

Bar Speak

with Andrew Lyons

directors of corporate trustees at risk

potential avenue for claims against the directors of corporate trustees has been highlighted recently by the South Australian Full

De Belle J v O'Neill, a corporate trustee distributed a profit in excess of \$500,000 to the trust beneficiary and thereby left itself with no trust assets. It then defaulted upon its obligation to pay rental under a commercial lease. The landlord obtained default judgement against the trustee for damages arising out of the breach of the lease and then claimed against the sole director of the corporate trustee relying upon s. 197 of the Corporations Act. That section provides that,

(1) 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.

It 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. (italics added)

The director's liability turned upon whether s. 197(1)(b) was satisfied. The trust deed contained the standard term stipulating that the trustee was entitled to be indemnified out of the trust assets.

On the narrow view, this right to indemnity was sufficient to prevent s. 197(1)(b) being satisfied and the director being held liable.

On the wider view, there would only be an entitlement to indemnity if the trustee had both the right to indemnity and there were sufficient trust assets to satisfy that right.

By a 3-1 majority, the Full Court adopted the wider view. Mullighan J held there could be no entitlement to be indemnified if there were no trust assets comprising the trust fund. Gray J noticed that the predecessor of the Full Court expressly endorsed the narrow view and said that the

introduction of a redrawn provision on the same area suggested a change from the narrow view. In his opinion, the sentence italicized above supported the argument that there could be no entitlement if there were insufficient trust assets.

On the wider view, when applied to the facts, the trustee was "not entitled to be fully indemnified against the liability out of trust assets" as there were no trust assets from which the indemnity could be satisfied. Thus the director was exposed to liability under s. 197.

De Belle J dissented. He said that a change in statutory wording did not require a conclusion that Parliament intended to alter the law. In his view, the italicized sentence means that a director who is not liable under the preceding words of s. 197(1) (because the trustee has a right to indemnity) will remain non-labile, even if the trust has insufficient assets to make that indemnity worthwhile.

While academic comment has discussed the uncertain meaning of s. 197, this appears to be the first decision upon the point. These judicial views are obiter as the ultimate decision turned upon another issue. Given the widespread use of corporate trustees, the issue is certain to be tested again.

It is not immediately apparent that the majority's adoption of the wider view will be followed. The introduction of a personal liability that undermines the corporate veil and upsets the basis upon which many structures and transactions have been founded might be thought to require a clearer expression of statutory intent. The Explanatory Memorandum to the amending Act does not disclose intent to make this change. The reasons of the dissenting Judge are cogent.

Nevertheless, until the matter is resolved, directors of trustee companies concerned about potential personal liability could consider defensive moves. For example, a trustee could try to sidestep the provision by incorporating a wholly owned, non-trustee, subsidiary to be the operating entity rather than have the trustee undertake that role. Use of a single director company as trustee will protect the director's spouse.

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