ACCOUNTING TIMES

A reminder about managing trustee liability

8 November 2023

The trustee of any form of trust (including self managed superannuation funds and limited recourse borrowing arrangements) will generally have a right of indemnity against the assets of the trust.

However, where a trust has individual trustees, their personal assets are exposed where the indemnity is not available, or the assets of the trust are insufficient to discharge the liability.

Many of the liability risks that attach to individual trusteeship can, to an extent, be relatively easily managed by ensuring the trustee of a trust is a company – so long as the company is a special purpose vehicle with nominal assets (ie $2 of share capital).

Personal liability of trustee company directors

The use of a properly structured corporate trustee does not provide complete protection, as there are still a number of statutory and third party obligations imposed on the directors personally.

For example, directors of a trustee company can be personally liable for:

1. personal guarantees to financiers;

2. work place health and safety legislation;

3. insolvent trading (under section 588G of the Corporations Act);

4. certain tax obligations such as in relation to phoenix activity, goods and service tax, the pay-as-you-go regime and superannuation guarantee charge;

5. misleading or deceptive conduct under section 18 of Schedule 2 to the Competition and Consumer Act 2010;

6. negligence; and

7. otherwise breaching directors' duties under the Corporations Act, as explored further below.

Corporations Act

There are a range of issues directors may be personally liable for under the Corporations Act, for example the duties to act with due care and diligence and good faith and to ensure there is no improper use of position or information.

Furthermore, section 197 is relevant, and provides as follows:

*'**Directors liable for debts and other obligations incurred by corporation as trustee***

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, 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.

This is so even if the trust does not have enough assets to indemnify the trustee.

The person is liable both individually and jointly with the corporation and anyone else who is liable under this subsection'.

Interestingly section 197 was varied after the decision in *Hanel v O'Neil* [2003] SASC 409.

In this case a director was held personally liable where the trust had insufficient assets to cover the claims it was otherwise liable for. This was despite the fact that the general view up until the decision was that a trustee company director would have no liability if the trustee company had a full indemnity against trust assets.

The decision essentially meant that, for a period of time (until the legislation was amended), the indemnity provided no practical defence unless the trust had the assets to back it up.

The amendments to section 197 ensured that a director of a corporate trustee will be personally liable only where the company's right of indemnity as trustee has been lost through disentitling conduct.

Recent reminders

The recent decision of *Reliance Financial Services Pty Ltd v Antalija Developments No 4 Pty Ltd (No 4)* [2023] NSWSC 1260 bluntly confirms the liability risks where there are individual trustees. In a succinct judgment the court confirmed that it is the clearest of legal propositions that a trustee contracts in the trustee's own name and is liable at law under the contracts that the trustee makes in the trustee's capacity as such.

The trustee's only recourse if it becomes liable to a third party by reason of its actions as trustee is to enforce its indemnity against the trust assets, if those assets are sufficient to meet the indemnity. A court has no discretion to relieve a trustee from this personal liability.

The decision in *Charlton v National Australia Bank Limited* [2021] NSWCA 111 provides further context in this regard.

Briefly, the facts involved a property purchased by an individual, with the contract confirming the person was acting as trustee.

Some years after the purchase, the individual granted a mortgage over the property to nab as security for financial facilities provided to the trust, although the person was named as mortgagor without any reference to the trust.

On subsequent default under the mortgage the individual claimed they had retired as trustee.

The court confirmed:

1. On a proper reading of the trust deed, a trustee was not able to unilaterally retire (in contrast, an appointor under the deed did have such a power). Therefore, the purported unilateral retirement was invalid and the individual remained as trustee of the trust.

2. There was no ability under the trust deed to imply a unilateral right to retire, as there was no gap in the drafting of the deed allowing such an approach. This outcome was contrasted with the decision in *Bunten v Muir* (1894) 21 R 370, where a clause in a trust deed assumed that the trustees had the power to resign but did not expressly state that to be the case and therefore was 'implied' into the deed by the court.

3. Even if the resignation of trusteeship was successful, this would not have discharged the individual from being liable to nab as the liabilities were incurred while acting as trustee.

4. That is, a trustee is personally liable for debts incurred as trustee, regardless of whether the trustee contracted with creditors as a named trustee, and even if the creditors did not know of the existence of the trust (see *Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth* (2019) 93 ALJR 807 and *ACES Sogutlu Holdings Pty Ltd (in liq) v Commonwealth Bank of Australia* (2014) 89 NSWLR 209).

5. The suggestion that the liabilities here were not in fact incurred by the trustee, but rather were 'future debts' at the time of the granting of the mortgage because they were not then immediately payable was also rejected.

6. The court confirmed that even assuming that the debts were not due and payable before the default, and therefore somehow not in fact liabilities, the argument was of no assistance to the trustee (noting that the utility of the argument was also doubtful because default appeared to have occurred before the purported resignation of trusteeship in any event).

7. The fact that the debts were not payable was irrelevant to the conclusion that they were liabilities for the purposes of determining the extent of the liability of, and indemnity imposed on, the trustee.

8. In other words, the debts were essentially a contingent liability of the trustee, that arose immediately on the loans being advanced (see *Hawkins v Bank of China* (1992) 26 NSWLR 562).

Denial of right of indemnity

The right of indemnity that is otherwise available for an individual trustee (or director of a corporate trustee) is subject to limitations, regardless of whether the assets of the trust are sufficient to cover a successful claim.

For example, the right of indemnity that is otherwise generally available to a trustee may be denied where the trustee is held to have acted in breach of trust.

As explained in *Fitzwood Pty Ltd (ACN 005 180 163) v Unique Goal Pty Ltd (In Liq) (ACN 064 926 843)* [2002] FCAFC 285, the right of indemnity may be denied where there is no evidence that the conduct of the trustee was carried out in good faith when otherwise engaging in what amounted to a breach of trust. If this occurs the trustee is not entitled to be indemnified by the assets of the trust in respect of the claims against the trustee for damages.

That is, the trustee loses its right at law of indemnity due to its breach of trust.

Conclusion

Given recent case law and legislative change, regardless of the factual matrix, it would seem difficult to build a compelling argument justifying the use of individual trustees of any form of trust – including SMSFs and LRBAs.

Specialist advisers therefore have an opportunity to proactively ensure both that new structures are established appropriately – and heritage structures are remedied – by the use of special purpose corporate trustees.