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SIX DIFFERENCES BETWEEN TRUSTEES AND COMPANY DIRECTORS

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[254] In litigation which settled on the second day of the trial late last year, three brothers were the only directors and shareholders of a private company, as well as being trustees of a discretionary trust. The trust deed was conventional, identifying the discretionary objects as the three brothers, members of their extended families, and companies of which they were members. The company actively traded, while the assets of the trust were two investment properties. Funds from the company's business were used to defray expenses of the investment properties. The same accountant prepared financial statements for the company and the trust, in ways which made the two seem indistinguishable. The company had a bank account, and a separate account was operated in the name of the trust. I suspect that similar structures are not uncommon throughout Australia.

When the brothers fell out, it appeared that no one had a clear idea of the complex legal relations which had been brought into existence. In particular, there was a poor appreciation of the distinctions between the roles of director and trustee, and the differences when the men disagreed. To be fair, the accounting and taxation treatment of trusts tends to encourage imprecise thinking in this area.

This note summarises six differences between trustees and company directors.

(1) No separate legal personality

First and foremost, the company has a distinct legal personality, while there is no separate legal person which is the "trust".[1] Assets are not owned by "the trust" nor is money lent to "the trust". Instead, the trustees own property and incur obligations in their capacity as trustees. References to "trust creditors" and "trust assets" must be understood as references to creditors of the trustee and assets owned by the trustee on trust. Thus, when the same men (very informally) agreed to lend company funds to "the trust", in fact the directors were causing the company to lend money owned by it to themselves in their capacity as trustees. When the company's funds were used to pay local council rates levied on the investment properties, this was accurately treated in the accounts as the incurring on indebtedness by the trustees to the company.

1 See most recently *Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth* [2019] HCA 20; 93 ALJR 807 at [24] (Kiefel CJ, Keane and Edelman JJ) and [129] (Gordon J).

(2) Different rights of creditors

Secondly, a company creditor can sue the company, obtain judgment against it, levy execution against its assets, and ultimately apply to wind it up. A creditor of a trustee "has a personal right to sue him and to get judgment and make him a bankrupt."[2] Thus, the trustees' creditor may sue them personally, and if necessary execute against their (personal) assets or make them bankrupt. Exceptionally, the trustees may have only contracted on the basis that recourse is limited to trust assets. This will turn on the particular contract, but it is commonly said that clear words are needed to achieve this.[3] In addition to the above, a creditor of the trustees may be subrogated to the trustees' right of indemnity against trust assets,[4] thereby permitting execution against, say, the bank account in the name of the trust. The nature of the trustees' right of indemnity was considered by two High Court decisions in the last year.[5]

[255] *(3) Different obligations owed*

Thirdly, the directors owe fiduciary obligations to the company. It being small and closely held, they may, contrary to the usual rule,[6] also owe obligations directly to the shareholders.[7] Members may also enforce rights under statute, including various rights under Chapter 2F of the *Corporations Act* and under the deemed contract created by the Constitution read with s 140 of the *Corporations Act*. The key difference is that there are three legal persons who are "internal" to the corporate relationship: directors, members and company, while there are only two in the trust relationship: trustee and beneficiary. Thus the beneficiaries may readily sue the trustees for breach of trust.

In relation to claims against third parties, normally the company or the trustee will be the plaintiff. In some circumstances, members may bring derivative actions in the name of the company, while a beneficiary may only bring claims against a third party in the beneficiary's own name in special circumstances. Such claims by members are regulated by statute;[8] those by beneficiaries are regulated at general law.[9]

(4) Access to information

Fourthly, members have rights to company documents in accordance with s 247A of the *Corporations Act*. The obligations of trustees to provide documents is regulated at general law, and is not free from controversy.[10]

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2 *In re Johnson; Shearman v Robinson* (1880) 15 Ch D 548 at 552 and see *Farstad Supply AS v Enviroco Ltd* [2011] UKSC 16; [2011] 1 WLR 921 at [69].

3 *Helvetic Investment Corporation Pty Ltd v Knight* (1984) 9 ACLR 773 at 773; *Elders Trustee and Executor Co Ltd v E G Reeves Pty Ltd* (1987) 78 ALR 193 at 253; *ALYK (HK) Ltd v Caprock Commodities Trading Pty Ltd and China Construction Bank Corporation* [2016] NSWSC 764 at [13].

4 *In re Raybould; Raybould v Turner* [1900] 1 Ch 199; *Vacuum Oil Company Pty Ltd v Wiltshire* (1945) 72 CLR 319 at 328 and 335-336.

5 *Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth* [2019] HCA 20; 93 ALJR 807 and *Franz Boesch as trustee of the Boensch Trust v Pascoe* [2019] HCA 49.

6 *Percival v Wright* [1902] 2 Ch 421.

7 *Brunninghausen v Glavanics* (1999) 46 NSWLR 538; [1999] NSWCA 199, which was recently considered in *O'Connor v O'Connor* [2018] NSWCA 214 at [42]-[54] and [71]-[91].

8 *Corporations Act 2001* (Cth), s 236.

9 See *Ramage v Waclaw* (1988) 12 NSWLR 84 at 91-93; *Alexander v Perpetual Trustees WA Ltd* (2004) 216 CLR 109; [2004] HCA 7 at [55]-[56]; *Colin R Price & Associates Pty Ltd v Four Oaks Pty Ltd* (2017) 251 FCR 404; [2017] FCAFC 75 at [102]; *Harker-Mortlock v Commonwealth Bank of Australia* [2019] NSWCA 56 at [5]. For the way in which the court's discretion regulating beneficiaries' claim is exercised, see *Treadtel International Pty Ltd v Cocco* [2016] NSWCA 360; 117 ACSR 116 at [73]ff (Barrett AJA).

10 Following *Schmidt v Rosewood Trust Ltd* [2003] 2 AC 709; [2003] UKPC 26 – see *Gray v BNY Trust Company of Australia Ltd (formerly Guardian Trust Australia Ltd)* (2009) 76 NSWLR 586; [2009] NSWSC 789 at [33] and G Dal Pont, "I Want Information! Beneficiaries' Basic Right or Court Controlled Discretion?" (2013) 32(1) *University*

(5) Removal

Fifthly, members may be able to remove the directors by ordinary resolution pursuant to s 203C.[11] Trust deeds commonly confer power upon an "appointor" to remove the trustee. Otherwise, application may be made to the Court to remove a trustee, but the Court's jurisdiction is quite limited.[12]

(6) Differences when the trustees do not agree

Sixthly, there are vital differences between directors and trustees when there is disagreement. A majority of the directors may (subject to the Constitution) bind the company by resolution passed at a directors' meeting. Ordinary resolutions binding the company may be passed by a majority of members at a members' meeting. The position is quite different in the case of a private trust with more than one trustee.

The basic rule – subject always to the trust deed – is that the decisions of the trustees of a private trust must be unanimous. The rule seems to be absent from Australian trust legislation, although it is now found in s 38 of the *Trusts Act 2019* (NZ).[13] Two commonly cited decisions from half a century ago are those of (Laurence) Street J and (Samuel) Jacobs J. Street J said:[14]

> "Inherent in this basic system of trusts is the principle that trustees must act unanimously. They do not hold several offices – they hold a single, joint, inseparable office. If conflicting business considerations lead to such a divergence that the trustees are not able to act unanimously, then the simple position is that they cannot act."

[256] Jacobs J said:[15]

> In the case of co-trustees of a private trust, the office is a joint one. Where the administration of the trust is vested in co-trustees, they all form, as it were, but one collective trustee and therefore must execute the duties of the office in their joint capacity.

Thus a majority of trustees of a private trust cannot (subject to the trust deed and to statute) bind the minority. "There is no law that I am acquainted with which enables the majority of trustees to bind minority."[16] One point of having more than one trustee is to require the joint exercise of trust powers, such as powers of investment and sale. If the trustees own shares, the voting rights must be exercised with the consent of all.[17] Where two or more trustees succeed to a share of a partnership, they will count as but one partner.[18] In contrast with the default position in private trusts, the trustees of a charitable trust may act by majority.[19]

What when the trustees disagree? There is some authority for the proposition that an act done by

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of Tasmania Law Review 52.

11 This is a replaceable rule.

12 The principles and authorities are collected in *Fay v Moramba* [2009] NSWSC 1428 (Brereton J).

13 The rule may be displaced by provision in the trust deed: see s 5(4) and Schedule 2.

14 *Sky v Body* (1970) 92 WN (NSW) 934 at 935-6.

15 *In the Estate of William Just deceased (No1)* (1973) 7 SASR 508 at 513. Further authorities are collected in *Dulhunty v Dulhunty* [2010] NSWSC 1465 at [31]-[37] (Slattery J).

16 *Luke v South Kensington Hotel Company* (1879) 11 Ch D 121 at 125 (Jessel MR).

17 See *Tisdale v Ballanday Pty Ltd* [2006] NSWSC 909 at [28] (Palmer J); *Sky v Body* was such a case.

18 *Malcolm Walter Atwell and Ian George Atwell as trustees of the Estate of Walter Charles Atwell v Roberts [No 3]* [2009] WASC 96 at [132] (E M Heenan J).

19 See *Re Whiteley; Bishop of London v Whiteley* [1910] 1 Ch 600; *Melsom v Velcrete Pty Ltd* (1995) 20 ACSR 291 at

one trustee, with the sanction and approval of the others, is regarded as the act of all.[20] But where one of two trustees of a deceased estate retained solicitors in Family Court proceedings, and the other appeared separately, the trustees were not regarded as having entered into the retainer, with the result that there was no entitlement to reimbursement from the estate for that and certain other costs.[21] However, the other trustee did concur in relation to some aspects (including an application to remove caveats) and to that extent reimbursement was authorised. Kaye J concluded his judgment thus:

> While the above conclusions may, in one sense, be somewhat harsh, nevertheless they are a reflection of the application of the long standing principle that all trustees must concur in the exercise of powers conferred on them relating to a trust estate. The rationale for that principle is that, in appointing more than one executor or trustee, the testator or settlor intended to protect the trust property, by ensuring that any decisions in relation to it be made by each of the trustees so appointed. Where there is disagreement between the trustees or executors, those differences are not to be resolved by them acting independently of each other, but rather by one or all of them making an application to this Court, under r 54.02 of the Rules of the Supreme Court, for appropriate directions and orders. In this case, given the ongoing level of disputation between the parties, it would have been appropriate for either of them to have approached the Court pursuant to that rule for the resolution of the issues which were at large between them.

Such problems are not new. A similar claim by a firm of solicitors who dealt with one trustee and said that the other had authorised the firm to look only to him was rejected by Sir James Bacon VC a century and a half ago.[22]

A trustee who will going to be unable to perform his or her duties as trustee because of absence or some other reason, may exercise statutory powers to appoint a delegate.[23] Otherwise, an absent trustee, or one [257] who refused to act, or who disagrees, can prevent the exercise of powers by the trustees. As Kaye J said, a solution in such cases is an application to the Court.

If those creating such structures wish to avoid the difficulties presented by the general law requirement that trustees' exercises of power be unanimous, they may either make provision in the trust deed, or alternatively appoint a company as the trustee. It also follows that there are important legal and practical differences when a family company is appointed trustee of a family trust, as opposed to members of the family being made trustees of the same trust.

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302 (Malcolm CJ), and *ACLBDD Holdings Ltd v Staechelin* [2018] EWHC 44 (Ch) at [147]. Query whether a resolution by the trustees of a charitable trust requiring unanimity is effective to achieve that end: see *Bray v Federal Commissioner of Taxation* (1977) 17 ALR 328 at 345 (Bowen CJ).

20 *Meseena v Carr* (1870) LR 9 Eq 260; *Edwards v Proprius Holdings Ltd* [2009] NZHC 689 at [15]-[16] (Winkelman J, as she then was). A narrower approach is found in some United Kingdom authorities, dealing with submissions based on estoppel: see *Preedy v Dunne* [2015] EWHC 2713 and *Fielden v Christie-Miller* [2015] EWHC 87 (Ch).

21 *Beath v Kousal* [2010] VSC 24 at [26]-[45].

22 *Lee v Sankey* (1873) 15 Eq 204.

23 *Trustee Act 1925* (NSW), s 64; *Trusts Act 1973* (Q), s 56; *Trustee Act 1936* (SA), s 17; *Trustee Act 1898* (Tas), s 25A; *Trustee Act 1958* (Vic), s 30; *Trustees Act 1962* (WA), s 54.