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21 March 2023

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Inquiry into Corporate Insolvency in Australia
Supplemental submission by way of response to question on notice
Insolvency of trusts

1 Introduction and question on notice

1.1 I refer to my submission dated 30 November 2022, which appears on the Inquiry's website as Submission No. 19.

1.2 I also refer to my appearance before the Committee at the Sydney hearing on the afternoon of 28 February 2023 (the **Sydney Hearing**).

1.3 At the Sydney Hearing, I was asked by the Chair to take on notice a request for a framework by which the issues that I (and others) have raised in relation to the insolvency of trusts might be addressed through Commonwealth legislation. Specifically, the question was:

> ***You've indicated that there might need to be a comprehensive legislative solution. On notice would you be able to think about providing such a framework?***

1.4 This supplemental submission responds to that request.[1]

1.5 I reiterate that, although I am a partner of the law firm Norton Rose Fulbright, my submissions to the Inquiry are made in my personal capacity. The views I express are my own and should not be taken to reflect those of the firm or of any other partner or employee of the firm, or of any client.

2 Response and summary of recommendations

2.1 In response to the question on notice I set out a framework for proposed draft legislation to amend the *Corporations Act* so that it properly addresses insolvent commercial trusts: see the detail in paragraph 4 and the Schedule. My recommendation is for the enactment of a new Chapter 5AA (titled *Dealings with Relevant Trusts and their*

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[1] I am grateful to Dr Allison Silink, barrister and senior lecturer at UNSW Law School, for her valuable assistance in the preparation of this supplemental submission. She reviewed several drafts of it, and some of the material reflects her comments and ideas.

External Administration) that would contain all the provisions needed for dealing expressly with relevant trusts.

2.2 The primary objective of the suggested framework is to equate or align, as far as legally possible, the legal risks and outcomes in insolvency faced by arm's length parties who do business with trustees of commercial trusts, with those of parties who deal with *Corporations Act* companies acting in their own right, but without otherwise interfering with the essential nature of the trust or the many benefits that accrue to those who use and deal with them as business vehicles.

2.3 Given the relatively rapid rise and extensive use of the trust in commerce in modern Australia, reform is due (some may even say overdue), and I believe that it is eminently achievable. The issues are now largely known[2] and the solutions are to be found in amending the *Corporations Act* so that it is fit for purpose in this regard.

2.4 To assist and expedite the preparation of draft legislation, and taking into account the detailed knowledge of relevant law and practical experience required to properly appreciate and address the issues, the Committee should consider establishing an expert panel or subcommittee to produce (or assist in the production of) an exposure draft bill, based on agreed guidelines and constitutional assumptions, within an agreed timeframe.

2.5 I would be happy to discuss with the Committee the ideal composition and terms of reference of such a panel or subcommittee.

3 Preliminary questions

3.1 Before engaging with the substance of the question on notice, I address (or expand upon my answers to) several anterior questions that were raised by Committee members at the Sydney Hearing.

Mr Hawke: ***Haven't you got to a point where you've got all this settled more now, and you have this common law? You're actually coming to us at the end of all this and saying, 'Now I'd like some law in place.'***

3.2 At the Sydney Hearing I said in my opening statement that the issues have

> *led to copious litigation over recent decades and forced the courts to fill the statutory vacuum by developing, in the usual stuttering, piecemeal fashion, a sort of 'common law of insolvency' for trusts.*

3.3 But I also said that

> *that project has only been (and can only ever be) partially successful. It has sometimes yielded outcomes that are baffling and inconsistent with what would have been the result had the insolvent entity been a company. Courts across the nation at both State and Federal levels have handed down conflicting decisions on various questions.*

3.4 I then gave some examples, noting that there are many others, and concluded that "the market is left in a state of ongoing uncertainty".

3.5 The work of the courts in this area is far from done; indeed, in some senses it has only just begun. This area has only really generated litigation for about 4 decades, mainly since the emergence of trading trusts in the 1970s. There are numerous questions in this area that are yet even to come before a court. In 2014 the then Chief Justice of New South Wales, the Hon TF Bathurst, noted extra-judicially that:

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[2] They are described in the materials noted in paragraphs 4.3 to 4.7.

> *how to deal with insolvent trusts and, particularly of late, insolvent managed investment schemes ... is probably one of the last outposts in insolvency law which has been left to the ingenuity of the Courts and the general law to solve.* [3]

3.6 Our courts and the general law are certainly capable of ingenuity, and demonstrate it regularly. But the development of the common law is slow and painstaking, and occasionally misfires. It is not a directed process and is not necessarily policy-based. Due to the foundational doctrines of precedent and *stare decisis*, it is essentially backward-looking and conservative; change comes slowly and in piecemeal fashion, and not at all unless parties have the wherewithal to take their dispute up to the appellate courts. The common law on any subject at any point in time is in essence the aggregated outcomes of the resolution over time of numerous random private disputes between self-interested parties in an adversarial context, decided upon the unique factual matrix prevailing in each case. Inconsistencies often appear between courts in different States, or between the State and Federal courts. It is simply not appropriate to leave the resolution of the many complex issues in the insolvency of trusts to a process that is so slow, random and uncertain.

3.7 As I argued in my Submission, the *Corporations Act* and modern company law more generally constitute a sophisticated and highly evolved (and ever-evolving) policy-based regulatory regime offering relatively efficient and orderly risk allocation, and a balance of investor and creditor protection, designed specifically with risk-taking profit-maximising activity in mind. This balance is reflected in the insolvency provisions in Chapter 5 of the *Corporations Act*.

3.8 None of this can be said in relation to trust law, which does not fully acknowledge the commercial trust or the complexities of insolvency, or reflect the policy objectives that have shaped corporate insolvency laws. Nor can those policy objectives be fully achieved by the courts through the common law process (and nor is it necessarily the role of the courts to pursue such policy objectives).

3.9 In any case, some outcomes can only be ordained by the state via the instrument of legislation, particularly as between parties who are not otherwise proximate through contract or other private law nexus. This so particularly in insolvency, where it is necessary to allocate (or reallocate) assets and losses among competing claimants who will be strangers to each other. For example, legislation can oblige the recipient of an unfair preference to disgorge the payment for the benefit of others who are otherwise unknown to them. And only legislation can mandate the deprivation of prima facie rights and entitlements inherent in the ranking and prioritisation of claims that takes place in insolvency.

3.10 Other examples of reforms to protect trust counterparties that can only be achieved by legislation are the establishment of a searchable public register and the provision of statutory "indoor management" assumptions (both discussed in the Schedule).

3.11 The fact is that market developments in the use of the trust as a business vehicle have raced ahead of the law. The issues are particularly acute with respect to trustees that manage multiple trusts; there is very little consideration at common law of how this scenario would play out if that type of trustee were to become insolvent. It is time for the law to catch up, as quickly as possible. That requires legislation.

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[3] The Hon T F Bathurst, 'The Historical Development of Insolvency Law' (2014) 39 *Australian Bar Review* 113.

Senator Scarr: ***Is there an issue around jurisdiction between the States and the Commonwealth with respect to trusts that make it a bit hazy as to whose jurisdiction it falls within? Do you have any thoughts as to why it's taken so long to try to address this issue?***

Mr Hawke: ***You might have answered your own question in relation to the corporations power of the Constitution. This is because we're a federation and this hasn't been addressed, isn't it? That's the answer to your question. As usual, with a lot of these complex things, because the states run the trusts, we need a referral. There is a constitutional question which you mentioned; therefore, is that why you're recommending this?***

3.12 Trust law is indeed a matter of State rather than Commonwealth jurisdiction, so national legislative reform would require consideration of constitutional issues. The Commonwealth Parliament has twice sought to bring trusts within its constitutional purview by referendum: see the *Constitution Alteration (Trusts) 1912* and the *Constitution Alteration (Industry and Commerce) 1926*. Both proposals (which related to trusts used for anti-competitive purposes or restraint of trade) failed to achieve the necessary majority.

3.13 Even though the Commonwealth Parliament enjoys the benefit of a "corporations power",[4] after a long history of difficulty in aligning company law across the Commonwealth, the *Corporations Act* (which includes the regulation of managed investment schemes that are configured as trusts with a corporate trustee) was enacted and operates with the benefit of State referrals of power: see *Corporations (Commonwealth Powers) Act 2001* (NSW) and equivalents in other states.

3.14 Commercial trusts operate nationally across State/Territory borders. Ideally, reform in this area would be implemented by the Commonwealth Parliament acting, if necessary, under referrals from the States, rather than by separate State (and Territory) legislation.[5] I do not claim constitutional law expertise and so I do not offer views or discuss the issues beyond this. That is best left to the experts.

3.15 While trusts with a corporate trustee could be dealt with in the *Corporations Act*, that would not be appropriate for trusts with a natural person as trustee. They might have to be dealt with in the *Bankruptcy Act* (again, possibly, with a referral of State powers) and, possibly, uniform supporting amendments to the State and Territory trusts legislation.[6] Of course, if recommendations to merge the two regimes are adopted (with appropriate State referrals), the constitutional issues in the distinction would be dealt with in that process.

3.16 As to whether constitutional complexities are the reason why issues around the insolvency of trusts have not been addressed before now by the Commonwealth, I am not aware that this has ever been debated in Parliament, or that the Commonwealth Government has ever sought, or even mooted, the necessary referrals from the States and been rejected.

Senator Scarr: ***What happens in other jurisdictions? For example, in England in this space, how do they deal with this issue?***

3.17 The trust, like so much of our law, is English in origin and it continues to operate in England and across the common law word (and even beyond that), despite being several centuries old (and much older than the company incorporated by registration, which was

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4 See section 51(xx) of the *Constitution.*

5 The Harmer Report itself noted that "a separate code for winding up trusts located in each State trustee legislation may result in different schemes in each State and Territory. The Commission prefers a uniform Australia-wide approach", at para 242.

6 This issue was noted in the Harmer Report, at para 270.

established in 1844). Because trusts were not designed or intended for active risk-taking business, and trustees did not typically borrow money or incur substantial debts, trusts only infrequently became insolvent. On the rare occasion on which that occurred, courts in the equitable jurisdiction managed affairs by applying rudimentary principles of accounting and bankruptcy law. Because of this, historically there was never any real pressure on Parliament to enact legislation specifically to deal with trust insolvency.

3.18 However, in Australia in the 1970s there emerged a new species of trust, the *commercial* or *trading* trust. Rather than simply investing in and managing passive assets, the trustee applies the trust fund in active risk-taking business endeavours, including borrowing money and incurring other business debts and liabilities, with a view to generating profit for distribution to equity holders (ie the beneficiaries), in the process exposing the trust to the real risk of insolvency. This is a species of trust that behaves just like a trading company.[7]

3.19 The modern trading trust is regarded across the common law world as an Australian idiosyncrasy.[8] In 1981 the late Professor Harold Ford famously (and somewhat presciently) described the Australian trading trust as a "commercial monstrosity", not least because of the risks it created for creditors.[9] An English commentator noted in 1995 that "Australia has developed concepts of trading trusts in the last decade or so which appear to be responsible for the only major source of modern learning of the topic of trustee liabilities, even though to English readers the words trading trust look like a contradiction in terms".[10] Another described the insolvent trading trust as a "specifically Australian problem".[11] Even in Australia, the trading trust has been described as an "antipodean mutation".[12] Tony Slater KC described the emergence and spread of the trading trust in the 1970s as "relatively sudden" and observed that it "has few parallels outside Australia".[13] More recently, Professor Matthew Harding of the Melbourne Law School noted that the widespread use of trading trusts is "a distinctive feature of the Australian business sector".[14]

3.20 In a decision handed down last year, the Privy Council observed that this use of the trust was *not* a feature of commercial life in the United Kingdom, and has caused Australian courts to give significant consideration to certain trust issues that have not arisen in the same way elsewhere. It went on to make extensive reference to Australian authorities in its decision.[15]

3.21 In my opening statement at the Sydney Hearing I put to the Committee a series of statistics that demonstrate how widespread is the use of the trust in Australian commerce and how significant a sector of the economy they represent. I am not aware that anyone is seriously suggesting that this state of affairs should cease. The trust is now an established, generally accepted and highly useful option on the menu of

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7 I say a "new species of trust" but there are distinct echoes in it of the pre-1844 unincorporated joint stock company, which was essentially an early form of what we would today call a unit trust: see N D'Angelo, *Commercial Trusts* (LexisNexis Butterworths Australia, 2014), Chapter 2 (*Evolution of the Australian Commercial Trust*).

8 See D Ipp, 'The diligent director' (1997) 18(6) *Company Lawyer* 162 at 167; C McCall, 'Trustees - risks they never thought they ran' (1995) 6 *Private Client Business* 419 at 422-423; A Trukhtanov, 'The irreducible core of trust obligations' (2007) 123 *Law Quarterly Review* 342.

9 HAJ Ford, 'Trading Trusts and Creditors' Rights' (1981) 13 *Melbourne University Law Review* 1 at 1.

10 McCall, footnote 8, at 423.

11 C Harpum, 'Book Review' (1986) 45 *Cambridge Law Journal* 347 in a review of PD Finn (ed), *Essays in Equity* (Law Book Co, 1984).

12 P Agardy, 'Aspects of Trading Trusts' (2006) 14 *Insolvency Law Journal* 7 at 7.

13 AH Slater, 'Amendment of Trust Instruments' (Paper presented at the Society of Trust and Estate Practitioners, Sydney NSW, 29 September 2009) at 2.

14 M Harding, 'Trusts and Statues in the Australian Federation', chapter in VK Liew and YC Wu (eds) *Asia-Pacific Trusts Law Volume 2: Adaptation in Context* (Hart Publishing, 2023), at 196.

15 See *Equity Trust (Jersey) Ltd v Halabi* [2022] UKPC 36, at [95] and following.

available business entities in Australia, offering valuable benefits to those who use and do business with them.

3.22 As part of my doctoral research, I spent a semester at Harvard Law School in 2011.[16] Part of that research was to examine exactly this comparative question, ie whether trusts are used in this way in any country outside Australia and whether lessons could be learned from the experience elsewhere. I discovered that there are no countries where trusts are used as business vehicles to engage in active risk-taking business, trade or commerce in the way that they are, and on the scale in which they are, in Australia. It is thus unsurprising that I found no useful insolvency legislation that relates specifically to trusts, although there are some elements in the United States *Bankruptcy Code*.[17]

3.23 Trading trusts are used to some extent in New Zealand. In 2019, after a lengthy and detailed consultation process over several years, the New Zealand Parliament enacted the *Trusts Act 2019* which substantially revised trust law in that jurisdiction (including by replacing the *Trustee Act 1956*). It contains no insolvency regime in relation to trusts.[18] And the insolvency provisions of the New Zealand *Companies Act 1993* have in common with their Australian counterpart a complete absence of provisions dealing specifically with insolvent trusts.

3.24 Singapore has a *Business Trusts Act 2004* which is broadly similar in concept and structure to the managed investment scheme regime in Chapter 5C of the *Corporations Act*. Like Chapter 5C, it contains no comprehensive insolvency regime to deal with those entities.

3.25 It thus appears that the phenomenon of the commercial or trading trust (as defined in paragraph 3.18 above) is Australian in origin and design, and so the solution for how they are to be dealt with in insolvency will also have to be Australian in origin and design.

4 Response to question on notice

Chair:* *You've indicated that there might need to be a comprehensive legislative solution. On notice would you be able to think about providing such a framework?

4.1 The question on notice does not require a detailed response that addresses all of the identified issues in this area, or the production of a draft exposure bill for proposed remediating legislation (at least, not at this stage).

4.2 Rather, the request was to provide ideas for a *framework* by which a comprehensive solution may be implemented. For these purposes, I do not address specifically or separately trusts with a natural person as trustee, or draw the distinction between them and trusts with a corporate trustee.

Materials reviewed

4.3 In considering a proposed framework, I reviewed carefully other submissions made to the Inquiry (ie in addition to my own) that expressly address trust insolvency and suggest models and/or solutions. I had particular regard to the submissions of Dr Garry

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16 The title of my thesis (completed in 2012) was *The Trust: From Guardian to Entrepreneur. Why the Changing Role of the Trust Demands a Better Legal Framework for Allocating Stakeholder Risk.*

17 The benefits and protections offered to stakeholders by the federal *Bankruptcy Code* are extended to certain types of trust which are functionally equivalent to corporations. The usefulness to us of those provisions is very limited, given the fundamental differences between Australian and US bankruptcy/insolvency laws.

18 According to one commentator, "[a] number of issues relating to the intersection between trust and insolvency law, largely relating to corporate trustees, were highlighted during the reform process culminating in the new Act. In the end these issues were largely deferred until a yet to be announced review of trading trusts. This deferral had the consequence that reform proposals that would have required the amendment of legislation governing personal or corporate insolvency did not proceed": L Taylor, 'Creditors and Trusts' (2021) 29(4) *Insolvency Law Journal* 229.

Hamilton and Dr David Morrison (Submission No. 5), the Law Council of Australia (Business Law Section) (Submission No. 30), the Australian Restructuring Insolvency and Turnaround Association (Submission No. 36), the Hon Reginald Barrett AO (Submission No. 72) and Dr Allison Silink (Submission No. 76).

4.4 Of course, I also revisited Chapter 6 (*Corporate trading trusts*) of the Harmer Report of 1988, the natural starting point in this discussion (although many of its more specific recommendations, and its suggested draft legislation, are now quite out of date, since the law and practice in this area have advanced materially since 1988).

4.5 I also revisited the work of the now defunct Corporations and Markets Advisory Committee (or CAMAC) on managed investment schemes, much of which can be applied more broadly to other commercial trusts.[19] In its 2012 Report it recommended, among other things, that "the *Corporations Act* should regulate the winding up of an insolvent scheme in a manner comparable to the regulation of the winding up of an insolvent company": see page 183.

4.6 I reviewed the Productivity Commission's Report *Business Set-up, Transfer and Closure* (Report No. 75, 30 September 2015) which, among other things, endorsed the alignment of laws on the insolvency of trusts with the regime for companies, consistent with CAMAC's recommendations: see page 433.

4.7 I also reviewed all 29 published submissions to the Commonwealth Treasury's Consultation titled *Clarifying the treatment of trusts under insolvency law* (15 Oct – 10 Dec 2021).

Conclusion and recommended framework

4.8 The overwhelming preponderance of opinion seems to be that the solutions are best implemented by modifying the *Corporations Act* so that, in insolvency, commercial trusts and their stakeholders are dealt with in a manner that reflects the treatment of companies and their stakeholders, insofar as legally possible given their legal and structural differences.

4.9 There appears to be no support for, say, a standalone "Insolvency of Trusts Act". Nor, at the other extreme, is the matter as simple as some sort of shorthand "deeming" of trusts to be companies for the purposes of insolvency law, or the like – that approach would only partially achieve objectives and comes with too high a risk of intended consequences.

4.10 Taking into account the models and solutions suggested in the materials noted above, and assuming the necessary referrals of power from the States, a reform framework would require amending the *Corporations Act* so that it formally recognises and applies properly to, and with respect to, relevant trusts and their stakeholders, reflecting the same policy prescriptions that underpin corporate insolvency.

4.11 This may be done in one of two ways:

(a) amend relevant specific parts of the *Corporations Act* individually so that they have "dual operation" with respect to companies and relevant trusts; or

(b) consolidate all the necessary provisions into a new Chapter (say, a new Chapter 5AA *Dealings with Relevant Trusts and their External Administration*) that contains all the provisions needed for dealing expressly with relevant trusts.

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[19] Before it was defunded and abolished in 2014, CAMAC produced 3 detailed papers on the subject: a Discussion Paper titled *Managed Investment Schemes* (June 2011), a Report titled *Managed Investment Schemes* (July 2012), and a further Discussion Paper titled *The Establishment and Operation of Managed Investment Schemes* (March 2014).

4.12 Given that the *Corporations Act* is already a highly complex (and arguably overly prolix) instrument, the former proposal would only exacerbate that.[20] My strong preference would be the latter proposal.

4.13 I set out in the attached Schedule what I believe should be the principal components of the proposed new Chapter 5AA, by reference to corresponding parts of the *Corporations Act* that currently apply in relation to companies.

4.14 The overall themes and objectives of the suggested framework can be summarised as follows:

(a) in Australia, trusts operate as unincorporated business entities and, in that form, can and do engage in the same commercial activities as *Corporations Act* companies, and on a very substantial scale across the economy;

(b) arm's length parties who conduct business with trusts face all the same risks as those who deal with companies (including the risk of their insolvency), plus a range of additional legal risks unique to the trust form;

(c) legal and other risks faced by those dealing with companies, both at the front-end (ie at the time of dealing) and at the back-end (ie in insolvency), are managed and ordered by sophisticated legislation that reflects prevailing socio-economic and political philosophies and policy positions, while risks faced by those dealing with trusts are not;

(d) there is no obvious policy reason why this should be so, and (to my knowledge) there has never been a deliberate executive or legislative determination that it should be so. The difference can only be explained by regulatory lag, an unintended consequence of the rapid growth in use of the trust as an unincorporated business vehicle in recent decades;

(e) in my view, the primary objective of any reform should be to equate or align, as far as legally possible, the legal risks and outcomes in insolvency faced by arm's length parties who deal with trustees of commercial trusts with those of parties who deal with *Corporations Act* companies acting in their own right, but without otherwise interfering with the essential nature of the trust or the many benefits that accrue to those who use and deal with them as business vehicles.

These objectives can be achieved by legislation at two levels.

Front-end reforms

4.15 Enact legally enforceable protections for arm's length parties who do business with trustees of relevant trusts, that operate at the point of transacting and reflect those that are available under the *Corporations Act* for parties dealing with companies acting in their own right.

4.16 This would shift the risk of internal irregularities (including fiduciary and manager misconduct) that can otherwise have catastrophic consequences for trust creditors in insolvency, away from them and back to the entity itself (ie the trustee and beneficiaries), just as currently occurs with companies.

Back-end reforms

4.17 Enact provisions dealing specifically with insolvent trustees and trusts that reflect the same policy prescriptions and yield the same or equivalent stakeholder outcomes as in a corporate insolvency under Chapter 5 of the *Corporations Act*, to the maximum extent

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[20] And noting that the Australian Law Reform Commission is currently working on a simplification program for corporations and financial services legislation: see its latest publication on this project, *Financial Services Legislation: Interim Report B* (ALRC Report 139).

possible, taking into account the legal and structural differences between companies and trusts. Some of this may be done by cross-referencing relevant parts of Chapter 5 of the Act (or replicating them with necessary changes), but some new provisions will be needed due to the nature of trusts and their differences from companies.

4.18 In particular, I endorse the suggestion made in several submissions (including my own) that, as part of this reform, the *Corporations Act* should recognise and deal with the fund or estate of a relevant trust in insolvency as a standalone economic (even though not legal) entity, separate from the trustee's personal estate and any other trust estate held by it. In the *Carter Holt Harvey* decision the High Court confirmed the fundamental trust law principle that, in insolvency, trust assets and liabilities may not be mixed with the trustee's personal assets and liabilities (or those of any other trust) and must be kept separate. Functionally, that requires an insolvency official to treat the trust as a separate economic entity as a practical matter in any case, even though the *Corporations Act* as currently drafted does not mandate it.[21]

I would welcome the opportunity to discuss the above further with the Committee.

Yours faithfully

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21 *Carter Holt Harvey Woodproducts Australia Pty Ltd v The Commonwealth* (2019) 268 CLR 524. See in particular the discussion in the submission of Dr Allison Silink, being Submission No. 76 on the Inquiry's website. The *Personal Property Securities Act 2009* already treats trusts with an ABN as a separate economic entity for the purposes of registering security interests against trust property: see PPS Regs Schedule 1 clause 1.5, and *Psyche Holdings Pty Limited* [2018] NSWSC 1254.

SCHEDULE
to supplemental submission of Nuncio D'Angelo dated 21 March 2023

Item	Corresponding part of the Corporations Act	Suggested components of new Chapter 5AA *Dealings with Relevant Trusts and their External Administration*
1.	Executive summary	***Overall summary*** In summary, the overall objective of the suggested framework is to equate or align, as far as legally possible, the legal risks and outcomes in insolvency faced by parties who deal with trustees of certain commercial trusts, with those of parties who deal with *Corporations Act* companies acting in their own right, but without otherwise interfering with the essential nature of the trust or the many benefits that accrue to those who use and deal with them as business vehicles. That requires legislation at two levels: (a) protections for parties who deal with trustees of relevant trusts, that operate at the point of transacting and correspond to those that are available to parties dealing with companies acting in their own right (**front-end reforms**); and (b) provisions dealing with insolvent trustees and trusts that reflect the same policy prescriptions and yield the same or equivalent stakeholder outcomes as in a corporate insolvency under Chapter 5, to the maximum extent possible (**back-end reforms**), in each case, after taking into account and allowing for the important legal and structural differences between companies and trusts. ***Which trusts?*** These new provisions should apply to: (a) any trust where the trustee carries on business, or otherwise voluntarily incurs debts and liabilities, in that capacity in Australia (subject in each case to an agreed *de minimis* threshold); and (b) registered managed investment schemes (**MIS**) to the extent issues are not already addressed by existing provisions governing them (together, **Relevant Trusts**). There is no need to force Relevant Trusts to incorporate, or to alter the fact that Relevant Trusts do not have separate legal personality. Trust creation, existence, functioning and remedies should remain matters regulated by State and Territory laws (including the general law of trusts), except to the extent of any inconsistency with these new provisions. These provisions would also override any terms in a trust instrument dealing with the winding up of a Relevant Trust, to the extent of

any inconsistency.

In the discussion that follows, where relevant, "trustee" includes the responsible entity of a MIS and "trust instrument" includes a MIS constitution.

Front-end reforms – a summary

1. Require Relevant Trusts to be registered with ASIC (unless already registered, or required to be registered, under the MIS provisions) and be given a unique numeric identifier, and oblige the trustee to use that identifier in all dealings in its trustee capacity.

2. Require trustees of Relevant Trusts to disclose, and maintain as current, certain information about themselves and the trust on a publicly searchable register maintained by ASIC.

3. To protect counterparties against the adverse effects of internal irregularities (including trustee misconduct), enact a series of statutory "indoor management" assumptions on which persons dealing with the trustee of a Relevant Trust may rely.

4. Enact provisions that extend (or replicate) the benefit of "statutory transfer" of MIS assets and liabilities, as available under sections 601FS and 601FT of the *Corporations Act* for the replacement of responsible entities, to the replacement of trustees of all Relevant Trusts.[22]

Back-end reforms – a summary

1. Include provisions that apply policies, principles and outcomes under Chapter 5 of the *Corporations Act* to Relevant Trusts. In particular, provide that:
   (a) the trust fund or estate of a Relevant Trust, being essentially the trust assets and liabilities; and
   (b) its stakeholders, being the trust creditors and equity participants (ie beneficiaries/members),

   are dealt with in insolvency as if the fund or estate were a standalone economic (even though not legal) entity, separate from the trustee's personal estate and stakeholders, and those of any other trust estate held by it.

2. Include provisions to deal with certain other trust-specific issues for Relevant Trusts.

Interpretation

Interpretation provisions would need to be included to ensure that the new Chapter 5AA prevails and overrides Chapter 5 in relevant circumstances. As a consequential change in relation to MIS, Part 5C.9 would be modified to avoid inconsistencies and overlaps.

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[22] See the issues discussed with *Recommendation 5* on page 13 of my Submission of 30 November 2022.

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<tr>
<td>2.</td>
<td>Chapter 2A Registering a Company</td>
<td>Registration

Provide for ASIC to establish and maintain a publicly searchable register of Relevant Trusts.

Registration would be mandatory for trustees that carry on business in Australia, or otherwise voluntarily incur debts or liabilities in favour of external parties in Australia, in a trustee capacity (not being arrangements that are registered or required to be registered as MIS under Chapter 5C, ie double registration would not be required). It might be appropriate to include a lower-end threshold by reference to minimum value of annual turnover or debts/liabilities to avoid imposing the burden on smaller arrangements.

A failure to register if and when required could lead to personal liability for trust debts for the trustee and the trustee's directors (overriding any contractual limitations that might otherwise operate). It could also lead to the Relevant Trust being wound up by the Court (just as is the case with registrable but unregistered MIS: see section 601EE). It should not affect the trustee's indemnity out of trust assets or in any other indirect way "punish" creditors.

The registered trust would be given a unique numeric identifier (say, an Australian registered trust number or ARTN).[23] A person could, of course, hold multiple ARTNs if it is the trustee of multiple such trusts (just as a company may now be the responsible entity of multiple MIS and hold multiple ARSNs). The trustee would be obliged to use the ARTN in all documents and dealings by the trustee in the relevant capacity.

There should be initial and ongoing lodgement obligations on the trustee of a Relevant Trust to keep certain information on the public register to protect creditors when dealing with the Relevant Trust and in insolvency, and to underpin the suggested new statutory indoor management assumptions (see next point). This could include initial and annual director certifications that support certain of the statutory assumptions (see in particular assumptions (a) to (d) in the next point), but would not include lodging the trust instrument (unless it is a MIS, in which case section 601EA(4)(a) already requires lodgement of the constitution). [24]</td>
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<td>3.</td>
<td>Chapter 2B.2 Basic features of a company</td>
<td>Statutory "indoor management" assumptions for persons dealing with trustees of Relevant Trusts

Under current trust law doctrine, internal irregularities in a trust (including trustee misconduct) can have catastrophic consequences for trust creditors in insolvency, even if they had no actual knowledge or notice of them at the time of transacting with the trustee. Some irregularities can be undiscoverable, and uncontrollable, by external parties, even after extensive due diligence and despite detailed transaction documentation. This has the effect of imposing risks and consequences on innocent "outsiders" that should properly be borne by "insiders". [25]</td>
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[23] This would be so even if the trust already has an ABN; after all, a company can have both an ACN and an ABN – they serve different purposes. The *Personal Property Securities Act 2009* (Cth) would be amended to allow registration of security interests by reference to a Registered Trust's ARTN (as it currently does for ABNs of trusts and ARSNs for registered MIS).

[24] See the issues discussed with *Recommendation 1* on page 9 of my Submission of 30 November 2022.

[25] The issues (including the risks to and consequences for trust creditors) are discussed in Attachment #2 to my Submission of 30 November 2022.

		Enact robust statutory "indoor management" assumptions for the benefit of external parties dealing with the trustee of a Relevant Trust (ie *not* being beneficiaries/members of the trust), similar in conception and effect to those in Part 2B.2 of the Act that are available to parties dealing with companies in their own right (see particularly sections 128 and 129), but modified to address issues specific to the trust form. This would shift the risks posed by internal irregularities and trustee misconduct away from innocent outsiders and back to the trustee and beneficiaries, just as the current corporate assumptions shift the risks of internal irregularities and director/officer misconduct away from innocent outsiders and back to the company. Some of the types of irregularity and misconduct that can lead to adverse outcomes for innocent trust counterparties include the matters addressed in the following suggested assumptions, which persons dealing with the trustee of a Relevant Trust should be entitled to make (this is not necessarily an exhaustive list): (a) a Relevant Trust that is held out by or on behalf of a person claiming to be its trustee, having the name and ARTN (or ARSN) shown on the ASIC register, is properly formed and exists as a trust; (b) the person shown on the ASIC register as the trustee of the Relevant Trust has been duly appointed, has not been removed or replaced, and is the only trustee of the Relevant Trust; (c) there are no former trustees of the Relevant Trust who have, in that capacity, an undischarged claim against the trustee or with respect to the property of that trust; (d) the Relevant Trust is governed by a written instrument that satisfies all formal and legal requirements for efficacy and enforceability, and is enforceable, as a trust instrument under the laws of a State or Territory of Australia, is duly executed and has been duly stamped (and, in the case of a constitution of a MIS, complies in all respects with the requirements of Chapter 5C of the Act); (e) if the trustee of a Relevant Trust, or a person on its behalf, gives a person an original or copy of the trust instrument (and any amendments and supplements) in connection with a dealing, that original or copy (as so amended and supplemented) discloses all the terms of the Relevant Trust other than those implied by law; (f) all provisions of the trust instrument have been complied with and the trustee has not committed a breach of trust; (g) the trustee has the trust power under the Relevant Trust to enter into and perform obligations in connection with the relevant dealing as trustee; (h) the relevant dealing is authorised and is in all respects a proper exercise by the trustee of its trust powers under the Relevant Trust, and does not cause or result in a breach of trust; (i) the trustee has the right to be indemnified in full out of Relevant Trust property for any debts and liabilities it incurs as trustee of the Relevant Trust in connection with the relevant dealing; (j) the trustee's personal liability for any debts and liabilities it incurs as trustee of the Relevant Trust in connection with the relevant dealing is not limited (including to its ability to discharge them out of the Relevant Trust property) except if and to the

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<tr><td></td><td></td><td>extent agreed with the counterparty to the dealing who is otherwise entitled to make this assumption;
(k) if the Relevant Trust is not registered as a MIS, it is not required to be so registered; and
(l) if the Relevant Trust is a registered MIS, it satisfies all of the formal requirements of Chapter 5C, and neither the responsible entity nor its directors or officers are in breach of their duties and obligations under that Chapter generally or in the responsible entity entering into and performing obligations in connection with the relevant dealing.
Just as with the corporate statutory assumptions:
• neither the trustee nor any beneficiary/member of the Relevant Trust would be entitled to assert in proceedings in relation to the dealings that any of the assumptions are incorrect: see section 128(1);
• a person would be entitled to make these assumptions in relation to dealings with another person who has, or purports to have, directly or indirectly acquired trust property from the trustee of a Relevant Trust. Neither the trustee nor that other person nor any beneficiary/member of the Relevant Trust would be entitled to assert in proceedings in relation to the dealings that any of the assumptions are incorrect: see section 128(2);
• the assumptions may be made even if the trustee or an officer or agent of the trustee acts fraudulently, or forges a document, in connection with the dealings: see section 128(3); and
• a person would not be entitled to make any of these assumptions if at the time of the dealing they knew or suspected that the assumption was incorrect: see section 128(4).
To achieve maximum risk alignment with parties dealing with companies acting in their own right, this regime would be expressly stated to be exclusive or exhaustive in relation to Relevant Trusts, so as to fully displace the equitable doctrines that disentitle a trust counterparty from asserting a direct or indirect claim against trust property (including in insolvency) at a much lower threshold of knowledge or notice (and even in some cases where they have no knowledge or notice) of internal irregularities or trustee misconduct.[26]</td></tr>
<tr><td>4.</td><td>Chapter 2B.6 Names</td><td>These provisions should be applied also to the names and unique numeric identifiers of registered trusts.</td></tr>
<tr><td>5.</td><td>Chapter 2C Registers</td><td>These provisions should be applied also to the register of Relevant Trusts.</td></tr>
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[26] As to which, see N D'Angelo, *Transacting with Trusts and Trustees* (LexisNexis Butterworths Australia, 2020), at 5.14 to 5.96.

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<td>6.</td>
<td>Chapter 5 External administration</td>
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Application of Chapter 5 policies, principles and outcomes to Relevant Trusts
Because the trust is so fundamentally different from a company (not least because it is not a separate legal entity), it is necessary to enact provisions, taking into account those differences, that yield the same or equivalent stakeholder outcomes in the insolvency of a Relevant Trust as those that result in a corporate insolvency under Chapter 5 of the Act, based on the same policy prescriptions regarding solvency, external administration, priority, ranking, voidable transactions, distributions, etc. Some of this may be done by cross-referencing relevant parts of Chapter 5 (or replicating them with necessary changes),[27] but some new provisions will be needed.
In particular, the provisions would recognise and deal with the trust fund or estate of a Relevant Trust as a separate economic (even though not legal) entity, with its own assets, liabilities, creditors and equity participants (ie beneficiaries/members), separate and distinct from those of the trustee personally and any other trust estate held by it. Among other things, this would ensure that:
(a) the assets of a Relevant Trust are only used to pay creditors of that Relevant Trust and not the personal creditors of the trustee, or the creditors of any other trust;
(b) the claims of creditors of a Relevant Trust are properly ranked inter se in the same way as creditors of a company, with the order of priority and distribution in liquidation of a Relevant Trust following the scheme that operates in relation to companies; and
(c) any residue after the discharge of all of a Relevant Trust's debts is distributed to the beneficiaries/members of the Relevant Trust.[28]
For efficiency, the same insolvency official could act concurrently in multiple capacities, ie in respect of the company personally and in respect of each Relevant Trust of which it was trustee (this may require provisions dealing with potential conflicts). An early task for a liquidator appointed to an insolvent trustee or Relevant Trust would be an exercise in taking accounts and allocating assets and liabilities to the trustee's personal estate and to the estate of each trust of which the trustee was trustee. In this, the liquidator would be given certain leeway to exercise discretions in good faith to deal with poor record-keeping etc by the trustee (subject to the Court's power to make a different determination on challenge by any affected stakeholder).
The assets of a Relevant Trust would include any recoveries under section 588FF (eg unfair preferences and other voidable transactions) if and to the extent the original transaction or conduct was entered into by the trustee in its capacity (or purportedly in its capacity) as trustee of that Relevant Trust.
Any debts of a Relevant Trust that could not be discharged out of the assets of that trust would become personal debts of the trustee, to be discharged out of the trustee's personal assets, pari passu with all its other personal debts in accordance with the existing provisions
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27 For example, note how the related party transactions regime in Chapter 2E of the *Corporations Act* is incorporated into Chapter 5C so as to apply to MIS, by Part 5C.7 of the Act.

28 Among other things, this would deal with the difficulties caused by the interpretation given to the expression "property of the company" by the High Court in *Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth of Australia* [2019] HCA 20 (as to which, see the submission of Dr Allison Silink, being Submission No. 76 on the Inquiry's website).

		of Chapter 5.[29] There would be provisions clarifying that the liquidator's remuneration, costs, expenses and disbursements are to be allocated across the personal and trust estates proportionately by reference to where effort is applied, determined by the liquidator in good faith and without need for a court order (subject to the Court's power to make a different determination on challenge by any affected stakeholder). ***Additional trust-specific changes*** In addition, new provisions should be included to deal with certain trust-specific issues for Relevant Trusts, for example (and this is not an exhaustive list): (a) *an "insolvent" Relevant Trust estate*: although a trust does not have separate legal personality, it is economically possible for a trust fund or estate to become "insolvent" without the trustee itself also being insolvent.[30] The law should permit the estate of a Relevant Trust to be placed into a form of external administration (including voluntary administration and liquidation) even if the trustee itself is not insolvent. For example: (i) a solvent trustee should be able to resolve to place an insolvent trust estate into voluntary administration or liquidation (and there should be incentives for it to do so, and/or personal sanctions for itself and its directors for failing to do so); and (ii) creditors of an insolvent Relevant Trust should be able to force that trust into liquidation. In either case, creditors of a Relevant Trust that has become insolvent should not have to wait (as they do under current law) until the trustee becomes insolvent (if ever) before the trust assets and liabilities are taken out of the control of the trustee and placed into the hands of insolvency practitioners (with them deemed to be appointed as replacement trustees for that purpose, with suitable limits on personal liability for antecedent debts and liabilities); (b) *"trustee ejection" clauses*: override or control "trustee ejection" clauses in trust instruments for Relevant Trusts, ie provisions that automatically remove (or give the beneficiaries or other person the power to remove) a trustee that is insolvent or subject to

[29] Subject, in the case of some creditors, to any agreed trustee limitation of liability clause, as to which, see generally Chapter 3 (*Trustee limitation of liability clauses*) of *Transacting with Trusts and Trustees* (footnote 26).

[30] For a suggested definition of when a trust (or trust fund or estate) may be said to be "insolvent" see *Transacting with Trusts and Trustees* (footnote 26), at 10.89. In summary, and reflecting the definition in section 95A of the *Corporations Act* for companies, a trust can be said to be solvent if, and only if, the trustee is able to pay all trust debts as and when they become due and payable out of trust assets and (where it is obliged to do so) its own assets; a trust that is not solvent in this sense can be said to be insolvent. A debt of a trustee is a "trust debt" of a trust if the trustee is entitled to apply the assets of that trust to pay it (even if it is also obliged to pay it out of its own assets), disregarding for the purposes of this definition any application of the clear accounts rule. A trustee may remain solvent while a trust under its control is "insolvent" if the trustee is protected from personal liability for trust debts by trustee limitation of liability clauses in all or most of its contracts: see *Transacting with Trusts and Trustees* (footnote 26) at 10.94 and following. The use of these clauses is very common in Australian commerce among professional trustee companies and other well-advised trustees: see generally Chapter 3 (*Trustee limitation of liability clauses*) of *Transacting with Trusts and Trustees* (footnote 26). I acknowledge that the suggestion in this paragraph (a) may be seen by some as somewhat radical and would need to be tested thoroughly in consultation over an exposure draft bill.

		any form of external administration; (c) *trustee's indemnity*: in a liquidation of a Relevant Trust, preserve and protect, for the benefit of unpaid trust creditors, the full value of the exoneration limb of the trustee's indemnity against Relevant Trust property, despite the terms of the trust instrument or any internal irregularity or trustee misconduct that might have otherwise impaired it (this would include disengaging or overriding the effect of the "clear accounts rule" with respect to creditors). This could be seen as an expansion and enhancement of section 601FH of the Act that applies in relation to MIS. However, creditors who are disentitled from relying on the new statutory assumptions discussed above might not enjoy this protection in relevant circumstances; (d) *insolvency officials' powers*: ensure that receivers, administrators and liquidators of a trustee (or of a Relevant Trust estate) are given plenary statutory powers to deal with trust assets and liabilities, unaffected by the terms of the trust instrument or any pre-appointment conduct of the trustee, and without requiring an application to any court; (e) *ranking of trust creditors*: the general *pari passu* rule in section 555 should apply to and among all creditors of a Relevant Trust, subject to the statutory priorities under section 556, as applicable to the trust. In particular, it should be made clear that unsecured creditors whose claims arise from dealings with a former trustee enjoy *pari passu* ranking with creditors whose claims arise from dealings with the current trustee (which will require that all present and former trustees' indemnity claims in relation to those debts must themselves rank *pari passu*);[31] (f) *"substantial security" in voluntary administration*: if, as suggested above, a Relevant Trust can be placed into voluntary administration, then the advantages currently available to a secured creditor of having "substantial security" (ie security over the whole or substantially the whole of the property of a company) should accrue to someone who deals with a trustee of a Relevant Trust and who holds security over the whole or substantially the whole of the property of the Relevant Trust;[32] (g) *exclude trust assets from "substantial security" test:* the test for whether a creditor holds security over the whole or substantially the whole of a company's property for the purposes of the voluntary administration provisions should exclude from the calculation the company's interests in all assets held on trust (with exception for an interest in trust assets arising from the trustee's indemnity claim for reimbursement or recoupment of trust debts and liabilities that it has discharged with its own money, which interest is properly regarded as personal to the trustee and not held on trust); (h) *modify directors' duties and liabilities*: for corporate trustees of Relevant Trusts, modify directors' duties to more fully and properly protect trust creditors by: (i) extending directors' personal liability for insolvent trading under sections 197 and 588G of the Act so that liability attaches if the fund or estate of the Relevant Trust is insolvent, even if the trustee itself remains solvent;[33] and

[31] This addresses the "third issue" discussed by the Privy Council in *Equity Trust (Jersey) Ltd v Halabi* [2022] UKPC 36.
[32] See the issues discussed with *Recommendation 2* on page 10 of my Submission of 30 November 2022.
[33] See the issues discussed with *Recommendation 7* on pages 14 to 16 of my Submission of 30 November 2022 (and see footnote 30).

		(ii) extending the director's common law duty to take into account the interest of creditors when a company is in the zone of insolvency to include a duty to take into account the interest of *trust* creditors when the Relevant Trust is in the zone of insolvency, even if the trustee itself is not;[34] (i) *limited liability for beneficiaries*: enact statutory limited liability for beneficiaries/members of Relevant Trusts, similar to that for shareholders of companies;[35] (j) *perpetuities*: abolish the rules against perpetuities and remoteness of vesting for Relevant Trusts;[36] and (k) *Court powers*: include a provision analogous to the useful section 447A (which appears in in Part 5.3A in relation to voluntary administration) by which the Court can make such orders as it considers appropriate as to how these provisions are to operate in respect of any particular Relevant Trust.[37]

34 See footnote 30.
35 See the issues discussed with *Recommendation 8* on page 16 of my Submission of 30 November 2022.
36 See the issues discussed with *Recommendation 6* on page 14 of my Submission of 30 November 2022.
37 This would be in addition to and not instead of the general right available to all trustees and their representatives to seek advice and direction from the Court under section 63 of the *Trustee Act 1925* (NSW) and equivalents elsewhere.