficiaries, to indemnify trustees or creditors. The liability of investors as principals if a trustee acted as agent is irrelevant to the Commission's reference. The effectiveness of an exclusionary provision in a trust instrument to deal with a case where the trustee is acting as the beneficiary's agent is irrelevant to the Commission's task. It is a red herring. Contrary to what the Consultation Paper states, the law in this respect is not unclear.

14. The Consultation Paper states that the case for reform is strongest in the case of managed investment schemes. The Consultation Paper does not address the question as to whether it is a requirement for the listing of a managed investment scheme that the constitution of the scheme exclude the liability of investors in the scheme. I assume the Listing Rules would so provide, but I have not checked this. As to unlisted registered managed investment schemes, whether investors' personal liability should be excluded should, one might think, be a matter for disclosure and for their decision. This was apparently the view of the Ministerial Council in the 1980s and nothing has been pointed to in the Consultation Paper as a matter of experience that indicates a need for change. If there were any such need, it should be dealt with by amendment of Part 5C.3 of the *Corporations Act* concerning the constitution of a managed investment scheme.

15. Reference is made in the Consultation Paper to trading trusts. Many trading trusts are conducted by a trustee of a discretionary trust where no question of indemnity of a trustee by discretionary objects will arise. In the case of other trading trusts, such as those that might be conducted through a unit trust, where there might be no exclusion in a trust deed of the beneficiary's liability to indemnify the trustee, I see no reason to prefer the interests of beneficiaries

over creditors. Why should the beneficiaries of such a trust be in a better position than a partnership that delegated management functions to a manager? The principle in *Hardoon v Belilios* should apply.

16. I would not support any legislation on this topic.

Oppression remedies

17. The issues raised under this heading are as much issues of philosophy as law.

18. The Consultation Paper noted that the report of the Victorian Law Reform Commission "Trading Trusts – Oppression Remedies" Report 2015 recommended that the law of trusts should make oppression remedies available to beneficiaries of trading trusts. The Consultation Paper invited comment if anyone did not consider that the Victorian Law Reform Commission had examined thoroughly the question of whether the law of trusts provided equivalent remedies to those available under Corporations Law (at para 3.5).

19. The Victorian Law Reform Commission's report correctly noted in section 3 that the oppression remedy provided in company law following the Cohen Committee Report arose from the rule in *Foss v Harbottle* (1843) 2 Hare 461; 67 ER 189. Generally (although not always: *Crawley v Short* [2009] NSWCA 410 at [121]-[122]) a director's duty is owed to the company and not to the individual shareholders and it is the company that is the proper plaintiff to complain of wrongs done by the directors to the company. This is now of course subject to statutory modification.

20. A trustee owes its duties not to the "trust" considered as a separate fictitious entity, but to the beneficiaries of the trust. It has always been open to beneficiaries to complain of conduct of a trustee said to have been engaged in in breach of trust.

21. This fundamental difference between the rights of shareholders to bring directors to account and the rights of beneficiaries to bring the trustee to account is not addressed in the report of the Victorian Law Reform Commission. In section 4 of the Commission's report it addressed the "different forms of equitable and statutory relief available to beneficiaries". The purpose of doing so was to "consider whether existing forms of relief in a situation of oppression enabled beneficiaries to extricate their interests in the trust structure." (para 4.1)

22. Having regard to that purpose it is not surprising that the Victorian Law Reform Commission did not address the right of a beneficiary to bring an errant trustee to account.

23. The Victorian Law Reform Commission's report contains a useful discussion of the width of the oppression remedy under Part 2F.1 of the *Corporations Act* in its application to a corporate trustee. Whether some of the New South Wales cases have given insufficient attention to s 53A of the *Corporations Act* is an issue that can be expected to be resolved in due course at appellate level. It does not require legislation and cannot be resolved by State legislation.

24. The question of whether a beneficiary of a unit trust whose trustee conducts trade, or a discretionary object of a discretionary trust whose trustee conducts trade, should have additional remedies analogous to those of a shareholder of a company raises large legal and philosophical issues.

25. At a legal level, one of the oppression remedies available to a shareholder is an order for winding up of a company. The Victorian Law Reform Commission correctly noted at (paras 4.11-4.15), a court does not "wind up" a trust like it does a company. The court is required to adhere to and fulfil the terms of a trust. A trust is terminated only when the trust property is distributed to the beneficiaries.

26. Writing extra-judicially Campbell JA observed:

> "Equity does not proceed, code-like, by a set of rules that can be stated in propositional form and are then applied in a deductive fashion to the facts of a particular case. Rather, it proceeds by reference to two quite distinct types of concepts. They are equity's standards, and its remedies.
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> The standards are the criteria by reference to which equity holds that the conduct of one person towards another is unconscientious. …
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> … Equity developed a wide range of remedies of its own. … The remedy [adopted in a particular case] was one that would require the person to do whatever actions were most likely, within the limits of what was practically possible, to undo the particular breach of equity's standards that had been committed, or that there was a threat to commit … (J.C. Campbell "Should the 'rule in *Hastings-Bass*' be followed in Australia? Trustees' Duty to Enquire and Trustees' Mistakes" (2011) 34 Aust. Bar Rev. 259 at 267-268).

27. Whether statute should permit a radically different approach whereby a judge is empowered to modify the terms of a trust, and order a transfer of one beneficiary's property to another, or otherwise alter, rather than enforce, property interests is a large issue.

28. Particularly is that so where the beneficiary has the right to call a trustee to account for conduct in breach of trust. A classical liberal view of the function of government, including through its judicial arm, is that it should be concerned with the protection and enforcement of property rights, not with their alteration in individual cases.

29. In my view the Commission should address the prospect of increased litigation if courts are given a discretionary power to alter property rights. The prospect of beneficiaries or discretionary objects of family trusts, the trustees of which carry on some "trading" (a term which would itself require definition) to seek a compulsory purchase of their "interest" when he or she complains about allegedly oppressive conduct of the family member who controls the trust, is one that the legal profession should welcome. Whether it would be in the public interest is a different question.