Introduction

The McMahon Clarke Guideline for Trustees & Responsible Entities is designed as a reference tool for trustees, responsible entities, compliance committee members and in-house counsel to help them understand the duties, liabilities and safeguards relevant to trustees and responsible entities.

Developed over a number of years in response to the issues our clients regularly seek our assistance with, this Guideline provides an overview of the trustee's role, duties, powers and rights and summarises the relevant legislative and regulatory frameworks.

The Guideline adopts a user-friendly approach, and is a practical guide to dealing with the issues which commonly arise for trustees and responsible entities.

We hope you find this Guideline a useful resource and we welcome your feedback.
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As pioneers and acclaimed specialists in the funds management sector, we are sought after by clients establishing and operating property funds (passive and development), property securities funds, mortgage funds, equities funds, alternative asset schemes, and fully managed strata title projects. McMahon Clarke registered the first managed investment scheme in Australia and has twice been involved in transactions awarded the Insolvency and Restructure Deal of the Year at the ALB Australasian Law Awards (Centro restructure 2012 and ABC Learning Centres receivership 2010).

We advise responsible entities and promoters of managed funds throughout Australia as well as investment managers, platform operators, brokers, custodians, advisers and other stakeholders in the financial services sector.

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McMahon Clarke is a specialist law firm consulting to Australian and international corporations, listed and private companies, business owners and high net worth and entrepreneurial individuals.

We have chosen to focus on the selected areas of capital markets, corporate advisory, employment, funds management, litigation & risk management, private client, and real estate.

Aligned with this expertise is our complementary industry focus on agribusiness, building & construction, energy & resources, family business, financial services and real estate projects.

Our industry recognition, innovative approach, and practical experience mean our clients receive focused, accurate and commercial legal advice to help them manage and grow their business.

From top 100 listed companies to new business ventures, our commitment to service delivery is the same. We embrace a contemporary attitude to our business which is reflected in our core values—focus, planning, recognition, balance and learning.

We know success in business today depends on the ability to create value for our clients. Our clients expect expertise, accountability, competence and integrity and we excel in these areas.

Please visit www.mcmahonclarke.com for more information about us.

Disclaimer: This Guideline is produced as general information and should not be relied upon as a substitute for detailed legal advice. Specific advice should be sought about particular legal issues.

This Guideline was last updated on 14 August 2014. Please reference McMahon Clarke if using any part of the Guideline.
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GUIDELINE FOR TRUSTEES & RESPONSIBLE ENTITIES

The role of trustee
PART 1 — The role of trustee

What is a trust?

A trust exists whenever the owner of property is bound by an obligation to hold that property for the benefit of another person. A trust is not a separate legal entity and cannot sue or be sued, or hold property in its own name. It can only operate through its trustee. Any legal entity that is capable at law of holding property in its own right may hold the office of trustee.

The beneficiary of a trust is the person or entity for the benefit of which the trustee holds the trust property, such as the unitholders in a unit trust or the investors in a managed investment scheme. It is not necessary for the beneficiary of a trust to be a person who actually exists at the time of the creation of the trust. There may be a trust in favour of an unborn child or in favour of a class of persons the make-up of which is unknown at the time of establishment of the trust. This means property can be held on trust for the future beneficiaries of the trust, even though the identity of those beneficiaries is not yet known.

Almost any kind of property can be held on trust (whether the property is real or personal, tangible or intangible). Legal title to trust property is vested in the trustee and a separate equitable interest in the trust property is vested in the beneficiaries. Whilst the beneficiaries do not legally own the trust property, they nevertheless have a recognised and legally enforceable interest in that property.

The trustee may be one of the beneficiaries but cannot be the only beneficiary. If the trustee is the sole beneficiary, then there is no trust because the same entity or person holds both the legal and equitable interest in the property.

What legislation is relevant?

Various matters to do with the operation of trusts are dealt with in the following acts of each state (or territory):

1. Trustee Act 1925 (ACT)
2. Trustee Act 1925 (NSW)
3. Trustee Act 1893 (NT)
4. Trusts Act 1973 (Qld)
5. Trustee Act 1936 (SA)
6. Trustee Act 1898 (Tas)
7. Trustee Act 1958 (Vic)

Trustees should ensure they are familiar with the provisions of the State Acts applicable to any states in which they carry on business. The State Acts are very similar, but do contain some differences.

Which rules relate to managed investment schemes?

In addition to the State Acts, the Corporations Act contains rules concerning managed investment schemes, which are a specific type of trust. There are many provisions in the Corporations Act relating to the regulation of responsible entities and the operation of managed investment schemes. A detailed analysis of those provisions is beyond the scope of this Guideline. However, managed investment schemes are still subject to the general law regarding trusts.

Throughout this Guideline, the generic terms ‘trustee’, ‘beneficiary’ and ‘trust’ will be used, unless we are referring specifically to a matter that relates to the responsible entity of a managed investment scheme. Responsible entities using this Guideline should assume that all sections are applicable to them unless specifically stated otherwise. In addition, the Guideline is applicable to unregistered managed investment schemes and excluded offers under the Corporations Act.
How is a trustee appointed?

A trustee is appointed either under the express terms of the trust deed, under a statutory power, or by the court.

The trust deed will normally include a provision dealing with the manner in which a trustee can be removed, and the manner in which a new trustee is appointed. Generally, the trust deed will either provide that a particular person has the right to appoint a new trustee, or that the beneficiaries are entitled to vote about the appointment of a new trustee. In the absence of a power contained in the trust deed, the State Acts specify the circumstances in which a trustee can be appointed and the person who can make that appointment.

The court has power to appoint a new trustee, both under its inherent jurisdiction and pursuant to the State Acts. This is only likely to occur where the conduct of the trustee has been brought into question, such as where the trustee has failed to adequately protect the trust property. If the court is called upon to appoint a new trustee, then its primary consideration will be the welfare of the beneficiaries. The court will look to appoint a trustee who will represent the interests of all of the beneficiaries, and is not likely to appoint someone who may be biased against some of the beneficiaries.

How does a trustee retire?

A trustee may retire from its position in one of the following ways:

1. By taking advantage of a specific provision within the trust deed.
2. By taking advantage of the provisions of the State Acts, and if the trust is a managed investment scheme, then under the Corporations Act.
3. If there are no express provisions, then by obtaining the consent of all of the beneficiaries.
4. If the consent of the beneficiaries cannot be obtained, then by obtaining the consent of the court.

How is a trustee removed?

The removal of a trustee against its will can occur in the following circumstances:

1. Where there is an express power contained in the trust deed for the beneficiaries or some other person to remove the trustee.
2. By application of the provisions of the relevant State Acts, and if the trust is a managed investment scheme, then under the Corporations Act.
3. The court may order the removal of the trustee. The court will only order the removal if it is satisfied the welfare of the beneficiaries require it. The court may use its discretion in making a decision, and its decision will be based on all of the circumstances of the case. A breach of trust will not necessarily lead to an order for removal by the court. However, the court is likely to remove the trustee if there is—
   a. a negation of the trust or conduct that is likely to jeopardise the security of the trust property
   b. evidence the trust will not be properly executed in the interests of the beneficiaries
   c. a trustee which has a conflict of interest and duty that is not being properly dealt with, or
   d. a trustee which is unable to act, such as where it is in financial distress or is absent from the jurisdiction.
GUIDELINE FOR TRUSTEES & RESPONSIBLE ENTITIES

Overview of a trustee’s duties

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PART 2 — Overview of a trustee’s duties

What is the nature of the duties imposed?
A trustee has a fiduciary relationship with the beneficiaries of the trust. Unlike other company directors, directors of trustee companies are not concerned merely with the interests of shareholders, but also with the interests of the beneficiaries on whose behalf the company is administering the trust.7

A trustee has duties imposed on it from three different sources as follows:
1. Specific duties created by the terms of the trust deed establishing the trust.
2. General duties implied by law and established by case law.
3. Statutory duties imposed by legislation. For example, in the case of a managed investment scheme, the following provisions of the Corporations Act impose further obligations on a responsible entity:
   (a) Section 601FC (1) sets out the duties of a responsible entity.
   (b) Section 601FC (2) provides that a responsible entity holds scheme property on trust for scheme members.
   (c) Section 601FC (3) provides that the duty of a responsible entity under the previous sections overrides any conflicting duty a director of a responsible entity has to the responsible entity as a company.
   (d) Section 601FG provides that a responsible entity may hold an interest in its scheme but only if the consideration payable for the interest is the same as if it were acquired by another person and it is subject to terms that do not disadvantage other scheme members.

What specific duties are owed?
The fundamental duty of a trustee is to act honestly in what it considers to be in the best interests of the beneficiaries of the trust. This fundamental duty forms the basis for every other specific duty of a trustee. Specific duties have evolved to give practical substance to the fundamental duty.

It is impossible to exhaustively list every duty of a trustee. Many identifiable duties are simply specific examples of a more general overriding duty of the trustee (eg the duty of a trustee not to mix trust funds with its own or other funds is an example of the duty of the trustee to preserve trust property). However, the duties can be summarised under the following categories:
1. To adhere to and carry out the terms of the trust.
2. To exercise due diligence and vigilance.
3. To account and to keep proper records.
4. To provide information.
5. To administer the trust personally and not to delegate its duties or powers.
6. To preserve trust property and to properly invest the trust funds.
7. To act impartially between the beneficiaries.
8. To avoid conflicts of interest and duty.

What standards are expected of a trustee?
In managing a trust business, the trustee should exercise the same care as an ordinary, prudent business person would exercise in conducting that business as if it were his or her own.8 However, in doing so, there is an added requirement that the trustee exercise caution. In King v Talbot,8 the court said:

It, therefore, does not follow, that, because prudent men may, and often do, conduct their own affairs with the hope of growing rich, and therein take the hazard of adventures which they deem hopeful, trustees may do the same; the preservation of the fund, and the procurement of a just income therefrom, are primary objects of the creation of the trust itself, and are to be primarily regarded.
The requirement of caution is used to differentiate the expectations placed upon a trustee compared to those placed on a director. In Daniels v Anderson, the court said:

While the duty of a trustee is to exercise a degree of restraint and conservatism in investment judgments, the duty of a director may be to display entrepreneurial flair and accept commercial risks to produce a sufficient return on the capital invested.

In Australian Securities Commission v A S Nominees Limited & Ample Funds Ltd, the court said:

I would add that underlying the distinction today is, probably, not merely an historical assumption about the separate purposes of companies and of trusts, but also a generalisation about the different risks that persons who invest their assets in companies on the one hand and in trusts on the other are considered likely to have assumed. Where the trustee is itself a company the requirements of care and caution are in no way diminished. And here, unlike with companies in general, these requirements have a flow-on effect into the duties and liabilities of the directors of such a company.

A trustee must give consideration to the fact its business is investing on behalf of others. Where “an ordinary prudent person of business” may take risks he or she might consider reasonable in the circumstances when they are dealing with their own funds, those risks may not be reasonable when the investment has been made on behalf of another person, such as a spouse, child or investors. A trustee must remember it is investing not only to provide a present income for the beneficiaries, but also as a means of preserving the capital for the benefit of the beneficiaries who will ultimately be entitled to it.

Is there a higher standard of care for professional trustees?

Directors of a professional trust company (which includes a responsible entity) are expected to demonstrate a greater level of expertise than non-professional trustees. Therefore, the standard of care they will be judged against is necessarily higher.

This was acknowledged by the court in Bartlett v Barclays Bank Trust Co Ltd, where Brightman J was prepared to impose such a higher duty of care on a trust corporation:

... a professional corporate trustee is liable for breach of trust if loss is caused to the trust fund because it neglects to exercise the special care and skill which it professes to have.

In Australian Securities Commission v A S Nominees Limited & Ample Funds Ltd, Finn J discussed the requirement that a professional trustee exercise a higher standard of care and take a cautious approach in conducting the trust’s business. His Honour considered the general common law standard of care applicable to trustees, and went on to observe:

The standard of trustee care and caution of which I have been speaking so far does not differentiate between types of trustee. It is of general application. That standard, moreover was settled a century ago and during a period when trust corporations were not used for the trading and investment purposes that are now commonplace in this country today. There is, in my view, a substantial question now to be answered as to whether a higher standard is not to be exacted from at least corporate or professional trustees (i) which hold themselves out as having a special or particular knowledge, skill and experience and (ii) which, directly or indirectly, invite reliance upon themselves by members of the public by virtue of the knowledge etc they appear to have.
What is the statutory standard of care and diligence for officers of a responsible entity?

As officers of a company, officers of a responsible entity of a registered scheme are already subject to the general statutory duty in section 180(1) of the Corporations Act to exercise the “degree of care and diligence that a reasonable person would exercise if they were a director or officer of a corporation in the corporation’s circumstances, and occupied the office held by, and had the same responsibilities within the corporation as, the director or officer”. It is clear this standard contains a number of subjective elements which are absent from the care and diligence duty imposed by section 601FD(1)(b) which requires an officer of a responsible entity to “exercise the degree of care and diligence that a reasonable person would exercise if they were in the officer’s position”.

In Australian Securities and Investments Commission v Australian Property Custodian Holdings Ltd (No 3), Murphy J discussed the relevant principles underlying section 601FD(1)(b) in some detail. His Honour observed:

I consider that the standard of care applicable where a corporation is a professional trustee, holding itself out to the public and being paid as such, will often be a more exacting standard...

While the duty of care under section 601FD(1)(b) and section 180(1) correspond, the standard of care under section 601FD(1)(b) will often be higher. This is so because:

(a) the relevant director will be the director of an RE acting as a trustee (and usually holding itself out and being paid as a professional trustee); and

(b) the scheme members will be vulnerable to:

(i) conflicts of interest between the RE’s interests in obtaining fees and the interests of the members, and/or

(ii) conflicts between the RE’s interest in obtaining fees and its duty to act in the members’ best interests and give their interests priority.

These factors, common in managed investment schemes under part 5C, will often require that the directors of such an RE exercise heightened care and caution and be scrupulous in dealing with any conflicts of interests and conflicts of interest and duty.

Can a trustee take risks?

The requirement for a trustee to act cautiously does not mean a trustee is constrained in the way it carries out the express terms of the trust deed. The trustee is still entitled to take calculated risks contemplated by the trust deed, for example, by investing the trust assets in a high risk investment. However, in doing so, the trustee must act cautiously in relation to any discretionary matters that arise.

The actions of the trustee must be judged in light of the specific purpose for which the trust was established. The purpose of the trust (as set out in the trust deed) may be intrinsically risky from the perspective of a prudent person of business (eg a venture capital fund or a fund established for speculative investments in futures or derivatives). However, a trustee’s duty to adhere to and carry out the terms of the trust overrides all other duties. A trustee will not be in breach of trust for dealing with the trust funds in the manner required by the trust deed. Of course, if funds have been raised from the public, then the trustee will need to ensure adequate disclosure has been made to the beneficiaries of the risk involved in the investment. If a trust is established for a hazardous or speculative purpose, then potential beneficiaries in the trust must have the risks fully disclosed to them so they understand the degree of risk and that their capital may be lost.
Case example—VBN v APRA

In VBN v Australian Prudential Regulation Authority (APRA), the Administrative Appeals Tribunal (the Tribunal) had to consider the performance of the trustee of the AXA Australian Staff Superannuation Plan (the AXA Fund) which was the superannuation fund for employees of National Mutual and related companies. The position facing the trustee was quite complex and, in some respects, arose specifically because it was a superannuation fund governed by specific legislation. However, the facts, and the Tribunal’s conclusions, are illustrative of a number of principles relevant for all trustees.

The facts
A summary of the relevant facts is as follows:

1. In 1997, the employer changed the rules of the AXA Fund to provide for improvement in benefits for long-serving members who resigned or who were made redundant. They could either take a lump sum or elect to leave their benefits with the AXA Fund and convert them at a later date to a pension. If they chose the latter option, then they were classified as deferred benefit members. The option to take a pension was quite valuable and, for each member who chose that option, the liability of the AXA Fund increased. However, an actuary was asked to comment on the additional costs of providing those benefits, and indicated it would not be necessary for National Mutual (as the employer) to increase its contribution rate in order to increase its contribution rate in order to fund these additional benefits. That advice was based on the assumption there would only be a small number of deferred benefit members. However, this proved to be incorrect.

2. In 1999, there was a new chief executive officer of National Mutual who was keen to improve the financial performance of the company and consequently reduced staff numbers in 2001 by 25 percent. Many of those who lost their jobs were long-serving staff members, and many elected to become deferred benefit members. The actuary expressed his concerns to the trustee from late 2000 onwards about the ability of the AXA Fund to pay these benefits. The deferred benefit liability continued to grow.

3. In addition to these difficulties, the trustee had to consider what crediting rate policy it would adopt. Each of the deferred benefit members was entitled to be paid interest on their accounts, and the crediting rate therefore had a significant impact on the fund’s position. The trust deed provided that the crediting rate was to be determined by the trustee after considering the advice of the fund actuary. For many years the trustee had operated on the basis that the crediting rate should be based on the rates earned on fund investments, but smoothed out to avoid fluctuations.

4. The actuary periodically reviewed the funding levels of the AXA Fund. Superannuation funds are assessed by looking at their vested benefit index (VBI). The relevant actuarial standard provided that the VBI should be no less than 100 percent (that is, assets should cover the vested benefits). The actuary advised that the VBI should actually be at 115 percent. Because there was a large surplus in 1998, the actuary suggested National Mutual could take a ‘contribution holiday’ and not make any further contributions for three years.

5. Because of adverse external influences, the decline in the VBI level was more dramatic than expected. The trust deed gave National Mutual the ability to decide on the level of contributions it should make to the AXA Fund, upon advice from the fund actuary. Despite the trustee’s concern about the VBI decline, National Mutual decided to continue with the contribution holiday.

6. In the face of the declining VBI, the trustee’s position in determining the crediting rate became even more difficult. If it followed the normal smoothing policy, then the crediting rate would exceed the earned rate for 2002 and would exacerbate the fund’s solvency problems. Eventually, National Mutual resumed making contributions and, in fact, made some additional payments to improve the VBI. However, it was adamant it would not make any further payments for the cost of past over-crediting.
7. National Mutual sought legal advice about ways for reducing the costs of the deferred benefits and indicated strongly to the trustee that it was unwilling to provide any additional contributions for the benefit of deferred benefit members. National Mutual threatened to close the fund if necessary.

8. It is evident the AXA Fund’s difficulties were as a result of three decisions made up to 1998—the introduction of the deferred benefit; the introduction of the policy of smoothing crediting rates; and the three year contribution holiday taken by National Mutual. Each of those decisions seemed reasonable at the time because the fund had a large surplus. In 2002, the AXA Fund was fast becoming insolvent. National Mutual was not prepared to provide sufficient contributions to fix the situation.

9. Eventually, upon advice from the actuary, the trustee abandoned the crediting rate smoothing policy (which used a three year average method) and implemented a plan of recouping past over-crediting. The interest rate crediting policy was changed in the final days of the financial year, effective for the whole of that financial year. In other words, it was retrospective.

10. The trustee had a legal obligation to provide information to members about the change to this policy. Clearly, if members had been given advance warning that there might be a negative crediting rate for the 2002 year, then they might have opted to take their money out of the fund. This would be very beneficial to the members who left, because they would lock in the benefits of the past over-crediting and avoid the negative rates which would apply moving forward. This would cause a negative impact on the financial position of the fund and the members who were not able to exit. The trustee sent a very carefully worded newsletter to the members. However, the newsletter omitted key details of the new policy.

11. Following the announcement of the negative crediting rate, some of the members complained to APRA and ASIC. As a result of the complaints, the trustee reconsidered the matter and reversed its previous decision in relation to the smoothing policy so the old policy would apply for the 2002 and 2003 years. The trustee sent out letters to all the affected members to inform them of the increase in the benefits, and National Mutual agreed to increase funding for those years so the VBI was back at 100 percent by the end of the 2005 year. This agreement was recorded in an enforceable undertaking given to APRA.

APRA’s position

In 2005, APRA determined that the trustee had contravened legislation and the general law which imposed on it duties to act honestly, to exercise care, skill and diligence, and to ensure its duties and powers were performed and exercised in the best interests of the beneficiaries.

APRA moved to disqualify the directors of the trustee from acting as directors on the basis they had—

1. not properly considered the retrospective impact of the crediting rate decision
2. failed to consider alternatives, such as seeking financial assistance from National Mutual
3. failed to communicate properly to the deferred benefit members, thereby creating a misleading expectation among those members, and
4. preferred the interests of the other members over the interests of the deferred benefit members.
The decision

The disqualified directors appealed to the Tribunal. The following points are interesting in relation to the proceedings before the Tribunal:

1. APRA called evidence from an actuary who suggested the proper way to proceed would have been to change the crediting policy prospectively (not retrospectively) and to approach National Mutual to provide further funding for members who exited the plan. However, he agreed the trustee and its directors had been faced with a difficult and complex situation.

2. The Tribunal noted the trustee had sought and received actuarial advice, had carefully considered that advice, and had then made a decision.

3. The Tribunal cited earlier authorities with approval to the effect that a court reviewing the trustee’s decision on the merits ought to be cautious, and not too readily impeach the trustee’s decision on the basis the court would have made a different decision. It will rarely be the case that there is only one decision that is the correct one in the circumstances.

4. The Tribunal cited the High Court in Attorney-General (Cth) v Breckler[^16]:

   Where a trustee exercises a discretion, it may be impugned on a number of different bases such as that it was exercised in bad faith, arbitrarily, capriciously, wantonly, irresponsibly, mischievously or irrelavently to any sensible expectation of the settlor, or without giving a real or genuine consideration to the exercise of the discretion. The exercise of a discretion by Trustees cannot of course be impugned upon the basis that their decision was unfair or unreasonable or unwise. Where a discretion is expressed to be absolute it may be that bad faith needs to be shown. The soundness of the exercise of a discretion can be examined where reasons have been given, but the test is not fairness or reasonableness.

5. The Tribunal found the trustee’s decision to impose a negative crediting rate breached the trust deed. It interpreted the trust deed to mean there must be a positive rate. However, this was not a basis for disqualifying the directors.

6. The Tribunal was also critical of the trustee’s communication of its decisions to the members, particularly considering there had been a long period of time when the trustee knew of the fund’s difficulties and the fact the crediting rate policy was causing an unacceptable burden to the fund. However, the trustee never raised this in its newsletters to members. When the decision was made to change the policy, the newsletter that was sent deliberately withheld information from the deferred benefit members so they would not elect to withdraw from the fund. However, the Tribunal did not make a finding that the trustee was in breach of the trust deed simply by reason of the inadequate disclosure. Again, this was no basis to disqualify the directors.

7. The Tribunal also had to consider whether or not the trustee could be impugned for failing to act in the best interests of the deferred benefit members. The Tribunal found this did not necessarily mean the trustee had breached its fiduciary responsibilities. The fact that a course of action is not in the best interests of one group of members does not necessarily mean the trustee has failed to act in the best interests of the members as a whole. In making its decision, the trustee was in a clear position of conflict between the interests of the deferred benefit members and the other members. Whilst the law imposes an obligation on the trustee to act impartially as between members, there must be occasions when a trustee exercising a discretionary power must choose to prefer some beneficiaries over others. The Tribunal found the trustee had steered the fairest course it could among all of its members.

The case involves a trustee who was in a difficult position and who was struggling to make an appropriate decision in circumstances where the fund was performing badly due to external circumstances and a combination of decisions made a few years earlier. The Tribunal appears to have taken a fairly lenient view of the trustee’s position in light of those difficulties. It should give trustees some comfort that courts and tribunals will have regard to the sometimes difficult commercial circumstances in which trustees must exercise their discretion.
What is a bare trust?

A bare trust is one where the trustee no longer has any active duties to perform (being those imposed by the trust deed) except to convey the trust property to the beneficiaries upon demand. Generally, the duties imposed upon the trustee are regarded as passive duties.

Issues about the rights and obligations of bare trustees can arise in various commercial contexts, particularly where there has been a failure of a venture resulting in an entity holding legal title of an asset where it is not the beneficial owner.

In <i>CGU Insurance Limited v OneTel Limited (In Liq.)</i>, the High Court said the following:

The trustee of a bare trust has no interests in the trust assets other than those which exist by reason of the office of trustee and the holding of legal title. Further, the trustee of a bare trust has no active duties to perform other than those which exist by virtue of the office of the trustee, with the result that the property awaits transfer to the beneficiaries or awaits some other disposition at their direction. One obligation of a trustee which exists by virtue of the very office is the obligation to get the trust property in, protect it, and vindicate the rights attaching to it. That obligation exists even if no provision of any statute or trust instrument creates it.

In June 2011, the Full Court of the Federal Court delivered judgment in <i>Bruton Holdings Pty Ltd (In Liq.) v Commissioner of Taxation</i>. The case sheds some light on the obligations a bare trustee has, even in the absence of express duties and obligations in the trust deed.

A summary of the facts is as follows:

1. Bruton Holdings Pty Ltd (Bruton) was the trustee of the Bruton Educational Trust. It applied to the Commissioner for endorsement as a tax exempt entity and was refused. Its appeal against that decision was dismissed. It paid $470,000 to its solicitors’ trust account for costs associated with the appeal.

2. Subsequently, Bruton went into liquidation. Under the terms of the trust deed, Bruton was no longer entitled to exercise any powers in relation to the trust, and became a bare trustee.

3. The Commissioner issued a notice of assessment to the trustee for $77 million, and then sought to garnish the money in the solicitor’s trust account. Bruton instituted proceedings seeking a declaration the garnishee notice was void pursuant to section 500 of the Corporations Act. Those proceedings ultimately went to the High Court and Bruton was successful with costs.

4. Bruton’s liquidator wanted to apply the monies in the trust account towards the difference between Bruton’s actual costs of the proceedings, and the amount recovered pursuant to the costs orders. The Commissioner disputed Bruton’s entitlement to do so, arguing that the obligations of Bruton, as a bare trustee, did not extend to opposing the garnishee notice by court action. The court said as follows:

1. A bare trustee has an obligation to protect and maintain the trust property. This includes an obligation to vindicate the rights associated with the trust property. What a bare trustee must do in discharge of its obligations will vary with the nature of the trust property and whatever might threaten it.

2. A high standard of conduct is expected of trustees in their role as fiduciaries. This high standard has many facets, but all require a trustee to be diligent in discharging its duties and obligations.

3. A trustee must discharge the duties of the trust, give careful consideration to the exercise of discretions under the trust, and refrain from acting beyond the authorisation given by the trust deed and any relevant statute. A bare trustee has a duty to maintain and protect the trust property and to refrain from active management that does not fall within this duty.
How does a custodian trustee differ from a managing trustee?

Custodians frequently hold assets on behalf of a managed investment scheme, and whether such an arrangement gives rise to duties beyond those of a bare trustee has been considered by the courts. A series of recent decisions (the Opus cases) has examined the distinction between a “custodian trustee” and a “managing trustee”.

The facts were as follows:

1. The Public Trustee of Queensland (Public Trustee) had been the custodian trustee of the assets of 11 managed investment schemes, for which Opus Capital Limited (Opus) was the responsible entity. The Public Trustee held the property of the managed funds in its name under 11 identical custody agreements (Custody agreements), and performed legal and administrative functions on the basis of instructions provided by Opus. The general tenor of the Custody agreements was that the Public Trustee was not to concern itself with decisions as to how the schemes or scheme property were managed.

2. The schemes were engaged in borrowing money from members of the public and from banks, and using that money to purchase and develop real property. The assets of the schemes principally comprised real properties and cash in bank accounts. The schemes were adversely affected by the GFC, and lenders who held securities over assets took steps to enforce their securities as against the Public Trustee as owner or mortgagor of the properties. This and other matters led the Public Trustee to become concerned about whether Opus would be able to pay its fees.

3. Therefore, the Public Trustee terminated the Custody Agreements in December 2008. Opus did not appoint a replacement custodian until June 2012 and then provided instructions to the Public Trustee to transfer all the assets.

In the first decision, Re Public Trustee of Queensland, the Public Trustee asked the court for judicial advice about:

(a) Whether it could commence proceedings against Opus to recover unpaid legal fees; and
(b) Whether it may properly act on Opus’ instructions to transfer the assets.

The Supreme Court of Queensland decided that it was proper for the Public Trustee to comply with Opus’ directions to transfer the assets. The court also allowed the Public Trustee to exercise a lien over enough of the scheme assets to cover the amount being claimed by it in the legal proceedings it wished to commence against Opus.

In the second decision, Public Trustee (Qld) v Opus Capital Ltd, the Public Trustee sought an order for Opus to pay to it $470,000 in respect of legal costs the Public Trustee had incurred in relation to the 11 managed investment schemes. The Supreme Court decided Opus was liable to pay the majority of these disputed legal fees. However, it also gave detailed consideration to the extent of the duties owed by the Public Trustee as a custodian trustee to the members of the schemes and to third parties. Dalton J reviewed the obligations and potential liability which might be incurred by the Public Trustee even when acting in accordance with instructions and said:

In my view there was real reason for the Public Trustee to think that, if it dealt with scheme property, in accordance with instructions from Opus, to the detriment of the members of the scheme, it might also be liable to make good that loss. Furthermore, there was real reason for the Public Trustee to think it might also incur liabilities to others, such as lenders to the schemes, if its acting in accordance with instructions from Opus caused these third parties loss.

...there was potential for liability in the Public Trustee to third parties, such as lenders, if it breached obligations it owed them at law. It would have been irrelevant in assessing that liability that the Public Trustee was acting according to Instructions from Opus under a Custody Agreement.

In an important aspect of the decision, Dalton J considered the obligations and potential liabilities that might arise due to the nature of the role of a custodian trustee:

A custodian trustee is a statutory invention apparently having its origins in s4 of the Public Trustee Act 1906 (UK). There is a division of functions normally reposed in one trustee between two, a managing trustee...
and a custodian trustee. In Forster v William Deacon’s Bank Limited Harnworth MR called the role of a custodian trustee “a lesser function than an ordinary trustee”. In Re Brook Bond and Co Ltd’s Trust Deed Cross J said, “It is apparent that the duties of a custodian trustee differ substantially from those of an ordinary trustee. If the trust instrument or the general law gives the trustees power to do this, that or the other, it is not for the custodian trustee to consider whether it should be done. The exercise of powers or directions is a matter for the managing trustees with which the custodian trustee has no concern, and he is bound to deal with the trust property so as to give effect to the decisions and actions taken by the managing trustee unless what he is requested to do by them would be a breach of trust or would involve him in personal liability”... Because of the equivalent of s19(2)(e) of the Trusts Act 1973 (Qld) it was held in IRC v Silverts Ltd that a custodial trustee is not a bare trustee. Evershed MR remarked that the distinction was, “...perhaps a fine one, but it is a real one”.

Dalton J went on to conclude that when the Public Trustee assumed legal title of the property of the schemes, it absolutely held this property on trust for the members of the schemes with all the associated obligations and duties. This was so even though Opus was also a trustee for the same beneficiaries, and notwithstanding the contractual relationship between the Public Trustee and Opus, the Public Trustee owed direct duties to the beneficiaries of the schemes. Further, the court held after the Custody Agreements terminated, and while the Public Trustee retained the legal title to the property of the managed investment schemes, it continued as a trustee for the investors in the schemes.

It is clear therefore that a custodian trustee will be construed to have responsibilities in excess of those of a bare trustee, and will have its own duties and obligations to consider which are separate and distinct from those owed by the managing trustee.
GUIDELINE FOR TRUSTEES & RESPONSIBLE ENTITIES

Specific duties of a trustee

3
PART 3—Specific duties of a trustee

Does the trustee have any initial duties?
The initial duty of a trustee upon being appointed is to acquaint itself with the terms of the trust deed and any other relevant documents. It must then ensure it is fully aware of the precise nature and circumstances of the trust property and what it is required to do with that property. Once it has identified all of the trust property, it must bring it under the trustee’s control. A trustee might find itself accountable to the beneficiaries for any loss caused to the trust property if it fails to take ownership and possession of it promptly.

Once the trustee is fully acquainted with the terms of the trust deed, it must ensure those terms are being strictly carried out. A trustee must act strictly in accordance with the terms of the trust, and those terms will be embodied in the trust deed. The trustee is not entitled to deviate from the terms of the trust unless all of the beneficiaries (of full legal capacity and absolutely entitled to the trust property) direct the trustee to do so. This would be an unusual situation, particularly in relation to a commercial trust. This does not mean the terms of the trust cannot be varied, but any variation must be done strictly in accordance with the terms of the trust deed.

A trustee has an obligation to take any necessary and reasonable action to obtain title to or possession of the trust assets. This might involve taking court proceedings against a co-trustee or a third party who holds property of the trust or owes a debt to it. If the trustee chooses not to commence proceedings for commercial reasons (that is, the cost of the proceedings is prohibitive, or the debtor has no capacity to pay the judgment), then the trustee must be able to justify its decision if challenged.

If a trustee becomes aware the previous trustee was responsible for a breach of trust, then it must consider what action is available to the trust to remedy the breach and make good any damage it has suffered. This might extend to taking legal action against the former trustee.

The significance of these initial duties becomes clearer when the other duties of a trustee are considered below.

What is the duty to adhere to and carry out the terms of the trust?
A trustee’s most important duty (which follows from its duty to acquaint itself with the terms of the trust) is to rigidly adhere to and carry out the terms of the trust. All of the other duties are applied subject to any provisions contained in the trust deed itself.

Subject to certain extremely limited exceptions, a trustee who departs from the strict terms of the trust will be in breach of trust and will be personally liable to make good any resultant loss to the trust. A trustee who acts outside of the terms of the trust (as contained in the deed) loses its right of indemnity from the trust assets for any liabilities incurred.

A trustee will only be justified in departing from the strict terms of the trust deed in the following circumstances:

1. The trustee has been directed to do so by all the beneficiaries (who are each of full age and capacity).
2. A statute requires the deviation. For example, some statutes impose duties or confer powers on trustees notwithstanding anything contained in the trust deed.
3. The terms of the trust deed cannot be carried out, either because they involve some illegality or they are impossible. For example, the trustee would be entitled to deviate from the terms requiring an immediate sale of trust property if a purchaser could not be found.
4. The court either orders or sanctions the deviation.

Circumstances will arise in the day-to-day administration of a trust which make it appear necessary or beneficial for the trustee to deviate from the strict letter of the trust deed. However, if the trustee does so, then it may subsequently be asked to satisfy the court that the deviation was necessary. If the deviation cannot be justified, then the trustee will be required to compensate the trust for any loss the trust has suffered.
Case example—Eagle Star Nominees

In Gill v Eagle Star Nominees Ltd, the court had to consider a situation where some of the investors in a film scheme brought action against the trustee, Eagle Star.

The facts

A summary of the relevant facts is as follows:

1. There was a prospectus issued by Cine Funds Pty Ltd (referred to as Cine, together with its associated entities) which offered a commercial, but speculative, investment in a film production enterprise with a return of not less than 56 percent of capital contributed within two years of the commencement of the venture. Obtaining those benefits was dependent upon the trustee putting in place a letter of credit issued by a bank in favour of the scheme.

2. Cine intended to produce and distribute a feature documentary relating to earthquakes and storms from the past.

3. Eagle Star was required to act as representative of the investors and to act as trustee of the monies paid by the investors as their contribution to the film scheme.

4. The principal source of revenue for investors was the exhibition of the film. A pre-sale and distribution agreement had been concluded by Cine with a third party which had undertaken to achieve sales for the film for an amount equal to not less than 56 percent of the budgeted cost of the film. The third party also undertook to have established an irrevocable bank letter of credit for the film, payable to Eagle Star, for the benefit of investors. In the event the proceeds from distribution of each film failed to provide 56 percent of its budgeted costs, then the letter of credit could be drawn.

5. The film had to be completed to the prescribed technical standard and rating, and it had to be completed within 12 months. In order for the letter of credit to be drawn upon, it had to be received by the issuing bank in Amsterdam by 6 September 1985. It also had to be accompanied by a receipt from a specified laboratory in Sydney, verifying it had received a 35 millimetre film and acknowledging it was technically fit for general distribution and screening in first class cinemas and for transmission by means of television. The bank was also to receive a warranty letter from Cine confirming it had complied with all of the representations and warranties in the pre-sale and distribution agreement.

6. As the date grew closer for the letter of credit to be called on, there was a suggestion in the correspondence between the parties that what would be provided by Mr Saunders (the representative of Cine responsible for producing the film) was not a 35 millimetre film, but a video, and there would have to be a substantial amendment to the requirements of the letter of credit. Closer to the date, a laboratory receipt was produced from a different entity to the one specified in the letter of credit and the receipt itself referred to the laboratory having received “one 16 millimetre and/or 35 millimetre” film. Clearly, that statement was nonsensical. Eagle Star does not appear to have objected to either of these things, despite the fact they amounted to non-compliance with the terms of the letter of credit.

7. As things transpired, Cine couriered the request to draw on the letter of credit and the supporting documents to the bank in Amsterdam two days before the expiry date. The courier, for unexplained reasons, did not deliver the package. The bank refused to pay on the letter of credit for numerous reasons, including the fact the request was not made by the expiry date, the laboratory receipt had been provided by the wrong entity, and there was a nonsensical reference to it being a 16 millimetre and/or a 35 millimetre film. In other words, the bank had more than enough reasons to refuse.
The decision

The judge found as follows:

1. One of the duties of Eagle Star was to be vigilant in requiring the observance by Cine of its covenants under the pre-sale and distribution agreement. It was under a general duty imposed by equity at least to act in relation to the business of the film venture with the same care as an ordinary, prudent person of business would extend towards his or her own affairs.

2. A professional trust company also owes a higher duty. The judge quoted the case of Bartlett v Barclays Trust Co. (No. 1)27 where the court said as follows:

   ... I am of the opinion that a higher duty of care is plainly due from someone like a trust corporation which carries on a specialised business of trust management. A trust corporation holds itself out in its advertising literature as being above ordinary mortals. With a specialist staff of trained trust officers and managers, with ready access to financial information and professional advice, dealing with and solving trust problems day after day, the trust corporation holds itself out, and rightly, as capable of providing an expertise which it would be unrealistic to expect and unjust to demand from the ordinary prudent man or woman who accepts, probably unpaid and sometimes reluctantly from a sense of family duty, the burdens of trusteeship. Just as, under the law of contract, a professional person possessed of a particular skill is liable for breach of contract if he neglects to use the skill and experience which he professes, so I think that a professional corporate trustee is liable for breach of trust if loss is caused to the trust fund because it neglects to exercise the special care and skill which it professes to have.

3. The evidence before the judge indicated there was a history of unreasonable and unexplained delays on behalf of Cine and Mr Saunders. The judge found that whilst it was not part of the trustee’s duty to supervise the production of the film or to exercise any expertise in relation to the production of the film, it was obliged to take reasonable steps to satisfy itself that what would emerge from the film production process would be a product capable of satisfying the requirements of the letter of credit.

4. Eagle Star could not be asked to warrant the box office success of the film. However, it should have put itself in a position in which it would have been made aware of any serious departure between what was called for by the terms of the letter of credit and what was actually produced.

5. For some time prior to the attempt being made, Eagle Star had every reason to be extremely cautious about the capacity of Mr Saunders and Cine to make an effective drawing on the letter of credit. Eagle Star was on notice that the performance of Mr Saunders had been dilatory and unsatisfactory and there were concerns as to whether Cine would fulfil its obligations. It did not take any action in relation to these issues, and this was a serious failure on the part of Eagle Star to adequately discharge its responsibilities as a trustee. Eagle Star should have undertaken some form of independent assessment.

6. The judge found that with the exception of the late delivery of the documents to Amsterdam, all of the deficiencies in relation to the attempt to draw on the letter of credit were deficiencies in respect of which Eagle Star was implicated. The efforts made to draw on the letter of credit were seriously deficient and this occurred in circumstances which, having regard to the history of the matter, called for vigilance on the part of Eagle Star. The judge therefore awarded damages to the investors.
What is the duty to account and keep proper records?

The trustee is required to keep proper accounts of all money received and paid. The form of the accounts will vary depending on the size and complexity of the trust.

The trustee is required to keep a current schedule of the trust property and an accurate and up to date list of the beneficiaries.

The costs of keeping the accounts are borne out of the trust property.

The trustee must, when asked to do so, give the beneficiaries full information as to the extent of the trust property and as to its investments.

The account must be provided in a timely manner, accurate, supported by documentary evidence and in a manner which is not designed to impede or confuse beneficiaries. Beneficiaries are entitled to inspect the trust accounts.

The trustee’s duty to keep and render accounts is usually specifically regulated by the terms of the trust deed. In practice, the primary concern of the trustee is usually to ensure the trust accounts are prepared and rendered in compliance with the terms of the trust deed.

The trustee also has a duty to ensure it pays the correct beneficiaries, and that it recovers any overpayment which is made to a beneficiary.

What is the duty to provide information?

A trustee has a duty to inform the beneficiaries of matters that are relevant to their interests. The trustee does not have a duty to inform the beneficiaries of matters they should be aware of without reference to the trustee. For example, it is not part of a trustee’s duty to inform a beneficiary about encumbrances the beneficiary has created over his or her interest. The trustee is not required to assist the beneficiary to sell or mortgage his or her interest. Consistent with this principle, a person proposing to grant a beneficiary a mortgage over his or her interest is not entitled to demand information about the interest from the trustee.

The trustee is not under a duty to explain to the beneficiaries how the trust is managed, or the reason a particular decision was made. However, such a duty will be enforceable against the trustee if it is specifically contained in the trust deed. A trustee’s decision is not open to challenge by the beneficiaries unless they can prove bad faith.

There is a difference of opinion in Australian courts about the principles which should guide a court in deciding whether a trustee should be ordered to disclose trust documents to a beneficiary of a trust. It is beyond the scope of this Guideline to deal with those differing approaches as the key principles of the law in this area remain unsettled.

The starting point is that beneficiaries of strict trusts (such as a unit trust) are entitled to see and to take copies of the trust documents. However, trustees can refuse beneficiaries access to certain kinds of information included in trust documents.

Two of the more common reasons for refusing a beneficiary’s request for information are as follows:

1. The trustee considers that to reveal the information is not in the best interests of the beneficiaries as a whole
2. It will prejudice the trustee’s ability to manage the trust assets efficiently or properly.

If that decision is challenged by a beneficiary, then the court will decide whether the information should be provided on a case-by-case basis. That is, there are no strict rules which govern whether a court will order that information should be provided to a beneficiary or not.

However, some guidance can be obtained by looking at previous factual scenarios considered by the courts.

The following table contains some of the categories of documents requested by beneficiaries which have been considered by the courts.
Categories of documents

Legal advice
There are two sorts of legal advice which have been considered:
1. Advice where the trustee requires guidance relative to the administration of the trust or to the conduct of proceedings on behalf of the trust.
2. Advice which relates to a dispute between the trustee and a beneficiary or beneficiaries.

Generally speaking, beneficiaries will be entitled to legal advice covered by point 1 above, but not legal advice covered by point 2.

Financial accounts of the trust
Financial accounts will generally need to be provided. A beneficiary is entitled to understand what has been done with the trust assets. This usually means providing accounts with sufficient detail to allow a beneficiary to understand what has happened concerning the investments, income, expenditure and distributions of the trust fund.

Documents containing information on the trustee’s decisions
Generally, a trustee does not need to disclose the reasons for exercising its discretionary powers. Accordingly, a trustee is not obliged to disclose trust documents that would disclose the trustee’s reasons for making a discretionary decision or the subjective process of the trustee’s reasoning.

Confidential documents (including a third party)
A trustee may be under an obligation to a third party, or a general obligation, to keep the terms of a document confidential. If the trustee discloses the information in those documents, then the trustee will be in breach of its obligations. The court will protect the trustee in this situation.

Confidential documents (relating to a business)
There can be situations in which a trustee, particularly a trustee conducting a business, claims a document is confidential on the grounds that it would be put in an impossible position if the beneficiary of the trust could, as a matter of right, claim to inspect documents relevant to the conduct of the business.

The court has had to consider a case involving documents comprised of briefs to counsel and advices from counsel on a dispute that a responsible entity was having with various managers and other sub-contractors connected with the fund. In that case, the court found that where the trust has numerous beneficiaries and those beneficiaries may have differing views about the wisdom of the course of action being pursued by the trustee in the dispute, the law will recognise some scope for a trustee to refuse to disclose information on the basis it is confidential and also because the disclosure is not in the interests of the beneficiaries as a whole.

Ultimately, when faced with a situation in which the trustee asserts that the documents requested are confidential in nature, the court will balance the duty of a trustee to make disclosure to beneficiaries of information about the trust with the equally fundamental obligation of a trustee to conduct the affairs of a trust in the interests of the beneficiaries as a whole.

Whilst the courts have recognised the existence of this limitation on a beneficiary’s entitlement to inspect certain trust documents, the courts make it clear the limitation cannot be used as an excuse for paternalism or to disregard the interests of beneficiaries.

The courts will only uphold the limitation to the extent it is required to protect the trustee’s ability to discharge its obligations. Therefore the availability of the discretion will depend very much upon the circumstances of the particular case.
Does a responsible entity have additional obligations to provide information?

Members of a registered managed investment scheme have a right under the Corporations Act to seek an order from the court authorising a member of the scheme, or another person, to inspect the “books of the scheme”.^{28}

The court may only make the order if it is satisfied the applicant is acting in good faith and the inspection will be for a proper purpose. Generally speaking, this statutory power broadens the categories of documents which a member of a registered scheme is entitled to inspect. This is because the courts have held the term “books of the scheme” should be given a broad interpretation so as to facilitate the inspection of documents relevant to the affairs and interests of the scheme.

This broad formulation has meant, for example, that members of a registered scheme have been entitled to inspect directors and officers insurance policies maintained by directors of the responsible entity.^{29}

Importantly, the courts have held that simple disgruntlement with the trustee’s management of the scheme is not sufficient for a member to show they are acting for a proper purpose.

The variety of factual scenarios considered under this section of the Corporations Act, and the breadth of the court decisions, make it difficult to make definitive statements about what will constitute a proper purpose and what will not. However, in previous cases, the courts have recognised the following purposes as being proper inspection purposes in the company context. These purposes have recently been cited with approval in the scheme context^{30} and would be applicable to a scheme:

1. To allow a member to investigate prima facie irregularities in a company’s financial accounts or transactions; for example, the creation of parallel financial records,^{31} or a loan transaction between companies with a large number of common directors.^{32}

2. To allow a member to investigate the conduct of the directors, and to satisfy itself about the commercial benefit obtained by the company in relation to a particular transaction, and to investigate the profit and cash flow of a company for a certain period.^{33}

3. To allow a member to investigate other reasonably suspected breaches of duty.^{34}

4. To allow a member to value the shares in the company, so as to—
   (a) negotiate a fair exit price from the company,^{35} or
   (b) examine the effect of a corporate debt transaction on the value of the shareholding.^{36}

A corresponding list of circumstances where the courts have refused applications is as follows:

1. To ascertain the value of the equity of redemption in respect of a mortgage issued over the member’s share by investigating the exercise of rights between mortgagor and mortgagee.^{37}

2. To outflank a claim for client legal privilege made (or anticipated) over the company’s books or to serve as a substitute for discovery in litigation.^{38}

3. To obtain confidential information for a competitor of the company.^{39}

4. To improve the chances of a take–over bid.^{40}

5. To ascertain whether the corporation is solvent.^{41}

As can be seen from the discussion above, it is difficult to provide clear and unequivocal statements about which requests for information a trustee and responsible entity must satisfy and those it can deny.

The key point made by the courts is that whether or not a trustee or responsible entity must provide a beneficiary with information will be determined on a case-by-case basis.
Case example—Snelgrove v Great Southern Managers Australia Ltd (In Liquidation)

In Snelgrove v Great Southern Managers Australia Ltd (In Liquidation), the Supreme Court of Western Australia considered an application by several investors (the Investors) in beef cattle projects which were operated as managed investment schemes. The responsible entity, Great Southern Managers Australia Ltd (Great Southern), was in liquidation.

Background
Each of the members of the schemes had entered into a Lease Management and Agistment Agreement with Great Southern, where the members leased a group of breeding age female cattle. They were also granted a licence to graze the cattle on land owned by an entity related to Great Southern. The members were entitled to the progeny produced by their cattle.

The Investors wished to commence proceedings against Great Southern and its directors for damages arising out of an arrangement where the members had exchanged their interests in the schemes for shares in Great Southern Ltd (GSL). The Investors wished to inspect the books of Great Southern to determine whether their proposed claims were covered by insurance.

The investors’ case
The Investors put their case on the following basis:

1. Great Southern and its directors had convened a meeting of scheme members on 1 December 2008 to pass the following resolutions:
   (a) A special resolution to amend the constitution to include a clause enabling the responsible entity to propose an arrangement which would be binding on all scheme members if the second resolution was passed.
   (b) A resolution (which was dependent on the change to the constitution) to approve an arrangement outlined in an explanatory memorandum, pursuant to which Great Southern could terminate the Lease Management and Agistment Agreements, sell all of the scheme members’ cattle progeny and assign all of the entitlements to distributions from the scheme to a related entity. In exchange, the members would be issued with shares in GSL.

2. The Investors alleged the arrangement had significant benefits for GSL, including the acquisition of all of the interests in the schemes from the scheme members and the acquisition by the Great Southern Group of a cattle business with a total value of over $250 million. The arrangement gave Great Southern Group improved flexibility to manage the cattle business, including the ability to sell some or all of the cattle business assets to realise the significant appreciation in the value of the land where the business was operated. This would enable the proceeds to be used to repay debt and reduce Great Southern’s gearing. The explanatory memorandum failed to disclose a number of important issues about the arrangement, particularly the benefits for the Great Southern Group.

3. At the time, there was significant uncertainty as to the Great Southern Group’s ability to continue as a going concern and its auditors were likely to qualify their audit report if the arrangement could not be put in place. Great Southern Group was required to refinance $105 million in senior debt in October 2009 and the ability of the Great Southern Group to operate within its financial covenants was dependent on asset sales.

4. For the acquisition of the scheme assets by the Great Southern Group to take place, either all of the members had to unanimously agree or the constitution had to be modified. As the unanimous agreement of the members was extremely unlikely, modification of the constitution was the only method by which the arrangement could be implemented. The Investors argued the amendment to the constitution could only take effect upon the amended constitution being lodged with ASIC. Nonetheless, the second resolution at the meeting was considered even though it relied upon the modification referred to in the first resolution being effective.
5. The meeting was adjourned on 1 December 2008 until 19 January 2009. During the adjournment period, the directors offered financial inducements to some scheme members and were successful in having them change their vote to support the arrangement.

6. But for the breaches of the Corporations Act, the investors alleged the resolutions would not have been passed and the scheme would have continued in operation with either Great Southern or a replacement acting as responsible entity. The Investors alleged the shares in GSL were worthless which was supported by the fact GSL and the entire Great Southern Group went into administration on 16 May 2009.

The investors sought an order from the court that they be entitled to inspect the insurance policies for Great Southern to ascertain the extent of the insurance cover. The liquidator opposed the application.

The decision

The liquidator argued the members no longer had standing because they asserted they had been stripped of their membership rights and the scheme was no longer in operation. The investors responded by arguing the resolutions were invalid and they were still entitled to be treated as members of the scheme. The judge accepted the investors’ submissions, and agreed they had standing to apply for access to the books of the scheme.

The liquidator claimed the insurance policies were not books of the scheme. The judge found the term ‘books of the scheme’ should be given a broad construction to facilitate the inspection of documents relative to the affairs and interests of the scheme. The judge rejected the liquidator’s submission that the insurance documents related specifically to the affairs of the responsible entity as distinct from the affairs of the members. The judge found that insurance policies which may respond to the members’ claims are for the benefit of the members as well as the responsible entity and are therefore books of the scheme.

The liquidator claimed that, as the members had already commenced their action, the real purpose in seeking the insurance policies was not to determine whether or not the proceedings ought to be commenced, but to assist the solicitors in advising on whether the action ought to be maintained. The judge concluded it was a proper purpose to inspect books when investigating whether or not there are good grounds to bring a derivative action or a personal action against a company. Therefore, by analogy, the members of the scheme had a proper purpose in determining whether or not to bring an action against the responsible entity.

Finally, the court had to consider whether or not it should refuse the application on discretionary grounds, even where it is satisfied the applicant is acting in good faith and the inspection is for a proper purpose. The judge found that, if Great Southern did not have insurance or the insurance was not of a sufficient quantum, the members might not proceed with the proposed action. This would prevent the resources of the parties and public resources from being wasted. For those reasons the court granted the members access to the insurance policies.
What is the duty to administer the fund personally and not to delegate powers?

The trustee is required to administer the trust personally. A practical application of this rule is the trustee is not entitled to delegate its powers and duties to a third person. In the past, this rule has been enforced rigidly against trustees. However, in more recent times, it has been recognised that a trustee might, out of necessity, be compelled to use the services of others. While the general prohibition exists at general law, it has been relaxed by statute and in most cases is displaced by the terms of the trust deed. So, for example, with trusts that invest in property, it is common for the trustee to appoint a property manager and for the trust deed to authorise it to do so.

Some of the State acts provide that a trustee may employ an agent to transact any business or do any act required to be transacted or done in the administration of the trust. However, the trustee is still under a duty to act cautiously and prudently in the appointment of any agent.

Delegation is usually specifically permitted under the trust deed. If that is the case, then a trustee will have the benefit of the power of delegation contained in the trust deed. The State Acts also allow a trustee to delegate its powers and duties in certain circumstances. However, the trustee will generally remain liable for the delegate’s acts or omissions. Delegation by a responsible entity is authorised under the Corporations Act. The responsible entity remains liable for any acts or omissions of an agent, even if the agent acts outside its authority (section 601FB).

Another practical application of the general rule is that a trustee must not allow its discretion to be fettered. This means the trustee must not bind itself in advance to conduct itself in the future in a particular way. In one case, a trustee was found to have breached its duty because it had agreed to sell the trust property for a fixed price at a specified future date.

The trustee must also not act on the instructions of another person. It is required to make its own decisions about what is in the best interests of the beneficiaries. It is the obligation of the trustee and not a stranger to determine how the interests of the beneficiaries of the trust would be best served. However, in determining how to exercise its discretion, it is appropriate for the trustee to seek financial, legal, accounting or other professional advice to guide it.

The beneficiaries cannot direct the trustee about the way in which it should exercise its discretion or manage the trust. The trustee is not required to consult the beneficiaries, and does not have to give reasons to the beneficiaries about its decisions.

If there are multiple trustees, subject to the trust deed which might say otherwise, the trustees must agree unanimously to any course of action or decision in order for that action or decision to bind the trust.

What is the duty to preserve trust property and to properly invest the trust funds?

A trustee is under a general duty to exercise its discretions so as to protect and advance the interests of the beneficiaries of the trust. This obligation requires a trustee to consider the exercise of its discretions. The trustee cannot act passively in relation to its powers. It must always be in a state of readiness to act when action would be advantageous to the beneficiaries. Through its powers, the trustee is given the means to protect and advance the beneficiaries’ interests.

A trustee is bound to invest the trust funds in order to earn income for the beneficiaries, even where the trust instrument does not expressly require it. A trust fund that is not invested is not safely preserved. As with all other duties and powers, a trustee’s first duty is to obey the directions of the trust deed. It is usual for a trust deed to contain specific directions and instructions dealing with the trustee’s powers of investment. If that is the case, then the trustee must adhere rigidly to those directions and instructions.

If the trust deed specifically prohibits an investment which would otherwise be allowed at law, then the trustee will be in breach of trust if it ignores that prohibition. However, if a trust deed authorises investments of a class not generally authorised by law, then the trustee is allowed to make the investment, but must exercise a high degree of prudence before making a particular investment. The courts have made it clear that special investment clauses will be construed...
strictly and the onus is on the trustee to prove a particular investment is within the scope of the clause.

If the trust deed does not contain any directions, then the trustee’s powers of investment will be governed by the State Acts. The powers of investment conferred on a trustee by the State Acts are in addition to any powers conferred on it by the trust deed. The State Acts provide:

1. A trustee can (unless expressly forbidden by the trust deed) invest trust funds in any form of investment and may at any time vary any investment. This is an extremely wide power.
2. They establish the standard of care required of a trustee in exercising its powers of investment and set out certain matters to which a trustee must have regard.
3. Any rules and principles of law or equity that impose a duty on a trustee exercising a power of investment continue to apply except to the extent they are inconsistent with any other statute or the trust deed.

The State Acts vary the general standard of care of a trustee in so far as it relates to its power of investment. The State Acts provide that subject to the terms of the trust deed, if a particular trustee’s profession, business or employment is or includes acting as a trustee or investing money on behalf of other persons, then that trustee must, in exercising a power of investment, exercise the care, diligence and skill that a prudent person engaged in that profession, business or employment would exercise in managing the affairs of other persons.

The State Acts also list a number of matters a trustee must have regard to in exercising its power of investment as follows:

1. The purposes of the trust and the needs and circumstances of the beneficiaries.
2. The desirability of diversifying trust investments.
3. The nature of and risk associated with existing trust investments and other trust property.
4. The need to maintain the real value of the capital or income of the trust.
5. The risk of capital or income loss or depreciation.
6. The potential for capital appreciation.
7. The likely income return and the timing of income return.
8. The length of the term of the proposed investment.
9. The probable duration of the trust.
10. The liquidity and marketability of the proposed investment during, and at the end of, the term of the proposed investment.
11. The total value of the trust estate.
12. The effect of the proposed investment on the tax liability of the trust.
13. The likelihood of inflation affecting the value of the proposed investment or other trust property.
14. The cost (including commissions, fees, charges and duties payable) of making the proposed investment.
15. The results of a review of existing trust investments.

What is the duty to act impartially between the beneficiaries?

The trustee has a duty to act impartially between the beneficiaries. This flows from its general duty to serve the interests of the beneficiaries of the trust.

In the absence of an express power in the trust deed to discriminate in particular circumstances, a trustee cannot act so as to favour some beneficiaries only or to burden others. A trustee cannot pick and choose among the beneficiaries as to whom it will serve. The general duty of a trustee to serve the interests of its beneficiaries is a duty to serve their collective interests rather than the individual interests of any of them.

The rule is applicable in the day-to-day administration of a trust. For example, where a trustee is preparing and distributing notices of meeting to unitholders in a unit trust, every unitholder is equally entitled to receive the notice. If any particular unitholder is not sent the notice of meeting, then it will have been unfairly discriminated against.

The trustee is most likely to need to consider this duty where it has to deal with different classes of beneficiaries, such as those that have an interest which gives them an entitlement to income from the trust compared to those that have a reversionary interest in the capital of the trust. The trustee also needs to consider the varying purposes of the trust and the needs and circumstances of the beneficiaries as to how they must be served.
trust. In those cases, the trustee has to make decisions that fairly deal with the interests of both the income beneficiaries and the capital beneficiaries.

Simply acting in accordance with the wishes of the majority of beneficiaries is not necessarily sufficient for a trustee to discharge its duty to act impartially. The trust deed may contain express provisions that require the trustee to act in accordance with the directions of the majority of beneficiaries. However, in the absence of such provisions, the trustee must satisfy itself that the wishes of the majority are in the interests of all the beneficiaries. If the majority’s wishes are no more than a formula for benefiting themselves alone (or for burdening the minority), then a trustee will be in breach of its duty to act impartially if it implements those wishes.

The statutory equivalent of this rule for responsible entities is found in section 601FC(1)(d) of the Corporations Act which requires a responsible entity to treat scheme investors who hold interests of the same class equally and members who hold different classes fairly.

In Gra-Ham Australia Pty Ltd v Perpetual Trustees (WA) Limited, unitholders in a unit trust sought to redeem their units immediately after the 1987 share market crash at the pre-crash values. The unitholders relied on a provision in the trust deed which enabled them to redeem their units at the price which was applicable seven days prior to the request. The trustee refused to redeem the units, and called a meeting of the unitholders where a resolution was passed to amend the trust deed so that the units could be redeemed for their current value.

The court found the trustee had acted appropriately. The trustee was aware that in excess of 50 percent of unitholders were seeking to withdraw their funds, which meant the withdrawing unitholders would be paid at the expense of those remaining in the fund. The court found the trustee was acting for the benefit of the unitholders generally by initiating the amendment to the trust deed. The trustee was found to have acted in good faith and fairly in respect of all unitholders.

What is the duty to exercise due diligence and vigilance?

The nature of the trustee’s relationship with the trust requires it to act with fidelity and prudence in relation to all of its dealings on behalf of the trust. In addition, the trustee must also act with diligence and caution. Refer to section 2 of this Guideline for further information about the standard of care required.

If a trustee is uncertain as to what steps it should take in the proper conduct of the affairs of the trust, then it is appropriate that it seek professional advice, for example, from a lawyer, accountant or other professional person. In some cases, the proper course of action may still be unclear and the trustee is then able to seek a direction from the court. Section 5 of this Guideline has further details in relation to obtaining directions from the court.
GUIDELINE
FOR No-conflict & no-profit rules
TRUSTEES & RESPONSIBLE ENTITIES
PART 4—No-conflict & no-profit rules

What are the no-conflict and no-profit rules?
The trustee has a general duty to act in good faith in the interests of its beneficiaries. There are two very important aspects to this rule:

1. A person in a fiduciary position is prohibited from entering into any engagement in which his or her personal interest conflicts with the duty to the trust. This is known as the ‘no-conflict’ rule. A trustee must avoid entering into transactions where there is a conflict (or a sensible possibility of conflict) between its duty to the trust and its own interests.

2. A person who is in a fiduciary position is not entitled to use that position to obtain a private advantage. This is known as the ‘no-profit’ rule. A trustee must not use its position, or information that has come into its possession as a result of its position, to gain a profit or advantage for itself.

Given the fiduciary nature of the relationship, a trustee is liable to account to a beneficiary for any profit derived as a result of both the opportunity and knowledge acquired through performing its role as trustee. It is generally irrelevant that a trustee acted honestly and in the beneficiary’s best interest, or that the profit would not have been made but for the trustee’s personal skill and judgment.

The trustee’s obligation to the beneficiaries means the trustee is prohibited from using or dealing with trust property, or any opportunity derived from the position as trustee, for its advantage. A trustee will act improperly if it gains an unfair advantage due to knowledge acquired as trustee. So, a trustee which is aware that assets of a trust or units in the trust are available for purchase is not entitled to use that information to its own advantage.

These prohibitions are designed to ensure the trustee’s loyalty to serve the interests of the beneficiaries is not distracted by a personal interest which conflicts with those interests.

In the case of Keech v Sandford, a trustee of a lease renewed the lease in its own name where the lessor had refused to renew the lease to the trust. The court found it was a strict rule that a trustee must not use knowledge gained in its position as trustee to gain an advantage for itself, even in circumstances where the beneficiaries were not in a position to take advantage of the lease. The court ordered the trustee to hold the lease on trust for the beneficiaries.

The trust deed will often contain provisions designed to prevent the application of this rule in certain circumstances. For example, it may specifically provide that the trustee may hold units in the trust or that it may contract with various related parties in capacities other than in its capacity as trustee of the trust.

These permissive provisions are often prefaced by the condition that the trustee must act in good faith.

In Estate Realties Limited v Wignall (No 2), the court had to consider a case where a stockbroking firm acquired shares from a client at the market price for those shares on the day of the purchase and after having been approached by the client to sell them. It then held the shares in a scheme and, through its own acumen and skill, was eventually able to sell the shares for a large profit.

Whilst the stockbroker was not under any duty to obtain the profit for the clients and had paid proper value for the shares, it was nonetheless ordered to account to the clients for the whole of the profit it had made because the opportunity to purchase the shares had come to its knowledge as a result of its fiduciary relationship with the clients.
Case example—Regal Hastings

Regal (Hastings) Ltd v Gulliver deals with the analogous fiduciary obligations of directors. In that case a holding company set up a subsidiary company to acquire the leases of two cinemas. The owner of the cinemas was only willing to lease them if the share capital of the subsidiary was completely subscribed. The holding company only had resources to subscribe for part of the shares, so the directors of the holding company agreed they would subscribe for the remainder of the shares with their own funds. The business was subsequently sold and the directors made a profit from the sale of their shares in the subsidiary. The purchaser of the holding company caused the holding company to bring an action against the former directors to account for the profit.

The court found the opportunity and special knowledge to acquire the shares had come to the directors in their position as fiduciaries. The directors had made a profit out of their position as directors, and in the absence of shareholder approval, they were obliged to account for the profit. The unusual aspect of this case is that the shareholders in the holding company were actually better off as a result of the directors agreeing to put their own money into the subsidiary. If they had not done so, then the business could not have been put in a position where it could be on-sold for a profit. In addition, the directors were in no way acting dishonestly or fraudulently.
Can the trustee sell property to, or buy property from, the trust?

The trustee must not sell its own property to the trust. There are also potential conflicts of interest for a trustee where it wishes to sell property to the trust from an entity which the trustee controls or in which it has an interest (or one of its directors or shareholders controls or has an interest). Also, the trustee must not purchase property from the trust. These restrictions are often referred to as the ‘self-dealing rule’, as in such transactions, the trustee is acting—

1. as the buyer (on its own behalf) and the seller (on behalf of the trust), or
2. as the seller (on its own behalf) and the buyer (on behalf of the trust).

In engaging in such a transaction, the trustee clearly places its personal interest in conflict with its duty to the beneficiaries. The purchase of trust property will include a situation where the trustee purchases the property of the trust for the purpose of holding the property for another trust of which it is also trustee.

These types of transactions will be set aside, regardless of how open or honest the trustee’s conduct was, or how fair the price. It is not a defence to an accusation of self-dealing to prove the price paid to the trust for the asset was the best price available after tenders were called, or that it was supported by a valuation. This will have relevance to trustees involved in the structuring and promotion of investment projects. For example, when a promoter is putting together a new property fund, it will often—

1. purchase the site (using some structure in which it or its directors or shareholders have an interest)
2. develop the site using a related company to undertake the building and construction work, and
3. promote a trust with itself as the trustee for the purposes of purchasing and holding the property.

This gives rise to potential conflicts of interest for the trustee in relation to the interests of the various entities.

Another situation where this type of conflict might arise is where a trustee of a trust wishes to purchase property from the trust for the purpose of rolling that property into another trust of which it is also the trustee. Alternatively, the trustee (or an entity associated with it) may wish to sell its own property to the trust.

What are the consequences of the rule against self-dealing?

The practical application of the duties referred to above to a trustee involved in the sale of its own property to the trust, or the purchase of property from the trust, is as follows:

1. The trustee is prevented from selling its own property to the trust or purchasing property from the trust by the rule against self-dealing.
2. The purchase of trust property by someone closely associated with the trustee is also open to suspicion. It raises a presumption that the purchase was for the trustee’s benefit, and this may be sufficient for the court to set aside the transaction. The interposing of a third party such as an agent or a company the trustee controls will not operate to circumvent the self-dealing rule. Where the trustee is a company which is part of a group, it is safest to assume any court asked to adjudicate on the matter will treat the companies as being the same entity for the purpose of determining whether or not the trustee is in breach of any of its fiduciary duties.
3. The sale of property held by a trustee for a trust (Trust 1) to another trust (Trust 2) in circumstances where it is also the trustee for Trust 2 is sufficient to breach the rule against self-dealing. The transaction is liable to be set aside by the court, even though the trustee is not getting any personal benefit from the sale. In any event, it is probably the case that the trustee will gain a benefit from the sale of the property to Trust 2 if the trustee carries on the business of administering trusts for payment of a fee. The advantageous purchase of trust property for Trust 2 could result in additional fees being paid for the administration of Trust 2; the trustee’s commercial reputation could be enhanced; and the value of its funds management business will be increased.
4. A trustee in a position of conflicting duties is not relieved from either duty. So, in the previous example, the trustee is not relieved of its obligations to the beneficiaries of Trust 1 to sell the assets of the trust for the highest price by virtue of the fact that it owes a separate duty to the beneficiaries of Trust 2 to purchase assets on their behalf at the lowest price. It would be impossible for the trustee to avoid a conflict between its duties to the respective trusts, because it cannot achieve the highest price for the seller whilst at the same time achieving the lowest price for the buyer.

5. The rule against self-dealing also operates to prevent a trustee from selling its own property to the trust. Issues in relation to the sale of property owned by a trustee (or one of its associates) to a trust often arise in relation to new schemes, where the promoter owns property which it intends to roll into the trust vehicle so that it can be exploited for the benefit of investors. In those circumstances, the self-dealing rule is normally circumvented by obtaining fully informed consent from the investors. To get fully informed consent, the trustee must make full disclosure to investors in the offer document and get them to sign an application form agreeing to invest on those terms.

These principles are inflexible and fundamental. Liability is strict. It is not a defence to a claim that a duty has been breached to say the trustee acted honestly and in good faith, or that the beneficiaries have not suffered any disadvantage. The transaction will only be possible if one of the exceptions applies (as set out below).

What are the exceptions to the rule against self-dealing?

There are some limited exceptions to the rule against self-dealing. A trustee may act in a position of conflict between interest and duty in the following circumstances:

1. It is authorised or contemplated by the trust instrument. If the trustee is relying on an express power in the trust deed allowing it to self-deal, then the following issues are relevant:
   (a) The power in the trust deed must be clear and unambiguous. Given the nature of the fiduciary relationship, it is likely the power in the trust deed would be strictly construed against the trustee by a court if it was asked to adjudicate on the matter.
   (b) Where it is contemplated the trustee will be buying and selling property between two trusts and it is the trustee of both trusts, it is essential the provision allowing self-dealing appears in the trust deeds for both trusts.
   (c) Even if such a provision exists, it is advisable for the trustee to have an independent board, committee or expert consider the transaction. The independent board or person should be provided with full disclosure so it can analyse the transaction and satisfy itself the purchase of the property from the trustee or the sale of property to the trustee is in the best interests of the investors in the trust. The purpose of the independent board or expert is to analyse the transaction without having a conflict of interest.
   (d) In any circumstances where there is a potential for a breach of duty to arise, the trustee should ensure it keeps accurate records of any information considered by the board or independent person so it can later prove (if necessary) appropriate consideration was given to the issues by the trustee.

2. It is authorised by each of the beneficiaries (who are of full age and capacity) and the transaction occurs at arms-length for a fair price. If the trustee is relying on the consent of the beneficiaries, then the following issues are relevant:
   (a) Consent needs to be obtained from each beneficiary. It is not possible to hold a meeting and obtain majority approval. Even unanimous approval from a meeting will not be sufficient unless all beneficiaries are present and vote. In any event, it would not be prudent to rely on a verbal approval. A signed consent should be obtained from every beneficiary.
(b) Even if the consent of the beneficiaries has been obtained, the court may still review the transaction and consider all of the circumstances to determine whether it is fair, just and equitable for the beneficiaries (or any of them) to withdraw their consent. The beneficiaries can apply to the court to withdraw their consent even after the transaction has been completed.

(c) A beneficiary will not be taken to have consented to a breach of trust unless he or she was of full age and capacity, had full knowledge and understanding of all of the material facts and the consequences of the consent, and was not induced by fraud or undue influence to give the consent.

(d) Partial disclosure will be treated as if there was no disclosure at all. It is insufficient disclosure to make a statement which discloses some relevant facts, but which requires the recipient of the information to make further enquiries in order to ascertain all of the relevant information. To avoid liability, a trustee must make full and frank disclosure of all material facts to the beneficiaries.

(e) It is not sufficient to prove the beneficiaries knew of the proposed breach of trust (ie the trustee’s intention to purchase the trust property), and did not object. There is no requirement for the beneficiaries to object to the proposed breach. It is up to the trustee to obtain each beneficiary’s fully informed express consent.

(f) In some circumstances, it will be contemplated in the offer document that the trustee will sell assets to the trust. In those circumstances, the beneficiary can be taken to have given its express consent to the self-dealing when he or she signs the application form to acquire an interest in the trust.

3. It is authorised by the court. It is possible for a trustee to apply to the court for a declaration permitting it to enter into a transaction which would otherwise be a breach of its fiduciary duty. That application would need to be supported by evidence the property had been adequately marketed after full disclosure of all matters relevant to the value had been disclosed and that the offer being made by the trustee represented the best price that could be obtained.
Case example — Clay v Clay

In Clay v Clay, the High Court considered the self dealing rule.

The facts

The circumstances were as follows:

1. Mr Clay had three children. After the death of their mother, he remarried and he and his second wife had a further child. Mr Clay died in 1970 leaving his estate to his four children when they attained the age of 25 years. In the meantime, there was a yearly payment of $20,000 to be made from his estate to his widow.

2. At the date of Mr Clay’s death, the four children and his widow were living with him in a residential property in Claremont which had been their home for many years. The four children continued to reside with Mrs Clay after the death of their father.

3. A solicitor was appointed as executor of the Will, and in 1973 he sold the Claremont home to Mrs Clay for $45,000. There was evidence this was the market value of the property at the time it was transferred.

4. Many years later, Mrs Clay’s three step-children sought a declaration from the court that she held one-quarter of the Claremont property on trust for each of them. With some hesitation, the Western Australian Supreme Court found there was sufficient risk that Mrs Clay’s personal interest in acquiring the Claremont property might impede the faithful performance of her duties as guardian to ensure the executor of the Will properly administered the estate. Mrs Clay appealed to the High Court.

The decision

The High Court found as follows:

1. The self-dealing rule provides that the sale by the trustee of the trust property to himself or herself is voidable by any beneficiary, however honest and fair the transaction is, and even if the sale is at a price higher than could be obtained on the open market.

2. The High Court acknowledged there was a view in the New South Wales courts that any changes made by statute over the years had left the self-dealing rule unaltered in its strict operation. However, it also acknowledged that in England there was some disagreement in the case authorities as to the circumstances, if any, where the self-dealing rule does not apply in its full stringency and where the trustee may be allowed to uphold the transaction.

3. Regrettably, the High Court did not take the matter any further because it determined that the children did not have a beneficial interest in the Claremont property at the date of the transfer to Mrs Clay, so the self dealing rule had no application. That is, Mrs Clay was not buying the property from her step children in her capacity as their guardian.

4. The Supreme Court had dealt with the matter by considering general principles about the avoidance of conflict between duty and interest. It had acknowledged it was a borderline case, but nonetheless found there was a sufficient risk the personal interest of Mrs Clay in acquiring and retaining the Claremont property might have impeded the discharge of her duty as guardian.
5. Notwithstanding the Supreme Court’s view, the High Court felt the better view was there was no sensible, real or substantial possibility of conflict in the necessary sense. There were a number of circumstances which indicated the conduct of Mrs Clay did not involve a breach of the duty she owed as guardian. These were as follows:

(a) She dealt with the trustee who had a power of sale, not with her step-children.
(b) She did not deal in the property of her step-children.
(c) She dealt in good faith.
(d) She paid market value and no loss accrued to the estate.
(e) She was guardian by virtue of her capacity as sole surviving step-parent, a very particular type of fiduciary role, although it may have some of the indicia of a trustee role.
(f) She could be seen to be acting in both her step-childrens’ interests and her own interests by providing a home for her step-children, her child and herself, especially as the Claremont property offered particular emotional support for the children, as well as herself, which would be lost to all of them if she did not acquire it.

6. Whilst the High Court found the self-dealing rule did not apply in these circumstances, it still acknowledged the existence of the rule and contemplated it still being stringently applied. The case illustrates that in some circumstances, the court will take a lenient view of the actions of trustees in determining whether or not there has been a conflict of interest and duty. However, it should be borne in mind that the case involved a step-mother making decisions in the best interests of herself and her step-children following the death of their father, and did not involve a trustee or a responsible entity operating in a commercial sphere. In a commercial context, the court is more likely to strictly apply the stringent rules regarding conflicts between duty and interest.
Can a trustee purchase a beneficiary’s interest?

There are potential conflicts of interest where the trustee wishes to purchase an interest or unit from an investor in a trust of which it is the trustee. Where a beneficiary in a trust wishes to sell its interest, the trustee will often attempt to facilitate the sale. There are two possible scenarios as follows:

1. The trustee may purchase the interest in its own right.
2. The trustee may purchase the interest to hold on trust for the benefit of beneficiaries in another trust of which it is also trustee.

Whilst the trustee has a duty not to purchase trust property or to sell its own property to the trust, the same considerations do not apply to the purchase or sale of a beneficiary’s interests in the trust. A distinction is drawn between the underlying assets of the trust, and the interest (or units) held by a beneficiary in the trust.

The courts have said a trustee cannot purchase trust property or sell its property to the trust because it has no one with whom to bargain. It is in the position of buyer and seller. However, this is not the case where the trustee is purchasing an exiting beneficiary’s interest in the trust or selling its own interests to an incoming beneficiary, because the beneficiary is able to negotiate with the trustee. The trustee has someone to bargain with.

Where a trustee is purchasing interests from an exiting beneficiary, the trustee must be able to show it gave fair value for the interests, and that it informed the beneficiary of all relevant information to enable the beneficiary to make a decision about whether or not he or she should sell the interests to the trustee.

The constraint placed upon a trustee seeking to purchase a beneficiary’s interest is often referred to as the ‘fair-dealing rule’.

The obligation on the trustee to make disclosure is very onerous. In the case of Dougan v Macpherson, the judge made the following comment:

I think that every learned judge who has dealt with this question has said that a court will always regard with great suspicion such a transaction, and will call upon the trustee to show that he has given full information, that he has kept back nothing, and that he has given an adequate price.

In Coles v Trescothick, the court said:
As to the objection to a purchase by the trustee, the answer is that a trustee may buy from the (beneficiary), provided there is a distinct and clear contract, ascertained to be such after a jealous and scrupulous examination of all the circumstances, that the (beneficiary) intended that the trustee should buy, and there is no fraud, no concealment, no advantage taken, by the trustee, of information acquired by him in the character of trustee.

In the case of a responsible entity of a managed investment scheme, section 601FG provides:

The responsible entity of a registered scheme may acquire and hold an interest in the scheme, but it must only do so:
(a) For not less than the consideration that would be payable if the interest were acquired by another person; and
(b) Subject to terms and conditions that would not disadvantage other members.

Whilst the section clarifies the circumstances in which a responsible entity can acquire and hold interests in a scheme, it does not exclude or modify the judge made law in relation to the considerations that are relevant when a trustee purchases an interest from a beneficiary.
Case example—Beale v Trinkler

In the case of Beale v Trinkler, 65 the New South Wales Supreme Court considered the fair dealing rule.

The facts

The circumstances were as follows:

1. Mr Beale and Clemelle Way Pty Ltd (a company associated with Mr Trinkler) purchased two properties as tenants-in-common in August 2002—Branch Lane for $1,550,000 and Bucketts Way for $200,000. Mr Trinkler and Mr Beale guaranteed the repayment of the money borrowed to purchase the properties. Mr Trinkler had difficulty deciding who should hold the sole share in his company, Clemelle Way. As a result, Mr Beale agreed to become the sole director and to hold the sole share on trust for Mr Trinkler. In this way, Mr Trinkler was the sole beneficiary of the company’s involvement in the venture. However, the legal ownership was held by Mr Beale on trust for Mr Trinkler.

2. The parties intended the properties would be sub-divided—Branch Lane into 100 rural lots and Bucketts Way into 27 residential lots. In the meantime, Mr Trinkler and Mr Beale would breed cattle on the Branch Lane property and the profits would be used to service the loan.

3. In 2005, Mr Trinkler asked Mr Beale to either buy him out or sell the properties and wind up the partnership. It was agreed an independent valuer should be appointed to value the properties and that Mr Trinkler would take Bucketts Way and Mr Beale would take Branch Lane and that they should each take a return of their initial contribution and 50 percent of any increase in the value of the other property. Mr Beale (who was a lawyer) drew up a heads of agreement and Mr Trinkler received independent advice about it and agreed to the deal. Mr Beale executed the heads of agreement in his own right and also signed on behalf of Clemelle Way in his role as trustee. The independent valuer then valued Branch Lane at $2.4 million and Bucketts Way at $420,000.

4. When it came time to settle the transfer of the two properties to give effect to the heads of agreement, Mr Trinkler refused to complete. Mr and Mrs Beale sought specific performance of the heads of agreement. The main argument on behalf of Mr Trinkler was that Mr Beale was acquiring the beneficial interest held by Mr Trinkler in the share in Clemelle Way and, as a trustee, he bore the onus of establishing he had complied with the fair dealing rule.

The decision

The judge found as follows:

1. The heads of agreement provided for Mr Beale to acquire Mr Trinkler’s beneficial interest in the share in Clemelle Way so it amounted to a purchase from a beneficiary and the fair dealing rule applied. Underlying the requirements of the fair dealing rule is the more general equitable principle that a fiduciary must not obtain any benefit or gain from a conflict of personal interest and fiduciary duty. The specific requirements of the fair dealing rule should be understood in this context. If a trustee gains no advantage at the expense of the beneficiary, then the fair dealing rule is not infringed.

2. The issue of whether or not fair value had been paid for the share was the subject of quite a lot of evidence before the judge. Mr Trinkler argued there had been an offer from a neighbour for a higher price shortly after the heads of agreement had been entered into, and Mr Beale refused to consider negotiating further with that neighbour. Instead, Mr Beale insisted on relying upon the independent valuation agreed to in the heads of agreement. The judge found neither Mr Beale nor Mr Trinkler was a land valuer, nor did they have any particular expertise in the valuation of land. The logical course was that adopted under the heads of agreement, which was the appointment of an independent valuer to value the properties and for the parties to accept the valuation.
3. It was submitted by Mr Trinkler that, notwithstanding the adoption of this approach, if the land was worth more than the value attributed to it by the independent valuer, then Mr Beale had failed to give full value and the heads of agreement should be set aside. The judge did not accept that a court of equity would endorse such an absolute and inflexible approach to the fair dealing rule. Just as the scope of the fiduciary duties will vary depending upon the sphere of activity in which the fiduciary undertakes to act on behalf of the beneficiary, so too the fair dealing rule must adapt to the relevant circumstances.

4. If by adopting a valuation report a fiduciary obtains no benefit or gain from a conflict of personal interest and fiduciary duty, and if the fiduciary gains no advantage at the expense of the beneficiary, then the fair dealing rule is not infringed even if the independent valuer was mistaken as to the market value of the property. The appointment of an independent valuer and the acceptance of his valuations did not involve Mr Beale taking advantage of his fiduciary position as trustee. On the contrary, the appointment precluded Mr Beale from benefiting from his role as a fiduciary, and it placed him and Mr Trinkler at arms-length because independent advice was sought by the parties.

5. As for the other elements of the fair dealing rule, the court found there was no lack of disclosure on Mr Beale’s part, and Mr Trinkler had the full benefit of Mr Beale’s judgment in drawing up the heads of agreement. For that reason, there was no abuse of Mr Beale’s position as trustee.
How does a trustee satisfy the fair-dealing rule?

In order to satisfy the fair-dealing rule, the trustee needs to satisfy the following criteria:

1. It paid full value for the beneficiary’s interest. This might involve ensuring the beneficiary has offered the interests for sale to other parties to establish the market value of the interests. In any event, the value should be determined in a manner the trustee believes accurately reflects the true value of interests in the trust. The value of the interests is not necessarily the value of the underlying trust assets.

2. It made full disclosure of all the facts which might have influenced the trustee’s desire to purchase the interest and which might have affected the beneficiary’s judgment in agreeing to sell the interest. This is consistent with the trustee’s obligation not to gain an improper advantage through information gained from its position.

3. If the trustee held a position in relation to the beneficiary which resulted in the beneficiary placing reliance upon the trustee’s judgment, then the trustee must give the beneficiary the full benefit of its judgment.

4. The transaction was at arms-length, and, in appropriate cases, the beneficiary obtained independent advice.

5. The beneficiary was of full age and capacity.

6. The trustee complied with any provisions of the trust deed governing its rights and obligations in respect of the purchase of the beneficiary’s interest. The trust deed governing the trust might have some impact on the issue of the trustee’s obligations and the mechanism for determining the sale price of the interest.

Provided these criteria are met, the trustee is entitled to purchase an interest from a beneficiary of the trust, either to hold in its own right or to hold as trustee for another trust.

Can a trustee purchase interests to hold for another trust?

Where a trustee of one trust (Trust 1) is purchasing interests from a beneficiary for the purpose of holding them on behalf of another trust (Trust 2), further issues arise as follows:

1. The trustee must be sure it does not have a conflict between its duty to Trust 2 and its own interests. The trustee owes a fiduciary duty to the investors in Trust 2 to ensure proper commercial considerations apply to the purchase of any assets (including units in a trust) on their behalf.

A trustee has a duty to concern itself primarily with promoting financial advantage to the trust. In Cowan v Scargill, the judge made the following comment:

*When the purpose of the trust is to provide financial benefits for the beneficiaries, as is usually the case, the best interests of the beneficiaries are normally their best financial interest. In the case of a power of investment … the power must be exercised so as to yield the best return for the beneficiaries, judged in relation to the risks of the investments in question.*

2. The trustee needs to ensure the purchase of interests from the beneficiaries in Trust 1 to be held on trust for Trust 2 has not been entered into for the trustee’s commercial purposes. For example, it would be inappropriate for the trustee to enter the transaction for the purpose of avoiding criticism from the beneficiaries in Trust 1 about the lack of a secondary market for their interests. The trustee will need to satisfy itself it is acting in the best interests of the beneficiaries in Trust 2 and it has thoroughly investigated and documented the benefit to Trust 2 of buying the interests. This will be important if the trustee later needs to prove it properly exercised its discretion as trustee in making the investment.

3. As with all other duties and powers, a trustee’s first duty is to obey the directions of the trust deed. It is usual for a trust deed to contain specific directions and instructions dealing with the trustee’s powers of investment. The trustee must adhere rigidly to those directions and instructions. Therefore, the trustee must ensure the trust deed contains a power to invest in units in another trust in the manner contemplated.
Provided these criteria are met, the trustee is entitled to purchase an interest from a beneficiary in the trust (Trust 1) to hold as trustee for another trust (Trust 2).

**Should the trustee make an offer to the other beneficiaries?**

If the trustee is able to show it has discharged its duty to the beneficiary that wishes to sell his or her interest in the trust (ie it has complied with the fair-dealing rule discussed above), then the question arises whether or not the trustee is required to offer the exiting beneficiary’s interests to the other beneficiaries in the trust before it proceeds to purchase the interests for itself.

It is clear a trustee is not entitled to take advantage of an opportunity presented to it where the opportunity arises as a result of its position as trustee. To do so would be a breach of the trustee's duty not to use information learned in the position of trustee to obtain a personal advantage.

The courts have shown a great reluctance to water down the effect of this rule. The position is somewhat analogous to the position where a company director (acting in his or her own right) takes advantage of an opportunity which has been offered to the company. In limited circumstances, the courts have found that a director is entitled to take advantage of such an opportunity, provided the company has already decided, for legitimate reasons, it will not pursue the opportunity itself and the director has informed the company of his or her intention to do so.67

The better view is that a trustee is entitled to purchase a beneficiary’s interest in a trust, provided the following matters are complied with:

1. The trustee has offered the interest to the other beneficiaries first, and provided them with full disclosure of the facts relevant to a decision to purchase the interests. In order to satisfy the requirement to make full disclosure, the trustee must inform the other beneficiaries of all matters in its knowledge that might affect the value of the interests, and the fact the trustee intends to purchase any interests not taken up by the other beneficiaries.

2. The trustee should give the beneficiaries a reasonable period of notice to express an interest in purchasing the interests.

3. If there are offers from the other beneficiaries to purchase more interests than are available, then it is necessary to distribute the interests on a pro rata basis between the beneficiaries expressing an interest in purchasing them. This is a result of the trustee’s duty to treat the beneficiaries equally.

4. It is not open to the trustee to purchase a pro rata amount of interests where all of the interests can be sold to other beneficiaries of the trust. Given the fiduciary nature of the relationship, a trustee cannot be too vigilant in avoiding situations where it might be criticised for obtaining an advantage for itself. This is particularly the case where the opportunity to purchase the interests came to the trustee’s knowledge as a result of its position as trustee.

5. If the beneficiaries in the trust do not wish to purchase the interests, then it is open to the trustee to purchase them.

There are no fiduciary duties preventing a trustee from facilitating the sale of interests from beneficiaries that wish to exit the trust to other parties not related to the trustee. However, the Corporations Act contains certain restrictions, such as whether or not that activity amounts to making a market or operating a financial market.68
GUIDELINE FOR Trustees’ powers and rights
TRUSTEES & RESPONSIBLE ENTITIES
PART 5—Trustees’ powers and rights

What powers does a trustee have?

Powers are generally conferred upon the trustee by the trust deed. However, additional powers may be conferred by the State Acts (as set out below) or, in some limited circumstances, by a court order.

Trustees should familiarise themselves with the powers granted by the State Act applicable to any trusts which they manage as the powers can supplement the express powers contained in the trust deed. For example, the State Acts (to varying extents) deal with the power to—

1. sell, subdivide or lease property
2. expend money on capital improvements to property
3. apportion expenditure between capital and income
4. grant easements and to mortgage property
5. sell property by auction
6. enter transactions involving a vendor’s mortgage over the property or a deferred payment for the property
7. surrender onerous leases over the property or to renew leases
8. compound liabilities
9. raise money by sale or mortgage
10. insure the property and to make decisions regarding the application of insurance money
11. deposit documents for safe custody
12. deal with reversionary interests
13. obtain valuations
14. cause the accounts to be audited
15. concur with any joint owners in relation to property
16. employ agents
17. delegate, and
18. carry on business.

In some circumstances, the powers in the State Acts will enable a trustee to augment the powers conferred on it by the trust deed.

Tasmania

Provision: Section 64 Trustee Act 1898 (Tas)

Effect: Unless the Act otherwise provides, nothing in the Act authorises a trustee to do anything which the trustee is expressly forbidden to do, or omit to do anything which the trustee is expressly directed to do, by the trust deed.

Victoria

Provision: Section 2(3) Trustee Act 1958 (Vic)

Effect: Unless the Act otherwise provides, the statutory powers are in addition to those conferred by the trust deed, and apply only insofar as there is no contrary intention expressed in the trust deed.

Western Australia

Provision: Sections 5(2) and 5(3) Trustees Act 1962 (WA)

Effect: Unless the Act otherwise provides, the statutory powers are in addition to those conferred by the trust deed, and apply only insofar as there is no contrary intention expressed in the trust deed.

Queensland

Provision: Section 4(4) Trusts Act 1973 (Qld)

Effect: Unless the Act otherwise provides, the statutory powers are in addition to those conferred by the trust deed, and apply only insofar as there is no contrary intention expressed in the trust deed, and have effect subject to the trust deed.

New South Wales

Provision: For example, sections 14 and 14A Trustee Act 1925 (NSW)

Effect: The powers conferred by the Act are expressly provided to be subject to the trust deed. If there is no express provision, then the Act overrides the trust deed.

South Australia

Provision: For example, sections 5 and 6 Trustee Act 1936 (SA)

Effect: The powers conferred by the Act are expressly provided to be subject to the trust deed. If there is no express provision, then the Act overrides the trust deed.
Northern Territory and Australian Capital Territory

Provision: For example, sections 5 and 6 Trustee Act 1893 (NT) and sections 14 and 14A Trustee Act 1925 (ACT)

Effect: The powers conferred by the Act are expressly provided to be subject to the trust deed. If there is no express provision, then the Act overrides the trust deed.

The powers contained in the trust deed will normally reflect the purpose of the trust. For example, if the trust owns a business, then the trustee will be granted the power to carry on the business. Where the trust property simply comprises land or funds to be invested on behalf of the beneficiaries, the trustee probably does not need to be granted a power to carry on business. However, in practice, many trust deeds are drafted so the trustee has the widest powers possible, and many specify the trustee has all of the powers to deal with the trust property that a natural person would have if they owned it in their own right. It is important to note the court will construe such clauses as restrictively as possible.

Does the trustee have discretion in relation to the exercise of its powers?

A trustee is not entitled to abdicate its discretion in relation to a power to another party or to allow another party to dictate the manner in which the discretion is exercised. It is permissible for the trustee to ask the views of the beneficiaries for their opinion in relation to the exercise of any discretionary power. However, there is no obligation imposed on the trustee to do so, regardless of the impact of its decisions upon the beneficiaries. The beneficiaries cannot direct the trustee to act in a particular way, even if they are all of legal age and capacity and the direction is unanimous. However, some of the State Acts provide that a person with an interest in the trust property who is aggrieved by a decision can apply to the court for review.69 If all of the beneficiaries are of legal age and capacity, then it will normally be in their power to take steps to wind up the trust.

If the court is asked to determine whether the trustee’s discretion has been properly exercised, then it will consider what enquiries were made by the trustee, the information the trustee had in its possession, and the reasons for exercising its discretion. If the trustee discloses reasons for the exercise of its discretion, then the court can assess the validity of those reasons.

The fact a trustee has a power to do something (such as to sell the trust property) does not mean it is required to do that act. The trustee retains a discretion concerning the manner and timing of the exercise of any powers. The trustee’s discretion must be exercised in accordance with the purpose for which it was conferred—that is, in the interests of the beneficiaries.

Generally, the court will not interfere with the trustee’s discretionary exercise of its powers unless it can be shown the trustee acted with bad faith. The court will not substitute its own decision about the way the discretion should be exercised simply because it would have come to a different decision to the trustee. The court will, however, intervene if it can be shown the discretion was exercised for an ulterior motive or fraudulently.

The court has been reluctant to formulate any stringent tests as to when a trustee’s discretion will be challenged. If it can be shown the discretion was exercised in bad faith, either through fraud or the making of a decision for an ulterior motive, then it might be possible to get the court to declare the decision to be invalid. However, mere carelessness or negligence on the part of the trustee in exercising the discretion will not amount to bad faith.
Case example—Parkes Management

In Parkes Management Ltd v Perpetual Trustee Co Ltd,70 the New South Wales Court of Appeal had to consider the exercise of a discretionary power by a trustee.

The facts

The relevant facts were as follows:

1. There were three unit trusts, all with substantially the same trust deeds, pursuant to which a number of property trusts were established. Parkes Management Ltd was the manager of the trusts and Perpetual Trustee Co Ltd was the trustee. Units in the trust were issued to members of the public and the units were listed and traded on the Sydney Stock Exchange. The trusts invested in real estate in New South Wales.

2. Pursuant to a clause of the trust deeds, the manager agreed it would retire from the management of the trusts if required to do so by the trustee upon the happening of a specified event. One of those events was if the trustee certified in writing that it would be in the interests of the unitholders for the manager to retire.

3. In due course, the trustee gave the manager a notice requiring it to retire. However, the manager did not retire but obtained an injunction that the trustee be restrained from giving the notice to the Sydney Stock Exchange. The matter then proceeded before the court by way of argument as to whether or not the trustee had been entitled to give the certificate. The manager argued the trustee had not formed the view in good faith that it was in the interests of the unitholders for the manager to retire, and the obligation of good faith should be implied into the trust deeds.

4. The judge at first instance found in favour of the trustee and dismissed the manager’s proceedings. On appeal, the manager sought to amend its case to allege the trustee had a duty to exercise the power given to it in the trust deeds only in good faith and for the purpose of the proper management and administration of the trust property, or otherwise in the interests of the beneficiaries. It also alleged the trustee had acted in bad faith in giving the certificate and the trustee did not have any reasonable basis to come to the conclusion it was in the interests of the beneficiaries for the manager to retire.

The decision

The court found as follows:

1. Evidence was not given during the hearing of the matter about the basis upon which the trustee had made its decision. The court found it is clear enough that where a trustee has a discretionary power and does not state the reasons for its exercise, the decision to exercise the power is not to be challenged merely on the ground that the conclusion at which the trustee has arrived is inaccurate.

2. Where the decision is open to challenge on the grounds of bad faith, the presence of an indirect motive or the absence of a fair consideration of the issues, it is not open to challenge because the court would not come to the same conclusion on the facts as the trustee. In some cases, the absence of any apparent ground to arrive at the conclusion adopted by the trustee might afford evidence to support a claim of bad faith or some other invalidating ground.

3. Where a trustee has a discretionary power, that power must be exercised with an absence of indirect motive, with honesty of intention, and with a fair consideration of the issues. The trustee’s conduct must be in good faith and it must not be influenced by improper motives.
4. The trusts had been set up under the previous provisions in the Companies Act (Act), and the court had due regard to the position of the trustee and the manager under the deeds and under the Act. It noted the manager was the source and origin of the trust, and, subject to supervision by the trustee, it substantially carried out the trust. In effect, the manager was the entrepreneur of investment schemes, which contemplated that both it and the unitholders would derive financial benefit. The appointment of the trustee was a requirement of statute as a safeguard to the interests of the unitholders. The trust deeds gave the trustee all the powers which it could exercise if it were the absolute and beneficial owner of the property and assets, but those powers were only to be exercised pursuant to the proposals put to it by the manager. The manager in fact had absolute and uncontrolled discretion as to the exercise of the powers of managing the trusts and was entitled to require the trustee to buy or sell any authorised investments.

5. The trustee argued that only a beneficiary could challenge the exercise of a power by the trustee. The court concluded that the manager was entitled to challenge the trustee’s decision. The manager was not entitled to challenge the decision merely on the ground that it was not in fact in the interests of the unitholders for the manager to retire from its position. That is, it couldn’t challenge the decision on the merits and ask the court to impose a different decision to the one made by the trustee. However, the manager could challenge the decision on the basis it was made without the trustee genuinely holding the opinion it was in the interests of the unitholders that the manager should retire.
What rights does a trustee have?
The law recognises that a trustee has a number of rights designed to protect its position and to ensure it is not required to expend its own resources in administering the trust. Those rights are to—
1. reimbursement and indemnity (dealt with below in this section)
2. sue on behalf of the trust (dealt with in the next section of this Guideline)
3. a discharge upon the termination of the trust
4. retain capital or income of the trust where a beneficiary is indebted to the trust or has been overpaid, and
5. seek advice from the court (dealt with below in this section).

Does the trustee have a right to indemnity?
There are three sources of the right of indemnity available to a trustee, as follows:
1. The general law of indemnity attaching to its position as trustee.
2. The statutory rights to be indemnified found in the State Acts.
3. The trust deed.

As the legal owner of the trust property, the trustee is personally liable for all debts it incurs in managing the trust. The trustee’s own assets are available to meet the liabilities of the trust. It makes no difference that it is described in the contract as “trustee”, except in rare instances where all of the circumstances indicate the parties intended the trustee’s liability would be limited. There is an exception if the trustee specifically agrees with the creditor before the debt is incurred that the creditor will only seek to recover the debt from the trust property. This highlights the importance of having written agreements in place which contain a limitation of liability.

In the absence of an express agreement limiting the trustee’s liability, the question will be determined by a proper construction of the document. Whether or not the trustee’s liability can be limited will depend on all of the circumstances of the case, including the nature of the contract; the subject matter of the contract; the capacity in which the parties entered into the contract; the precise words used by the parties; and any indicia of the intentions of the parties when they entered into the contract as to whether or not the liability of the trustee would be limited. If judgment is entered against the trustee by a creditor, then the rule is that a creditor has no direct right of recourse against the trust assets. The creditor’s judgment is against the trustee, and the trustee has a right to indemnity out of the trust assets in respect of liabilities properly incurred in the affairs of the trust. The creditor has a right to be subrogated to that right (ie to step into the trustee’s shoes), but the creditor’s claim depends on the existence of a right by the trustee to be indemnified. If the liability incurred by the trustee was not properly incurred, then the trustee will not have a right of indemnity and the creditor will not have a good claim to subrogation.

The trustee’s right of indemnity is an equitable, proprietary right which is in the nature of a first charge or a right of lien over the trust assets. The trustee may even sell trust property in order to satisfy its charge or lien. The right of indemnity survives the retirement of the trustee, so it is available to a former trustee in respect of expenses properly incurred on behalf of the trust while it was trustee of the trust. The indemnity does not extend to expenses incurred unnecessarily or improperly, or which were not connected with the role of trustee.

Whilst trustees might be called upon to meet debts from their personal assets, they are entitled to have recourse to the trust property to reimburse them for any debts paid on the trust’s behalf. That right exists under the general law and the State Acts. Of course, in most circumstances, the trustee will discharge liabilities of the trust directly out of the trust property, and this is permissible.

If the trustee discharges liabilities of the trust from the trustee’s own assets, then the trustee is automatically entitled to a charge or a right of lien over the trust property for any liabilities which have not been reimbursed to it. With some exceptions, the trustee can exercise those rights over any trust assets in its possession, including income and capital.
The trustee is entitled to be indemnified for expenses which were properly incurred. Expenses will be properly incurred if they are authorised by the trust deed or by the general law. The general law entitles the trustee to be indemnified for liabilities incurred in good faith which benefit the trust, even if they are not authorised by the trust deed. This will include the following:

1. General outgoings associated with any land held by the trust (such as rates and taxes).
2. Expenses incurred in carrying on any business (if the carrying on of the business is authorised by the trust deed).
3. Expenses incurred for the improvement of the trust’s assets.
4. Liabilities incurred by the trustee in the course of administering the trust, provided the trustee acted in accordance with the standard expected of it. For example, if the trustee is sued by a person who comes onto a property and injures themselves, then the trustee is entitled to be indemnified from the trust property for any claim brought by that person provided it had acted as a reasonably prudent person in the position of owner of the property. This would include attending to proper maintenance of the property and having in place adequate public liability insurance.
5. Legal costs incurred in administering the trust, such as the cost of bringing proceedings in the court to protect trust property. A trustee will not be able to recover the costs of proceedings which are unnecessary or where an excessive amount of costs have been incurred. A trustee is personally liable for the costs of any legal proceedings which are occasioned by its misconduct or neglect of duty (see below in relation to the right to seek advice from the court).

The right of indemnity for liabilities properly incurred not only extends to the trust property, but is also enforceable against each of the individual beneficiaries, provided they are of legal age and full capacity. If the trust property is insufficient to fully indemnify the trustee, then the trustee is able to demand indemnity directly from the beneficiaries.

The beneficiaries are only liable to indemnify the trustee in proportion to the interest they hold in the trust, so they cannot be required to pay more simply because other beneficiaries are incapable of paying their share. Unit trusts and managed investment schemes typically limit a beneficiary’s liability to its investment in the trust.

The right of indemnity will generally be limited or lost if the trustee acts in—

1. negligently
2. fraudulently
3. contrary to the terms of the trust deed, or
4. contrary to the proper performance of its duties, including its specific duties under the Corporations Act if it is a responsible entity.

**Can the trustee seek advice from the court?**

A trustee has a right to seek advice and directions from the court when it is in doubt as to the propriety of a particular action that is contemplated, or it is faced with conflicting interests between classes of beneficiaries.

Judicial advice is a discretionary power conferred upon the Supreme Court in each of the State jurisdictions pursuant to the various State Acts to provide private and personal advice to a trustee of a trust. The scope of the matters about which the Court can provide judicial advice varies in different States. However, as a general comment, there must be a question about the management or administration of the trust property or a question about the interpretation of the trust deed.

The legislative purpose of these sections is to provide a procedure which, if adopted, will not only protect a trustee from later complaint that he or she should have acted otherwise, but also protect the trustee from personal liability for costs incurred. It is therefore an important protective mechanism for trustees and should be considered as part of a trustee’s risk mitigation strategy in any decision concerning the trust which is likely to give rise to a claim. It is useful in the following situations:

1. Resolving doubt as to whether it is proper for a trustee to incur costs and expenses involved in taking a particular course of action (including whether or not to defend allegations of breaches of trust).
2. Obtaining approval for a particular dealing with trust property, such as a sale to the trustee which would otherwise be prohibited by the rule against self-dealing.
3. Seeking approval for a proposed trust reconstruction. Such reconstructions often involve complex arrangements, with the trustee having competing and overlapping duties to different trusts, as well as self-interest. The chances of having a conflict of interest are high. The process is designed to provide an inexpensive and simple mechanism for determining questions relating to the trust. In theory, trustees can apply for and obtain judicial advice fairly quickly. Often the trustee will be the only party to the application and the trustee will provide the court with the relevant facts and documents concerning the issue at hand. There is an onerous obligation on the trustee to make full disclosure to the court. The court might seek to hear from other parties, but ultimately the advice given is private between the court and the trustee.

Whether or not an application is worthwhile will depend on the nature of the decision, and the risk to which the trustee is exposed. As a result of a 2008 High Court decision (Macedonian Church, referred to below), the issue of obtaining judicial advice in a litigious context has become particularly important. The High Court had to consider a dispute concerning trust property where the trustee was accused of a breach of trust. The court found one of the reasons for enabling a trustee to obtain judicial advice is to resolve doubt about whether it is proper for the trustee to incur the costs involved with commencing or defending litigation concerning the trust.

In Macedonian Church, the High Court went a step further, saying that where a trustee is being sued for breach of trust, not only can a trustee seek judicial advice but it should seek judicial advice before taking any steps in defence of the action. This is an important mechanism to ensure the interests of the trust are protected. Consequently, a trustee who fails to seek advice on the question of whether to defend an action may run the risk that its costs of defending the action may not be ‘properly incurred expenses’ for the purposes of its indemnification from the assets of the trust.
Case example—Mirvac Funds—Reconstruction example

In Re Mirvac Funds Ltd & Anor, the court dealt with the following situation:

1. Mirvac Funds Ltd (Mirvac) was the responsible entity of the Mirvac Property Trust (MPT) and Capital Property Management Ltd (Capital) was the responsible entity of the Capital Property Trust (CPT). Mirvac had proposed a merger by stapling the securities of Mirvac Ltd, MPT and CPT to form the Mirvac Group. Mirvac commenced proceedings seeking approval from the court for two proposed schemes of arrangement relating to the merger and for judicial advice in relation to the proposed amendments to the trust deeds.

2. The directions sought from the court were as follows:
   (a) Whether Mirvac and Capital were justified in convening meetings of their respective unitholders to consider the resolutions to give effect to the merger.
   (b) Whether each of them was justified in amending their respective constitutions in the manner proposed. The amendments were in order to give effect to the stapling of the securities. It was also necessary to restructure the securities in each entity so they had the appropriate weighting of each to the others.
   (c) Whether each of them was justified in effecting and implementing the merger proposal.

3. The court found the application for orders convening a meeting to approve a scheme fell within the established law and practice of the court.

4. It was not necessary to add to the volume of paper by distributing the full text of the relevant amended constitution to the unitholders. It was more useful, and consistent with principles frequently annunciated by the courts with respect to disclosure in a notice of meeting, to give a concise and clear summary of the effect of the changes which is materially comprehensive.

5. The court has jurisdiction to provide judicial advice to responsible entities. The court gave advice that the two responsible entities would be justified in proceeding on the basis that the making of the proposed amendments, following approval by special resolution of unitholders, would be within the powers of alteration which they possess. The court also gave advice to the responsible entities to the effect they were justified in convening meetings to consider the proposals which were to be put to the unitholders.

6. The court declined to provide judicial advice in relation to giving effect to and implementing the merger proposal, because in the context of the proposed meetings, a broad judicial commendation of the course of conduct to be embarked upon in circumstances which could not then be known would be an unwise exercise of the court’s power.
Case example—Macedonian Church—Litigation example

In Macedonian Orthodox Community Church St Petka Inc v His Eminence Petar The Diocesan Bishop of The Macedonian Orthodox Diocese of Australia and New Zealand, the High Court considered the court’s power to provide judicial advice to a trustee.

The facts

The relevant facts were as follows:

1. The case involved a particularly bitter dispute and was just one component of a raft of litigation between the litigants. The matter came to the High Court through a dispute about land containing a parish church. This land was originally held on trust, but was transferred to the appellant association on its incorporation in 1992.

2. In 1997, the association sacked its parish priest, Father Mitrev. He, and the other respondent in this matter, the Bishop, commenced proceedings relating to that dismissal, alleging breach of trust in relation to the land and seeking removal of the association as trustee (the main proceedings). In April 2003, a court decided the land was held by the association on trust for the benefit of the Macedonian Orthodox religion. However, there was an ongoing dispute about the terms of this trust which impacted on the question of its breach, and a trial date was set.

3. As trustee, the association applied to the court for judicial advice concerning whether it was justified in defending the main proceedings and expending trust funds in that defence. Unless it was allowed recourse to the trust property, the association had no other means of conducting a defence.

4. At first instance, the court ordered the association would be justified in defending the main proceedings, and was entitled to have recourse to certain trust property to fund the defence. That order was set aside by the Court of Appeal, but was restored by a unanimous High Court.

The decision

The reasoning applied by the High Court was as follows:

1. The power to give advice to trustees is not limited to cases where the parties are at loggerheads. Their Honours commented that the legislative scheme established for judicial advice indicates it is desirable that trustees in doubt as to a course of action should not proceed with it and seek relief to be excused from a possible breach of trust afterwards, but rather, seek judicial advice first.

2. Their Honours made a series of general points about the interpretation of the statutory power to give advice. Firstly, it was inappropriate to ‘read in’ limitations on the power, unless such limitations were to be found in the words of the statute. There was no limitation precluding the giving of advice where proceedings were adversarial in nature, or where the trustee was being sued for breach of trust, or where removal of the trustee was sought. The wording of the relevant legislation only imposed one limitation; the question must be in respect of the management or administration of the trust, or concern the construction of the trust instrument.

3. Secondly, nothing in the language of the statute indicated that any factor was more significant or should automatically be accorded more weight than another when the court considered the exercise of its discretion to advise. The mere fact the advice is connected with a contest between adversaries does not lessen the court’s ability to give that advice.

4. Thirdly, statutory proceedings for advice are informal in nature and were introduced to provide a “cheap and simple process of determining questions”. This points to a wider, rather than a narrower, use of the process, so as to assist the court’s administration of trusts by orders less extreme than a general administration order.

5. Fourthly, the advice the court gives to the trustee is “private advice because its function is to give personal protection to the trustee”. This differs greatly from the normal function of the court where it sits to decide issues between litigants.
6. Fifthly, as a general rule, the court’s advice that the defence may be mounted should not be considered determinative of the issues in the main proceedings. They said the decision to give advice that it would be proper to defend proceedings “is radically different from deciding the issues that are to be agitated in the principal proceeding”.

7. Their Honours said it was “understandable that the legislature should enact provisions enabling [trustees] to take advice before embarking on any course which might carry a risk of incurring costs that might be outside the indemnity”. This implies that in a given case, a trustee who has not sought advice may not be able to claim costs incurred as properly incurred expenses.

8. The uncertain nature of litigation, and the unknown extent of costs and indemnification, meant obtaining judicial advice concerning whether or not a suit should be defended leaves the trustee in no doubt as to whether the expenses of the defence will be properly incurred, and are therefore the subject of indemnification. This certainty in turn offered protection to the trust itself; the interests of the trust were not subordinated to the trustee’s fear of personal liability. This led their Honours to a crucial observation as follows:

   ... a necessary consequence of the provisions of (the Act) ... is that a trustee who is sued should take no step in defence of the suit without first obtaining judicial advice about whether it is proper to defend the proceedings.

9. The rule appears to have been stated as a general one. Trustees who fail to seek advice on the question of a defence for breach of trust run the risk their costs of defending may not be “properly incurred expenses” for the purposes of indemnification. This is clearly of greater importance where the trustee cannot independently fund a defence, but is significant to all trustees.

The decision makes it clear that if a trustee is faced with a situation where it may be accused of a breach of trust for taking a particular course of action, then the trustee should first consider approaching the court for judicial advice. Further, if a trustee is sued for a breach of trust, then the High Court has indicated the trustee should first approach the court for judicial advice about whether to defend the proceedings.
A recent decision of the New South Wales Supreme Court, *Re Perpetual Investment Management Ltd as responsible entity for 10 schemes listed in the summons*, has questioned whether the High Court’s unequivocal statement in the *Macedonian Church* case applies to professional trustees in the same way that it applies to gratuitous trustees. Justice Robb in *Re Perpetual Investment Management:*

...wondered whether the law has developed to the point where in every case a trustee must seek judicial advice before defending or commencing proceedings, rather than that it should do so in some circumstances, and may do so in others.

While the law is still developing in this area, the High Court’s decision still applies and it would be prudent for all trustees to apply for judicial advice when considering whether to defend or commence proceedings.

**What about a trustee’s remuneration?**

Trustees should bear in mind that the court has wide-ranging powers to make orders about the conduct of the affairs of a trust. The ability to apply to the court can be very useful in a range of circumstances, including where the trustee wishes to be remunerated for services performed on behalf of the trust. Generally, with a commercial trust or a managed investment scheme, the amount of remuneration will be governed by the trust deed or constitution. However, there are circumstances where the trustee’s position is not adequately addressed, and that is when the court can step in to fill the gap.

In July 2011, the Queensland Court of Appeal had to consider this issue in *Zevering v Callaghan & Ors.* The details are as follows:

1. In 1999, 26 people (including Ms Zevering) participated in a solicitor’s mortgage scheme. About $1.1 million was advanced to a property developer engaged in the subdivision and sale of land known as Outlook Estate. The property developer fell into default and the project stalled. The participants then established a trust which took over the mortgage and completed the project. At an initial meeting of unitholders, it was resolved that the trustees should be remunerated for their work on the project at the rate of $20 per hour.

2. Ms Zevering was one of the trustees. The trustees completed the development and had sold all of the lots for a profit by 2007. Ms Zevering claimed remuneration of $686,000, calculated as $100,000 per annum for six years, for acting as project coordinator, together with commission of 2.5 percent of gross revenue by way of success fee. She, and her witnesses, gave evidence of the substantial amount of work she had done in completing the subdivision, obtaining council approvals and arranging for the sale of the lots. She also presented evidence about the commercial rate which would have been applicable if someone else had been engaged to undertake the work. The other trustees argued Ms Zevering had overstated her contribution.

3. The trial judge found against Ms Zevering and said she was not entitled to remuneration other than in accordance with the original resolution. However, the Court of Appeal took a different view. It considered that, both in relation to its inherent jurisdiction and the power given to it under the *Trusts Act 1973* (Qld), it was entitled to authorise the payment of remuneration to Ms Zevering for her services.

4. The circumstances of the case which were relevant in determining what remuneration should be authorised were as follows:
   (a) The trust was established to carry out a commercial purpose; namely taking over the mortgage and completing the development and subdivision of land.
   (b) The purpose of this task was to enable the beneficiaries to recover their capital and interest invested in the scheme. That purpose had been successful.
   (c) It was agreed at an early stage that the trustees would be remunerated for their work.

5. The Court of Appeal thought it was appropriate to authorise the payment of $150,000 to Ms Zevering as remuneration for her services. This represented more than one year’s remuneration for an arms’ length project coordinator.

6. Interestingly, the court also ordered the costs of both parties in relation to the appeal be paid out of the assets of the trust on an indemnity basis.

7. In February 2012, the High Court refused an application made by Ms Zevering to appeal about the amount of remuneration awarded to her.
GUIDELINE
FOR Breach of duty
TRUSTEES & RESPONSIBLE ENTITIES
PART 6—Breach of duty

What are the consequences of a breach of duty?

A trustee can be in breach of its duties by undertaking an act negligently or dishonestly, or by failing to act when it ought to have done so. The duties imposed on a trustee (dealt with in Parts 3 and 4 of this Guideline) will often impose a positive obligation on a trustee to take steps to protect or promote the trust assets, and it is not acceptable for a trustee to be passive in its management of the trust.

If a trustee is in breach of its duties it will lose most of the protection afforded to it by the law (such as its right to be indemnified from the trust property) and it will be personally liable to compensate the trust for any loss or damage suffered.

The consequences that follow a breach of duties will depend on the nature of the breach. A breach does not automatically require the trustee to compensate the trust. For example:

(a) the breach may be of a minor or technical nature, or
(b) the trust instrument might discharge the trustee from liability for some kinds of breaches.

A trustee will be accountable for any benefit or gain which it personally acquired as a consequence of the breach of its duty.

Who can bring an action for breach of trust?

A trustee can be sued by the following parties:

1. A beneficiary.
2. A co-trustee, if there is one.
3. A new trustee. Upon taking office, a new trustee has a duty to fully acquaint itself with the workings of the trust. If it discovers a breach of trust on the part of the former trustee, then it has a duty to investigate that breach of trust and consider whether or not it is in the interests of the trust to bring an action against the old trustee.

If the trust has suffered a loss, then the proper plaintiff to bring an action on behalf of the trust is the trustee. However, on occasions, one or more of the beneficiaries may have a claim against the trustee (for example, if they claim to have been unfairly treated) and in those circumstances, the beneficiaries can commence an action, but must join the trustee and all of the other beneficiaries as defendants to the action.

In certain circumstances, beneficiaries may seek to sue a third party on the basis that a trustee has failed or refused to commence proceedings on behalf of the trust. The courts have found that in special or exceptional circumstances, the beneficiaries may have standing to pursue an action against a third party. In Pearson v Commissioner of Taxation, the Federal Court refused an application by a beneficiary to bring an appeal against the Commissioner of Taxation for a determination about an issue affecting the trust. The court found the fact the trustee had declined to challenge the Commissioner’s decision was not an exceptional circumstance which would justify the beneficiary in bringing the action. One of the judges went further and said the appropriate course for the beneficiary was to obtain legal advice about the prospects of successfully challenging the decision and provide that legal advice to the trustee. The beneficiary should then make a request of the trustee to file a notice of appeal and undertake to fund the legal costs involved in the appeal. If the beneficiary had done all of those things, then there might have been a stronger case made out for the beneficiary’s rights to pursue the action.

In some circumstances, it might be possible for the beneficiaries to bring an action directly against third parties who have unlawfully received the trust property. In such a case, the beneficiaries are normally required to exhaust any right to bring an action against the trustee before commencing proceedings against the recipient of the trust property.

What remedies are available for breach of duty?

The nature of the remedy which will be granted to the beneficiaries will depend on the circumstances of the case, but could include the following:

1. Declarations: Beneficiaries can seek a declaration from the court in relation to any controversy that arises between the beneficiaries and trustee. The court has a wide discretion to make declarations in relation to disputes involving trusts, such as in relation to disputes over the
title of property, the existence or the extent of the trustee’s duties and obligations in particular situations, or whether or not a proposed course of conduct is proper.84

2. Damages: A trustee may be required to restore a trust estate to the same position it would have been in had no breach of duty been committed by the trustee. If a trustee has taken assets from the trust and used them for its own benefit, and if the assets have increased in value, then the trustee will be required to compensate the trust for the increased value of the assets. The trust may also be entitled to have interest paid on any amounts. However, it is not necessary for the beneficiary to show a specific loss suffered as a result of the trustee’s breach of duties.

3. An account of profits: An account of profits is an alternative remedy to seeking damages and is used to require a trustee to account to the beneficiaries for any profit made as a result of a breach of its duties. Beneficiaries will usually seek an account of profits if they believe it will show that the profit made by the trustee is greater than the amount of compensation with interest that they could receive by way of damages. For example, if a trustee has used trust assets and has made a greater profit than the trust would have been able to make (by using the trustee’s skill to take advantage of a business opportunity), then the beneficiaries would most likely elect to seek an account of profits, rather than compensation. The court is not required to make an allowance from the profit for the work and skill employed by the trustee in earning the profit, but may do so. It can be an effective way for beneficiaries to recoup losses made through a breach of trust.

4. A constructive trust: This requires the trustee to hold any assets acquired in breach of its duties on trust for the beneficiaries.

5. An injunction: This is an effective remedy to restrain a trustee from acting in breach of trust, such as to restrain the trustee from selling assets at an undervalue. The beneficiaries would need to present compelling evidence to prevent a sale in those circumstances. An injunction would also be available to restrain distributions of trust funds which the beneficiaries claim are in breach of the trust deed.

6. Receiver: In some cases, the court might entertain an application for the appointment of a receiver. In Yunghanns v Candoora No. 19 Pty Ltd (No. 2),85 the court found it was appropriate to appoint a receiver to a trust in circumstances where the trustee had refused to disclose proper accounting records in relation to the financial affairs of the trust and the directors who controlled the trustee treated the trust funds as their own and had a hostile relationship with one of the beneficiaries. In that case, the court said the appointment of a receiver might be appropriate “if misconduct, waste, or improper disposition of assets can be shown, or if it appears that the trust property has been improperly managed, or is in danger of being lost or if it can be satisfactorily established that parties in a fiduciary position have been guilty of a breach of duty”. The appointment of a receiver can cause the trust to incur significant expense, and should be seen as a remedy of last resort.

7. Removal of trustee: Not all breaches of trust will result in an action being commenced against the trustee. In some circumstances, the beneficiaries may simply seek to remove the trustee, either via an express power contained in the trust deed (if there is one), or by applying to the court. If the trust is a managed investment scheme, then the beneficiaries can call a meeting in accordance with the relevant provisions of the Corporations Act and seek to have the responsible entity replaced.

8. Rescission: This remedy can be used by a beneficiary to set aside contracts entered into by a trustee in breach of the self-dealing rule. This is rarely denied unless a good faith purchaser has obtained the interest from a trustee.

Can the trustee be excused from a breach?
The courts have jurisdiction to relieve a trustee from the consequences of a breach of trust where the trustee can show it has acted honestly, reasonably and ought fairly to be excused for the breach of trust.86
Case example—Investa Properties

In Investa Properties Ltd, Justice Barrett considered a situation where a solicitor acting for a responsible entity had failed to lodge a form 309 due to forgetfulness or oversight. The background was as follows:

1. From the date of its appointment, a new responsible entity starts to hold all of the scheme’s property on trust for the scheme members (section 601FC(2)). If any of the scheme property is subject to a charge, then the new responsible entity takes the property subject to the charge.

2. Section 264(1) requires the new responsible entity to file a form 309 with ASIC and give notice to the chargee that it has become the owner of property which is subject to a charge. The Corporations Act requires the notice to be given within 45 days of becoming responsible entity of the scheme.

3. This step can often be overlooked by an incoming responsible entity who is in the process of taking over the books and records for the scheme and coming to grips with the scheme’s activities.

4. If this step is overlooked and notice is not given to ASIC and the chargee within time, then section 266(4) provides the court can extend the time if the failure was “accidental or due to inadvertence”; is not prejudicial to the position of creditors or shareholders; or for other grounds if the court thinks it is just and equitable.

The court found the solicitors oversight was “due to inadvertence” and probably also “accidental” in terms of the Corporations Act. The judge also found it was an appropriate case in which to exercise his discretion to extend the time because there was no hint of any possibility of winding-up or administration, and there were no other charges relevant to the operation of the priority provisions in the Corporations Act. There was no issue of prejudice being caused to any party.

The failure to comply with the Corporations Act also amounts to a breach (albeit a technical one) of the responsible entity’s duties as trustee. The court has power to excuse a trustee from liability for a breach where it has acted honestly and reasonably. In this case, Justice Barrett found the responsible entity had relied upon its solicitors to advise it of the obligation to complete all necessary steps upon it becoming responsible entity of the particular scheme. Accordingly, he found the responsible entity had acted honestly and reasonably and ought to be excused from any breach of trust.
GUIDELINE FOR *Insolvency issues* TRUSTEES & RESPONSIBLE ENTITIES
PART 7—Insolvency issues

Can a trust be insolvent?

Trusts and managed investment schemes are not legal entities, and cannot be insolvent in the legal sense of the word. Unlike a company, a trust was not originally intended to be used for entrepreneurial risk-taking activities like trading and carrying on a business (and the borrowing of large sums of money which goes with those activities). As trusts evolved to be passive vehicles for the protection and preservation of the trust fund, there was little perceived risk of insolvency and a body of law has not developed to deal with it.

It is only legally correct to speak of the solvency or otherwise of the trustee of the trust or the responsible entity of the managed investment scheme. However, it has become common to refer to an ‘insolvent trust’ or ‘insolvent managed investment scheme’ which is really a reference to a situation where the trust property is insufficient to meet the liabilities of the trust to creditors.

Solvency can only be judged as a whole of entity issue. It is not legally possible for a person to be solvent in one capacity (ie in its personal capacity) and insolvent in another capacity (ie in its capacity as trustee of a particular trust). When a trustee enters into an arrangement or agreement with another party, even if it is expressly in its capacity as trustee, it is personally liable for the debts and liabilities incurred under that contract. This is because the trust is not a separate legal entity, and so the contract is directly between the responsible entity (or trustee) and the other person. However, as noted earlier in this Guideline, the responsible entity (or trustee) has either an implied or express right to be indemnified out of the trust assets for those liabilities as long as they were incurred in the proper performance of the trust. That right of indemnity can be lost if the responsible entity (or trustee) acted in breach of the trust or beyond its authority.

Of course, in most circumstances, the trustee’s potential exposure to personal liability is dealt with by having a limitation of liability clause in the commercial agreements it enters. This highlights the importance of having such clauses.

What is the impact of the Corporations Act?

At present, the administration of an insolvent trust or managed investment scheme is guided by a mix of limited legislative provisions, common law and equitable principles. The global financial crisis and the collapse of a number of responsible entities who managed multiple schemes has resulted in an increase in the volume of judge made law as administrators have resorted to the courts for advice as to how aspects of the administration should be carried out. However, there are still many aspects of trust insolvency that are not well dealt with by the current body of law.

In August 2012, the Corporations and Markets Advisory Committee (CAMAC) released its report on insolvency issues in managed investment schemes. None of its recommendations have yet been implemented. In March 2014, CAMAC released another discussion paper on managed investment schemes this time focused more broadly on the regulatory regime for schemes generally. CAMAC has taken the view that the law as it relates to corporations should be generally applied to schemes.

As it currently stands, the corporate insolvency provisions of the Corporations Act in relation to administration, receivership and liquidation do not apply to trusts and managed investment schemes.

Chapter 5C of the Corporations Act, commencing at section 601EA, deals with managed investment schemes. The winding up provisions in part 5C.9 of the Corporations Act are very limited, and are confined in their application to registered schemes.

By virtue of section 601FC(2), a managed investment scheme is a trust, and trust law applies to it. Section 601GA(1) requires the constitution of a registered scheme to make adequate provision for the winding up of the scheme.

Section 601NC provides that a responsible entity can wind up a scheme if it considers the purpose of the scheme has been accomplished or cannot be accomplished. To do so, it must give notice to the members and ASIC, informing the members that it will wind up the scheme unless a meeting of the scheme is called within 28 days. If no meeting is called, then it may proceed to wind up the scheme.
Section 601ND(1)(a) enables the court to order that a managed investment scheme be wound up where it is of the view that it is just and equitable to do so. An application for an order under that section can be made by the responsible entity, one of its directors, a member of the scheme, or ASIC.

A responsible entity is obliged to wind up a scheme in certain circumstances, but the Corporations Act does not refer to insolvency as one of those grounds. In some cases, responsible entities have applied to the court to wind up the scheme on the just and equitable ground in circumstances where the scheme has become insolvent and the unitholders were not prepared to continue to support it.

Section 601NF deals with the circumstances where the responsible entity is not able to conduct the winding up of the scheme. It provides that a court may appoint a person to conduct the winding up if the responsible entity has ceased to exist or is not properly discharging its obligations. The court can also give directions about how a scheme is to be wound up.

The provisions do not apply to an unregistered managed investment scheme (sometimes called an excluded offer). An unregistered scheme is lawful (and does not need to be registered) if it complies with the relevant exclusions in the Corporations Act. Section 601EE(2) authorises the court to wind up a managed investment scheme that was required to be registered but which was unregistered.

What special problems do managed investment schemes face?

The situation can become more complex where the responsible entity itself is insolvent. If it is only the scheme, and not the responsible entity, which is insolvent, then it is feasible for the responsible entity to undertake the winding up. However, as has been seen in recent years, where a responsible entity manages a number of managed investment schemes, and itself becomes insolvent, difficulties arise in dealing with each of the managed investment schemes, particularly in circumstances where some of them are solvent and some of them are not.

Because of the complex nature of the relationship between the responsible entity and the scheme, it has often been seen to be difficult to have the same liquidator appointed to the responsible entity and the schemes. A liquidator of the responsible entity, of course, has a duty to act in the interests of the creditors of the responsible entity, and then in the interests of the shareholders. However, the responsible entity itself (which the liquidator now controls) has overriding obligations under the Corporations Act to act for the benefit of the scheme members. There have been a number of cases that have dealt with this potential conflict faced by a liquidator.

Where the responsible entity is itself insolvent, and it manages a large number of schemes, being able to quickly determine the viability of each of the schemes and find an alternative responsible entity becomes paramount. It is often difficult to find a replacement responsible entity given the possible exposure for liability for debts of the scheme once it becomes appointed as responsible entity.

Another difficulty arises where there are large borrowings secured over scheme assets. It is common for there to be a secured creditor (such as a bank) that has the capacity to appoint a receiver over the assets of the scheme and it may seek to sell the land upon which the scheme is operated.
Case example—Rubicon

In *Re Rubicon Asset Management Ltd,* the court had to deal with an insolvent responsible entity.

The facts
The relevant facts were as follows:

1. The responsible entity was insolvent and had administrators appointed. It managed five schemes, each of which required winding up.
2. Normally, the responsible entity would be responsible for the costs of winding up the schemes. The administrators were concerned there were not sufficient assets available to pay those costs. However, as part of the responsible entity’s Australian financial services (AFS) licence requirements, it had the amount of $5 million in a term deposit account to meet its net tangible asset requirements. The administrator asked the court to determine whether it could recover the costs of the winding up of the schemes from that amount, even though the effect of this would be to reduce the amount of assets available to the unsecured creditors of the responsible entity.
3. The Corporations Act allows the court to give directions about how a scheme is to be wound up.

The decision
The court found that as a matter of public policy, it was desirable for insolvent schemes to be wound up. The duties of the responsible entity continue even where it is under external administration. It was appropriate for the court to order the winding up of the schemes under the just and equitable ground contained in the Corporations Act.

The public interest may justify the winding up of a scheme if the scheme has broken down or if the protection of investors requires it be wound up. In this case, the court found the schemes should be wound up for the following reasons:

1. The schemes had been suspended for many months and the suspensions were unlikely to be lifted as the schemes were insolvent.
2. The directors’ and officers’ insurance for the schemes had expired.
3. The responsible entity had breached the conditions of its AFS licence which it was required to hold in order to perform the function of responsible entity.
4. The continued management of the schemes was an ongoing burden for the responsible entity.
5. In three cases, the schemes had terminated according to their terms and had to be wound up.

In order to save costs, the court thought it appropriate that the administrators of the responsible entity should be appointed to wind up the schemes. This was because they already had extensive knowledge of the schemes. The court also noted that insolvent responsible entities may be ordered to wind up schemes even if it diminishes the funds available to creditors of the responsible entity. It is inherent in the statutory scheme that, because the responsible entity remains responsible for the schemes, it may have to expend monies from its own resources to perform its obligations.

The administrators had submitted that they could not be involved in the winding up of the schemes unless the responsible entity was able to use its own assets, to the extent necessary, to meet the costs and expenses of the winding up. The court accepted that one of the purposes underlying the requirement to hold a specified amount of net tangible assets was to ensure the responsible entity could meet its obligations, including managing the schemes in an orderly way and in accordance with their constitutions.

An important factor in exercising this discretion was that the bulk of the responsible entity’s liabilities were liabilities of the schemes themselves.
Can a scheme be wound up by a creditor?

Section 601ND(1)(b) allows the court to wind up a managed investment scheme on the application of a creditor who has issued execution or other process on a judgment against the responsible entity in its capacity as the scheme’s responsible entity and has had it returned unsatisfied.

Once a judgment is obtained, the judgment creditor will usually attempt to ‘execute’ on the judgment. The judgment creditor can do this by having a writ of execution issued (which directs the bailiff to seize property of the judgment debtor to satisfy the judgment). Section 601ND(1)(b) contemplates that a writ of execution has been returned unsatisfied.

A number of practical difficulties might arise in trying to execute against trust property or scheme property as generally that property cannot be taken to satisfy a judgment which has been given against the trustee (responsible entity). This is because of the nature of the trustee’s ownership of the trust assets. Even though the judgment is against the responsible entity for a debt incurred on behalf of the scheme, the bailiff cannot seize the scheme’s property to satisfy the judgment debt.

Once the winding up order is made, the winding up will proceed in the normal way for a managed investment scheme which means the responsible entity goes about winding it up (ie there is no appointment of an external administrator or liquidator). The only circumstances in which the winding up would be conducted by another party would be if the court formed the view that the responsible entity is not capable of properly winding up the scheme.

In the course of the winding up of the scheme, all of the scheme assets are gathered in and the responsible entity has to determine how they will be dispersed. The judgment creditor cannot directly access the scheme assets, but has a right to stand in the position of the responsible entity in seeking to be indemnified for the debt from the scheme assets. As noted earlier in this Guideline, this is referred to as a right to be subrogated to the trustee’s right of indemnity over the trust assets. This is the only way in which a creditor can access trust assets.

An important consequence of the creditor’s right of subrogation is that its right is only as strong as the trustee’s right to be indemnified. That is, if the trustee has acted in a way which causes it to lose its right to be indemnified out of the trust property, then the creditor will also lose that right. This is the issue which causes the most consternation for financiers lending money to responsible entities acting on behalf of a scheme. It is not an issue that has been well dealt with in most finance documents. The breach by the trustee which causes it to lose its right of indemnity may not even be directly related to the finance transaction and could be unrelated.

The loss of the trustee’s right of indemnity will not interfere with the financier’s right to look to payment of the debt from the trustee in its personal capacity.

However, as indicated above, that right will normally have been given up by the inclusion of the limitation of liability clause in the contract. The protection of the trustee is very much dependent on the limitation of liability clause being properly drafted.

Whilst any judgment creditors’ ability to recover actual assets might be limited (for the reasons set out above), any enforcement action will be taken directly against the responsible entity. This could have serious consequences in relation to the default provisions in the finance facilities the responsible entity has for the individual schemes that it manages. In other words, action by a judgment creditor in relation to one ‘insolvent’ scheme could contaminate the other schemes.
Case example—Environinvest and Great Southern

In Environinvest Ltd v Great Southern Property Managers Ltd (No. 2), the circumstances facing the court were as follows:

1. Mr Downey was appointed as the liquidator of Environinvest. Environinvest was the responsible entity of a scheme which carried on the agricultural business of growing trees on land which was leased from Great Southern. Subsequent to Mr Downey’s appointment as liquidator of the responsible entity, he was also appointed as liquidator of the scheme as no other person could be found to take that appointment.

2. At the time the appointment was made, it was commonly understood that Mr Downey’s appointment would expose him to a perceived conflict of interest and also the risk of an actual conflict, when discharging his separate duties as liquidator of the responsible entity and liquidator of the scheme. The judge directed that a committee of management be formed to deal with any conflict issues and Mr Downey undertook to comply with any direction of the committee to apply to the court for directions. The application to the court was as a result of a direction being given to Mr Downey by the committee.

3. Environinvest did not have sufficient assets with which to meet the lease obligations to Great Southern. Despite Mr Downey’s endeavours, it was not possible to find any third party to take over the lease or to purchase the trees on the leased land. He had determined it was in the best interests of Environinvest to disclaim the leases, even though this would have an adverse impact on the scheme members who had an interest in the trees.

Some of the scheme members were represented at the hearing before the court. They urged the court not to give approval to Mr Downey’s decision to disclaim the leases because this might effectively prevent the scheme members from later contending Mr Downey had committed a breach of duty. They did not allege they could currently formulate such a case against him. The judge found that the application was, in effect, to excuse Mr Downey from a potential conflict in making the decision in circumstances where such a conflict had been anticipated, and a mechanism had been created by the court to deal with it. In the absence of assistance from the court, the judge was concerned Mr Downey may be compelled to resign as liquidator of the responsible entity or as the person responsible for winding up the scheme.

The judge felt this would be unacceptable, given the difficulties they had in finding someone to take responsibility for the winding up of the scheme.

There was no other criticism made of Mr Downey in relation to the job he was performing. In those circumstances, the court declared that Mr Downey was permitted to exercise his power to disclaim the leases, notwithstanding the disclosed conflict of duty. The court said the evidence strongly supported the validity of such a decision on Mr Downey’s part.
Can a director of the responsible entity be liable?

The directors of responsible entities need to be aware of their potential to be personally liable to creditors if for some reason the right of indemnity from the scheme assets is lost. Section 197 provides—

197(1) A person who is a director of a corporation when it incurs a liability while acting, or purporting to act, as trustee, is liable to discharge the whole or a part of the liability if the corporation:

(a) Has not discharged, and cannot discharge, the liability or that part of it; and
(b) Is not entitled to be fully indemnified against the liability out of trust assets solely because of one or more of the following:

(i) A breach of trust by the corporation;
(ii) The corporation's acting outside the scope of its powers as trustee;
(iii) A term of the trust denying, or limiting the corporation's right to be indemnified against the liability.

It is informative to note the history of that provision. In Hanel v O'Neill, the trustee had given notice to its landlord that it was going to vacate premises, and it then subsequently distributed all of the trust benefits to the beneficiaries and finalised the affairs of the trust. The landlord later obtained judgment against the trustee for about $23,000 for breach of the lease. Whilst the trustee was entitled to indemnity from the trust assets, all of the assets of the trust had already been distributed to the beneficiaries so there was no amount left to pay the judgment debt.

The landlord then pursued the directors of the trustee under the section which was the predecessor to the current section 197. The previous section provided the directors were required to personally discharge a liability, even if the fact they could not obtain an indemnity from the trust assets was because the trust did not have sufficient assets to make the indemnity payment to the trustee. In other words, the directors were not only liable where the failure to make a payment was because they had lost the right to the indemnity for some reason (eg for a breach of trust) but were also liable where the reason the indemnity was not being made was because of insufficient funds.

That decision was criticised in RJK Enterprises Pty Ltd v Webb where Justice Douglas in the Queensland Supreme Court refused to follow it on the basis it was plainly wrong. Section 197 was subsequently amended and the test is now formulated so the directors are only personally liable if they cannot be fully indemnified from the trust for one of the specified reasons set out in the section (being either a breach of trust, acting outside the scope of its powers, or because of an express term denying indemnity). In our view, the section is no longer intended to encompass circumstances where the only reason the directors cannot be fully indemnified is because the trust has insufficient assets to indemnify them. Whilst this appears to be the clear intention of the redrafted section, to date there have been no cases considering the new section 197.

Directors should be mindful that they might be personally liable to creditors if the responsible entity is denied a right of indemnity from the trust because of a breach of trust or because it has acted outside of its authority. This is designed to ensure that directors of corporate trustees pay particular attention to ensuring the corporate trustee properly undertakes its responsibilities as trustee.
Glossary

ACT Act
Trustee Act 1925 (ACT)

ASIC
Australian Securities & Investments Commission

ASX
Australian Securities Exchange

Corporations Act
Corporations Act 2001

NSW Act
Trustee Act 1925 (NSW)

NT Act
Trustee Act 1893 (NT)

QLD Act
Trusts Act 1973 (Qld)

SA Act
Trustee Act 1936 (SA)

State Acts
VIC Act, ACT Act, NSW Act, NT Act, QLD Act, SA Act, TAS Act, and WA Act

TAS Act
Trustee Act 1898 (Tas)

VIC Act
Trustee Act 1958 (VIC)

WA Act
Trustees Act 1962 (WA)

References to sections
References to sections are to sections of the Corporations Act unless otherwise stated.

Notes

1 Section 6 in Australian Capital Territory, section 6 in New South Wales, section 11 in the Northern Territory, section 12 in Queensland, section 14 in South Australia, section 13 in Tasmania, section 41 in Victoria, and section 7 in Western Australia

2 Section 70 in Australian Capital Territory, section 70 in New South Wales, section 27 in the Northern Territory, section 80 in Queensland, section 36 in South Australia, section 32 in Tasmania, section 48 in Victoria, and section 77 in Western Australia

3 Section 8 in Australian Capital Territory, section 8 in New South Wales, section 14 in the Northern Territory, section 14 in Queensland, section 15 in South Australia, section 14 in Tasmania, section 44 in Victoria, and section 9 in Western Australia

4 Section 601FL

5 Section 70 in Australian Capital Territory, section 70 in New South Wales, section 27 in the Northern Territory, section 80 in Queensland, section 36 in South Australia, section 32 in Tasmania, section 48 in Victoria, and section 77 in Western Australia

6 Section 601FM

7 Elders Trustee and Executor Co Ltd v Higgins (1963) 113 CLR 426

8 Speight v Gaunt (1883) 9 App Cas 1

9 (1869) 40 NY 76

10 (1995) 13 ACLC 614

11 (1995) 13 ACLC 1,822

12 [1980] 1 Ch 515

13 (1995) 13 ACLC 1,822

14 [2013] FCA 1,342

15 (2006) AATA 710


17 [2010] 242 CLR 174

18 [2011] 193 FCR 442

19 [2012] QSC 281

20 [2013] QSC 131

21 IRC v Silverts Ltd [1951] 1 All ER 703

22 Forster v William Deacon’s Bank Limited [1935] Ch 359, 365, 372

23 Ibid, 267


25 [1957] 1 All ER 703

26 (1992) unreported decision of Gleeson CJ in the New South Wales Supreme Court

27 [1980] Ch 515
28 Section 247A
29 Snelgrove v Great Southern Managers Australia Ltd (in liq) (receiver and manager appointed) [2010] WASC 51
30 Snelgrove v Great Southern Managers Australia Ltd (in liq) (receiver and manager appointed) [2010] WASC 51 at para 66
31 Vinciguerra v MG Corrosion Consultants Pty Ltd [2007] 61 ACSR 583
32 Cascastle Pty Ltd v Renak Holdings Ltd [1991] 6 ACSR 115
33 United Rural Enterprises Pty Ltd v Lopmand Pty Ltd [2003] NSWSC 404
34 McNell v Hearing & Balance Centre Pty Ltd [2007] NSWSC 942
35 Timios v French Caledonia Travel (1994) 13 ACSR 658
36 United Rural Enterprises Pty Ltd v Lopmand Pty Ltd [2003] NSWSC 404
37 United Rural Enterprizes Pty Ltd v Lopmand Pty Ltd [2003] NSWSC 404
38 Czerwinski v Syrena Royal Pty Ltd [No 1] (2001) 34 ACSR 245; [2000] VSC 125
39 Knightswood Nominees Pty Ltd v Sherwin Pastoral Co Ltd (1989) 15 ACLR 51; 7 ACLC 536
40 Garina Pty Ltd v Action Holdings Ltd (1989) 7 ACLC 962
41 Keenfern Pty Ltd v Thorlock International Ltd (2002) 20 ALC 1,322 at [9]; [2002] WASC 142. There has been some doubt expressed about this finding if it is intended to state a general principle
42 [2010] WASC 51
43 Section 53 in Australian Capital Territory, section 53 in New South Wales, section 54 in Queensland, section 20 in Tasmania, section 28 in Victoria, and section 53 in Western Australia—no equivalent provisions apply in the Northern Territory or South Australia. Section 20 of the Tasmanian Act restricts who can be the agent to a financial institution or legal practitioner. The NSW, Qld, Vic and WA Acts all allow an “other person” to be appointed as agent
44 Section 64 in Australian Capital Territory, section 64 in New South Wales, section 56 in Queensland, section 17 in South Australia, section 25A in Tasmania, section 30 in Victoria, and section 54 in Western Australia
45 Stephenson’s Settled Estates (1906) 6 SR (NSW) 420
46 Luke v South Kensington Hotel Co (1979) 11 Ch D 121; Beath v Kousal [2010] VSC 24
47 Adamson v Reid (1880) 6 VLR (E) 164; Byrnes and Another v Kendle [2011] HCA 26
48 Section 14, 14A, 14B and 14C in Australian Capital Territory, sections 14, 14A, 14B and 14C in New South Wales; sections 5 to 8 (inclusive) in the Northern Territory; sections 21 to 24 (inclusive) in Queensland; sections 6 to 9 (inclusive) in South Australia; sections 6 to 9 (inclusive) in Tasmania; sections 5 to 8 (inclusive) in Victoria; and sections 17 to 20 (inclusive) in Western Australia
49 Section 14A in Australian Capital Territory, section 14A in New South Wales; section 6 in the Northern Territory; section 22 in Queensland; section 7 in South Australia; section 7 in Tasmania; section 6 in Victoria; and section 18 in Western Australia
50 Section 14C in Australian Capital Territory, section 14C in New South Wales; section 8 in the Northern Territory; section 24 in Queensland; section 9 in South Australia; section 8 in Tasmania; section 8 in Victoria; and section 20 in Western Australia
51 [1989] 1 WAR 65
52 Hospital Products Limited v United States Surgical Corp (1984) 156 CLR 41
53 Boardman v Phipps [1967] 2 AC 46
54 Warman International Ltd v Dwyer (1995) 182 CLR 544
55 (1726) Sel Cas temp king 61; [1726] EWHC CH J76
56 [1992] 2 NZLR 615
57 [1967] 2 AC 134
58 Union Trustee Co of Australia Ltd v Gorrie [1962] Qd R 605
59 Re James [1948] SASR 143
60 Boardman v Phipps [1967] 2 AC 46
61 Gluckstein v Barnes (1900) AC 240
62 (2001) 202 CLR 410
63 [1902] AC 197
64 (1804) 9 Ves 234
65 [2008] NSWSC 347
66 [1985] Ch 270
67 Queensland Mines Ltd v Hudson (1978) 18 ALR 1
68 Sections 766D and 767A
69 Section 8 Trusts Act 1973 (Qld) and section 94 Trustees Act 1962 (WA)
70 (1977) 3 ACLR 303
71 Helvetic Investment Corporation Pty Ltd v Knight (1982) 7 ACLR 225
72 Section 59 in Australian Capital Territory, section 59 in New South Wales; section 36 in the Northern Territory; section 72 in Queensland; section 35 in South Australia; section 27 in Tasmania; section 36 in Victoria; and section 71 in Western Australia
73 Pursuant to the constitution (in most cases), section 601Ga(2) and the general law
74 The legislation appears in all Australian jurisdictions except the Northern Territory and Tasmania. Section 63 Trustee Act 1925 (ACT); Section 63 Trustee Act 1925 (NSW); section 96 Trusts Act 1973 (Qld); Supreme Court (General Civil Procedure) Rules 2005 (Vic); section 91 Trustee Act 1925 (SA); section 92 Trustees Act 1962 (WA). It is possible (and probably likely) the Supreme Court in both the Northern Territory and Tasmania have an inherent jurisdiction in equity to provide judicial advice
In New South Wales and Australian Capital Territory, section 63 Trustee Act 1925 (NSW) and section 63 Trustee Act 1925 (ACT) extend to questions concerning the interpretation of the trust instrument.

Section 83 in Australian Capital Territory, section 83 in New South Wales; section 96 in Queensland; section 91 in South Australia; and section 92 in Western Australia. Section 69(1) Administration Probate Act 1919 applies in South Australia with similar effect. The Supreme Court (General Civil Procedure) Rules 2005 apply with similar effect in Victoria.

Lidden v Composite Buyers Ltd (1996) 139 ALR 549
Re Diplock [1948] Ch 465

The relevant power appears in the procedure rules for the Federal Court and each of the state Supreme Courts.

Octavo Investments Pty Ltd v Knight (1979) 144 CLR 360