CORPORATE INSOLVENCY AND RESTRUCTURING FORUM ON:
THE MYSTERIES AND MAGIC OF SINGLE RESPONSIBLE ENTITIES
AND MANAGED INVESTMENT SCHEMES

INSOLVENCY ISSUES

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1. Introduction

Managed investment schemes (Schemes) have become an integral part of the Australian economic landscape. Essentially, a Scheme is an investment device in which participants contribute in the hope of producing financial benefits. MIS are operated by a single 'responsible entity' which acts as both trustee and manager of the Scheme. That is to say, the assets of a scheme are held on Trust by the responsible entity for the benefit of the scheme members.

That being so, while there is a statutory overlay which has an impact on the winding up of schemes themselves, the primary insolvency issues which arise in relation to responsible entities and Schemes arise because of the trustee/beneficiary relationship between the responsible entity and the Scheme members. It is that relationship which influences the circumstances in which those dealing with the Scheme can have access to the Scheme Property.

This paper will look briefly at:
(a) the legal nature of the scheme and its relationship with the responsible entity;
(b) the winding up of a scheme;
(c) the winding up of a responsible entity; and
(d) the issues which arise by virtue of the responsible entity's trust status for those seeking to recover assets from the insolvent estate of a responsible entity.

2. General Principles

2.1 Interests

On the insolvency of a responsible entity or Scheme there will be a number of competing interests:
(a) the responsible entity;
(b) the participants in the Scheme (the Scheme Members);
(c) creditors of the responsible entity whose debt arose in the course of the responsible entity's functions in relation to the Scheme (the **Scheme Creditors**); 

(d) creditors of the responsible entity whose debt was incurred other than in relation to the responsible entity's management of the Scheme (the **General Creditors**); and 

(e) the external administrator of the responsible entity and/or the Scheme.

### 2.2 Managed Investment Schemes

For the purposes of this paper, it is sufficient to make some very general observations about managed investment schemes.

Schemes are investment devices in which participants contribute money (or money's worth) which is pooled in a common interest to produce financial or proprietary benefits. Schemes are regulated by chapter 5C of the Corporations Act (**CA**).

Schemes must be registered with ASIC and operated by a licensed public company acting as a single ‘responsible entity’.

The responsible entity acts as trustee for the scheme members and is responsible for the conduct of the scheme.

The Scheme must be constituted under a constitution that complies with chapter 5C of the CA and be operated in accordance with a ‘compliance plan’ which must be audited annually and, ordinarily, monitored by a compliance committee.

Responsible entities, their officers, employees and compliance committee members are subject to a range of onerous statutory and other duties in relation to the conduct of the Scheme.

The legislation governing Schemes, introduced in 1998, merged the roles of manager and trustee into the one role of ‘single responsible entity’. However, the responsible entity remains a trustee of the Scheme’s assets.

While ASIC policy has the effect that most responsible entities are required to appoint an external custodian of scheme property, the external custodian operates as a bare trustee and only holds the scheme property as agent for the responsible entity. The scheme property is thus the responsible entity's equitable interest in the property held by the custodian.

### 2.3 Trusts

As mentioned above, a Scheme, among other things, is a trust.

It has become a common (and bad) practice to speak of a trust as if it had a distinct legal personality, and creditors ‘of a trust’ but as the above propositions illustrate, this usage that should be confined to the laity, such as accountants 1.

A trust, unlike, for example, a Corporation, is not a legal entity. Therefore, although phrases such as 'trust assets' and 'trust creditors' are commonly used, it is important to remember that a trust cannot own assets or have creditors.

The same can also be said of a Scheme.

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Scheme assets, therefore, are assets which are 'owned' by the responsible entity and which are held by the responsible entity on trust. Similarly, Scheme Creditors are creditors of the responsible entity – not the Scheme.

3. Winding Up Schemes

3.1 Winding up registered Schemes

Part 5C.9 of the CA sets out the relevant provisions in relation to the winding up of Schemes. There are a number of ways in which a registered Scheme can be wound up.

(a) a Scheme’s constitution may provide that the Scheme is to be wound up:
   (i) at a specified time; or
   (ii) in specified circumstances or the happening of a specified event.

(b) on the passing of an extraordinary resolution by the members of the scheme directing the responsible entity to wind it up.

(c) on the responsible entity of a scheme giving notice to wind the Scheme up if it considers that the purpose of the scheme has been accomplished or cannot be accomplished.

(d) the Court may direct the responsible entity of the scheme to wind it up:
   (i) if the Court thinks it is just and equitable that the scheme be wound up; or
   (ii) within 3 months before the application for the order was made, execution or other process was issued on a judgement, decree or order obtained in a Court (whether an Australian Court or not) in favour of a creditor of, and against, the responsible entity in its capacity as the scheme’s responsible entity and the execution or process has been returned unsatisfied. An order for winding up a Scheme in relation to an unsatisfied judgment can be made by a creditor and may be a distinct advantage in circumstances where winding up the responsible entity would decrease the potential return to the creditor.

An order that the scheme be wound up on just and equitable grounds can be made on the application of:

(A) the responsible entity;
(B) a director of the responsible entity;
(C) a member of the scheme; or
(D) ASIC.

The responsible entity must ensure that the scheme is wound up in accordance with its constitution.

The court may appoint a person to take responsibility for ensuring a registered scheme is wound up in accordance with its constitution and make any orders the Court thinks necessary for the scheme to be properly wound up.

The Court may also give directions about how a registered scheme is to be wound up if it thinks it is necessary to do so. The appointment of a person to wind up a scheme or
directions from the Court in relation to the winding up of a scheme may be sought by the responsible entity, a director of the responsible entity, a member of the scheme or ASIC.

3.2 **Duties owed by the responsible entity**

Winding up of a Scheme essentially involves the distribution of the Scheme assets which is to be done in accordance with the Schemes constitution. In circumstances where the constitution does not adequately prescribe the procedure to be adopted by the responsible entity the Court may give directions as to how the responsible entity should be wound up.

Among the assets of the Scheme which should be had regard to will include causes of action which may be available to Scheme Members or the responsible entity in respect of contraventions of the CA in the running of the Scheme.

The responsible entity owes extensive duties by virtue of the general law, the Corporations Act and the scheme's constitution and compliance plan which should be considered by a liquidator of a Scheme as potential assets in the winding up.

Among the responsible entity's duties are to:

(a) act honestly;

(b) act in the best interest of members and, if there is a conflict between the members' interest and its own interest, give priority to the members' interest;

(c) treat the members who hold interests of the same class equally and members who hold interests of different classes fairly;

(d) not make use of information acquired as a responsible entity in order to:

   (i) gain an improper advantage for itself or another person; or

   (ii) cause detriment to scheme members;

(e) ensure that the scheme property is:

   (i) clearly identified as scheme property; and

   (ii) held separately from property of the responsible entity and property of any other scheme.

The Scheme's constitution must also meet certain requirements and a failure on the part of the responsible entity to ensure that the constitution meets those requirements is a breach of the CA giving rise to civil penalty orders.

Similarly, the responsible entity must also ensure that the scheme's compliance plan meets the requirements of s601HA. Failure to meet those requirements can also give rise to civil penalties against the responsible entity or persons involved in the responsible entity's contravention.

Given that s601HA provides that the compliance plan must contain ‘...adequate measures that the responsible entity is to apply in operating the scheme to ensure compliance with this act and the scheme's constitution’ it is likely that in any winding up of a Scheme there will be an arguable breach of s601HA which could give rise to a right to seek civil penalty orders against the responsible entity, its directors and officers.
3.3 Winding up unregistered Schemes

Unregistered Schemes may be wound up at the direction of the Court on the application of ASIC, the responsible entity, or a member under s601EE. Section 601EE is couched in very wide terms which allows ASIC, a member of the Scheme or the responsible entity to seek that an unregistered scheme be wound up.

Having said that, the courts have interpreted s601EE to require the court to exercise its discretion on the same basis as it would in relation to an application to wind up a company on the ‘just and equitable’ ground in s461(1)(k) of the CA. Namely, that an order should be made where it would serve the public interest such as, for instance, protecting investors.

Thus in ASIC v Pegasus Leveraged Options Group Pty Ltd Davies AJ ordered that the scheme be wound up on the basis that funds remained to be distributed, and that it was in the investors and the public's interest that the scheme be wound up in formal administration. Accordingly, an issue for external administrators to consider when appointed to an responsible entity is whether or not the Schemes operated by the responsible entity are registered. If not, the administrator can seek to have the Schemes wound up under s601EE.

A liquidator or receiver may also be appointed by the Court under s601EE for the purpose of winding up an unregistered scheme.

Section 601EE allows the Court to make such orders as it considers appropriate for the winding up of the Scheme including orders as to the appropriate basis for the distribution of surplus and the appropriate method for allocating losses in relation to different classes of investors.

Using of the wide discretion permitted the Court under s601EE the Court can and has allowed the responsible entity itself to wind up an unregistered scheme under the supervision of registered liquidators.

4. Winding up Responsible Entities

Responsible entities, unlike Schemes, are ordinary companies and subject to the same provisions in relation to insolvency and external administration as other companies. However, the complicating factor in relation to responsible entities is their role as trustee of the Schemes property and the fact that they hold property both for itself and for Scheme. Thus the issue becomes what interests can seek what assets on the insolvency of a responsible entity.

4.1 The responsible entity holds scheme property on trust

While it is ordinary for responsible entities to have custody agreements with external custodians which provide that the custodian is not to be considered a trustee of the scheme property in any sense other than as trustee holding legal title to the scheme property as agent for the responsible entity. Essentially, where scheme property is held by a custodian, the

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2 41 ACSR 561
3 See also ASIC v Chase Capital Management Pty Ltd (2001) 36 ACSR 778
4 Lawloan Mortgages Pty Ltd v Lawloan Mortgages Pty Ltd (2003) 21 ACLC 289
responsible entity remains a trustee for members and the trust property is the responsible entity's equitable interest in the property held by the custodian.

4.2 The rights of a Scheme Creditor

As mentioned above, a Scheme is not a legal entity and cannot incur liabilities on its own behalf. A responsible entity incurs debts on behalf of the Scheme and is personally liable for those debts. A Scheme Creditor (ie a creditor whose debt was incurred by the Company within its power as manager of the Scheme) is therefore entitled, unless the contrary is agreed, to enforce its rights against the personal assets of the responsible entity.

A Scheme Creditor has no direct recourse to the Scheme's assets which are held on trust. However, a Scheme Creditor will generally be subrogated to a responsible entity's right to be indemnified out of the Scheme assets (or by the beneficiaries personally) for liabilities incurred on behalf of the scheme.

It is only through this right of indemnity that a scheme creditor can satisfy its debts against scheme assets.

A responsible entity's right of indemnification has priority over any call by the Scheme Members for a distribution of assets held on trust.

4.3 Reimbursement and exoneration

A responsible entity, ordinarily, has a right to be indemnified out of scheme assets for liabilities incurred on behalf of the scheme. Different principles may apply, however, depending on how this indemnity is given effect.

If a responsible entity has met a liability from its own funds, then the right to indemnity is known as reimbursement or recoupment.

However, if the responsible entity is using assets held on trust directly to satisfy a liability to a creditor, then this is known as exoneration.

This distinction might be very important in determining whether a responsible entity's right of indemnity is an asset which, upon the insolvency of a responsible entity, accrues for the benefit of general creditors (ie creditors whose debts arose otherwise than by an act of the responsible entity's for the Scheme) as well as scheme creditors.

5. Priority between General Creditors and Scheme Creditors

A responsible entity has no entitlement to be indemnified, from either scheme members personally or from scheme assets held on trust, for debts which are not incurred on behalf of the scheme. There is therefore no direct or indirect means for which a general creditor can access assets held on trust to meet liabilities owing to it by an responsible entity.

The only qualification to this statement is the possible right of a general creditor to share in the benefit of any right which a Scheme creditor has to be subrogated to a trustee's rights of indemnity. Any such right, however, would be at the expense of the trust creditors rather than the beneficiaries.

That is to say, one of the assets of an insolvent responsible entity in external administration may be its entitlement to be reimbursed for expenses incurred relating to the Scheme.
recovery, which is really a recovery that only arises because of the Scheme Creditor's rights, could form a part of the general assets of the responsible entity to be distributed equally to trust creditors and general creditors alike on the following basis:

(a) The Corporations Act favours equal distribution between Creditors in the same class. Ordinarily, Trust Creditors and General Creditors are both unsecured creditors and on that basis rank equally (subject to the discussion below).

(b) The right to indemnity from the Scheme is an asset of the Company. That asset is not held on Trust. It therefore should be available for the benefit of all creditors of the Company.

(c) Commercially, the Scheme Creditors will normally have regard to the assets held on trust by the responsible entity and debts incurred on behalf of the Scheme when deciding whether to lend money.

(d) Similarly, General Creditors would not have regard to the assets held on trust when deciding whether or not to lend money to a company. It is therefore commercially desirable to treat Scheme assets and Scheme creditors separate from the general assets and general creditors of a company.

(e) A responsible entity has security over, or a proprietary interest in, the Scheme assets held on trust to the extent of its right to be indemnified from those assets. The Scheme Creditors are subrogated to these rights, and are therefore in an equivalent position to a creditor with security over the Trust Assets. They are therefore also entitled to share equally with the General Creditors to the extent that the debts owing to them exceed the value of their security.

(f) The right of indemnity does not change the nature of trust assets from being trust assets. As such, they should not be available for any purpose other than purposes associated with the Trust.

5.2 Does a scheme creditor hold security over scheme assets?

The issues which need to be considered here are:

• what is the nature of the interest which a responsible entity has in assets held on trust to support the right of indemnity;

• when does that interest arise; and

• how and when does a scheme creditor become subrogated to this right?

A trustee’s right of indemnity from trust assets is supported by an equitable lien over those trust assets. The lien is over the assets themselves, rather than over the beneficiaries’ interest in those assets.

The trustee’s interest is normally described as arising at the time the liability is incurred. However, Meagher & Gummow have suggested that:

5 Octavo Investments Pty Limited v Knight (1979) 144 CLR 360
6 Chief Commissioner of Stamp Duties v Buckle (High Court of Australia, 23 January 1998).
it is more accurate to see the lien as one which at best attaches only potentially as the liability of the trustee arises, and crystallises only upon proceedings for enforcement and upon it being clear that there is a balance on the account between trustee and beneficiary in favour of the former. 7

There do not appear to have been any cases that have expressly had to consider this issue.

The precise manner in which a creditor becomes subrogated to a trustee’s right of indemnity also does not appear to have been expressly considered in any case. It was stated in Octavo Investments that the right of subrogation arises on the trustee’s bankruptcy or insolvency, although it was not an issue in those proceedings whether the right might in fact arise at some earlier date.

Thus there is an issue as to whether the right of subrogation will be available to give a trust creditor priority over other creditors or in essence, security over the Scheme assets. The opinion has been expressed that a trust creditor is in the same position as a secured creditor by virtue of the right of subrogation. 8

5.3 Re Enhill

A number of cases have considered priority issues between trust creditors and general creditors. Most of these cases begin their discussion of this issue by looking at the decision of the Full Court of the Victorian Supreme Court in Re Enhill Pty Limited [1983] VR 561.

That case, like the majority of cases on this point, concerned an application by a liquidator to apply proceeds of the sale of trust assets towards the liquidator’s own costs and expenses. This particular issue is considered later in this paper. The primary importance of Re Enhill is not the decision itself, which allowed the liquidator to recover his costs, but the reasoning adopted by the court in coming to this conclusion.

The court followed the reasoning of the High Court in Octavo Investments which emphasised that a Trustee’s (or responsible entity’s) right of indemnity is a proprietary interest which belongs to the company. The Court noted that:

in these circumstances to hold that a trustee in bankruptcy could only apply the proceeds of the right of indemnity towards some only of the bankrupt’s creditors viz creditors of the trust business, would deny the very purpose of the right of indemnity which is to exonerate the trustee’s personal estate. In a case like the present therefore, the proceeds of the trustee’s lien are available for division among the bankrupt’s creditor’s generally, not only among creditors of the trust business.

5.4 The response to Re Enhill

In commenting on the judgment in Re Enhill, Meagher and Gummow state, with characteristic caution, ‘this decision is obviously wrong...its vice is the assumption that trust property transferred to the trustee to meet a trust liability somehow ceases to be trust property’ 9.

This criticism might at first be difficult to understand. For example, where a trustee uses the proceeds from the sale of trust assets to reimburse itself for the costs of meeting a liability incurred on behalf of the trust, then clearly those proceeds would cease to be trust assets. The same principle would apply if the assets themselves, rather than the proceeds of the assets, were used to reimburse the trustee.

The reasoning of Meagher & Gummow should be understood, however, in the context of exoneration, rather than reimbursement.

The facts of Re Enhill and other decided cases concern the right of exoneration, rather than reimbursement. This distinction was expressly mentioned in Re Suco (considered below). In the case of exoneration, the argument is that trust assets (or the proceeds from the sale of trust assets) remain trust property until they are transferred to the creditor. They therefore never become beneficial property of the trustee and are therefore never available for general creditors.

The resolution of this issue would therefore appear to depend on how exoneration works. The different lines of reasoning are:

(a) The beneficial interest in the assets (or in the proceeds of the assets) is transferred directly from the beneficiaries to the trust creditors. This is (implicitly) the view favoured by Meagher & Gummow.

(b) The beneficial interest in the assets (or in the proceeds of the assets) passes from the beneficiary to the trustee, which then meets a liability incurred on behalf of the trust from its own assets. This is (implicitly) the interpretation favoured by the Full Court of the Victorian Supreme Court in Re Enhill.

5.5 Subsequent cases

The Full Court of a South Australian Supreme Court also considered this issue in Re Suco Gold Pty Limited (1984) 33 SASR 99. The Full Court rejected the approach taken in Re Enhill. It held that although the right of reimbursement was a right which belonged equally to all creditors, the right of exoneration only existed for the benefit of trust creditors. The Full Court emphasised that to hold otherwise would result in trust assets being used for an unauthorised purpose.

Subsequent cases around Australia have generally followed the approach in Re Suco. While Victorian Courts regard themselves as bound by the decision of the Full Court in Re Enhill, that decision has now been confined to claims by liquidators to be reimbursed out of trust assets. For example, in Collie v Merlaw Nominees Pty Limited (unreported, 28 February 2001) Warren J of the Victorian Supreme Court held:

...of course, the distinguishing feature of Enhill was that the Court was concerned with the entitlement of a liquidator and the costs of the winding up. No such factor arises in the present case. Mr Nolan relied upon Enhill to support the proposition that all creditors must be treated equally and none ought to be put at an advantage by way of subrogation of the trustee’s right of indemnity. ...As a general proposition trust assets are only applied to trust liabilities. The present case is not one where a liquidator seeks costs as was the case in Enhill.
5.6 Result
Accordingly, the most common position will be that the responsible entity's right to be reimbursed out of the Scheme assets will be an asset available to both Scheme Creditors and General Creditors with the relatively narrow exception in exoneration cases. Such cases will be rare as in most exoneration instances the money will have already been transferred direct from the Scheme Property to the Creditor.

6. Priority between Scheme Creditors and Scheme Members

6.1 Issues
Some of the issues which might arise in the winding up of a responsible entity or scheme include:

(a) to what extent can the scheme members protect the scheme assets from the Scheme Creditors and/or the General Creditors;

(b) can the General Creditors benefit directly or indirectly from any rights which the Scheme Creditors have to be indemnified (either directly or indirectly) from the Scheme Assets;

(c) can the Scheme Creditors share in a distribution of the General Assets over and above their rights to the Scheme Assets; and

(d) what rules govern priorities between different Scheme Creditors?

6.2 The creditor’s right of subrogation against assets held on trust
Assets held on trust are generally excluded from the estate of an insolvent or bankrupt trustee. Further, as mentioned above, the creditors of a trustee have no direct recourse to assets held on trust, but only a personal right against the trustee. It might therefore be thought that assets held on trust are not available to meet debts incurred by a trustee on behalf of the trust. Such a result could clearly result in the beneficiaries receiving an unfair windfall.

The resolution of this issue is that, although assets held on trust do not form part of a trustee’s estate, the right to be indemnified from those assets does. It is this right to be indemnified that indirectly gives trust creditors priority over the beneficiaries. The relevant principles are summarised in Vacuum Oil Company Pty Limited v Wiltshire (1945) 72 CLR 319 and Octavo Investments Pty Limited v Knight (1979) 144 CLR 360.

In summary, Scheme Creditors will have priority over the interests of beneficiaries if, and only if, the responsible entity has a right of indemnity in respect of the debts owed to the Scheme Creditors.

6.3 The right of indemnity
The right of a trustee to be indemnified will normally be set out in the trust deed, or, in the case of responsible entity, in the constitution. For example, the trust deed or Scheme's constitution will often state that the trustee will be indemnified for all obligations incurred by the trustee/responsible entity, acting in that capacity, except those that are incurred as a result of deliberate wrongdoing.
Two issues which can arise are:

(a) to what extent does the trustee have a right of indemnity if one is not granted by the trust deed or constitution; and

(b) can the trustee and beneficiary agree that the trustee will have no right of indemnity?

6.4 The right of indemnity in the absence of contractual agreement

The general principal is that a trustee will have a right to be indemnified out of trust assets for liabilities incurred as trustee unless those liabilities arise out of the 'personal fault' of the trustee. Note that there will also often be a right to be indemnified by the beneficiaries personally, although this is a more restricted right.

The exclusion for 'personal fault' includes, for example, liabilities incurred due to the negligence of the trustee. The requirement that the fault be personal provides protection to a trustee if it is liable for the negligence of an agent (as in that case the fault is not 'personal').

The application of this principle to a corporation was considered in Nick Kritharas Holdings Pty Limited (in liquidation) v Gatsios Holdings Pty Limited (unreported, 3 May 2001). The difficulty he considered was how to apply a notion of personal 'fault' to an inanimate object such as a company. He essentially applied the 'directing mind and will' test, which is sometimes used when considering the application of the criminal law to a company.

An example of which would be that the vicarious liability of a corporate trustee, for instance, for the negligent driving of a motor car in the course of trust business would still attract indemnity. However, deliberate dishonest conduct by the managing director on behalf of a corporation might deprive a corporate trustee of indemnity.

There is still room for the law to develop on this point.

6.5 Can a trustee waive its right of indemnity?

A creditor of a trust or scheme is subrogated to the trustee/responsible entity's right of indemnity. Any action to recover a debt from assets held on trust will therefore be brought in the name of the trustee/responsible entity. The beneficiaries of the Scheme can raise, by way of defence to such an action, any right they might have against the responsible entity. For example, the Scheme Member would not be liable if they could show that the responsible entity was acting outside its powers. A beneficiary would also be entitled to set off any claim it might have against the trustee.

However, what is the position if the scheme's constitution expressly excludes any right of indemnity? The beneficiaries would argue that this would be effective to frustrate the right of a creditor to recover a debt from assets held on trust as those rights depend exclusively on the rights of the trustee. This view was supported by Brooking J in RWG Management Limited v Commissioner for Corporate Affairs [1985] VR 385 at 395.

The contrary view is that the right of indemnity is fundamental to the position of a trustee and cannot be excluded by agreement between the trustee and beneficiary. There are also public policy reasons for holding that the right of indemnity cannot be excluded, due to the potential prejudice to creditors. This view was favoured by McPherson J in Kemtron Industries Pty Ltd v Benett v Wyndam (1862) 4 DF & J 259.
Limited v CSD (Qld) 1 Qd R 576 at 584. Recently, Santow J also endorsed this approach in JA Pty Limited v Jonco Holdings Pty Limited (unreported, 10 March 2000).

In summary, the law is still unsettled as to whether a trustee or responsible entity can agree to waive its right of indemnity. A cautious creditor, when dealing with a scheme, would want to ensure that:

- the responsible entity has and will always have a right of indemnity from the scheme assets, preferably phrased as broadly as possible;
- the responsible entity is complying and will at all times comply with its obligations under the constitution; and
- the responsible entity’s obligations to the scheme members will never exceed a certain value (as otherwise the scheme member may have a right of set off those obligations against the obligation to indemnify the trustee).

It should be borne in mind that s197 of the CA imposes a liability on directors for any liabilities incurred while a company is acting as a trustee which the company cannot meet or which the trustee is not entitled be indemnified out of the trust assets.

6.6 The trustee’s right of indemnity from beneficiaries personally

In addition to a right to be indemnified out of assets held on trust, a trustee will also often have a right to be indemnified by the beneficiaries personally. The extent of this right is not considered in detail in this paper. It may depend for example on both the nature of the trust (eg whether it is a discretionary trust) and the number of beneficiaries.

It is common practice for $2 companies to be the beneficiaries of a trust in an attempt to negate the effect of any right of indemnity against the beneficiaries personally.

An alternative method is to use a discretionary trust, as there is normally no right of indemnity from the beneficiaries personally with such a trust. In McLean v Burns Philp Trustee Co Pty Limited [1985] 2 NSWLR 623 Young J suggested that equity would not permit beneficiaries to defraud creditors in this manner, although he did not state how equity would do so. He also noted, however, that equity would not interfere where, as in that case, there were proper commercial reasons for limiting the liability of beneficiaries.

6.7 The rights of liquidators

A series of authorities have considered the particular right of liquidators to recover their costs from trust assets. These authorities have developed a distinction between work performed by the liquidator in administering the trust and general liquidation work.

A liquidator has a right of indemnity for costs and expenses incurred in administering the trust. This work includes identifying or trying to identify trust assets and those entitled to them, recovering or attempting to recover trust assets, realising or attempting to realise trust

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11 Bastion v Gideon Investments (Austin J, 6 October 2000).
assets, protecting or tempting to protect trust assets and distributing trust assets to those beneficially entitled to them.\(^\text{12}\)

Whether or not the remainder of a liquidator’s costs and expenses can be recovered from trust assets depends on the extent to which a company’s activities were engaged in as a trustee. The liquidator will be entitled to recover all of its costs where all of the company’s assets are trust assets and all of its liabilities are trust liabilities.\(^\text{13}\) This will typically be the case with a standard trading trust. One reason for this rule is that the liquidation is probably necessary for the proper administration of the trust.

Where the company carried on a mixture of trust and non-trust activities, then some form of apportionment will probably be required.\(^\text{14}\) However, Meagher & Gummow have suggested that the costs and expenses of a liquidation should in no circumstances be recoverable from trust assets.\(^\text{15}\) They point out that: ‘after all, an individual trustee’s funeral expenses cannot be paid out of trust assets’. A possible response to this comment is that the liquidation or bankruptcy of a trustee, unlike the death of a trustee, will frequently be a consequence of the activities conducted on behalf of a trust.

### 6.8 Resigning as responsible entity

Where a liquidator is appointed to a responsible entity who is insolvent but the scheme itself remains viable the external administrator will need to consider very quickly whether it has the means to continue to operate the Scheme and most often the answer will be the administrator will not wish to continue to operate the Scheme.

However, responsible entities are not permitted to simply resign. Section 601FL of the CA provides that a responsible entity that wants to retire must call a meeting of the members to explain its reasons and allow the members to choose a new responsible entity.

If the members do not choose a new responsible entity or the chosen responsible entity does not accept the appointment the responsible entity can apply for the appointment of a temporary responsible entity.

It then becomes the temporary responsible entity’s responsibility to arrange the appointment of a new responsible entity (s601FQ).

If the responsible entity no longer meets the requirements of s601FA in that it is deregistered, changes type, ceases to be a public company or loses its operating license, a member of the scheme or ASIC may apply to the Court for appointment of a temporary responsible entity.

Alternatively, ASIC may deregister the scheme and apply for its winding up under s601ND or a member may approach the Court for winding up of the scheme on just an equitable grounds.

On the change over of a responsible entity the rights, obligations and liabilities of the former

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\(^{12}\) **Thirteen Coromandel Place v CL Custodians Pty Limited (In Liquidation)** (Finkelstein J, 1 March 1999); Bastion, Supra.

\(^{13}\) Bastion, Supra

\(^{14}\) **13 Coromandel Place, Supra.**

responsible entity are deemed to become the rights, obligations and liabilities of the new responsible entity.

7. Conclusion

The current law, although unsettled in some areas, is probably as follows.

(a) If a trustee has a right to be reimbursed for debts that it has paid on behalf of the trust, the benefit of that right of reimbursement is a benefit of both trust creditors and general creditors.

(b) If a right of exoneration is available to use trust assets to meet trust liabilities, then this right of exoneration is a benefit only available to the trust creditors.

(c) The costs and expenses of a liquidator which do not relate to normal trustee activities will probably only be recoverable so far as those costs are attributable to the administration of trust property.

(d) It is not clear whether trust creditors are entitled to share in a distribution of general assets if and in so far as the general creditors receive a lower return than that of trust creditors.

(e) The interests of scheme members in assets held on trust will only be affected in so far as an insolvent responsible entity has a right to be indemnified out of those assets.

(f) A right of exoneration of trust assets represents property of a trustee which is available for the benefit of trust creditors only.

(g) A right of reimbursement from trust assets represents property of a trustee which is available for the benefit of creditors generally.

(h) Trust creditors are only entitled to recover their debts from general assets to the extent necessary to ensure that general creditors do not receive a better return than trust creditors.

(i) Trust creditors probably rank equally in any distribution of trust assets.

These last 2 points in particular are quite contentious. There is also still room for argument as to (b), although the balance of authority favours the proposition stated.

The difficulties in this area are unlikely to be resolved until a court specifically examines both the nature of a trustee’s right of indemnity and the nature of a trust creditor’s right of subrogation to that right of indemnity.