External administration of insolvent trustees and trusts - Legislative suggestions
Dr Nuncio D'Angelo and ARITA

Item	Corresponding part of the Corporations Act	Suggested components of new Chapter 5AA *Dealings with Relevant Trusts and their External Administration*
1.	Executive summary	***Overall summary*** In summary, the overall objective of the suggested framework is to equate or align, as far as legally possible, the legal risks and outcomes in insolvency faced by parties who deal with trustees of certain commercial trusts, with those of parties who deal with *Corporations Act* companies acting in their own right, but without otherwise interfering with the essential nature of the trust or the many benefits that accrue to those who use and deal with them as business vehicles. That requires legislation at two levels: (a) protections for parties who deal with trustees of relevant trusts, that operate at the point of transacting and correspond to those that are available to parties dealing with companies acting in their own right (**front-end reforms**); and (b) provisions dealing with insolvent trustees and trusts that reflect the same policy prescriptions and yield the same or equivalent stakeholder outcomes as in a corporate insolvency under Chapter 5, to the maximum extent possible (**back-end reforms**), in each case, after taking into account and allowing for the important legal and structural differences between companies and trusts. ***Which trusts?*** These new provisions should apply, to: (a) any trust where the trustee carries on or is starting an enterprise including activities done in the form of a business[1], in their trustee capacity in Australia (subject in each case to a prescribed *de minimis* threshold); and

[1] Consistent with section 9.20 of A New Tax System (Goods and Services Tax) Act 1999

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		(b) registered managed investment schemes (**MIS**) to the extent issues are not already addressed by existing provisions governing them However, the new provisions should never apply to a superannuation fund regulated under the *Superannuation Industry (Supervision) Act* 1993, and the "back end" provisions will only apply where a trustee or trust are insolvent. [2] (together, **Relevant Trusts**). The new provisions should have no practical impact on a trustee or trust which remains solvent, paying its debts as and when they fall due[3] – in the same way that the insolvency provisions in Chapter 5 of the *Corporations Act* do not impact on solvent companies. There is no need to force Relevant Trusts to incorporate, or to alter the fact that Relevant Trusts do not have separate legal personality. Trust creation, existence, functioning and remedies should remain matters regulated by State and Territory laws (including the general law of trusts), except to the extent of any inconsistency with these new provisions. These provisions would also override any terms in a trust instrument dealing with the winding up of a Relevant Trust, to the extent of any inconsistency. In the discussion that follows, where relevant, "trustee" includes the responsible entity of a MIS and "trust instrument" includes a MIS constitution. ***Front-end reforms – a summary*** 1. Require Relevant Trusts to be registered with ASIC (unless already registered, or required to be registered, under the MIS provisions) and be given a unique numeric identifier, and oblige the trustee to use that identifier in all dealings in its capacity as trustee of that trust.

[2] See footnote 14 below.

[3] Definition of solvent in s95A of the *Corporations Act*.

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		2. Require trustees of Relevant Trusts to disclose, and maintain as current, certain information about themselves and the Relevant 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 for protection. 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.[4] ***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's 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. [5] 2. Include provisions to deal with certain other trust-specific issues for Relevant Trusts.

[4] See the issues discussed with *Recommendation 5* on page 13 of Nuncio D'Angelo's Submission of 30 November 2022 to the Parliamentary Joint Committee on Corporations and Financial Services inquiry into Corporate Insolvency in Australia (PJC Inquiry).

[5] This is consistent with how the Courts have been dealing with trusts where the trustee is wound up in insolvency, via the appointment of a receiver to the trust assets (See for example - Trustee with multiple trusts: *Donnelly (Liquidator), in the matter of Dunjey Property Pty Ltd (in liq)* [2023] FCA 1254, Trustee with one trust: *Sanderson, in the matter of Jabaluka Pty Ltd (in liq)* [2022] FCA 1012)

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		Interpretation Interpretation provisions would need to be included to ensure that the new Chapter 5AA prevails and overrides Chapter 5 in relevant circumstances. As a consequential change in relation to MIS, Part 5C.9 would be modified to avoid inconsistencies and overlaps.
2.	Chapter 2A *Registering a Company*	***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 incurred 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**).[6] 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. The ARTN would also materially improve the position with respect to secured creditors of non-MIS trusts under the *Personal Property Securities Act 2009* (Cth) and the Personal Property Securities Register. The challenges

[6] 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).

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		facing those creditors, and those searching the Register, are well known.[7] The ARTN could be used as the unique identifier for such registrations. 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). [8]
3.	Chapter 2B.2 *Basic features of a company*	***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 the trust's "insiders". [9] Parliament should, enact robust statutory "indoor management" assumptions for the benefit of external parties dealing with the trustee of a Relevant Trust (ie *not* being beneficiaries/members of the trust), similar in conception and effect to those in Part 2B.2 of the Act that are available to parties dealing with companies in their own right (see particularly sections 128 and 129), but modified to address issues specific to the trust form. This would shift the risks posed by internal irregularities and trustee misconduct away from innocent outsiders and back to the trustee and beneficiaries, just as the current corporate assumptions shift the risks of internal irregularities and director/officer misconduct away from innocent outsiders and back to the company.

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[7] The issues are briefly canvassed in the Final Report of the 2015 statutory review of the Personal Property Securities Act 2009 (the "Whittaker Review") (see paragraph 6.7.4) and discussion materials released by the Attorney General on proposed reform of the Act and Regulations: see https://consultations.ag.gov.au/legal-system/government-response-to-pps-review.

[8] See the issues discussed with *Recommendation 1* on page 9 of Nuncio D'Angelo's Submission of 30 November 2022.

[9] The issues (including the risks to and consequences for trust creditors) are discussed in Attachment #2 to Nuncio D'Angelo's Submission of 30 November 2022 to the PJC Inquiry.

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		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 (this is not necessarily an exhaustive list): A person is entitled to make the following assumptions in relation to dealings with the trustee of a Relevant Trust acting in that capacity: (a) a Relevant Trust that is held out by or on behalf of a person claiming to be its trustee, having the name and ARTN (or ARSN) shown on the ASIC register, is properly formed and exists as a trust; (b) the person shown on the ASIC register as the trustee of the Relevant Trust has been duly appointed, has not been removed or replaced, and is the only trustee of the Relevant Trust; (c) there are no former trustees of the Relevant Trust who have, in that capacity, an undischarged claim against the trustee or with respect to the property of that trust; (d) the Relevant Trust is governed by a written instrument that satisfies all formal and legal requirements for efficacy and enforceability, and is enforceable, as a trust instrument under the laws of a State or Territory of Australia, is duly executed and has been duly stamped (and, in the case of a constitution of a MIS, complies in all respects with the requirements of Chapter 5C of the Act); (e) if the trustee of a Relevant Trust, or a person on its behalf, gives a person an original or copy of the trust instrument (and any amendments and supplements) in connection with a dealing, that original or copy (as so amended and supplemented) discloses all the terms of the Relevant Trust other than those implied by law; (f) all provisions of the trust instrument have been complied with and the trustee has not committed a breach of trust; (g) the trustee has the trust power under the Relevant Trust to enter into and perform obligations in connection with the dealing as trustee; (h) the dealing is authorised and is in all respects a proper exercise by the trustee of its trust powers under the Relevant Trust, and does not cause or result in a breach of trust;

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		(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 dealing; (j) the trustee's personal liability for any debts and liabilities it incurs as trustee of the Relevant Trust in connection with the 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 dealing. To maintain parity 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

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		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.[10]
4.	Chapter 2B.6 *Names*	These provisions should be applied also to the names and unique numeric identifiers of registered Relevant Trusts.
5.	Chapter 2C *Registers*	These provisions should be applied also to the register of Relevant Trusts.
6.	Chapter 5 *External administration*	***Application of Chapter 5 policies, principles and outcomes to Relevant Trusts*** Because the trust, as an economic entity, 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),[11] 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 of other trust estate held by that trustee. 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;

[10] As to which, see N D'Angelo, *Transacting with Trusts and Trustees* (LexisNexis Butterworths Australia, 2020), at 5.14 to 5.96.

[11] 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.

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		(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 and not to the trustee or its shareholders.[12] 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.[13] There would be provisions clarifying that the liquidator's remuneration, costs, expenses and disbursements are to be allocated across the personal and trust estates in accordance with the principles established in *Water v Widdows* [1984] VR 503 and confirmed in *Re CMI* [2015] QSC 96. These cases establish that remuneration directly related to establishing the fund are applied to the fund and general costs are allocated proportionately across the funds based on realisations within the funds. These amounts can be determined by the liquidator in good faith and

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

[13] Subject, in the case of some creditors, to any agreed trustee limitation of liability clause, as to which, see generally Chapter 3 (*Trustee limitation of liability clauses*) of *Transacting with Trusts and Trustees* (footnote 10).

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		without need for a Court order (subject to the Court's power to make a different determination on challenge by any affected stakeholder). ***Additional trust-specific changes*** In addition, new provisions should be included to deal with certain trust-specific issues for Relevant Trusts, for example (and this is not an exhaustive list): (a) *an "insolvent" Relevant Trust estate*: although a trust does not have separate legal personality, it is economically possible for a trust fund or estate to become "insolvent" without the trustee itself also being insolvent.[14] 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 itself 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);

[14] For a suggested definition of when a trust (or trust fund or estate) may be said to be "insolvent" see *Transacting with Trusts and Trustees* (footnote 10), at 10.89. In summary, and reflecting the definition in section 95A of the *Corporations Act* for companies, a trust can be said to be solvent if, and only if, the trustee is able to pay all trust debts as and when they become due and payable out of trust assets and (where it is obliged to do so) its own assets; a trust that is not solvent in this sense can be said to be insolvent. A debt of a trustee is a "trust debt" of a trust if the trustee is entitled to apply the assets of that trust to pay it (even if it is also obliged to pay it out of its own assets), disregarding for the purposes of this definition any application of the clear accounts rule. A trustee may remain solvent while a trust under its control is "insolvent" if the trustee is protected from personal liability for trust debts by trustee limitation of liability clauses in all or most of its contracts: see *Transacting with Trusts and Trustees* (footnote 10) at 10.94 and following. The use of these clauses is very common in Australian commerce among professional trustee companies and other well-advised trustees: see generally Chapter 3 (*Trustee limitation of liability clauses*) of *Transacting with Trusts and Trustees* (footnote 10). It is acknowledged that the suggestion in this paragraph (a) may be seen by some as somewhat radical and would need to be tested thoroughly in consultation via an exposure draft bill.

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		(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*);[15] (f) *"substantial security" in voluntary administration*: if, as suggested above, a Relevant Trust can be placed into voluntary administration, then the advantages currently available to a secured creditor of having "substantial security" (ie security over the whole or substantially the whole of the property of a company) should accrue

[15] This addresses the "third issue" discussed by the Privy Council in *Equity Trust (Jersey) Ltd v Halabi* [2022] UKPC 36. The *Halabi* decision, which held that indemnity claims of successive trustees rank *pari passu*, is directly contrary to the weight of Australian authority, which maintains that they rank in accordance with the general equitable princple of "first in time prevails if the equities are equal": see most recently *Francis (Trustee) in the matter of Fotios (Bankrupt) v Helios Corporation (No 3)* [2023] FCA 251. This effectively places creditors of a successor trustee at a disadvantage vis-a-vis any undischarged creditors of a former trustee in a trust insolvency.

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		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;[16] (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;[17] and (ii) extending the director's common law duty to take into account the interests 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;[18] (i) *limited liability for beneficiaries*: enact statutory limited liability for beneficiaries/members of Relevant Trusts, similar to that for shareholders of companies;[19] (j) *perpetuities*: abolish the rules against perpetuities and remoteness of vesting for Relevant Trusts;[20]

16 See the issues discussed with *Recommendation 2* on page 10 of Nuncio D'Angelo's Submission of 30 November 2022 to the PJC Inquiry.
17 See the issues discussed with *Recommendation 7* on pages 14 - 16 of Nuncio D'Angelo's Submission of 30 November 2022 to the PJC Inquiry (and see footnote 14).
18 See footnote 14.
19 See the issues discussed with *Recommendation 8* on page 16 of Nuncio D'Angelo's Submission of 30 November 2022 to the PJC Inquiry.
20 See the issues discussed with *Recommendation 6* on page 14 of Nuncio D'Angelo's Submission of 30 November 2022 to the PJC Inquiry.

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		(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;[21] and (l) *solvent trusts*: there needs to be provisions to deal with "solvent" trusts when an insolvent trustee is placed into external administration. The external administrator needs to be empowered to find a new trustee for the "solvent" trust, move the "solvent" trust from external administration and replace the insolvent trustee.

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