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Review of the regulatory framework for managed investment schemes
Submission

1 Introduction

1.1 This submission is in response to the Consultation Paper titled *Review of the regulatory framework for managed investment schemes*, dated August 2023.

1.2 I am a partner of the law firm Norton Rose Fulbright, but I make this submission 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.

1.3 I write as someone with a keen interest in the subject. I have published and presented on commercial trusts, including those that are registered managed investment schemes (or **MIS**), for many years.[1]

1.4 I fully support the Consultation and welcome the opportunity to make a submission. I am particularly pleased that Treasury has taken up the excellent work in this area that was begun by CAMAC in 2011 and terminated prematurely by its abolition in 2014.

1.5 Because there are some common themes, I disclose that:

(1) I was a co-author of a submission to Treasury's consultation on *Clarifying the treatment of trusts under insolvency law* (October 2021);[2] and

(2) I made personal submissions to the Parliamentary Joint Committee on Corporations and Financial Services inquiry on *Corporate Insolvency in Australia* (September 2022) (the "**PJC Inquiry**").[3]

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1 See Annexure A for a selection of publications. In this submission, the expression "***Transacting with Trusts***" means N D'Angelo, *Transacting with Trusts and Trustees* (LexisNexis Butterworths Australia, 2020).

2 See the submission at https://treasury.gov.au/sites/default/files/2022-04/c2021-212341-dangelo-nuncio.pdfof trusts under insolvency law (treasury.gov.au).

3 See my submission (#19) and supplemental submission (#19.1) at https://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Corporations_and_Financial_Services/CorporateInsolvency/Submissions. See also Chapter 14 of the final Report, at https://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Corporations_and_Financial_Services/CorporateInsolvency/Report.

1.6 While those submissions related to trusts more generally and not just MIS, much of what was said in them could be applied to trusts that are MIS. I have included here relevant arguments and materials from those submissions, including in particular in Annexure B (which, with some modification, substantially replicates the Schedule to my Supplemental Submission to the PJC Inquiry).

2 Focus of this submission: scheme creditors' rights

2.1 I am a practising lawyer with several decades' experience negotiating and enforcing financing and commercial contracts across a wide range of transactions. Very often in Australia a party to a transaction will be a trust (or, more precisely, a company acting as trustee of a trust), which may also be a MIS (in which case the contracting party is a company acting as responsible entity (or **RE**) of the scheme). That presents transacting counterparties, whether financiers or suppliers of goods and services, with a series of legal risks and challenges that do not exist when they deal with a *Corporations Act* company acting on its own account.

2.2 With some exceptions, I do not respond specifically to the questions in the Consultation Paper. My submission rather is of a general nature. In particular, I want to direct Treasury's attention to the position of creditors and other external counterparties who transact business with REs and MIS, because they are materially disadvantaged in terms of legal protections when compared to those who deal with companies transacting on their own account, particularly when it comes to insolvency.

2.3 I acknowledge that the Minister's media release of 4 August 2023 stated that the Consultation was to ensure that the MIS "effectively protects *investors* from unnecessary financial risk" and to seek feedback on whether "the rights of *investors* are adequately protected". But it also stated that the Consultation is to consider if the MIS "remains fit-for-purpose", and the media release of 8 March 2023 noted that the Consultation would also "identify potential gaps," and consider "whether an insolvency regime is required for MIS". Question 21 in the Consultation Paper asks "Would a tailored insolvency regime for schemes improve outcomes for scheme operators, scheme members *and creditors*?" Based on those latter criteria, the position of creditors and other external counterparties properly forms part of the inquiry.

2.4 Thus, to the extent necessary to establish a nexus with the Consultation Paper, this submission responds primarily to the issues raised in Chapter 6 (*Winding up insolvent schemes*), although there is also some application to the issues in Chapter 3 (*Scheme governance and the role of the responsible entity*).

3 Themes of this submission

3.1 Chapter 5C of the *Corporations Act* has been with us substantially in its current form since 1998. However, as a regulatory regime it is lop-sided. Unlike the Act generally which, in respect of companies, carefully weighs and balances the competing interests of investors (shareholders) and creditors, when it comes to MIS Chapter 5C is self-evidently an *investor* protection regime that, except incidentally, largely ignores creditors. Among other things, it contains no "indoor management" protections and no insolvency provisions with respect to MIS, of the kind that apply under the Act to protect external parties when they deal with a company acting on its own account. This defect is not compensated by the general law of trusts, whose primary focus is and always has been the protection of beneficiaries and "their" property, with relative indifference to the interests of trust creditors.

3.2 The underlying themes of this submission are these:

(1) in Australia, MIS operate as unincorporated business entities and, in that form, can and do engage in all the same commercial activities as *Corporations Act*

companies acting on their own account, and on a very substantial scale across the economy;

(2) arm's length parties who conduct business with MIS 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 unincorporated nature of the MIS;

(3) 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 the *Corporations Act*, which is a sophisticated piece of legislation that reflects prevailing socio-economic and political philosophies and policy positions. Legal and other risks faced by those dealing with REs and MIS are not so managed or ordered – MIS are only partially regulated by the *Corporations Act* and almost none of that regulation is designed for creditor protection;

(4) there is no obvious policy reason for this disparity of treatment. The difference can only be explained by regulatory lag, an unintended consequence of the rapid growth in use of the trust and the MIS as unincorporated business vehicles in recent decades;

(5) from scheme creditors' perspective, the law should be reformed to equate or align, as far as legally possible, their legal protections, risks and outcomes (including in enforcement and insolvency) 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 MIS or the many benefits that accrue to those who use and deal with them as unincorporated business vehicles.

3.3 In its 2012 Report titled *Managed Investment Schemes*, CAMAC 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. The Productivity Commission's report *Business Set-up, Transfer and Closure* (Report No. 75, 30 September 2015) endorsed the alignment of laws on the insolvency of trusts with the regime for companies, consistent with CAMAC's recommendations: see page 433. They were not alone in this: see paragraph 5.2 below.[4]

3.4 As a telling historical aside, in some respects the MIS can be seen as a modern version of the pre-1844 English unincorporated joint stock company, an unregulated trust-based business entity that proved to be so dangerous to investors and creditors that (after a failed attempt at abolition with the *Bubble Act* of 1720) they were outlawed by the series of legislation that began with the *Joint Stock Companies Act* and the *Joint Stock Companies Winding-Up Act* of 1844 and culminated in the *Companies Act* of 1862. The Australian colonies soon followed. As a policy matter, it is quite extraordinary that substantial unincorporated business entities are permitted, and indeed encouraged, to exist in 21st century Australia *without* a dedicated policy-based regime for managing stakeholders' risks and allocating assets and losses in insolvency. This is all the more surprising when one considers that these entities are permitted to raise funds from the public and carry on business just like a *Corporations Act* company. A comparison with the pre-1844 unincorporated joint stock company is irresistible. It is disappointing that, almost 180 years after the process of legislating for the winding up of companies began in England, there is no equivalent legislation for Australian entities that are the direct descendants of the unincorporated joint stock company.

4 The calls for a legislated insolvency regime for commercial trusts can be traced as far back as the Harmer Report of 1988 and numerous publications of academics, practitioners and judges since.

3.5 I now highlight 2 specific areas for reform:

(1) statutory indoor management assumptions; and

(2) insolvency provisions.

3.6 I also address certain miscellaneous other matters.

4 Statutory indoor management assumptions

4.1 Managing risks in insolvency begins at the transaction stage. For the reasons that follow, I recommend that Chapter 5C of the *Corporations Act* be amended to insert innocent outsider (or "indoor management") protections for external parties dealing with REs and MIS. These provisions should correspond (as applicable) to those that are available to persons dealing with companies on their own account under the *Corporations Act*, tailored to the complexities of the trust in the form of a MIS. I have suggested a range of possible assumptions in Annexure B.

4.2 These provisions would protect persons who are innocent of disentitling knowledge or suspicion against adverse consequences of internal defects in the MIS, and RE misconduct, and allow them to transact with REs with a higher degree of confidence and with lower transaction costs and risks.

4.3 Importantly, they would eliminate a range of unexpected adverse outcomes (and associated litigation) in the insolvency of a MIS and/or RE.

Compare and contrast: when dealing with a company on its own account

4.4 Company law provides generous innocent outsider (or indoor management) protections, including statutory assumptions, that benefit persons who transact and otherwise deal with a *Corporations Act* company. So long as they are not affected by *actual* knowledge or suspicion that there is something wrong, counterparties may deal with a company with confidence, with minimal or no due diligence in relation to essential matters like existence, legal status, power, authority and internal compliance (including compliance with officers' duties), beyond obtaining and checking an ASIC search: see sections 124 to 129 of the *Corporations Act*. Their claims will be upheld in enforcement or insolvency despite constitutional or governance defects in the company, or fiduciary misconduct by directors and managers, at the time of the dealing.

4.5 From a policy perspective, by this mechanism the law shifts internal risks in a company to its internal stakeholders to manage (where they properly belong), and allows otherwise vulnerable external parties without actual knowledge or suspicion to deal with companies more easily and efficiently, and with confidence.

When dealing with the RE of a MIS

4.6 Almost none of those protections are relevant or applicable to any trustee or RE capacity in which the company may transact. And neither Chapter 5C, nor the law of trusts that supports it, provide any equivalents. Such protections as there are in the general law of trusts are fragile and easily lost, and tend in their strictness to preference beneficiaries (ie members) over outsiders (including creditors) – disqualification is certainly not limited to *actual* knowledge or suspicion.[5]

4.7 From a policy perspective, the law leaves vulnerable external counterparties to bear the consequences of internal risks. Constitutional and governance defects, and fiduciary misconduct by the RE, at the time of the dealing (and even some that may arise or occur later) may ultimately result in external counterparties having limited or no access to the value of MIS assets on enforcement or insolvency.

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5 See generally Chapter 5 (*Risks when transacting with trustees*) of *Transacting with Trusts*.

Examples that expose the difference

4.8 Take this simple example: if a company purports to give an unsecured guarantee to a creditor and, in doing so, its directors are in breach of their duties to act in good faith in the best interests of the company and for a proper purpose, then under sections 128 and 129 of the *Corporations Act* the creditor can still enforce the guarantee and participate in a distribution of the company's assets in insolvency, unless the counterparty actually knew of the breach or suspected it: section 128(4). By contrast, if a company purports to give an unsecured guarantee as the RE of an MIS, and in doing so breaches similar duties as RE (see section 601FC(1) and general law equivalents), the creditor does not have any access to the MIS assets, whether in enforcement or in insolvency, *even if they did not know of or suspect the breach*. The breach disengages the trustee's indemnity, leaving nothing to which the creditor may subrogate on enforcement (noting that subrogation is the only means by which an unsecured creditor can access the value in trust or scheme assets).

4.9 Take this second example: say an RE borrows money under a loan agreement for the purposes of the MIS and at every step it acts entirely properly, in accordance with its powers and duties. Prima facie, the lender will have access to scheme assets on enforcement or insolvency, via the RE's indemnity. But some time before that, in an entirely unrelated transaction, the RE had made a large investment that was not in accordance with the MIS constitution and thus was in breach. That investment proves unsuccessful and the losses fall on the RE personally, which means it must make good by paying an amount equal to the losses into the scheme fund. In those circumstances, due to the operation of the "clear accounts rule", the RE will have no right to indemnify itself out of MIS assets against a claim under the loan agreement, unless and until it makes good on its liability. If it is unable to do that, the result may be that the lender will have no or reduced access to the MIS assets on enforcement or insolvency, *even if they did not know of or suspect the earlier, unrelated breach*.[6] There is no equivalent to this outcome for a company acting on its own account, even if the RE is equated with the directors; a director's liability to account to the company for a breach of duty has no effect on the claims of uninvolved external creditors against the company.

4.10 Take this third example: to secure scheme obligations, an RE gives a creditor security over a scheme asset. Unbeknownst to the creditor, there is a prohibition in the scheme constitution against the RE encumbering scheme assets, so the security is given in breach of trust. The RE defaults and the creditor proceeds to enforce against the encumbered scheme asset, but is challenged by the members (or the RE's insolvency official), on the basis of both (a) an exception to the bona fide purchaser rule, arguing that the creditor was not "without notice" of the prohibition (having "constructive notice" of it), and (b) the *Barnes v Addy* doctrine, arguing that they were knowing recipients of trust property in breach of trust (again, on tests that disentitle a person simply for failing to make enquiries). In neither case would it be necessary to prove that the creditor had *actual* knowledge or suspicion of the prohibition. Neither of these would be available defences if the dealing was with a company acting on its own account and there was similar prohibition in its corporate constitution, so long as the creditor did not have *actual* knowledge or suspicion of it.

4.11 All of this means that financiers and others contemplating transacting with the RE of an MIS (including commercial contracting counterparties in a non-financing context) must fend for themselves and seek whatever protection may be available by private means. Well-advised counterparties will be aware of the risks and will conduct (or have their advisers conduct) detailed pre-transactional due diligence of a kind that is not necessary when dealing with a company acting as principal. But no matter how diligent they may be, those measures cannot fully protect them.

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6 Incidentally, the same result would flow if the unrelated breach took place *after* the loan transaction.

4.12 In the event, the costs of transacting (including legal costs and management time) will be higher. [7]

RE's powers specifically

4.13 With both companies and trustees (including REs) there are two questions to consider in relation to each dealing entered into by them:

(1) did it have the requisite *power* to enter into that dealing?

(2) was entering into that dealing a *proper exercise* of that power? [8]

The question is whether, and the extent to which, a failure on either point could comprise a counterparty's ability to enforce their dealing against, and access the value in enterprise assets of, the company or trust (or MIS), including in insolvency. This part deals with the first point.

4.14 With companies incorporated under the *Corporations Act* the answer to the first question is straightforward, thanks to section 124 which effectively abolished *ultra vires* for companies incorporated under the Act.[9] There is no equivalent for trusts and trustees (or MIS and REs). A trustee (or RE), in that capacity, has only those powers given it in the constituent instrument, and some incidental and ancillary powers under general law. Thus, the *ultra vires* problem is real. As noted above, a dealing entered into beyond trust power can generate material adverse consequences for both the RE and external parties dealing with it.

4.15 For a trust-based enterprise whose purpose is profit-seeking through business activities involving risk-taking behaviour by the trustee, in the course of which trust assets are put at risk and contract debts and liabilities are incurred, the trustee requires the maximum possible scope of authority. Giving the trustee the widest possible powers eliminates (or at least materially reduces) the risk of the trustee performing an act that is beyond power and thus in breach of trust. This operates to the benefit of both the trustee and creditors, who claim though the trustee. In the Australian market, this is achieved privately by including an omnibus power provision in the trust instrument (or, in the case of an MIS, the constitution) which is sometimes described in market parlance as a "plenary powers" or "universal powers" clause.[10]

4.16 Some plenary powers clauses quite deliberately set out to mimic the language and concepts in section 124(1). In doing this, drafters seek to give the RE the most extensive powers available under law. However, that can and does lead to confusion.[11] A universal powers clause in a trust instrument does not have the same effect on a trust as section 124(1) has on a company; they address entirely different factual and legal matrices. Section 124 will, of course, apply to a trustee or RE as a company but it cannot apply with respect to a trust or MIS, which is not a juristic person (and is certainly not an entity to which section 124 applies).[12]

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7 And all of this can be particularly challenging to explain to offshore counterparties in jurisdictions that do not have trusts, or trusts that engage in commerce in the way Australian trusts do.

8 See generally Chapter 2 (*What concerns trustees when they transact*) of *Transacting with Trusts*.

9 Section 124(1) provides, as relevant, that 'A company has the legal capacity and powers of an individual both in and outside this jurisdiction'.

10 An example clause is set out in *Transacting with Trusts* at 2.95. Of course, a plenary powers clause alone is not sufficient in relation to an MIS; section 601GA of the *Corporations Act* requires certain powers to be specified in the constitution.

11 See the discussion on this point in the *Wellington Capital* litigation: at first instance, *ASIC v Wellington Capital Ltd* [2012] FCA 1140; on appeal, *ASIC v Wellington Capital Limited* [2013] FCAFC 52; and in the High Court, *Wellington Capital Limited v ASIC* [2014] HCA 43.

12 Of course, despite the breadth of language (including use of expressions like "absolute discretion"), plenary powers clauses do not give a trustee or RE unfettered or absolute rights in dealing with trust property. Plenary powers clauses cannot eliminate breaches that arise from an improper exercise of power.

4.17 There is no reason in logic or policy that the RE of a scheme and the external counterparties with whom it deals should be exposed to the *ultra vires* problem. Leaving the critical and fundamental question of power to the private market, with all that entails including the risk of errors in drafting, is not appropriate for entities that raise money from the public and deal with arm's length creditors and other counterparties.

4.18 I recommend that Chapter 5C be amended to include an equivalent to section 124 for REs and MIS. The current requirements of section 601GA of the Act are wholly inadequate in this regard.

4.19 If, as a matter of private bargain, in relation to a given MIS the promoters and investors wish to restrain or limit the RE's powers, then the Act should contemplate that in a manner similar to that applicable to company constitutions. Section 125 allows for a company's constitution to "contain an express restriction on, or a prohibition of, the company's exercise of any of its powers" or to narrow the scope of its objects, but no act of the company in contravention is invalidated as a result: section 125(2). Section 129(1) then allows a counterparty to assume that the constitution has been complied with, and section 129(4) allows them to assume that the company's officers have properly performed their duties. The company remains bound to its engagements, any counterparty's claim remains sound (absent disentitling actual knowledge or suspicion) and, importantly, the assets of the enterprise continue economically to support any liabilities incurred.

4.20 By contrast, under current law if an RE enters into a transaction acting beyond its given powers the consequences for both it and the counterparty are dramatically different. While the engagement is not invalidated, the RE has no right to apply scheme property in respect of any debts or liabilities arising from that act. The counterparty's claim is undermined; even if ignorant of the want of power and innocent of the breach of trust arising from it, there is no indemnity to which it may subrogate to get at the trust assets and it is left with a personal claim against the RE alone (which is, of course, only as good as the RE's financial position). The investors enjoy a possible windfall gain (although they may suffer the cost of expensive litigation if this outcome is challenged).

4.21 Thus, in order for a provision like section 125 to work properly in a MIS context it would need to be accompanied by statutory indoor management assumptions along the lines of ss129(1) and (4) (as affected by s128) (see the suggested assumptions in Annexure B).

5 Insolvency provisions

5.1 As mentioned above, an obvious lacuna in the Chapter 5C regime, certainly from a creditor's perspective, is the complete absence of provisions dealing with scheme assets and liabilities, and stakeholders' rights and liabilities, in the insolvency of a MIS.[13]

5.2 This is indeed a most curious omission. Chapter 5C was the final output of a lengthy consultation process, which resulted in recommendations made by the Australian Law Reform Commission and Companies and Securities Advisory Committee in their joint report *Collective Investments: Other People's Money* (Report No 65, 1993) and by the Financial System Inquiry Committee in *Financial System Inquiry: Final Report* (AGPS, 1997). One suggestion in the former was the inclusion of administration and winding up regimes for insolvent schemes. Chapter 8, headed "Terminating, winding up and voluntary administration of a scheme", expressly discussed insolvency. The Report contained draft legislation that would have applied many of the provisions applicable to

[13] I do not regard the relatively meagre provisions in Part 5C.9 as being in any way sufficient or equivalent to the comprehensive regime in Chapter 5 of the *Corporations Act* relating to the insolvency of companies. On what I mean by "insolvent scheme" see footnote 6 in Annexure B.

the winding up and voluntary administration of companies to collective investment schemes.[14]

5.3 In a puzzling outcome, these recommendations were not enacted and neither the Second Reading Speech for the *Managed Investments Bill 1997* (Cth) which emanated from that report, nor the Explanatory Memorandum for that Bill, explain the reasons for this omission. The result was that the Chapter 5C regime was introduced into the legislation with almost no machinery for dealing with insolvent MIS.

5.4 The *Corporations Act*, and modern company law more generally, are the culmination of a centuries-long process of reform by legislatures and the judiciary. The Act is a sophisticated and highly evolved (and ever-evolving), policy-based, statutory regulatory regime offering relatively efficient and orderly risk allocation, and a balance of investor and creditor protection, designed with risk-taking, profit-maximising activities in mind.

5.5 This balance is reflected in the insolvency provisions in Chapter 5 of the Act. Due to their more vulnerable position as outsiders, that regime throws a protective cloak around creditors and, subject to certain conditions, gives them a preferential position over investors in and around insolvency.

5.6 By contrast, neither Chapter 5C nor general trust law demonstrate these characteristics, or acknowledge the complexities of insolvency when it comes to MIS.

5.7 With some exceptions, MIS (in common with trusts generally) are effectively invisible to the insolvency provisions of the *Corporations Act* and there is no equivalent statute for them. MIS are left to be dealt with as part of the insolvency of the RE as a company, but with no legislative guidance as to how MIS assets, liabilities and creditors should be dealt with separately from the RE's own personal assets, liabilities and creditors. Faced with this legislative vacuum the courts have had to develop a primitive "common law of insolvency" for trusts and MIS in the traditional manner, via the case-by-case resolution over time of private disputes between self-interested parties in an adversarial context. This has not always been – and can never be – completely successful. Many gaps are left and insolvencies involving trusts and MIS continue to generate litigation and yield unpredictable outcomes for all stakeholders. In 2014 the then Chief Justice of New South Wales, the Hon TF Bathurst, noted extra-judicially that:

> 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. [15]

5.8 Australian courts and the general law are certainly capable of ingenuity, and demonstrate it regularly. But this is patently not a matter that should be left to the courts.

5.9 In my submission to the PJC Inquiry I made a range of suggestions for the enactment of insolvency provisions applicable to MIS (and other commercial trusts). I attach the substance of those recommendations in Annexure B.

5.10 Without more detailed analysis I do not at this stage have strong preference for whether insolvency provisions for MIS should, as suggested in Question 21 of the Consultation Paper, reflect (to the extent relevant) those for CCIVs in Part 8B.6 of the *Corporations Act* (which, unlike the general insolvency provisions in Chapter 5 of the Act, are entirely untested). The important point to make at this stage is that there *should be* express provisions in Chapter 5C for dealing with the insolvency of REs and MIS.

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14 See Volume 1 at 8.11-8.14, the draft Explanatory Memorandum in Volume 2 at 14.7-14.14 and Pt 5.3B of the proposed *Collective Investments Scheme Bill* at p70 and following of Volume 2.

15 The Hon T F Bathurst, "The Historical Development of Insolvency Law" (2014) 39 *Australian Bar Review* 113.

6 Miscellaneous related matters

RE directors' personal liability under s588G and s197 [16]

6.1 The personal liability of directors of REs for scheme debts under section 588G and section 197 of the *Corporations Act* should be geared to the solvency/insolvency of the MIS and decoupled from the solvency/insolvency of the RE itself. [17]

6.2 Two provisions of the *Corporations Act* appear on their face to be designed to protect creditors, including trust/scheme creditors, in insolvency by fixing personal liability on directors of a corporate trustee:

(1) section 588G and the rest of Part 5.7B Division 3 (*Director's duty to prevent insolvent trading*); and

(2) section 197 (*Directors liable for debts and other obligations incurred by corporation as trustee*).

6.3 The problem with both of them is that neither operates to protect trust/scheme creditors against losses if a trust/scheme becomes insolvent, if and for so long as the corporate trustee/RE remains solvent. This scenario can occur if the trustee/RE has contractually limited its personal liability for trust/scheme debts to its recourse to trust/scheme assets - a technique that is commonplace in Australian commerce.[18] In this way, the trustee/RE is not obliged (as would otherwise be the position at general law) to use its own money to make up any shortfall in the fund in discharging trust/scheme debts, leaving its personal solvency unaffected by the insolvency of the trust/scheme.

Section 588G

6.4 Directors' liability for insolvent trading under section 588G requires, among other things, that, subject to certain defences:

(a) a debt is incurred by the company (and, although the Act does not expressly say so, that would include a trust or scheme debt), and

(b) the company is insolvent at that time, or becomes insolvent by incurring that debt, or by incurring at that time debts including that debt.

If a corporate trustee (or RE) is not in the relevant state of insolvency at the time it incurs a trust (or scheme) debt, then section 588G cannot operate; there is no statutory duty on the directors not to incur that debt.

6.5 This is so even if *the trust/scheme* is insolvent at the time the debt is incurred such that the creditor cannot be paid out of trust/scheme assets and could not recover from the trustee/RE personally because a liability limitation clause operates.[19] Section 588G only imposes a duty on directors not to allow the company to incur trust/scheme debts when *the company* is insolvent (or near insolvent); it does not impose a duty on them, or

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16 The issues raised in this part are discussed in detail in Chapter 4 (*Directors of trustees: duties and liabilities*) of *Transacting with Trusts*.

17 See footnote 6 in Annexure B for a suggested definition of "insolvent scheme".

18 See Chapter 3 (*Trustee limitation of liability clauses*) of *Transacting with Trusts*. So common and accepted is the practice of trustees seeking, where possible, to limit their personal liability under material contracts, that a legal adviser who does not adequately warn an intending trustee (even an experienced one) of the issue of personal liability and the desirability of limiting it runs the risk of a negligence suit: see *Astley v Austrust Ltd* (1999) 197 CLR 1.

19 I would note that, while trustee liability limitation clauses commonly in use in the market do contain disapplication provisions that switch off the limitation and restore full personal liability for certain trustee misconduct, I do not recall ever seeing a provision that operates to have that effect solely because the trustee incurs a debt while the trust is insolvent (although I have recommended that they should: see *Transacting with Trusts* at 4.68).

the company, not to incur *trust/scheme* debts if or when the *trust/scheme* is insolvent (or near insolvent).

Section 197

6.6 By section 197, a person who is a director of a corporation when it incurs a liability while acting, or purporting to act, as trustee, can be personally liable (jointly and severally with the corporation itself) to discharge the whole or a part of the liability, in the circumstances described in subsections (1)(a) and (b). A creditor seeking recourse under section 197 in relation to a given trust debt must first establish that the trustee is insolvent, ie that it "has not discharged, and *cannot* discharge" that debt: section 197(1)(a). However, it does not need to establish that the trust is insolvent; indeed, the state of solvency of the trust is irrelevant. This is reinforced in the official Note to section 197(1) in the Act: "The person will not be liable under this subsection merely because there are insufficient trust assets out of which the corporation can be indemnified".

6.7 When it comes to a MIS, the catalysing circumstance for liability to fix under section 197 is that the RE's indemnity has been impaired (by a breach of trust or *ultra vires* act by the RE), or negated or limited (by a term of the scheme), with the result that the RE is unable to access scheme assets, or sufficient of them, to discharge the debt: section 197(1)(b). That, in turn, would mean that the creditor's route of access to those assets via subrogation to the RE's indemnity will have been concomitantly compromised, leaving it with a personal claim against the RE only, which, as mentioned, will be insolvent – hence the right then to proceed against the directors personally.

6.8 It follows that in a situation where the RE is solvent, in that it *can* pay the debt, but is not obliged to do so because it enjoys the benefit of a limitation clause, the aggrieved creditor falls at the first hurdle and section 197 cannot operate. This is so even if one or more of the three conditions described in section 197(1)(b) apply such that the indemnity is impaired or unavailable.[20]

6.9 In order for sections 588G and 197 to operate properly to protect creditors of re MIS in insolvency, they need to be geared to the state of solvency of the scheme and decoupled from the solvency of the RE.

Abolition of the rule against perpetuities

6.10 The rules against perpetuities and remoteness of vesting should be abolished for MIS.

6.11 One of the attractive features of a *Corporations Act* company as a business vehicle is perpetual succession. A company may potentially live forever. If it is being wound up and deregistered, that is disclosed publicly on the ASIC record so that actual and potential counterparties can know or find out about it.

6.12 With very few exceptions, trusts (including MIS) do not and cannot have an indefinite life. They are subject to the ancient rules against perpetuities and remoteness of vesting. Well drafted trust instruments (and MIS constitutions) will allow for this and have perpetuity clauses giving the trust a life of up to 80 years, but not all do. It is even possible for a trust instrument to be so defective in this regard that the trust fails to come into existence at all. It is not unusual in practice to come across trusts that, under due diligence, are exposed as suffering some defect or other in this regard, or even occasionally the possibility that the vesting date will occur during the life of a proposed transaction.

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20 Unless, perhaps, the relevant condition is (1)(b)(i) (a breach of trust) or (1)(b)(ii) (the corporation has acted outside the scope of its powers as trustee), *and* the trustee's standard limitation of liability clause is so drafted that this triggers a disapplication provision in the clause, thus restoring full personal liability of the trustee.

6.13 If this is not checked and dealt with by an intending transacting counterparty they may have serious difficulties in enforcement or insolvency.

6.14 South Australia has resolved with this problem by abolishing those rules.[21] The rules have also been abolished in relation to superannuation trusts and funds.[22]

6.15 The rules should be abolished for all MIS (including those that exist on the date of abolition).

Limited liability for investors/members

6.16 This part responds to Question 22 in the Consultation Paper.

6.17 Members of MIS should have statutory limited liability, of the kind that is available for shareholders under section 516 of the *Corporations Act* (which limits the liability of shareholders in a company limited by shares to amounts unpaid on their shares, if any).

6.18 Surprisingly, for a regime that is clearly built around investor protection, Chapter 5C contains no statutory limited liability for investors of the kind that is available to shareholders in companies. As the Consultation Paper acknowledges at paragraph 6.3, this can be difficult to explain to potential foreign investors, particularly those within the Asia-Pacific region. But in my experience in practice, it is not only *foreign* investors who are surprised to hear that they do not have statutorily guaranteed limited liability, or that clauses commonly included in MIS constitutions do not and cannot protect them from liability in every circumstance.

6.19 In my book *Commercial Trusts* I dedicated an entire chapter (Chapter 3) to the legal risks of beneficiaries of commercial trusts, including the risk of personal liability for enterprise debts.[23] Promoters who are aware of the risks seek to limit investors' liability by private means, including exclusion clauses in the trust instrument, but these efforts are not and cannot provide a complete solution, particularly in insolvency.

6.20 In 2017-2018 the NSW Law Reform Commission conducted a review of laws relating to beneficiaries of trusts. The issues around beneficiary liability are well ventilated in the Commission's Consultation Paper (Consultation Paper No. 19), the public submissions, and the final report (NSWLRC Report No. 144).[24] As a result of that work, in 2019 the *Trustee Act 1925* (NSW) was amended to insert a new section 100A which provides that beneficiaries are not liable to indemnify the trustee or make any other payment to the trustee or any other person for any act, default, obligation or liability of the trustee, except in certain limited circumstances. To date, no other State or Territory has enacted an equivalent.

6.21 This reform (at least in substance, if not precisely in that form) should be adopted into Chapter 5C for the benefit of MIS members.

7 Conclusion

7.1 The issues described in this submission, and others consistent with the themes described above, can only be properly resolved by legislation. It is inappropriate that they are left to be dealt with by private means and, when that fails, by the courts, where outcomes can be unpredictable and often out of alignment with corresponding outcomes in relation to a *Corporations Act* company.

7.2 It is somewhat surprising that, in 21st century Australia, persons who do business with a MIS or who otherwise extend credit to or transact with a MIS, suffer risks, costs and

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21 See section 61 of the *Law of Property Act 1936* (SA).

22 See section 1346 of the *Corporations Act*, section 343 of the *Superannuation Industry Supervision Act 1993* (Cth) and complementary provisions in State and Territory trusts legislation.

23 See N D'Angelo, *Commercial Trusts* (LexisNexis Butterworths Australia, 2014).

24 See the NSWLRC's website at: www.lawreform.justice.nsw.gov.au/Pages/lrc/lrc_current_projects/Beneficiaries/Beneficiaries.aspx.

losses, particularly in insolvency, that are not borne or suffered by those who engage in identical dealings with a company acting on its own account.

7.3 I would welcome the opportunity to discuss these issues with you further.

Yours faithfully

N D'Angelo

ANNEXURE A

Selection of relevant publications

Books and chapters

N D'Angelo, *Transacting with Trusts and Trustees* (LexisNexis Butterworths Australia, 2020).

N D'Angelo, *Commercial Trusts* (LexisNexis Butterworths Australia, 2014).

"Reforming the Commercial Trust: Trans-Tasman Approaches", chapter in S Griffiths, S McCracken and A Wardrop (eds), *Exploring Tensions in Finance Law: Trans-Tasman Insights* (Thomson Reuters, 2014).

Articles and papers

N D'Angelo, "Directors of insolvent trustees and trusts: duties and liabilities in respect of beneficiaries and trust creditors" (2017) 35 *Company & Securities Law Journal* 75.

N D'Angelo, "Trustee 'ejection clauses': consequences for liquidators, receivers and creditors (2016) 17 *Insolvency Law Bulletin* 96 (republished in (2016) 13-14 *Butterworths Corporation Law Bulletin* [257])

N D'Angelo, "The trust as a surrogate company: the challenge of insolvency" (2014) 8 *Journal of Equity* 299.

N D'Angelo, "Can we trust the trust?" (2014) 30 *Australian Banking and Finance Law Bulletin* 112.

N D'Angelo, "Managed investment schemes and other commercial trusts: the risks creditors run", Banking & Financial Services Law Association's 30th Annual Conference, Gold Coast, Queensland, August 2013.

N D'Angelo, "The CAMAC Report on managed investment schemes: another opportunity missed?" (2012) 23 *Journal of Banking & Finance Law & Practice* 253.

N D'Angelo, "When is a trustee or responsible entity insolvent? Can a trust or managed investment scheme be 'insolvent'?" (2011) 39 *Australian Business Law Review* 95.

N D'Angelo, "The unsecured creditor's perilous path to a trust's assets: is a safer, more direct United States-style route available?" (2010) 84 *Australian Law Journal* 833.

N D'Angelo, "The trust: evolution from guardian to risk-taker, and how a lagging insolvency law framework has left financiers and other stakeholders in peril" (2009) 20 *Journal of Banking & Finance Law & Practice* 279.

ANNEXURE B

Suggested amendments to the *Corporations Act* to deal with insolvent MIS

<table>
<tr><th>Item</th><th>Suggested amendments to the Corporations Act</th></tr>
<tr><td>1.</td><td>
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 (including MIS), 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 MIS) 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 (including REs of MIS), 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 REs) and trusts (and MIS) 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 (and MIS).
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) 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 RE 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.
</td></tr>
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	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 provisions prevail and override Chapter 5 in relevant circumstances. In particular, Part 5C.9 would be modified to avoid inconsistencies and overlaps.
2.	**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**).[1] 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).
3.	**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". 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

1 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).

	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) (where "trustee" incudes an RE): (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 (or scheme); (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 (or RE) 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 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.[2]
4.	**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),[3] 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.[4] 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 of Chapter 5.[5] 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):

2 As to which, see *Transacting with Trusts* at 5.14 to 5.96.

3 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.

4 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.

5 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*.

(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.[6] 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 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*);[7]

(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

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6 For a suggested definition of when a trust (or scheme) may be said to be "insolvent" (or, as described in some authorities, "unviable") see *Transacting with Trusts* at 10.89. In summary, and reflecting the definition in section 95A of the *Corporations Act* for companies, a trust (or scheme) can be said to be solvent if, and only if, the trustee (or RE) is able to pay all trust (or scheme) debts as and when they become due and payable out of trust (or scheme) assets and (where it is obliged to do so) its own assets; a trust (or scheme) that is not solvent in this sense can be said to be insolvent. A debt of a trustee (or RE) is a "trust debt" of a trust (or scheme) if the trustee (or RE) is entitled to apply the assets of that trust (or scheme) 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 (or RE) may remain solvent while a trust (or scheme) under its control is "insolvent" if it is protected from personal liability for trust (or scheme) debts by trustee limitation of liability clauses in all or most of its contracts: see *Transacting with Trusts* 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*. 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.

7 This addresses the "third issue" discussed by the Privy Council in *Equity Trust (Jersey) Ltd v Halabi* [2022] UKPC 36.

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;

(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; and

   (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;[8]

(i) *limited liability for beneficiaries*: enact statutory limited liability for beneficiaries/members of Relevant Trusts, similar to that for shareholders of companies;

(j) *perpetuities*: abolish the rules against perpetuities and remoteness of vesting for Relevant Trusts; 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.[9]

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8 See footnote 6.

9 This would be in addition to and not instead of the general right available to all trustees (including REs) and their representatives to seek advice and direction from the Court under section 63 of the *Trustee Act 1925* (NSW) and equivalents elsewhere.