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Victorian Law Reform Commission
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Submission re Trading Trusts – Oppression Remedies

Dear Dr Bendall

1. I write to make a submission regarding the VLRC's recently released Consultation Paper regarding Trading Trusts – Oppression Remedies (June 2014).

2. Rather than directly answering each of the questions laid out in the Consultation Paper, I propose instead to make an overall submission regarding the subject matter of the Consultation Paper, together with a couple of more minor observations on discrete aspects of the material contained in the Consultation Paper.

Overall submission

3. It seems to me that a large part of the difficulty in grappling with the Reference arises out of the fact that it raises a functional question (as to whether the courts need a power to provide a remedy to correct conduct which is oppressive as between equity owners of a business) but applies it to a doctrinal context (as to trading trusts specifically). This generates considerable difficulty in defining the trading trusts to which any such remedy should apply.

4. The same difficulty arises in the context of arguments as to whether creditors ought to have direct access to trust assets in execution of judgments obtained against trustees regarding trust contracts. In that context, there have been calls made for creditors to have such access on the basis that creditors would have that access if they had contracted with a corporation (e.g., D'Angelo's recent book, *Commercial Trusts* (2014), and his numerous previous articles).

5. In both of these contexts, there is a strong argument to be made that the doctrinal form which the business takes (whether a corporation, a trust, or some other legal form) ought not to make a difference to the functional substance of the way in which business activity is regulated.

6. As the VLRC states in paragraph [2.31] of the Consultation Paper, "Despite the presence of a discretionary trust, the structure closely resembles a proprietary

company where an oppression remedy would ordinarily be granted." The same sort of functional approach is evident in the passage from Ferguson J's judgment in *Wain v Drapac* which is quoted in paragraph [3.65] of the Consultation Paper, where she says:

> "Were that interpretation to be accepted, then in cases such as the present, where there is a complex corporate structure that is a mixture of companies and trusts *but in a real sense only one business is conducted* by the corporate group, the legislation would be rendered virtually useless to remedy the real harm that has been caused by the oppressive conduct." (emphasis added)

7. I mention this because it seems to me that this makes the case for an oppression remedy strongly. Where the business is organised as a corporation, it has been thought fit to provide the courts with a power to correct oppressive conduct (in ss 232-234 of the Corporations Act). Functionally speaking, the equity owners of a business should be in no worse position for having chosen to arrange their business affairs through a different legal structure, be it a trust or some other legal arrangement. If, as a matter of legislative policy, it is important for the courts to be able to rectify oppression between equity owners, it is arguable from a functional perspective that it should not matter which legal structure has been adopted.

8. This approach, obviously, takes little cognisance of the legal form in which the business is structured – that is the point of a functional analysis. If that is the argument that is being made, then there seems to be a case for saying that the oppression remedy should be made available to all businesses, leaving the courts to develop principles as to when and how it should be applied in individual cases, taking into account the specific legal form in which the business is being run.

9. For example, there has been some suggestion that managed investment schemes and other unit trusts need not be subject to any oppression remedy regime that is created for trading trusts, on the basis that the regime in Ch 5C of the Corporations Act already covers that context. But if an incident of oppression were to occur in such a context, why should the equity owners of that business not also have available to them the sort of protection which is already available to equity owners of corporations, and potentially the equity owners of trading trusts (if such is the recommendation of the Commission). Oppression is oppression, no matter in what formal legal context it occurs.

10. Related to these general observations, if the oppression remedy is to be made available only for trading trusts (however that category ends up being defined), then it seems that the focus is on the legal structure rather than a functional analysis. If that is to be the focus, then there would be merit in considering other aspects of trading trusts which generate legal difficulties (such as the insolvency of such trusts, and the rights of creditors of trading trusts). If that is to be the approach, then much could be learned by looking at other jurisdictions that have adopted bespoke legislative regimes for trading (or business) trusts, such as Singapore's Business Trusts Act 2004.

Other observations

11. In paragraph [4.64] of the Consultation Paper, reference is made to a suggestion that the doctrine of fraud on a power would only apply where a unitholder could show that the trustee's actions have eroded the substratum of the unit trust. It seems to me that

this underplays the potential application of the doctrine of fraud on a power. Its application will depend on the specific power which is at issue in a given case, as there is a fraud on that power where that power is used for a purpose for which that power was not given. In the context of a power to change the constitution of a unit trust (or any other trust) one can readily understand the argument that a trustee would not act in fraud of that power unless it was used in a way that undermined the substratum of the trust. But that is not necessarily the case in respect of all powers which a trustee might use in a potentially oppressive manner. In other words, the fraud on a power doctrine could potentially have a broader application than is suggested in paragraph [4.64]. However, this point does not undermine the argument that there will be cases, functionally, where oppression may need to be remedied and where the fraud on a power doctrine will not avail.

12. As to the remedy for fraud on a power, this depends on whether the power is legal or equitable. In Australia, there is also case law which (based on a misunderstanding of English authority) suggests that the exercise of power is merely voidable, as opposed to void (which is the predominant view in England). Either way, however, neither approach would provide the court with an obvious basis for making a buyout order.

13. I had a little difficulty understanding the statement in paragraph [6.16] that "As shown in Chapter 2, the trust deed is capable of excluding many of the trustee's duties including the right of indemnity." The right of indemnity is a right, rather than a duty. Furthermore, the right of indemnity is not discussed in chapter 2 (from what I can tell, it seems first to be mentioned in paragraph [4.22]). There is complicated case law as to whether the trustee's proprietary right of indemnity against the trust assets (as distinct from the personal right of indemnity against trust beneficiaries) is capable of being removed by the trust deed: see, e.g., *Kemtron Industries Pty Ltd v Commissioner of Stamp Duties* [1984] 1 Qd R 576, 585; *Agusta Pty Ltd v Provident Capital Ltd* [2012] NSWCA 26 at [39], (2012) 16 BPR 30,397; *Franknelly Nominees Pty Ltd v Abrugiato* [2013] WASCA 285 at [205]-[235]. On the basis of this case law, there is a sound basis for arguing that the indemnity provided for by s 36(2) of the Trustee Act 1958 (Vic) is capable of being removed by the trust deed, on the basis of s 2(3) of the same Act (and by analogy with the reasoning adopted in the *Franknelly* decision), but that is not beyond doubt. That, obviously, does not mean that the indemnity cannot be removed by legislation (or by a court order where legislation so empowered the court), but the point is that this would be a consequence for third party creditors, who would lose their ability to subrogate to that indemnity. The extent of that consequence depends on the extent to which trusts in Victoria exclude the trustee's proprietary right of indemnity.

Yours sincerely,

Matthew Conaglen