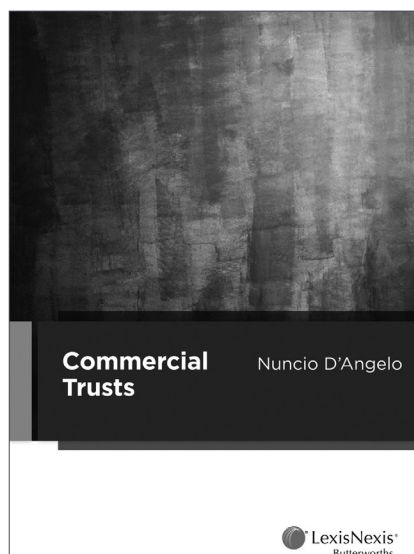


## Commercial Trusts

By Nuncio D'Angelo | LexisNexis Butterworths | 2014



As others would doubtless observe, this book is concerned with the normative rather than the doctrinal. Dr D'Angelo's hypothesis is that the trust device has evolved from the role of a guardian to become a vehicle for entrepreneurial activity. However this evolution has been imperfect, with the result that participants are exposed to serious risks of which they are often unaware. The book is concerned with the legal risks involved in commercial trusts.

The style of the book is practitioner focussed. Chapter 1 sets out the author's purpose, methodology and taxonomy as well as the historical and statutory context of the commercial trust. This will be useful to those unfamiliar with the field, but the author's style is sufficiently intuitive that moderately well informed readers need not dwell. Chapter 2 contains an interesting and easily read historical account of the evolution of the trust and equity's achievements along the way. The trust morphed from a device for the disposition of real property into one chosen for the entrepreneurial aggregation and commercial deployment of capital. The ingenuity of commercial

lawyers saw the trust instrument expand the trustee's powers by contract and generally mimic the desired features of a corporate structure (but without the maintenance of capital doctrine).

As the author notes, the extent of use of the trading trust is peculiar to Australia, due in large measure to preferable tax treatment. The author's central point is that trust law did not keep pace with this normative change in the use of trusts and that the commonplace notion that a corporate structure and a trust structure are interchangeable is hopelessly naive. Quite apart from sub-optimal advice, it might be thought that this parity myth has been encouraged by creeping and broadly parallel regulation of trading trusts through amendments to successive company law statutes.

The fragility of the trading trust essentially comes down to the fact that it has three features which were never envisaged at the conception of the trust notion: an equity investor, a corporate trustee and a lender. Hence the central analysis of the book is within separate chapters devoted to the legal risks inherent in the trading trust structure from the perspective of each of them.

Starting with the investor, the author directly challenges the widely held assumption that the investor acquires limited liability through a web of careful drafting in the trust instrument. He contends that the investor may incur personal liability to a creditor directly, where the trustee/investor relationship has acquired the character of agency, through either rights or acts of control of the trustee by the investor. The theoretical basis of this is not really controversial, although whether that ought to be regarded as a shortcoming of trust law is questionable, since it is

essentially a common law question of agency and privity of contract. Those common law principles apply equally to corporations and trusts. It is precisely because a shareholder has no proprietary interest in a company's assets, has the statutory limitation of liability and (by the replaceable rule in section 198A and its predecessors in the 'Table A' articles of successive company law statutes, unless modified) no power of management or control, that the agency principle is less likely to be enlivened with a shareholder. It is the absence of these basal characteristics in a commercial trust, that increases the risk of agency principles being enlivened. What the author carefully makes clear, is that this is a risk of uncertain dimension for commercial trusts because of the absence in the authorities of any clear articulation of a control test for trusts.

Secondly, the author contends that such personal liability may result from a creditor being subrogated to the trustee's right of indemnity from the investor beneficiary personally. This is somewhat more uncertain territory, given that many of the cases where a personal indemnity has been found have given weight to what could also be regarded as control questions. At the least, some form of adoption of the trust by the beneficiary must be involved since it cannot be the case that the first a beneficiary under a secret trust might hear of it, is when the trustee who has properly leveraged the fund and suffered from a swing in the market, calls for indemnity. The author demonstrates that precisely what more is required is unclear in the authorities. In practice this avenue of liability is less of a problem for commercial trusts, since the personal indemnity from the investor is usually negated in the trust instrument. As to subrogation,

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the author demonstrates that there is little clear authority on this question. He advocates a dual function for the well drafted limitation clause in loan or contract documents: limit recourse to the trust property and have the counterparty expressly waive any rights to pursue the investor personally (just as trustees are always assiduous to secure for their own benefit).

Moving to the corporate trustee, the author carefully points out the many pitfalls for a commercial trustee and how these may be ameliorated in the trust instrument and third party contracts. He issues the perennially necessary reminder to commercial trustees, that they have an irreducible obligation to act honestly and in good faith for the benefit of the beneficiaries, regardless of the breadth of the trust instrument. Very close attention is given to the language and effect of various common forms of limitation, which vary in quality.

The chapter dealing with the risks for creditors ought to open eyes in banking houses throughout Australia; although it probably won't. As the author points out, the priorities which flow under the statutory regime for companies, can be inverted in some circumstances with commercial trusts: equity holders can enjoy priority over unsecured lenders. The risks include the absence of an indoor management rule and the risk of accessorial liability for breach of trust. Perhaps the least appreciated risk is that the only access which an unsecured creditor of an insolvent trustee has to the trust fund is by subrogation to the

rather fragile trustee's right of indemnity / power of exoneration. Misconduct by the trustee, even without participation or knowledge by the lender, may impair the right and power and thus the creditor's only avenue to recovery. The application of the rule in *Cherry v Boulton* in relation to the power of exoneration is subject to particular and reasoned criticism by Dr D'Angelo. One question which is not considered is whether these problems could be overcome by a trust instrument which elevated the interests of the class of prospective lenders to that of a priority beneficiary in certain circumstances. Hence the corpus could be held on trust to pay debts properly incurred by the trustee and then for the unitholders; much like an old fashioned Will trust.

There is a separate chapter on the particular problems of insolvent trusts, which is a little repetitive, but serves to crystallise what is probably the key contribution of the book. While it is a legal truism that there is no such thing as an insolvent trust, the author points out that there is real practical utility in demonstrating 'practical insolvency', not least in relation to when an application might be made for the trustee to wind up an MIS. However there is no clear authority as to how this is properly demonstrated and the author canvasses the authorities and possibilities.

The main body of the book concludes with a thought provoking chapter on possible reforms. At one level, it could be argued that what the author identifies as the most commercially pernicious risks of the commercial trust, arise directly from

the central genius of the trust notion: the creation of a separate beneficial and proprietary interest in someone other than the legal owner of the property. Would the result of the many possible reforms which are discussed, merely be to create a form of tax preferred, 'regulation light', corporation? It would hardly be the first time in commercial history that the prize of a lesser tax impost has caused business people to turn a blind eye to the risks involved. This book is a salutary reminder and detailed analysis of those risks. However it is probably unfair to pin the blame entirely on preferential tax treatment. From an informed investor's point of view, the oft described 'coterie of rights' comprised in a company share looks rather pale beside the proprietary interest which a trust confers. Equally, from an entrepreneur's perspective, it is hard to match the flexibility to issue and redeem interests as units, which the common unit trust offers. Certainly those interested in the question of law reform, as well as in the comparative advantages and disadvantages of the commercial trust structure, will benefit from the book.

There is also a substantial body of appendices with not only useful reference material, but a significant body of template clauses and a checklist designed to address specific risks highlighted in the book. This is sufficiently practical to cause the publisher to include a specific disclaimer and exclusion.

While the style of the book is unashamedly practical and compendious, it is extensively referenced to existing authority and scholarship, which will render it a useful companion for barristers and solicitors alike.

Reviewed by Wayne Muddle SC