MinterEllison.

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Manager
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The Treasury
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Dear Sir/Madam

Submissions in response to 'Clarifying the treatment of trusts under insolvency law' paper dated 15 October 2021

We refer to the Treasury's paper 'Clarifying the treatment of trusts under insolvency law' dated 15 October 2021 (**Consultation Paper**) inviting submissions on the issues raised in the Consultation Paper.

MinterEllison thanks the Treasury for the opportunity to make these submissions on the Consultation Paper.

MinterEllison's position is that the Consultation Paper raises complex legal and policy issues concerning the intersection of corporate insolvency law and trust law that warrant careful consideration by Government prior to the development of any law reform proposals. Many of these issues have previously been recommended for law reform. Despite this there is no legislative scheme dealing with the insolvency of trusts noting that most of the issues raised in the Consultation Paper having been the subject of law reform proposals since the Harmer Report. Thus the complex problems arising in the insolvency of trusts have largely been solved by the "ingenuity"[1] of the nationwide superior and appellate courts in the context of litigation. And in our assessment the cost of doing so has not been wasted.

Given the prevalence of trusts with corporate trustees as vehicles for commerce in Australia, any legislative reform regarding corporate trustee insolvency should focus on clarifying the position of stakeholders and providing certainty of the outcomes.

In our view it would not be appropriate for legislation to treat insolvent trusts as separate entities. To do so would unnecessarily contradict and undermine the fundamental principles of trust law. With certain modifications discussed below, we consider that some of the recommendations in Chapter 6 of the Harmer Report together with further or other measures could be considered for implementation by way of amendment to the existing external administration legislation in the Corporations Act. The power of the Court to make ameliorative orders (analogous to s 447A) should apply to any legislative provisions in respect of trust insolvency.

We welcome further consultation with Treasury about these matters prior to any draft legislation being released.

We set out below MinterEllison's responses to the specific questions in the Consultation Paper.

[1] The Hon T F Bathurst AC, Chief Justice of New South Wales, 'The Historical Development of Insolvency Law' (Paper delivered to the Francis Forbes Society for Australian Legal History, Sydney, [97] https://www.supremecourt.justice.nsw.gov.au/Documents/Publications/Speeches/Pre-2015%20Speeches/Bathurst/bathurst_20140903.pdf.

Please note that the views expressed in these submissions do not represent the views of MinterEllison's clients.

Responses to list of questions

Question 1 – Should the corporate insolvency framework be amended so that it expressly provides for the external administration of insolvent trusts with a corporate trustee? If so, what external administration processes should the amendments apply to?

Yes. We consider there is merit in legislating to specifically amend and extend the current external administration regime under the *Corporations Act 2001* (Cth) (**Corporations Act**)[2] to accommodate corporate trustees.[3] We consider that the corporate insolvency legislation could specifically address the scenario whereby companies under external administration hold trust assets.

It should be nevertheless noted that this scenario is not limited to cases where assets are held pursuant to the terms of a specific trust deed or like instrument. Property and assets can be held on trust under various different arrangements, including:

1. deposits held by stakeholders under property or business sale agreements;

2. the proceeds of the sale of goods under retention of title arrangements;

3. moneys placed on deposit by way of security for the performance of obligations which in each case are expressed to be held "*on trust*";

4. trusts created under standalone legislation, for example in respect of moneys paid to an Australian financial services licensee pursuant to s 981H, and in relation to protected accounts under s 16AF of the *Banking Act 1959* (Cth); and

5. funds held by incorporated professional services firms, real estate or travel agents and the like.

It can never be the case that property of this character might be made available to satisfy the claims of the trustee's creditors, in priority to the claims of the defined beneficiaries.

We consider that the recommendations in Chapter 6 the Harmer Report (other than the recommendations at [253], as to which see our response to Question 13 below, and at [261] and [265], as to which see our responses to Questions 8, 9 and 10 below) should be given further consideration in the context of potential legislative reform.

Corporate trustee insolvency legislation *could* apply in all external administration processes (as defined in s 5-15 of the IPSC) of corporate trustees under the Corporations Act. However, as defined external administration includes voluntary administration. The case for and mechanics of specific provisions dealing with the *liquidation* of a corporate trustee may appear straightforward. Much greater analysis would be needed to adapt for voluntary administration or, potentially, receivership, which can be used to trade on the business of an insolvent company. Complexity will arise in connection with issues such as the availability of trust assets to meet the renumeration and liabilities of the voluntary administrator or receiver, where these items are not separately approved by the beneficiaries of the trust and the merits or otherwise of potentially depleting trust assets through ongoing trading, which could have been otherwise be made available to satisfy the claims of the pre-appointment creditors through the trustee's right of indemnity.

We consider that any proposed legislation should afford standing to external administrators, creditors, beneficiaries, ASIC and any interested person in the trust assets to apply to the Court, in order to ensure that parties can be heard in relation to their particular circumstances in the sometimes complex issues that arise in corporate trustee insolvency.

[2] Unless otherwise stated, in these submissions references to sections are to sections of the Corporations Act.
[3] These submissions do not address the proposed amendments in respect of corporate collective investment vehicles (**CCIV**) under the public consultation legislation that implements the tax and regulatory components of the CCIV regime and related explanatory materials at https://treasury.gov.au/consultation/c2021-200373. Having said this, given the proposed CCIV law reforms also concern their insolvency Government should consider any proposed law reform in relation to corporate trustees generally having regard to the CCIV proposals and experience of insolvency of managed investment schemes under the Corporations Act. However, contrary to the proposals in respect of CCIVs, we do not consider that trusts should be treated as separate entities in insolvency.

The Court should also be vested with a broad power to apply or modify any external administration regime as it applies to corporate trustees, to permit the Court to modify the rules in appropriate cases where flexibility is desirable to achieve just outcomes.[4]

Question 2 – What benefits would a legislative framework deliver?

We consider that carefully considered and appropriately drafted legislation to deal with the insolvency of corporate trustees may provide greater clarity and certainty for businesses and insolvency practitioners regarding the insolvency of corporate trustees.

We consider that amendments to the external administration legislation to recognise the existence of trusts and clarify how trust assets are to be treated could aid in the preservation of economic value for the corporate trustee's creditors and trust beneficiaries.

We also consider that the time and costs associated with court applications by liquidators of insolvent corporate trustees, including e.g. to seek their appointment as receivers of trust property and approval of remuneration and expenses, could be reduced by a delegation of power to Registrars or Associate Justices of courts, in certain circumstances where such applications involve relatively simple or straightforward cases which meet certain criteria that could be prescribed by regulation. That being said in our experience the complexity, cost and expense of such applications can be overstated, especially when balanced against the transparency and accountability that comes with the formality of a court application to permit a liquidator to deal with property to which, prima facie, they are not appointed.

Question 3 – Is there potential for detrimental or unforeseen impacts if the statutory regime is extended?

We consider that any legislation dealing with the insolvency of corporate trustees should not constrain the flexibility of the general law to regulate novel or peculiar situations involving the insolvency of trusts. We consider that any legislative framework should reflect the already established principles and ensure that flexibility is retained in the laws regulating sometimes competing concepts of corporate insolvency and trust law.

Care will also need to be taken to ensure that there are no unintended consequences arising from the intersection of any proposed reforms with the trust arrangements of the kind referred to in our answer to Question 1, including those created under both State and Federal legislation.

Question 4 – Should legislation expressly set out when a trust is deemed to be insolvent?

The statutory definition of insolvency in s 95A(2) is sufficient and should apply to the determine whether any corporate trustee is insolvent. In our view, there is no need for legislation to prescribe when the trust is itself insolvent, for the reason that the trust is itself not a separate legal entity.

Question 5 – What is the most appropriate way to prescribe when a trust is taken to be insolvent?

See our response to Question 4 above.

Question 6 – Should the power of an insolvency practitioner to administer the trust assets and liabilities be expressly provided for in legislation?

As recommended in the Harmer Report at [245]-[247], but subject to the comments already made we agree that there may be benefit in the legislation stating that a reference to the property of the company extends to property it holds on trust for another person or any trust assets. That being said we note that the definition of "*property*" in s 9 also extends to property held beneficially (an "*equitable estate*"), in the context of those Parts of the Corporations Act enumerated in paragraphs (a) – (i) of the definition, which are, exclusively Parts dealing with external administration.

Such a provision will need to align with the case law principles settled by the High Court of Australia that the proprietary interest in trust property arising from the exoneration limb of the trustee company's right of indemnity is property of the trustee company.[5]

[4] See e.g. s 447A.
[5] *Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth* [2019] HCA 20; 368 ALR 390 at [60], [95] and [98] per Bell, Gageler and Nettle JJ, and at [107] and [141] per Gordon J; see also at [55] per Kiefel CJ, Keane and Edelman JJ.

The legislation should provide for the power of an external administrator of a trustee company to administer the trust assets and liabilities in their capacity as external administrator.

Another or concurrent approach may be to have any power to deal with trust property exercisable only following the giving of a prescribed form of statutory notice of intention to do so, to the beneficiaries of the trust notifying them of the amount claimed by the corporate trustee under its right of indemnity and advising them that unless they make payment for the amount claimed or give notice of objection within e.g. a 21 day period the external administrator of the trustee will take steps to realise the property. If the external administrator receives a notice of objection, then they should be required to commence court proceedings against the objectors as respondents.

Question 7 – 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?

We consider that such a provision could be desirable for clarity and certainty, but the legislation should provide that the same insolvency practitioner may do so subject to court order, and include provision for their specific duties and how they are to manage any conflicting duties.[6]

Question 8 – Should the affairs of a trustee company and each trust it administers be resolved separately in external administration?

In our view, where a trustee company's role was to act as trustee and not on its own behalf these issues could be dealt with together in external administration on the basis that trust creditors and non-trust creditors should be entitled to the proceeds of the exercise of the right of indemnity. If there are multiple trusts, or the company acted on its own behalf and as a trustee, then it would be appropriate that the affairs of the trustee company and the trusts it administers to be resolved separately in external administration with court approval of the apportionment of trust assets being necessary.

Question 9 – Should there be a statutory order of priority in the winding up of a trust?

We consider the statutory priorities under s 556 should apply in the winding up of a trust, subject to our suggestion to vest a broad power in the Court so that in appropriate cases trust assets could be available to pay the trustee's non-trust related debts if that is required to achieve just outcomes for non-trust creditors and beneficiaries.

Question 10 – 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?

Subject to our earlier responses, we consider that the statutory priorities under s 556 should apply to the distribution of proceeds from the exercise of the trustee company's right of indemnity, and trust assets should generally only be applied to discharge trust liabilities.[7] There may be unfairness in the application of this default position to non-trust creditors in cases where the trustee company acted principally as trustee of a single trading trust, and whereby non-trust creditors who contracted with the trustee would not be entitled to access the proceeds from the trustee's exercise of the exoneration limb of the right of indemnity. That is a good reason why the Court should have the power to make appropriate orders modifying this position in appropriate cases.

Question 11 – 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?

Yes. In our view the ipso facto stay provisions in the Corporations Act should be extended to apply to liquidation (only). We consider there is merit in including a specific statutory provision that a term or a condition of a trust instrument or agreement that might have the effect of removing an insolvent corporate trustee or excluding or limiting a company from exercising the right of indemnity against trust property for debts and liabilities properly incurred by the company in the conduct of a trust be void as against an external administrator of the company, other than with external administrator consent or Court order.

[6] See e.g. s 601FD.
[7] *Jones (in his capacity as liquidator of Killarnee Civil & Concrete Contractors Pty Ltd (ACN 085 230 486) (In Liq)) v Matrix Partners Pty Ltd* (2018) 124 ACSR 568; [2018] FCAFC 40 at [99].

This should not, however, entrench the company's role as trustee, against the wishes of beneficiaries who may nevertheless terminate their appointment under the terms of the trust instrument.

There should also be consideration to legislative clarification as to the scenario where an insolvent former trustee might be denied access to trust assets to satisfy its right of indemnity because it no longer acts as trustee. That may require an application to the Court for the external administrator of the trustee to be appointed as receiver of trust assets. The legislation could for example enshrine the principle that a former trustee does not lose access to its right of indemnity out of trust assets in relation to trust debts incurred prior to it ceasing to act as trustee.

Question 12 – What would be the impacts of any such limits?

We consider that the restrictions suggested in our response to Question 11 above may assist external administrators by ensuring that such provisions are not effective and will make the law in Australia uniform on this issue. We also consider that this may reduce potential unfairness to creditors as their rights are otherwise potentially prejudiced because their right of subrogation to the trustee's right of indemnity could also be excluded.

Question 13 – Are there any other issues that need to be considered in light of the questions above?

The principles of investor beneficiary limited liability should apply so that the liability of an investor in a unit trust should be limited to the amount the unitholder expressly agreed to contribute to the trust, in an analogous way that shareholder liability is limited under the Corporations Act. The legislative limitation of liability should apply notwithstanding any provision to the contrary in the trust deed or in the winding up of the trustee. This issue has been the subject of many law reform proposals since the 1990s, and in our view should be considered for enactment in legislation.[8] It is desirable that any amendments apply to registered managed investment schemes and publicly listed unit trusts, which should be readily achievable by way of amendment to the Corporations Act given these kinds of trusts operate essentially as corporations by another name.[9] It would be desirable that uniform amendments be made to the Trustee Acts of each State and Territory, or alternatively a referral of State power be made to the Commonwealth to allow the passing of such legislation to the extent required.

To improve transparency for counterparties contracting with trustees, the legislation could also provide that public documents and negotiable instruments of a corporate trustee state the trust details and ABN, similar to the requirements which apply to companies,[10] and public registers similar to the public ASIC and ABN lookup website search facilities to obtain details regarding the trusts of which the trustee acts. It may also be desirable for a statutory indoor management rule similar to ss 128 and 129 apply in the case of corporate trusts.

However we consider it would not be appropriate that any power of sale extend to any assets that are subject to a retention trust and similar funds given these are in effect moneys held on trust for a beneficiary for a particular commercial purpose.

Question 14 – What is the most appropriate model by which a statutory regime could be expressed in the legislation?

See our responses to Questions 1 to 13 above. We consider that these matters are capable of being legislated by appropriate amendments to the existing legislation in Chapter 5 of the Corporations Act, without the creation of a new regime. We welcome further consultation with Treasury about these matters prior to any draft legislation being released.

[8] See e.g. Australian Law Reform Commission and Companies and Securities Advisory Committee, Collective Investments: Other People's Money, Report 65 (1993) [11.37]; NSW Law Reform Commission, Laws relating to beneficiaries of trusts (Report No 144, May 2018) [2.5].
[9] The Hon T F Bathurst AC, Chief Justice of New South Wales, 'Commercial Trusts and the Liability of Beneficiaries: Are Commercial Trusts a Satisfactory Vehicle to be Used in Modern Day Commerce?' (Speech delivered at the 2021 Harold Ford Memorial Lecture, University of Melbourne, 5 October 2021), [77] https://www.supremecourt.justice.nsw.gov.au/Documents/Publications/Speeches/2021%20Speeches/Bathurst_20211005.pdf.
[10] See s 153.

Please do not hesitate to contact us if you would like to discuss any of the above matters.

Yours faithfully
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