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COMMERCIAL TRUSTS AND THE LIABILITY OF BENEFICIARIES: ARE COMMERCIAL TRUSTS A SATISFACTORY VEHICLE TO BE USED IN MODERN DAY COMMERCE?

TUESDAY 5 OCTOBER 2021*

SYNOPSIS

Despite the trust not having its origins in commerce, despite the passage of almost 40 years since Professor Harold Ford published 'Trading Trusts and Creditors' Rights', and despite numerous calls for reform, there remains no comprehensive legislative regime governing what is colloquially described as the insolvency of commercial trusts. This lecture will examine the adequacy of the current regime in Australia as it concerns the liability of beneficiaries in the event of insolvency of a commercial trust. It will examine the question of whether the decision of *Hardoon v Belilios* [1901] AC 118 has any relevance to the problems facing commercial trusts today.

INTRODUCTION

1. Commercial trusts are a key and unique feature of the Australian commercial landscape. Despite their popularity, they are an imperfect vehicle for financial transactions and investments. The prevalence of trusts in commercial transactions has raised important questions surrounding the applicability of equitable doctrines to the modern world of commerce. These questions have been raised by many over decades but, as yet, remain largely unanswered. This evening, I will consider the difficulties that arise from the current use of commercial trusts from the perspective of the beneficiaries, or investors, of these trusts.

* I express my thanks to my Research Director, Ms Jessica Elliott, for her assistance in the preparation of this address.

2. In the 1901 Privy Council decision of *Hardoon v Belilios*, the right of trustees to a personal indemnity from a beneficiary in respect of liabilities incurred by reason of the retention of trust property was described by Lord Lindley as resting upon the "plainest principles of justice".[1] *Hardoon* is authority for the principle that a trustee (or responsible entity in the case of a managed investment scheme) has the right to be indemnified by beneficiaries (or members) who are of full legal capacity and absolutely entitled for liabilities properly incurred by the trustee in the administration of the trust.

3. The trustee is personally liable for debts incurred as trustee.[2] This liability extends to any debts properly incurred in the course of carrying on the business of the trust and not merely to the extent of the trust's assets.[3] As a result, if the debt is not satisfied, the individual trustee may be bankrupted or the corporate trustee wound up.[4] The personal liability of beneficiaries is in addition to the trustee's right of indemnity from the trust assets under both general law,[5] and statute in all states.[6] The principle in *Hardoon* is relevant where the trust is colloquially referred to as 'insolvent'; that is, where the trust assets are insufficient to reimburse the trustee for a liability properly incurred in the administration of the trust.

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[1] [1901] AC 118.

[2] *Octavo Investments Pty Ltd v Knight* (1979) 144 CLR 360 at 367; [1979] HCA 61. See also *Vacuum Oil Co Pty Ltd v Wiltshire* (1945) 72 CLR 319 at 324; [1945] HCA 37.

[3] B H McPherson, 'The Insolvent Trading Trust' in P D Finn (ed) *Essays in Equity* (The Law Book Company Limited, 1985) 142, 143.

[4] See J D Heydon and M J Leeming, *Jacobs' Law of Trusts* (LexisNexis Butterworths, 8th ed, 2016) [21.02].

[5] *Re Exhall Coal Co Ltd* (1866) 35 Beav 449 at 453; 55 ER 970 at 971; *Re Pumfrey* (1882) 22 Ch D 255 at 262; *Jennings v Mather* [1902] 1 KB 1 at 9; *Commissioner of Australian Federal Police v Cornwell* (1990) 98 ALR 677 at 681; *Hayman v Equity Trustees Ltd* (2003) 8 VR 557.

[6] *Trustee Act 1925* (NSW) s 59(4); T*rustee Act 1958* (Vic) s 36(2); *Trusts Act 1973* (Qld) s 72; *Trustees Act 1962* (WA) s 71; *Trustee Act 1936* (SA) s 35(2); *Trustee Act 1898* (Tas) s 27(2); *Trustee Act 1925* (ACT) s 59(4) and *Trustee Act* (NT) s 26. It is also important to note that a trustee does not have a right of indemnity for liabilities arising from a breach of trust, or for liabilities that were illegal or contrary to public policy. Further, the right of a trustee to be indemnified can be removed by agreement between the trustee and beneficiary, or can be precluded or restricted by a provision in the trust deed.

4. Whilst notions of fairness between the trustee and the beneficiary demanded that the beneficiary should bear the liability in the particular circumstances in *Hardoon,* I do not think that the situation is always so clear, particularly as it concerns the liability of investors in managed investment schemes.

5. This lecture will examine whether the application of the principle of beneficiary liability espoused in *Hardoon* to insolvent trusts continues to represent the "plainest principles of justice" today. My objectives are modest. First, I will address the peculiarities that arise from the application of centuries old equitable principles and doctrines to the so-called commercial trust. Secondly, I will illustrate the difficulties that arise from this and finally, I will consider options for reform. In that context, I will also consider the desirability of the abolition of the rule in *Hardoon* as has occurred in NSW by the passage of s 100A of the *Trustee Act 1925* (NSW).

6. It is a great honour to have been invited to deliver the Harold Ford lecture. Professor Ford was at the forefront of the development of Australian corporate law for many decades. His scholarship and leadership in numerous law reform committees played a significant role in the development of the law in Australia and educating generations of Australian lawyers. Professor Ford extensively studied the commercial trust in Australia, and I will consider some of his views shortly.

7. The pertinence of this topic has only increased given the challenges faced by many businesses due to the pandemic. In periods of economic downturn, the practical implications of this issue and the need for clarity are more important than ever before.

A FEW POINTS OF CLARIFICATION

8. Before we proceed any further, a few points of clarification may be useful. First, what do I mean by a commercial trust? It has become common practice in Australia to classify a trust as 'commercial' or 'trading'. This serves to distinguish a trust that is created predominantly for commercial objectives from the more

traditional uses of a trust.[7] The distinction between 'commercial' and 'traditional devices' was recognised by Lord Browne-Wilkinson in *Target Holdings v Redferns*, who noted that "[i]n the modern world the trust has become a valuable device in commercial and financial dealings", and that "specialist rules" developed in connection with the "traditional" trust may be inappropriate for commercial trusts.[8]

9. Trusts are used in an exceptionally wide variety of situations in Australia and other common law jurisdictions. Consistent with their origins, trusts remain popular in family and testamentary contexts. However, trusts are also deployed in a range of settings that are far removed from their medieval origins. In Australia, trust relationships are common in all manner of commercial relationships and form an indispensable part of the machinery for many commercial transactions.

10. Professor Michael Bryan has remarked that the term 'commercial trust' is "too crude to do justice to the adaptability of the trust concept applied for business purposes".[9] This is undoubtedly true. Trusts are used in Australia for an incredibly varied range of commercial purposes. On one end of the spectrum, a married couple may use a discretionary trust in their small family-owned business to benefit themselves and their children. On the other end of the spectrum, trusts are frequently used in superannuation funds or managed investment schemes. Furthermore, commercial trusts vary significantly in their lifespan. Some commercial trusts are established merely to facilitate a commercial objective and then abandoned, whilst other trusts are more enduring.[10] This lecture will focus on managed investment schemes structured as trusts and other commercial

[7] Nicholas Mirzai, 'The commercial trust in insolvency – A persistent concern for insolvency practitioners and their advisors' (2018) 45 Australian Bar Review 193, 193.

[8] *Target Holdings Ltd v Redferns* [1995] 3 All ER 785 at 795; [1996] AC 421 at 435.

[9] Michael Bryan, 'Reflections on Some Commercial Applications of the Trust' in Ian Ramsay (ed) *Key Developments In Corporate Law and Trusts Law: Essays in Honour of Professor Harold Ford* (LexisNexis Butterworths, 2002) 205, 207.

[10] Ibid 214-215.

trusts. Superannuation funds structured as trusts are outside the scope of this lecture.

11. Secondly, despite its colloquial usage, the term 'insolvent trust' is meaningless. It is a fiction to talk of an 'insolvent trust'. A trust is a relationship that is recognised by and enforceable in equity. [11] It does not have legal personality and cannot be insolvent under the *Corporations Act 2001* (Cth).

12. In a commercial trust it is the trustee, which is typically a corporation, that enters into contracts and transactions with third parties, as the trust itself lacks this capacity. The corporate trustee that owns property and rights and liabilities in relation to the trust, however, may become insolvent under the *Corporations Act 2001* (Cth). Kiefel CJ, Keane and Edelman JJ in *Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth* 268 CLR 520; [2019] HCA 20 noted that "the trust is not a separate entity and therefore does not have a separate solvency status from the trustee".[12] The creditors of the trustee in respect of debts incurred by it in administering the trust receive protection by virtue of the trustee's rights of reimbursement and exoneration.

13. Despite the technical inaccuracy of the term, 'insolvent trust', it is commonly used in a colloquial sense to refer to what others describe as a 'financially unviable trust',[13] or a "commercially insolvent" trust. In considering what is an 'insolvent trust', it is important to focus on the assets of the trust, and particularly that these assets are insufficient to support the trustee's right of exoneration. Commentary on s 601ND of the *Corporations Act* pertaining to the winding up by the Court of a managed investment scheme on the just and equitable ground also provides a useful definition of a 'commercially insolvent' managed investment scheme.[14]

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[11] See generally Mark Leeming, 'What is a trust?' (2009) 7 *Trusts Quarterly Review* 5.

[12] *Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth of Australia* (2019) 368 ALR 390; [2019] HCA 20 at [24].

[13] See further Nuncio D'Angelo, *Commercial Trusts* (LexisNexis Butterworths, 2014) 290.

[14] Commentary on s 601ND of the *Corporations Act* defines a 'commercially insolvent' managed investment scheme as being where the "responsible entity has no funds to continue the management and administration of the scheme and no reasonable prospect of getting in those funds or the liabilities referable to the scheme cannot be met as they fall due from the scheme's income or readily realisable assets". See *Australian Corporations Legislation* (LexisNexis Butterworths, 2019) 992 citing *Re PWL – ACN 084 252 488 Ltd; Ex parte PWL Ltd (No 2)* [2008] WASC 232; *Re*

THE EVOLUTION OF THE TRUST INTO A COMMERCIAL VEHICLE

14. When examining the current use of trusts in the commercial sphere, it is useful to keep in mind the long history of the trust. There is a long-held view that "equity had no place in the world of commerce".[15] This begs the question: how and why did the trust evolve into a commercial vehicle?

15. The trust pre-dates its better-known competitor in the world of commerce, the corporation. Equity, and the concept of a common law trust, was largely devised in family and testamentary contexts in the Middle Ages. The trust proved an invaluable institution in preserving family wealth through the vicissitudes of life and to transfer intergenerational wealth.[16] Professor John Langbein notes that for centuries "the trust was primarily used as a passive device for holding ancestral land".[17] Concerns about liability were unnecessary in the traditional family trust of medieval England where the trustee held land, rather than active businesses, and therefore rarely took on liabilities.[18]

16. As a result, the authors of *Jacobs on Trusts* identify that "the trust was not in its origin and perhaps never has been primarily a device of commerce."[19] It is certainly true that the trust was *not* devised for commercial purposes. However, I think the current prevalence of commercial trusts in Australia challenges the idea that the trust has *never* been primarily a device of commerce.

17. Despite its origins in the family and testamentary context, the trust has played a significant role in the world of commerce for centuries. The trust was not only

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Environinvest Ltd (2009) 69 ACSR 530; [2009] VSC 33 at [104]-[105]; *Capelli v Shepard* (2010) 264 ALR 167; 77 ACSR 35; [2010] VSCA 2.

[15] See P J Millett, 'Equity's place in the law of commerce' (1998) 114 *Law Quarterly Review* 214. See also John Mummery, 'Commercial Notions and Equitable Potions' in S Worthington (ed), *Commercial Law and Commercial Practice* (Hart Publishing, 2003) 29, 42.

[16] Ibid 30; John H Langbein, 'The Secret Life of the Trust: The Trust as an Instrument of Commerce' (1997) 107 *Yale Law Journal* 165, 165.

[17] John H Langbein, 'The contractarian basis of the law of trusts' (1995) 105(3) *Yale Law Journal* 625, 640-642.

[18] John Morley, 'The Common Law Corporation: The Power of the Trust in Anglo-American Business History' (2016) 116 *Columbia Law Review* 2145, 2175. See also Langbein (n 17) 640-642.

[19] R P Meagher, W M C Gummow, K S Jacobs, *Jacobs' Laws of Trusts in Australia* (Butterworths, 6th ed, 1997) lxxvii.

used for commercial purposes but was critical in encouraging economic and financial innovation.[20] When the corporation was in its infancy during the 18th and 19th century, the trust was "a real competitor to the corporate form".[21] It is important to remember that limited liability of corporations is only a recent phenomenon. Trust law supplemented what legal historian Frederic Maitland described as the "meagre law of corporations".[22] Many industrial and commercial enterprises were structured through trusts, known as 'deed of settlement' firms.[23] Maitland declared in 1902 that by using trusts, "[i]n truth and in deed we made corporations without troubling king or parliament though perhaps we said we were doing nothing of the kind".[24] Maitland described the trust as "a most powerful instrument of social experimentation" which "enabled men to form joint-stock companies with limited liability, until at length the legislature had to give way".[25]

18. When the United Kingdom passed its first general incorporation statute, the *Joint Stock Companies Act 1844*,[26] trusts outnumbered corporations by a ratio of more than ten to one.[27] Further, even after the introduction of this Act which allowed for incorporation by the simpler means of 'registration', thereby avoiding the need for a Royal Charter or Act of Parliament,[28] only four of the 882 large business trusts in existence chose to incorporate.[29] I do note that at this stage,

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[20] Gordon Clark, 'Pension fund governance: expertise and organizational form' (2004) 3(2) *Journal of Pension Economics & Finance* 233, 236.

[21] R P Austin and I M Ramsay, *Ford's Principles of Corporations Law* (Lexis Nexis Butterworths, 12th ed, 2005) [2.130].

[22] Frederic William Maitland, *The Collected Papers of Frederic William Maitland,* ed H A L Fisher (Cambridge University Press, 1911) vol 3, 279.

[23] H A J Ford, 'Unit Trusts' (1960) 23(2) *The Modern Law Review* 129, 30.

[24] Maitland (n 22) 271, 278.

[25] Ibid 278-9. Maitland also cited a number of examples of financial innovation including the establishment of the London Stock Exchange and Lloyd's of London.

[26] 7 & 8 Vict c 110 & 111.

[27] Morley (n 18) 2146-2147.

[28] Tan Cheng-Han and Wee Meng-Seng, 'Equity, Shareholders and Company Law' in Paul S Davies and James Penner (eds), *Equity, Trusts and Commerce* (Hart Publishing, 2017) 1, 2.

[29] Ibid; Morley (n 18) 2161.

corporations did not yet have limited liability.[30] The introduction of the *Limited Liability Act* heralded the start of a decline in the use of commercial trusts in the United Kingdom.[31]

COMMERCIAL TRUSTS IN AUSTRALIA

19. Meanwhile, in Australia commercial trusts have been a prominent feature of the Australian commercial landscape since the latter part of the twentieth century and only continue to increase in popularity. The prevalence of commercial trusts in Australia was described by Professor Ford as an "Australian idiosyncrasy",[32] whilst it has been described by others as an "Antipodean mutation",[33] which "has few parallels outside Australia".[34] In 2017 to 2018, over 900,000 trusts lodged tax returns in Australia, disclosing an aggregate gross business income of $394 billion.[35] I note that this data includes *all* trusts and is not limited to commercial trusts. By comparison, in the United Kingdom only 149,000 trusts lodged tax returns during the same period.[36] The difference in these figures can be hardly

[30] Limited liability was extended to joint stock companies by the *Limited Liability Act 1855.*

[31] See further *Elders Trustee & Executor Co Ltd v EG Reeves Pty Ltd* [1987] FCA 332 at [152] (Gummow J); Nuncio D'Angelo, 'Managed investment schemes and other commercial trusts: the risks creditors run' (Speech, Banking & Financial Services Law Association 30th Annual Conference, Gold Coast, 29-31 August 2013) 8.

[32] Harold AJ Ford and Ian Hardingham, 'Trading Trusts: Rights and Liabilities of Beneficiaries' in P D Finn (ed), *Equity and Commercial Relationships* (The Law Book Company Limited, 1987) 48, 53; D'Angelo (n 13) 72.

[33] Heydon and Leeming (n 4) [21.03]. See also J D Merralls QC, 'Commentary' in P D Finn (ed), *Equity and Commercial Relationships* (The Law Book Company Limited, 1987) 86, 86.

[34] AH Slater, 'Amendment of Trust Instruments' (Speech, Society of Trust and Estate Practitioners, Sydney, 29 September 2009) 2.

[35] See 'Trusts', *Australian Taxation Office* (Web Page, 31 March 2021) <https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Taxation-statistics/Taxation-statistics---previous-editions/Taxation-statistics-2017-18/?anchor=alltaxreturns#alltaxreturns>.

[36] HM Revenue & Customs, 'National Statistics: Trust statistics September 2019' *GOV.UK* (Web Page, 26 September 2019) <https://www.gov.uk/government/statistics/trusts-statistics-september-2019>.

surprising when a leading English text, *'Lewin on Trusts'* describes using a trust to carry on business as "nowadays unusual".[37]

20. Trusts are popular as a commercial vehicle in Australia because of the unique advantages they offer compared to the corporation. In 1904, the Supreme Court of Massachusetts remarked on the ingenuity of commercial trusts that possessed "most of the advantages belonging to corporations, without the authority of any legislative act, and with freedom from the restrictions and regulations imposed by law upon corporations".[38] Almost 120 years later, this still holds true today in Australia. The ease of establishment, unincorporated status, lighter regulatory framework and more tax-effective distribution of business income under a trust structure means that the commercial trust is an attractive corporate vehicle.[39] As Nuncio D'Angelo has explained, commercial trusts prospered in the 1970s in Australia due to their favourable tax treatment.[40] Notably, trusts provide corporate flexibility and asset protection, while avoiding the regulatory framework that applies to corporations. To some extent these benefits may be limited.

21. However, as with all good things, the benefits associated with commercial trusts come at a price. The very features of trusts that make them so attractive also expose their participants to greater risk. By avoiding the comprehensive and policy-driven regulatory regime of the *Corporations Act*, participants in trust structures equally miss out on the protections that such regulation affords.

TRUST LAW ILL-EQUIPPED TO GOVERN COMPLEX INSOLVENCY ISSUES

22. There is a noticeable lack of a comprehensive regime dealing with the insolvency of trusts. Given the origins of the trust it is hardly surprising that trust law is ill-equipped to govern complex insolvency issues that arise. Traditional trusts did

[37] L Tucker et al, *Lewin on Trusts* (Thomson Reuters, 20th ed, 2020) [36.107].

[38] *Hussey v Arnold* (1904) 70 NE 87 at 87.

[39] See D'Angelo (n 13) 79. See further Alex C Evans, 'Why We Use Private Trusts in Australia: The Income Tax Dimensions Explained' (2019) 41(2) *Sydney Law Review* 217.

[40] D'Angelo (n 13) 76.

not trade and did not have creditors, and accordingly there was no need to develop an insolvency regime suited to trusts and trustees.

23. A comprehensive and relatively predictable insolvency regime under the *Corporations Act* applies in respect of companies in Australia.[41] This regime did not come about all at once but evolved over centuries to address the problems arising from the corporation having a separate legal personality and limited liability. In contrast, there is no specific statutory regime for dealing with insolvency in the case of commercial trusts or managed investment schemes. None of the shareholder rights or protections in the *Corporations Act* apply to investors in commercial trusts. It is important to emphasise that because of the nature of the trust, not all the provisions of the *Corporations Act* would be suitable.

24. Further, there is no statutory assurance of limited liability for investors in commercial trusts. In the absence of a comprehensive legislative regime regulating member liability, the liability of beneficiaries is dependent upon the legal form of the scheme, the terms of the trust deed and the characterisation of an interest in the scheme.[42]

25. Where managed investment schemes are structured as trusts, as most are,[43] trust law applies in addition to the statutory regime of Chapter 5C of the *Corporations Act*.[44] Even Chapter 5C, which regulates managed investment schemes, does not deal in any substantive way with insolvency. Justice Barrett flatteringly described Chapter 5C as 'flirting' with the insolvency of managed

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[41] Nuncio D'Angelo states that the Act is "a sophisticated and highly evolved, policy-based, statutory regulatory regime offering orderly risk allocation and a balance of investor and creditor protection, designed with commerce in mind". See Nuncio D'Angelo, 'Commercial trusts in practice: the trust as a surrogate company' (Speech, The Supreme Court of New South Wales Annual Commercial and Corporate Law Conference, 15 November 2016) 5.

[42] The characterisation of an interest in a scheme depends on the proper construction of the trust deed or constitution. See *CPT Custodian Pty Ltd v Commissioner of State Revenue; Commissioner of State Revenue v Karingal 2 Holdings Pty Ltd* (2005) 224 CLR 98 at [29]-[51].

[43] V Battaglia, 'The liability of members of managed investment schemes in Australia: An unresolved issue' (2009) 23 *Australian Journal of Corporate Law* 122.

[44] I note that the broad definition of a 'managed investment scheme' also includes non-trust based managed investment schemes.

investment schemes.[45] The legislative framework for managed investment schemes in the *Corporations Act* does not provide for limited liability for members. Nuncio D'Angelo compares the situation to that of unincorporated joint stock companies in pre-1844 England, as almost all matters to do with insolvency and the winding up of managed investment schemes are delegated to the courts to develop a body of common law.[46]

26. Ultimately, managed investment schemes that become insolvent are governed by the general law of trust. The 'regulatory regime' (if one may call it that) for trusts effectively comprises decisions of various courts of equity over centuries, with some overlay by State and Territory trust legislation and Chapter 5C in the case of registered managed investment schemes structured as trusts. Further, until relatively recently, the decisions of these courts of equity concerned trusts that were not involved in commerce.

HARDOON V BELILIOS AND COMMERCIAL TRUSTS

27. *Hardoon v Belilios* was an appeal to the Judicial Committee of the Privy Council from a judgment of the Full Court of the Supreme Court of Hong Kong. The appellant was the registered holder of shares in a company and held them on trust for the respondent, who was the sole beneficial owner of the shares. The shares were not fully paid up when the company went into liquidation. Calls were made on the trustee in respect of the shares in the winding-up of the company. The trustee's liability to pay calls on the shares did not derive from any decision of the trustee but simply from holding the shares on trust for the respondent. After the trustee paid the calls made by the liquidator, he brought an action against the respondent beneficiary for indemnification.

[45] R I Barrett, 'Insolvency of Registered Managed Investment Schemes' (Speech, Banking and Financial Services Law Association Annual Conference, Queenstown, New Zealand, July 2008) 2.

[46] Nuncio D'Angelo, 'Managed investment schemes and other commercial trusts: the risks creditors run' (Banking & Financial Services Law Association, 2013) 45.

28. The Judicial Committee held the respondent personally liable to indemnify the trustee for the calls made. Lord Lindley stated that:

> "The plainest principles of justice require that the cestui que trust who gets all the benefit of the property should bear its burden unless he can shew some good reason why his trustee should bear them himself".[47]

Lord Lindley further stated that:

> "…where the only cestui que trust is a person sui juris, the right of the trustee to indemnity by him against liabilities incurred by the trustee by his retention of the trust property has never been limited to the trust property; it extends further, and imposes upon the cestui que trust a personal obligation enforceable in equity to indemnify his trustee".[48]

29. The decision is authority for the principle that a beneficiary of full legal capacity who is absolutely entitled to the trust property is personally liable to indemnify the trustee in respect of any liability properly incurred as trustee.[49] Lord Lindley described this as "no new principle, but is as old as trusts themselves". It is outside the scope of this lecture; however, I note that it has been suggested that the cases considered by Lord Lindley in *Hardoon v Belilios* are not authority for the principles that he drew from them.[50]

30. Lord Lindley recognised certain exceptions to this principle, namely where property was held on trust for tenants for life, or for infants, or in the case of "special trusts limiting the right to indemnity", where there was no beneficiary who could be justly expected or required personally to indemnify the trustee.[51]

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[47] *Hardoon v Belilios* [1901] AC 118, 123.

[48] Ibid 124.

[49] Ibid 118.

[50] For a comprehensive and insightful discussion of the authorities relied on by Lord Lindley see J C Campbell, 'The Undesirability of the Rule in Hardoon v Belilios' (2020) 34(3) *Trust Law International* 131, 133- 152. See also R A Hughes, 'The Right of a Trustee to a Personal Indemnity from Beneficiaries' (1990) 64 *Australian Law Journal* 567, 570-571.

[51] *Hardoon v Belilios* [1901] AC 118 at 127.

CORRELATIVE BENEFIT AND BURDEN IN COMMERCIAL TRUSTS

31. The principle in *Hardoon* is premised upon the rationale that a person who receives all or part of the benefit of trust property must also bear all or the proportionate part of the burden associated with it. That was the basis upon which the beneficiaries were found liable to indemnify the trustees in *Balkan v Peck*. [52] Interestingly, it has been suggested that irrespective of *Hardoon* the trustee in that case could have recovered on restitutionary principles, on the basis that he had paid over the trust assets to beneficiaries in the mistaken belief he had discharged all liabilities incurred as trustee. If that was correct, the new s 100A of the *Trustee Act* would not have relieved the beneficiaries from liability. The principle applies irrespective of whether the beneficiaries requested that the trustee incur the liability or the payment in question.[53]

32. In *Causley v Countryside (No 3) Pty Ltd*,[54] the New South Wales Court of Appeal approved the statement of McGarvie J in *J W Broomhead (Vic) Pty Ltd v J W Broomhead Pty Ltd*,[55] that "the basis of the principle is that the beneficiary who gets the benefit of the trust should bear its burdens unless he can show some good reasons why the trustee should bear the burdens himself". In *J W Broomhead*, the principle in *Hardoon* was applied to hold unit holders in a unit trust liable to indemnify the trustee where the trust property was insufficient to satisfy the trustee's proprietary right of indemnity.[56] McGarvie J held that principle in *Hardoon* applies "where there is more than one beneficiary and all of them are sui juris and entitled to the same interest as absolute owners between them".[57]

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[52] *Balkin v Peck* (1998) 43 NSWLR 706 at 712.

[53] Ibid 713.

[54] (NSWCA, 2 September 1996, unreported).

[55] [1985] VR 891 at 936.

[56] See *J W Broomhead (Vic) Pty Ltd v J W Broomhead Pty Ltd* [1985] VR 891; *Causley v Countryside (No 3) Pty Ltd* (NSWCA, 2 September 1996, unreported); *Fitzwood Pty Ltd v Unique Goal Pty Ltd* [2002] FCAFC 285.

[57] [1985] VR 891 at 936.

33. The principle in *Hardoon* is well-recognised in Australian law,[58] and has been applied to trusts with multiple beneficiaries.[59] Furthermore, the New South Wales Court of Appeal has held that the liability of a beneficiary to indemnify the trustee extends to liabilities incurred before the person even became a beneficiary.[60]

34. In *Balkin v Peck*, Mason P, with whom Priestly JA and Sheppard AJA agreed, stated that:

> "It is understandable why Lord Lindley [in Hardoon v Belilios [1901] AC 118 at 123] emphasised the equitable basis of the right in a trustee context. However, the notion of a right to contribution, recoupment or indemnity is not peculiar to equitable relationships. Such rights, unless grounded in contract or statute, derive from the unfairness of a person who gets all or part of the benefit of property or a legal transaction not bearing all or the proportionate part of the burden associated with it."[61]

35. Lord Blackburn in the 1881 decision of *Fraser v Murdoch* stated that the rule that a "cestui que trust … is personally liable to indemnify the trustees for any loss accruing in the due execution of the trust" is "perhaps…too broadly stated, as something must depend on the nature of the trust and of the interest of the *cestui que trust*".[62] 140 years later, I think there is merit in Lord Blackburn's idea that the principle of beneficiary liability is "too broadly stated", and that "something must depend on the nature of the trust".

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[58] *Paul A Davies (Australia) Pty Ltd (in liq) v Davies* [1983] 1 NSWLR 440; *J W Broomhead (Vic) Pty Ltd (in liq) v J W Broomhead Pty Ltd* [1985] VR 891; *McLean v Burns Philp Trustee Co Pty Ltd* [1985] 2 NSWLR 623; *Rosanove v O'Rourke* [1988] 1 Qd R 171; *Causley v Countryside (No 3) Pty Ltd v Bayside Brunswick Pty Ltd* (Supreme Court of New South Wales, 20 April 1994, unreported); *Balkin v Peck* (1998) 43 NSWLR 706 at 712 per Mason P (Priestly JA and Sheppard AJA agreeing); *Rosanove v O'Rourke* [1998] 1 Qd R 171; *Chief Commissioner of State Revenue v CCM Holdings Trust Pty Ltd* [2014] NSWCA 42 at [72] per Gleeson JA; *Wieland v Texxcon Pty Ltd* [2014] VSCA 199 at [95].

[59] *Balkin v Peck* (1998) 43 NSWLR 706; Hughes (n 50).

[60] *Causley v Countryside (No 3) Pty Ltd* (NSWCA, 2 September 1996, unreported). See also Campbell (n 50).

[61] (1998) 98 ATC 4,842 at 4,847.

[62] [1881] UKHL 740, 18 SLR 740, 745.

36. According to the logic of Lord Lindley, the obligation of the beneficiary to reimburse the trustee arises from equitable principles derived from the relationship between the beneficiary and the trustee, namely that "[t]he profits, if any, go to the cestui que trust; the losses if any should be borne by him rather than by the trustee provided the trustee was not to blame for causing the losses". Whilst this may have represented the 'plainest principle of justice' in 1901, I am not sure that it still plainly represents justice today in its application to commercial trusts.

37. Let us consider a hypothetical situation in which the principle in *Hardoon* would arise. The trustee, using its powers bona fide and exercising the requisite degree of care required, enters into a particular transaction. The beneficiary did not request that the trustee enter into this transaction, and nor did they acquiesce with knowledge that the trustee was entering into such a transaction. A liability arises from this transaction that cannot be satisfied from the trust property. Which of three parties should bear the loss? Should the trustee be required to meet such liability from its own resources? Or should it be entitled to an indemnity from the beneficiary? Or should the loss resulting from a deficiency in the trust assets be borne by creditors?[63]

38. Interestingly, these concerns are not new and in fact mirror many of the reasons for granting corporations statutory limited liability. The notion that it is inappropriate for mere investors, who did not take part in the management of a company, to be liable for its debts to an unlimited extent has a long history, tracing back to the *Limited Liability Act 1855* in the United Kingdom and the *Companies Act 1862* in the Australian colonies.[64]

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[63] I note that beneficiaries may also have an obligation to indemnify the trustee for a reason other than the fact that they are beneficiary if the trustee is the agent of the beneficiary. See *Rankin v Palmer* (1912) 16 CLR 285. This may occur where the beneficiaries exert sufficient control over the trustee in incurring a debt or liability, giving rise to an agency and principal relationship. For example, if a beneficiary requests a trustee to incur a liability, the beneficiary is personally liable to indemnify the trustee in respect of that liability irrespective of the extent of their beneficial interest as they are the agent of the beneficiary.

[64] Derek French, *Mayson, French & Ryan on Company Law* (Oxford University Press, 2017) 57. See also T F Bathurst, 'The historical development of corporations law' (2013) 37 *Australian Bar Review* 217; Nuncio D'Angelo, 'Shares and Units: The Parity Myth and the Truth About Limited Liability (2011) 29 *Company & Securities Law Journal* 477.

MANAGING POTENTIALLY UNLIMITED LIABILITY IN PRACTICE: EXPRESS LIMITATION OF LIABILITY

39. In practice, how do commercial trusts deal with the potentially unlimited personal liability of its investors? The trustee's right to personal indemnity against the beneficiaries can be excluded expressly or by implication in the trust deed.[65][66]

40. It is usual and current commercial practice to waive or limit the liability of beneficiaries by express provision in the constitution of the trust or registered scheme. In the case of a managed investment scheme, such a provision usually would limit liability to any amount that remains unpaid in respect of the member's subscription for interests in the scheme (not dissimilar to the *Corporations Act*) and provide that members are not required to indemnify the responsible entity or creditors against any liabilities of the responsible entity incurred in the course of operating the scheme.[67]

41. There is also a category of cases where the nature of the relationship between the trustee and beneficiary is such that there is no right of indemnity. Lord Lindley in the subsequent case of *Wise v Perpetual Trustee Co Ltd,*[68] recognised that the principle in *Hardoon* was not applicable where "the nature of the transaction excludes it".[69] Lord Lindley held that a social club, like other unincorporated

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[65] *Hardoon v Belilios* [1901] AC 118 at 127; *RWG Management Ltd v Commissioner for Corporate Affairs* (Vic) [1985] VR 385 at 394 (where Brooking J recognised that the trustee's right to be indemnified by the beneficiaries personally could be excluded by the trust instrument); *McLean v Burns Philp Trustee Co Pty Ltd* (1985) 2 NSWLR 623; *Causley v Countryside (No 3) Pty Ltd* (NSWCA, 2 September 1996, unreported); *Wise v Perpetual Trustee Co* [1903] AC 139. However, there remain other judges and commentators who suggest that the right is not capable of exclusion. See, e.g., McPherson J in *Kemtron Industries Pty Ltd v Commissioner of Stamp Duties (Qld)* [1984] 1 Qd R 576 at 585; Santow J in *JA Pty Ltd v Jonco Holdings Pty Ltd* (2000) 33 ACSR 691; [2000] NSWSC 147 at [86]; McPherson (n 3) 150. For further analysis of the legal uncertainty see Peter Edmundson, 'Express limitation of a trustee's right of indemnity' (2011) 5 *Journal of Equity* 77.

[66] The Privy Council expressly contemplated the possibility of "special trusts limiting [and, seemingly also excluding] the right to indemnity". See *Hardoon v Belilios* [1901] AC 118, 127.

[67] Battaglia (n 43) 124; Garry T Bigmore and Simon Rubenstein, 'Rights of Investors in Failed or Insolvent Managed Investment Schemes' in *Insolvent Investments* (LexisNexis Butterworths, 2015) 211, 226.

[68] [1903] AC 139.

[69] *Wise v Perpetual Trustee Company Limited* [1903] AC 139 at 148.

associations, is founded on the implicit understanding that its fluid members are not liable to pay moneys beyond their annual subscriptions.[70]

42. What is the difference between a social club and for example, a unit trust where the members are also constantly changing?[71] On the face of it, the two do not seem so different. However, the decision emphasised that social clubs were not "associations for gain". Unit trusts are not associations; however, their profit-making objective may exclude the limitation of personal liability by circumstances.[72]

43. This begs the question: is the principle in *Hardoon* such a problem if it possible to exclude the trustee's right to personal indemnity against the beneficiaries by express provision in the trust deed? In my opinion, whilst this may currently be used to deal with this risk, it is far from ideal. This is for three reasons.

44. First, trust deeds, like any legal document, may be poorly drafted. As a result, the extent of an investor's liability may be simply left unspecified or left uncertain. In my opinion, it is unsatisfactory that the current level of protection to investors depends on the competency of drafters. Furthermore, even when it is specified, it is common in the Product Disclosure Statement to disclose the limitation of liability with a condition stating that the courts have not yet definitively determined the efficacy of this claim.[73] In my opinion, it is important that investors can be assured of their potential liability to the greatest extent possible and in a way that does not rely on an economically inefficient and legally uncertain means of expressly incorporating a term in the trust deed.

45. Secondly, the uncertainty surrounding the effectiveness of express limitation of liability clauses is compounded by the existence of a broadly framed public policy exception. Young J in *McLean v Burns Philp* cited two situations where "public policy … militates against a party limiting its liability", being "where the exclusion

[70] See Heydon and Leeming (n 4) [21.05].

[71] See further Battaglia (n 43) 139.

[72] See also Ford (n 23) 150.

[73] Ibid.

of liability is with respect to negligence or breaches of trust" and where such clauses are "used as a cloak for fraud".[74] The uncertainty generated from such a broadly framed exception has been described as an "anathema to the investment community".[75]

46. Finally, trust deeds that limit or exclude the trustee's right to personal indemnity against the beneficiaries can pose significant problems for creditors who may be reluctant to conduct business with a trust if their ability to recover debt is limited.[76] Unlike the framework in the *Corporations Act* which balances the interests of all involved in a transaction, the situation for creditors is less clear. The creditor's right of subrogation is wholly derivative on the right of indemnity of the trustee.[77] Consequently, if the trustee's right of indemnity from the beneficiaries personally is excluded, then there is no right to which the creditor can be subrogated.[78] Professor Ford doubted whether a creditor can subrogate to the trustee's right to personal indemnity from the beneficiaries. Leaving aside the uncertainties on this issue,[79] if the trustee's right to personal indemnity was excluded, in accordance with current commercial practice, then the creditor is unable to subrogate to this right.

47. Some argue that the concerns of creditors have little place in the law of trusts. Professors Ford, Lee and McDermott state that "the fact that the trustee's right of indemnity has existed for the benefit of the trustee and not for the benefit of creditors who are owed debts related to the trust" should not be obscured.[80] Others argue that creditors are well-positioned to take care of their own interests

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[74] *McLean v Burns Philp Trustee Co Pty Ltd* (1985) 2 NSWLR 623 at 641.

[75] Barrett (n 45) 9.

[76] See Ahmed Terzic, 'Subrogation to the Trustee's Personal Right of Indemnity' (2017) 91 *Australian Law Journal* 736, 748.

[77] Heydon and Leeming (n 4) [21.12].

[78] See *Re German Mining Co; Ex parte Chippendale* (1853) 43 ER 415 at 427; *Wise v Perpetual Trustee Co Ltd* [1903] AC 139; *McLean v Burns Philp Trustee Co Pty Ltd* (1985) 2 NSWLR 623 at 640-641.

[79] See further D'Angelo (n 13) 140-142.

[80] H A J Ford, W A Lee and P M McDermott, *Principles of the Law of Trusts* (Thomson Reuters) [14.3930].as cited in Edmundson (n 65) fn 145.

as they can control whether or not they lend and on what terms.[81] Richard Posner, the American jurist argues that creditors may be appropriate risk bearers because they are less risk averse than shareholders and are better able to appraise the risk.[82] I do not think these justifications necessarily hold true in reality.

48. Creditors, like investors, have varying degrees of sophistication and vulnerability. Whilst creditors can control whether they lend and on what terms, many trust creditors may be unaware that they are even dealing with a trust, particularly when they are dealing with a corporate trustee. If in fact creditors are aware of this, they may be unable to seek information about the trustee's right of indemnity and may not realise that their right to recourse against the trust's assets are worthless unless the trustee's right of indemnity is of value.

MYTH OF PARITY AND IMPROVING FINANCIAL LITERACY

49. In my opinion, the public understanding of trusts remains limited. Like creditors, beneficiaries or members of a managed investment scheme may also be unaware of the risks they are exposed to. Whilst the concept of the limited liability company in Anglo-Australian law is well-established and familiar to the public, the same cannot be said about trusts. There is a wide-spread recognition that many investors in commercial trusts are unaware that they face potential liability beyond that of their intended contribution. A recent NSW Law Reform Commission Report noted that there is a "common assumption of limited liability" by investors in commercial trusts.[83] Nuncio D'Angelo describes this as the "parity myth",[84] where "[i]nvestors have been encouraged to regard companies and unit

[81] K Lindgren, 'A superannuation fund trustee's right of indemnity' (2010) 4 *Journal of Equity* 85, 95.

[82] Richard Posner, 'The Rights of Affiliated Corporations' (1976) *The University of Chicago Law Review* 499, 501-502.

[83] NSW Law Reform Commission, *Laws relating to beneficiaries of trusts* (Report No 144, May 2018) [2.5].

[84] D'Angelo (n 13) 95. See also D'Angelo (n 64).

trusts, and therefore shares and units, as economically and functionally aligned".[85]

50. From the perspective of a lay investor, what is the difference between investing in a commercial trust and investing in a registered company? Investing in a unit trust bears superficial resemblance to investing in a company. It is hardly surprising that investors perceive that "owning units in a unit trust is the same as owning shares in a company".[86] Ford and Hardingham have commented that:

> "The differences between trading trusts and registered companies are highly technical and outside the understanding of not only most lay investors but also most professional investment advisers. Only when liquidation in insolvency supervenes will minds be concentrated enough to appreciate the technicalities".[87]

51. Even professionals working in the field mistake the nature of trusts. Leeming JA noted in a recent decision that both parties, who were accountants, held "the incorrect but prevalent notion that a trust is a legal person".[88] Leeming JA noted that neither party in that decision "had a correct understanding of the legal nature of the trust, despite their academic and professional qualifications, and despite the fact that the accountancy practice was conducted by the trustee of a unit trust". If even accountants are mistaken, it is hardly surprising that retail investors are under this illusion.

52. The consequences of the myth of parity between trusts and corporations are significant. Unless an investor is familiar with the intricacies of trust law and, specifically, the differences between company law, they may mistakenly believe that their liability is limited in an analogous way to that of a shareholder in a company. They may incorrectly assume that their liability is limited to the amount that they invest. Investors should know the extent of their liability. Otherwise, they are unable to make investment decisions based on an accurate

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[85] D'Angelo (n 64) 480.

[86] Kenneth Sydney Jacobs and John Dyson Heydon, *Jacobs' Law of Trusts in Australia* (LexisNexis Butterworths, 7th ed, 2006) [312].

[87] Ford and Hardingham (n 32) 84.

[88] *Kelly v Mina* [2014] NSWCA 9 at [103].

understanding of the risks involved in dealing with a trust as opposed to a limited liability company.

53. This myth of parity is unfortunately not a new phenomenon. The mistaken belief that some investors may have had as to the extent of their liability was noted in 1984 by the Companies and Securities Law Review Committee,[89] and in 1993 by the Australian Law Reform Commission and the Companies and Securities Advisory Committee.[90] This still holds true today. It is unsurprising that many people lacking in financial experience find comfort in the idea of putting their money in the hands of an expert manager of a unit trust.[91]

54. This illusion of parity raises the question: is there a problem with the application of the *Hardoon* principle in a modern commercial context, or is the problem merely that the public does not understand the risks? If the problem is simply one of knowledge, then improving financial literacy would be an easy fix.

55. In my opinion, improving financial literacy is always a positive outcome and would undoubtedly improve public understanding and decision-making in this area. Investors should know the extent of their liability and appreciate the risks associated with dealing with a trust as opposed to a limited liability company.

56. However, I doubt that improving financial education is a sufficient response. I agree with the remark by Associate Professor Scott Donald that, "it would be

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[89] In 1984 the Companies and Securities Law Review Committee wrote to the Ministerial Council that "the investing public sees the purchase of units in a public unit trust as analogous to the purchase of shares in a limited liability company" and consequently that the investing public "generally assumes that the limited liability that attaches to shares in such companies applies equally to units". See Companies and Securities Law Review Committee (August 1984) as cited in Companies and Securities Advisory Committee, *Liability of Members of Managed Investment Schemes* (Report, March 2000) 1.

[90] In 1993 the Australian Law Reform Commission and the Companies and Securities Advisory Committee noted that many investors choose to invest in managed investment schemes because they lack "the experience or expertise to recognise the pitfalls and risks involved in investing" and "do not want the worry and responsibility of day to day management of their money". See Australian Law Reform Commission and the Companies and Securities Advisory Committee, *Collective Investments: Other People's Money* (Report No 65, June 1993) [3].

[91] Sarah Worthington, 'Public Unit Trusts: Principles, Policy and Reform of the Trustee and Manager Roles' (1991) 15(1) *UNSW Law Journal* 256, 258.

naïve to assume financial literacy programmes can solve the problem entirely".[92] This sentiment is echoed by Robert Flannigan who notes that "[f]ull information is a cure only if the population is able and willing to absorb it. That seems unlikely when the issue is ostensibly complex".[93]

57. Professor Ford considered whether improving financial literacy would sufficiently address this issue. In an interview in 2010, Professor Ford noted that despite more onerous requirements for prospectuses, "recent cases of failed managed investment schemes suggest that more needs to be done to alert investors to the existence of any liability to pay more than the initial investment".[94] However, he noted that "there will always be investors who are unaware of the non-existence of free lunches" and that "it is hard to see how they can be protected short of requiring the regulator to vet the merits of particular investments, something which is not politically possible".[95] I agree with Professor Ford that more needs to be done than improving financial education. There will always be limits to public understanding on these issues.

MUCH AGITATION YET LITTLE ACTION

58. The legal and business communities have repeatedly agitated for change to the status quo. Countless state and Commonwealth bodies have toiled over the complexities of this issue and possible reform for decades.[96] Inquiries conducted by the Companies and Securities Law Review Committee in 1984,[97] the Australian Law Reform Commission and the Companies and Securities Advisory

[92] M Scott Donald, 'Beneficiary, Investor, Citizen: Characterising Australia's Super Fund Participants' in M Scott Donald and Lisa Butler Beatty (eds), *The Evolving Role of Trust in Superannuation* (The Federation Press, 2017) 33, 42.

[93] Robert Flannigan, 'The Political Path to Limited Liability in Business Trusts' (2006) 31(3) *Advocates' Quarterly* 257, 292.

[94] Ian Ramsay, 'Professor Harold Ford and the development of Australian corporate law' (2011) 29 *Company and Securities Law Journal* 29, 40.

[95] Ibid.

[96] See further Carl Möller, 'How Have Managed Investment Schemes Coped with the Challenges of Insolvency?' in Stewart J Maiden (ed), *Insolvent Investments* (LexisNexis Butterworths, 2015) 7, 16.

[97] Companies and Securities Law Review Committee (n 89).

Committee in 1993,[98] the Companies and Securities Advisory Committee again in 2000,[99] and the Corporations and Markets Advisory Committee in 2012,[100] recommended that members of a managed investment scheme should have limited liability analogous to shareholders of a limited company. In 2015, the Productivity Commission suggested that "there may be merit in aligning the insolvency of trusts with the regime for companies".[101]

59. Why has there been such stagnation? Despite decades of inquiries, the issue has a limited public profile and consequently, limited political will to enact necessarily complex and little-understood reforms. Combine insolvency law with trust law and you have perhaps the world's most unexciting and complex area in which to initiate reform. The terms 'beneficiary', 'sui juris' and 'liability' are not the glamorous, discussion-generating buzzwords governments seek when spearheading reforms. Aside from this, it is hard to muster, let alone maintain, public support for reform in this area when many do not understand the need to make such changes. Most members of the public do not understand the liability issues that arise nor appreciate "what is at stake for them or their communities".[102] Another explanation for the paralysis is that quite simply, there is no magic solution. The intersection of trust law and insolvency law is far too technical and complex for there to be a simple solution.

60. However, after decades of stagnation, there has been some recent progress. In 2018, the NSW Law Reform Commission recommended that the rule in *Hardoon* be abolished by statute.[103] The Commission observed that "[i]deally, such

[98] Australian Law Reform Commission and the Companies and Securities Advisory Committee (n 90) [11.37].

[99] Companies and Securities Advisory Committee, *Liability of Members of Managed Investment Schemes* (Report, March 2000) 1.

[100] Corporations and Markets Advisory Committee, *Managed Investment Schemes* (Report, July 2012) 201.

[101] Productivity Commission, *Business Set-up, Transfer and Closure* (Report No 75, 30 September 2015) 433.

[102] Flannigan (n 93).

[103] NSW Law Reform Commission (n 83) Ch 2.

reforms should be made by amending the *Corporations Act*",[104] however, given "the failure of the Commonwealth to respond to the issue over many years… NSW can and should adopt the reform through its *Trustee Act*… pending Commonwealth action".[105]

61. In November 2019, s 100A was inserted into the *Trustee Act 1925* (NSW).[106] The section states that "the rule of equity known as the rule in *Hardoon v Belilios* is abolished" and also provides that this "does not prevent a trustee … from recovering any amount that a beneficiary under the trust is liable to pay for a right, interest or other entitlement" and that it "does not affect any liability that a beneficiary under a trust may have in a capacity other than as a beneficiary".

62. Thus far, s 100A has received virtually no judicial consideration in this state. It was referred to in *Ludwig v Jeffry (No 3)* [2021] NSWSC 23 at [24]-[34] but only in the context of whether the liability of the beneficiary arose before the enactment of the section. It was also referred to by the NSW Court of Appeal in *Chief Commissioner of State Revenue (NSW) v Benidorm Pty Ltd* [2020] NSWCA 285, where Leeming JA noted at [24] that s 100A abrogated the rule in *Hardoon* with retrospective effect.

63. It is beyond the scope of this paper to deal with s 100A in detail. However, as was pointed out by Professor Campbell, there may well be a number of other ways in which a beneficiary could be found liable to indemnify a trustee. Further, it is questionable whether in an area of considerable commercial importance a different statutory regime should apply between states.

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[104] Ibid [2.41].

[105] NSW Law Reform Commission, *Laws relating to beneficiaries of trust* (Consultation paper 19,2017) [2.32].

[106] *Trustee Act 1925* (NSW) s 100A inserted by the *Justice Legislation Amendment Act (No 2) 2019* (NSW) sch 1 cl 1.23. I am grateful for an advanced copy of an article by J C Campbell, 'The New Section 100A Trustee Act 1925 (NSW): When a Beneficiary is Personally Liable to Indemnify a Trustee' (2020) 14 *Journal of Equity*.

SHOULD COMMERCIAL TRUSTS BE ENCOURAGED?

64. Despite the entrenched nature of commercial trusts in Australia, when considering reform in this area, it is nonetheless worth asking ourselves the radical question – do we actually want to encourage the use of commercial trusts?

65. Many would argue that it would be overly proscriptive to require the use of a registered company instead of a commercial trust. Professor Ford and Ian Hardingham asked:

> "[w]ould the State be too paternalistic if it said to promoters of collective public investment for trading that their efforts should be channelled through a registered company? … Doubtless, there would be a view expressed that such a change would be in the direction of over-regulation. Moreover, it would be said to deprive promoters of a choice now open to them."[107]

However, they concluded that the choice of a trust "is not one available in the natural order of things". They went so far as to describe the use of a commercial trust as a "rudimentary form" of the registered company and questioned whether the law regulating registered companies should "be subverted by allowing use of a rudimentary form?"

66. Despite these criticisms and the many issues that arise from insolvent trusts, I do not think that the commercial world should abandon the use of trusts. The history of the trust and commerce is long. Furthermore, the enduring nature and popularity of the commercial trust demonstrates that trust law sufficiently addresses some business needs in a way that is not possible under a limited liability company. Rather than trying to channel the commercial world away from what is clearly a very popular commercial vehicle, I think that we should respect the long history of the trust in commerce, the choice of commercial vehicle and instead encourage evolution in the law of trusts.

67. The success of equity and trusts in the world of commerce over centuries derives from its capacity to adapt to a changing environment. The trust has been and

[107] Ford and Hardingham (n 32) 84.

continues to be a remarkably resilient institution. Frederic Maitland in his lauded lectures on equity characterised the trust as "an 'institute' of great elasticity and generality; as elastic, as general as contract".[108] The centrality of principles of fairness, morality and conscience to the doctrines of equity have contributed to their adaptability.[109] As the authors of *Meagher, Gummow and Lehane's Equity, Doctrines and Remedies* note, "[t]he fundamental notions of equity are universal applications of principle to continually recurring problems; they may develop but cannot age or wither".[110] This has ensured that the trust has not only survived the transition from feudalism in Medieval England to capitalism, but has been transplanted into the law of almost all of the Britain's former colonies, many of which are leading financial centres, including Singapore, Hong Kong, the Channel Islands, Bermuda, the Cayman Islands and the British Virgin Islands.[111] Furthermore, the versatility and popularity of the trust is exemplified by its re-imagination in countries that were never British colonies and have not adopted the tradition of the Common Law, including in South Korea, Japan and more recently China.[112] This should give us confidence that any reforms are just another step in the long and remarkably resilient evolution of the trust.

IS THERE A NEED FOR REFORM?

68. I now turn to the question: is there a need for reform? Are commercial trusts suitable for the modern commercial environment in which they are utilised? More specifically, does the principle in *Hardoon* reflect not only the wishes, but the

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[108] F W Maitland, *Equity : a course of lectures*, eds A H Chaytor and W J Whittaker (Cambridge University Press, 1932) 23.

[109] See Anthony Mason, 'The Place of Equity and Equitable Remedies in the Contemporary Common Law World' (1994) 110 *Law Quarterly Review* 238; Lord Justice Hoffman, 'Equity and its Role for Superannuation Pension Schemes in the 1990s' in M Scott Donald and Lisa Butler Beatty (eds), *The Evolving Role of Trust in Superannuation* (The Federation Press, 2017) 72, 72-73.

[110] R P Meagher, J D Heydon and M J Leeming, *Meagher, Gummow and Lehane's Equity, Doctrines and Remedies* (Butterworths LexisNexis, 4th ed, 2002) xv.

[111] Brooke Harrington, 'Trusts and financialization' (2017) 15(1) *Socio-Economic Review* 31, 46.

[112] Ibid 32, 42. For further information about the transplant of the trust in civil law nations see Ying-Chiew Wu, 'Trusts Reimagined: The Transplantation and Evolution of Trust Law in Northeast Asia' (2020) 68 *The American Journal of Comparative Law* 441.

understanding of those who use commercial trusts? Does the status quo encourage desirable social objectives?

69. Any discussions of reform in this area raise fundamental questions about the role of law in society and how it should evolve. Does the law develop in isolation from mainstream society and the world of commerce, or does it evolve to serve the needs of business and the market economy?

70. Proponents of the view that legal evolution occurs autonomously from broader society may argue that the increasing use of commercial trusts occurred *despite* the limited protections for the liability of beneficiaries. One may reason that commercial trusts were in fact so popular because they did not offer the same protections under the *Corporations Act.* The lack of responsiveness of trust law to its commercial context in fact cemented the popularity of commercial trusts by ensuring a lighter regulatory framework and more flexibility.

71. Conversely, many strands of contemporary legal theory challenge us to remember that the law operates within its social, political and economic environment. For example, advocates for a functional interpretation of the law argue the law should respond to the needs of business and the world of commerce.[113]

72. However, whilst undoubtedly a sound idea, in my opinion, this is not always so simple. Exactly whose needs should the law protect? The interests of those involved in a trust are varied, contested and conflicting. Minds will differ on the extent to which beneficiaries, trustees and creditors should be protected and on the extent to which we should tinker with long-standing equitable principles.

73. In my opinion, the need for reform depends on the nature of the commercial trust. I do not think that there is any need for reform regarding the liability of beneficiaries in all commercial trusts. For example, consider a block of land held on trust by a corporate trustee where the beneficiaries are absolutely entitled and sui juris. It is unlikely an insolvency situation will arise in this situation; however,

[113] See e.g. Ian Ramsay, 'The Politics of Commercial Law' (2001) *Wisconsin Law Review* 565, 568; Phillip Lipton, 'A History of Company Law in Colonial Australia: Economic Development and Legal Evolution' (2007) 31 *Melbourne University Law Review* 805, 831.

if it did, I do not think that reform is necessarily needed. The principle of the correlative benefit and burden is much clearer in this case. Furthermore, despite the decades of consideration of the area, the current situation has not caused too many problems.

74. However, I think that the case for reform is much stronger in the case of managed investment schemes and other publicly listed trusts. The illusion of many investors that investing in a trust is analogous to buying shares in a limited corporation is deeply concerning. People who invest in these schemes would be staggered to know that they could be liable over and above their initial investment. Reform in the case of managed investment schemes is also more straightforward than other possible reforms given its regulation under Chapter 5C of the *Corporations Act*, which also already offers some protections for creditors.

75. I do not think the common practice of scheme constitutions limiting liability is adequate. The fact that trust deeds must be drafted to "reshape and reallocate risk among the trust parties" is an economically inefficient means to manage this risk.[114] While it is generally assumed that an express limitation of liability in the trust constitution would be effective, there remains significant risk given the many issues that arise from poor drafting and subsequent interpretation by the courts. The ambiguities associated with provisions purporting to limit beneficiary liability were recently illustrated by Keane J in *Korda v Australian Executor Trustees (SA) Ltd*.[115] In obiter, Keane J noted that if a trust could be imputed (which it was not) a clause in the Trust Deed was "not cast in terms which were apt to exclude an equitable obligation which rests upon the 'plainest principles of justice'".[116] I agree with the remark made by Leeming JA that "it is to be regretted that, especially in an insolvency context where there is every reason to avoid litigation

[114] Derwent Coshett, 'Understanding and reforming the trustee's right of indemnity' (2019) 33(2) *Trust Law International* 45, 53.

[115] (2015) 255 CLR 62; [2015] HCA 6.

[116] *Korda v Australian Executor Trustees (SA) Limited* (2015) 255 CLR 62; [2015] HCA 6 at [235].

and focus on an efficient and cost-effective process, the position is presently as contestable as it seems to be".[117]

76. In that context, it must be remembered that it was only recently that the High Court in *Carter Holt Harvey Woodproducts Australia Pty Ltd* laid to rest the fallacy in *Re Enhill* (1983) VR 561 that the proceeds of a trustee's right of indemnity could be made available for the benefit of all creditors of the trustee, not just those whose debts were incurred in the course of the administration of the trust or for its benefit.

WHAT SHOULD REFORM LOOK LIKE?

77. So what should reform to the liability of beneficiaries in managed investment schemes and publicly listed trusts look like? If managed investment schemes and publicly listed trusts are essentially corporations by another name, then there is a strong argument that they should be governed as such, rather than twisting the law of trusts. If, on the other hand, commercial trusts are truly trusts, albeit in a commercial context, then is there a danger of modelling reforms too closely on principles derived from corporations law?[118] All of us this raises the overarching question: are commercial trusts an appropriate vehicle for limited liability?

78. In my opinion, commercial trusts, even when used as pseudo-corporations, are not simply corporations and are still trusts.[119] Whilst many are quick to compare beneficiaries in commercial trusts to shareholders, I think this analogy is too simplistic and misleading. We cannot overlook the origins of the trust in equity and the fact that the trust, whilst not originally designed for commercial purposes, is no stranger to the world of commerce. Rather than simply importing the single

[117] Mark Leeming, 'Trustees' Rights of Indemnity, Insolvency and Statutory Distributions to Preferred Creditors' (2018) 92 *Australian Law Journal* 503, 508.

[118] See further Paul Heath, 'Bringing trading trusts into the company line' (2010) 16(9) *Trusts & Trustees* 690.

[119] As Richard Flannigan has stated, "[t]e fact of the matter is that trusts are not corporations and beneficiaries are not shareholders". See Flannigan (n 93) 289.

principle of limited liability from corporations law into trust law, I think any reform needs to recognise the unique place of the commercial trust in Australia, sitting between both corporations and trust law.

79. I am the first to admit that there is no silver bullet that can simply and comprehensively address the many issues identified. However, in my opinion, simply abolishing the rule in *Hardoon* is not enough. The protections to creditors, directors and shareholders in corporations law evolved over centuries of statute and caselaw. Any reform that mandates limited liability must also consider and balance the interests of beneficiaries, creditors and trustees. Simply abolishing the rule in *Hardoon* does not balance these competing interests. In my opinion, consideration of reform in this area has overwhelmingly focused on the interests of beneficiaries and neglected the interests of trustees and creditors who are also relying on the trustee's right of exoneration. Their interests must also be considered.

80. I think two principles should guide any reform. First, any reform must be uniform across Australia. It would lead to absurdity if states enact different provisions. There are potential difficulties that may arise as a result of NSW enacting s 100A, particularly where the trust trades in a number of state jurisdictions. I recognise the challenges in any reform given that trust law is governed by a complex overlay of both federal and state legislation and sits alongside the common law. I do not think that piecemeal reform is an adequate solution to the complexities of this issue and would likely create more issues due to variations in the liability of beneficiaries across different jurisdictions.

81. Secondly, any reform should not take away the simplicity of the trust. Commercial trusts were historically favoured due to their ability to circumvent the difficulties of incorporation, and currently so, to circumvent the regulatory regime of the *Corporations Act*. I think it is important that any reform does not create an onerous and inflexible regulatory framework that erodes this flexibility, whilst ensuring both creditors and beneficiaries are adequately protected.

TRUST LAW REIMAGINED IN OVERSEAS JURISDICTIONS

82. When considering how we balance competing interests to reform the liability of beneficiaries in managed investment schemes and other publicly listed trusts, I think it is helpful to consider the approaches taken in overseas jurisdictions. Whilst reform has stagnated in Australia, this has not been the case elsewhere. Dr David Chaikin and Eve Brown note that "nearly every major developed common law nation in the world has moved to modernise and codify trust law, including the United Kingdom, United States, Hong Kong, Singapore, Ireland and New Zealand".[120] A Canadian scholar has described that "trust law has spent the last quarter-century changing at an exhilarating speed", a so-called "stripping of the trust" as "legislatures worldwide have been eliminating traditional rules of trust law".[121] This should give us confidence that reform, although long-coming, is possible in Australia.

83. A study of the approaches taken in jurisdictions overseas shows that there has been reform in this area. That reform, however, is by no means uniform. On one end of the spectrum are the recent trust law reforms in New Zealand. The *Trusts Act 2019* (New Zealand) came into effect on 31 January 2021 and purports to make "the law of trusts … fit for purpose".[122] Despite this, s 81 pertaining to the trustee's liability for expenses and liabilities incurred, and the trustee's right to indemnity, seems to do nothing to change the common law position.

84. On the other extreme is the *Delaware Business Trust Act*,[123] (subsequently renamed the *Delaware Statutory Trust Act*) which was introduced in 1988. Under the Act, a business trust that operates in some manner that generates profit shall be a "separate legal entity" which enables full control by beneficiaries without

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[120] David Chaikin and Eve Brown, Submission to Productivity Commission, *Inquiry into Barriers to Growth in Services Exports* (28 September 2015) 13.

[121] Adam S Hofri-Winogradow, 'The Stripping of the Trust: A Study in Legal Evolution' (2015) 65 *University of Toronto Law Journal* 1, 1.

[122] New Zealand, *Parliamentary Debates*, 8 May 2019 (Chris Hipkins, Minister of Education on behalf of the Minister for Justice).

[123] 12 Del. Code Ann § 3801-20.

exposure to personal liability.[124] The Act provides that "except to the extent otherwise provided in the governing instrument of the statutory trust, the beneficial owners shall be entitled to the same limitation of personal liability extended to stockholders of private corporations".[125] A number of states followed with similar legislation,[126] and uniform legislation was subsequently introduced.[127]

85. Canada has also implemented reforms to limit the liability of unit-holders in trusts in an analogous way to shareholders in a corporation. As in Australia, concerns were raised about the increasing prevalence of trusts into commerce and the position of beneficiaries as compared to shareholders. The Uniform Law Conference of Canada, in a 2006 report titled 'Closing the Gap between Traditional Trust Law and Current Governance Expectations' concluded that "investors in publicly-traded issuers should enjoy comparable immunity from personal liability regardless of the legal form of the underlying issuer".[128] The Report stated that "in addition to the arguments that justify limited liability for shareholders in corporations, further arguments apply in the case of trusts", namely that "investors rarely understood the degree of risk they were incurring" and that imposing a statutory limitation of liability would resolve uncertainty, reduce transaction expense and encourage capital formation.[129] The Report noted that the Uniform law should "subsume and standardize the unitholder liability shield so that the same unit-holder liability regime applies on a uniform basis throughout the country".[130]

86. The Uniform Law Conference considered the various formulations of statutory limitation of liabilities in existing Provincial Acts. It is interesting to note that the

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[124] Flannigan (n 93) 271.

[125] 12 Del. Code Ann § 3803.

[126] See Flannigan (n 93) fn 62.

[127] *Uniform Statutory Trust Entity Act* (2009).

[128] Uniform Law Conference of Canada, *The Uniform Income Trusts Act: Closing the Gap between Traditional Trust Law and Current Governance Expectations* (Report, August 2006) [63].

[129] Ibid [62].

[130] Ibid [65].

approach adopted in the *Ontario Act* which immunises unit holders from the liabilities of "the trust or any of its trustees", as opposed to the narrower formulation in other Acts which only immunised unit holders from the liabilities of the "trustee" was preferred for its certainty and comprehensiveness.[131] This was despite the Conference observing that "the language negating any liability of the beneficiaries for liabilities of the trust perhaps implies that the trust is a separate legal person when it generally is not".[132]

87. Following this recommendation, s 8 of the Canadian *Income Trusts Act* provides that "the liability of a unit-holder of a trust, as a unit-holder, for any obligation or liability arising out of or from the administration, management or assets of the trust or any conduct of a trustee… is limited to the unit-holder's interests in the units of the income trust".[133] This uniform legislation applies only to "trusts (other than mutual funds) that are publicly traded".[134] The use of such trusts has declined in Canada following changes to the *Income Tax Act* which eliminated the tax advantage of unit trusts by 2011.[135]

88. In the middle of the spectrum is Singapore. The *Business Trusts Act*,[136] enacted in 2005 is focused on trusts that have profit maximisation as their primary objective.[137] Under the Act, the business trust is *not* regarded as a separate legal entity. Despite this, s 32 of the Act explicitly provides that the liability of a unit holder in such a trust is limited to the amount which the unit holder expressly agreed to contribute to the Business Trust. This limitation of liability applies

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[131] Ibid [66].

[132] Ibid.

[133] See Uniform Law Conference of Canada, *Income Trusts Act* (2008) <https://www.ulcc.ca/en/home/548-josetta-1-en-gb/uniform-actsa/income-trusts-act/658-income-trusts-act>.

[134] Ibid s 1.

[135] Kevin P McGuinness, *Canadian Business Corporations Law* (LexisNexis Canada Inc, 3rd ed, 2017) [3.166]-[3.168].

[136] (Singapore, cap 31A, 2005 rev ed).

[137] See further, Hang Wu Tang, 'The Resurgence of 'Uncorporation': The Business Trust in Singapore' (2012) *Journal of Business Law* 683.

notwithstanding any provision to the contrary in the trust deed, or the winding up of the business trust.[138]

89. Finally, England is currently considering reform. The Law Commission of England and Wales has initiated a reform project titled 'Modernising Trust Law for a Global Britain' to review what is described as "an outdated area of the law",[139] to "see how the law can be modernised and help ensure Britain's trust services are competitive in the global market".[140] The Commission recognised "the development of alternative, flexible trust and trust-like structures in other jurisdictions that are not available in England and Wales, such as Jersey Foundations and Cayman Star Trusts", noting that whilst "not all of these structures may be suitable… there is a strong argument that their advantages and disadvantages should be evaluated".[141] It will be useful for Australia consider the approach ultimately adopted in England.

90. There has been no uniform approach in resolving the issue. However, the approaches taken in other jurisdictions shows that there has been a recognition in many countries that where people invest in a publicly listed trust, their liability should be limited in an analogous way to investors in a corporation. I think that it is helpful to look at varying reforms in other jurisdictions and how they have balanced the interests of beneficiaries, trustees and creditors to consider what approach should be taken in Australia.

CONCLUSION

91. Professor Ford famously expressed grave concern in his article 'Trading Trusts and Creditors' Rights' that "[t]he fruit of this union of the law of trusts and the law

[138] *Business Trusts Act* (Singapore, cap 31A, 2005 rev ed) s 32(2).

[139] Law Commission, *Thirteenth Programme of Law Reform* (Report No 377, 13 December 2017) [2.24].

[140] 'Modernising Trust Law for a Global Britain', *Law Commission* (Web Page) <https://www.lawcom.gov.uk/project/modernising-trust-law-for-a-global-britain/>.

[141] Law Commission (n 139).

of limited liability companies is a commercial monstrosity".[142] This lecture has explored one aspect of this commercial monstrosity as it concerns potentially unlimited liability for beneficiaries in commercial trusts arising from the principle in *Hardoon*. In my opinion, I think that reform is needed to better protect investors who are under the illusion that investing in a trust is analogous to a limited corporation. This is easier said than done. However, I think it is not enough to simply abolish the rule in *Hardoon*. Any reform must balance the interests of beneficiaries, trustees and creditors.

[142] H A J Ford 'Trading Trusts and Creditors' Rights' (1981) 13(1) *Melbourne University Law Review* 1, 1.