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Contents

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Hold on tight, it's going to get bumpy — improving the regulation of insolvency practitioners

Martin Hirst GADENS LAWYERS

The Corporations Amendment (Insolvency) Bill 2007 (Cth) proposes wide-ranging reforms to the *Corporations Act 2001* (Cth).

Although some of the reforms seek to address aspects of the regulation of insolvency practitioners, there has been much afoot in other arenas.

The need for reform in the regulation of insolvency practitioners has also been noted by the judiciary. At the Insolvency Practitioners Association of Australia (IPAA) National Conference 2006, which was held in Brisbane in October 2006, his Honour Justice R P Austin delivered a paper that dealt, in part, with the regulation of insolvency practitioners and emphasised the benefits of self-regulation as opposed to statutory regulation.[1]

At the time of the conference, although there was no public exposure draft of a Bill, his Honour expressed the view that:

> Consumers of the services of insolvency practitioners, and the community generally, are entitled to demand a system of regulation in which insolvency practitioners are held to standards of loyalty, avoidance of conflicts, independence and impartiality that are:
> - fair;
> - effective to preserve the system of voluntary administration which depends on compliance with proper standards;
> - realistic and practical, and therefore achievable on a day-to-day basis without undue compliance costs;
> - comprehensible, so that practitioners can ascertain what is required of them in any given situation, or at least understand the reasoning process that will be applied to assess their compliance.
>
> Self-regulation is usually better than public regulation in performing the task of designing compliance strategies that are realistic, practical, cost-effective and comprehensible … Self-regulation has advantages … because self-regulators tend to understand their industry or profession, and the modus operandi of the players, better than public regulators. But self-regulation is sometimes less reliable when it comes to the fairness and efficiency of regulatory outcomes. Self-regulation tends to be treated as sufficient by governments and public regulators only when it is perceived to be pro-active and energetic and there are no unsatisfactory outcomes.
>
> …
>
> … but self-regulation will not be preferred unless the professional body's alternative to legislation is manifestly credible.

So, what are the proposals in the Bill that impact on the regulation of insolvency practitioners?

There is only a small number and, in some respects, a couple have become unnecessary as a result of the developments in the law since the Parliamentary Secretary to the Treasurer (Chris Pearce) announced on 12 October 2005 that the government would be proceeding with an integrated package of reforms to improve the operation of Australia's insolvency laws.

The main areas of practice that the Bill seeks to regulate are:

- education and experience;
- independence;
- inducements for appointment;
- insurance;
- annual statements;
- cancellation of registration, transfer of books and records, discipline; and
- remuneration.

Some of the changes are major and others minor (or incidental to others).

Education and experience

The Bill requires practitioners to have and maintain educational and experiential qualifications to work in the industry.

In addition to the Bill, both the Australian Securities and Investments Commission (ASIC) and the IPAA have been active in the area of regulation.

That activity has resulted in:

- ASIC's Policy Statement (PS) 186 in relation to its approach to the registration of liquidators and official liquidators. It is clear that ASIC will require liquidators to prove that they have the requisite expertise and have maintained that expertise and experience to become registered as, and remain registered as, a liquidator. PS 186 addresses ASIC's:
  - approach to the criteria liquidators must meet to become a registered liquidator;
  - approach to what liquidators must do to remain registered as a liquidator; and
  - requirements to register liquidators under the categories of 'official liquidator' or 'liquidator of a specified body corporate';[2] and
- a commitment from the IPAA to:
  - set standards through revised guides and codes;
  - deliver education;
  - discipline members;[3] and
  - work closely with the government.

Independence

The proposal in relation to independence includes the requirement for the provision of a formal certificate of independence prior to the first meeting in a voluntary administration.

Part of the proposal is that the certificate of independence should be limited to two pages.

Some of the sillier responses to this proposal are:

- What happens when I get to the end of the second page? Do I stop?
- What sized font should I use? If it is small/big I can fit a lot more/less in?

The IPAA provides sensible and reasonable comments in relation to this aspect,[4] and questions the practicality of the proposal. On one reading it seeks information about future relationships, on another aspect it takes the view that minor or trivial relationships need not be disclosed.

In addition, as currently framed, all relationships would need to be disclosed. There should be a time limit on the relationship. The IPAA recommends that the disclosure should be limited to the preceding two years.

Prohibition of inducements

The Bill proposes a prohibition of inducements to directors and others for the referral of work.

This is central to the conduct of an ethical practice. The acceptance of inducements undermines the impartiality and independence of an appointment. If it does not actually have that effect, it creates the impression of partiality.

This practice is already frowned upon by the IPAA. The Statement of Insolvency Standards, APS 7, provides in part that:

> … each professional assignment undertaken, a member … shall both be, and be seen to be, free of any interest which is incompatible with objectivity and independence.

Insurance

The Bill will require liquidators to maintain adequate:

- professional indemnity insurance; and
- 'fidelity' insurance and security bonds, much like other professionals.

Annual statements

This is to some extent related to the issues of education, experience, discipline and insurance.

The current requirement for statements every three years will be replaced by a requirement for annual statements addressing the issues of education, experience, discipline and insurance; and additional issues such as courses and education, and the nature of the work undertaken.

This has, to some extent, been taken up by ASIC's PS 186.

Discipline

This is probably the most contentious area of regulation.

ASIC will be given extended powers and will (in limited circumstances) be able to cancel the registration of a practitioner if they are made bankrupt, are disqualified or die.

The files will be able to be transferred to another practitioner. This addresses the highly unsatisfactory situation that currently exists where it is necessary to make application to the court (to replace a court appointee).

As stated in the announcement of October 2005 by Treasury:[5]

> This proposal deals with a gap in the current regime, protecting creditors and other stakeholders with an interest in an external administration conducted by a person whose registration is cancelled or suspended.

In addition, the Companies Auditors and Liquidators Disciplinary Board (CALDB) procedures will be supplemented to enable it to:

- conduct a pre-hearing conference involving only the chairman, to determine a timetable for the matter;
- admonish or reprimand a person for failing to comply with orders made during the pre-hearing period;
- publish reasons for its decisions; and
- postpone the operation of its orders to protect the interests of creditors by allowing the orderly transfer or completion of assignments.

Very few insolvency practitioners who have been before the CALDB have enjoyed the experience.[6]

Complaints in relation to the CALDB include the nature of its composition. Although the insolvency profession is represented on the CALDB, the majority of expertise is in other areas.

A body that is more representative would be preferable, although this would, no doubt, carry with it its own problems leading to complaints that an industry body:

- cannot regulate itself; and
- is not independent of (or seen to be independent of) its members.

The IPAA is a body with credibility and a broad representation of members. It does not have the resources (both in staffing and infrastructure) to adequately carry out this task at present. As a result, it has (unfortunately) found it necessary to cede much of its (future) power to regulate to ASIC.

Remuneration

The Bill seeks to deal with the remuneration of insolvency

practitioners and to make provision for the matters that are to be considered by courts.

The reforms contain the following elements (among others):

- provision of greater detail regarding the basis for remuneration being provided to creditors;
- ASIC's ability to ask the court to review a voluntary administrator's remuneration; and
- various changes to the mechanics for fixing remuneration.

To a great extent, this reform has been overtaken by the profession and the courts devising a satisfactory resolution to the issue of fixing practitioner remuneration.

Most of the elements of the resolution between the profession and the courts were devised after the announcement of the reforms.

That resolution accepted by the courts involves insolvency practitioners presenting information setting out:

- the date the work was done;
- brief particulars of the work done;
- the number of hours expended;
- the relevant grade or classification of the person performing the work; and
- the hourly rate of the person.[7]

Hourly rate

A practitioner's remuneration was traditionally assessed on a time basis, with practitioners relying on the IPAA's *Guide to Hourly Rates Scale and Staff Classifications* (Scale of Fees) to determine the rates to be charged by each member of their staff and themselves.

On 31 March 2000, the IPAA announced that it would cease production of the Scale of Fees. Even though the Scale of Fees has not been updated for some time, many practitioners continue to use the last published scale (often indexed to CPI) as a basis for the calculation of their fees.

For many years, judges have said how difficult it is to fix the remuneration of a practitioner and how the courts were ill-equipped to conduct the detailed examinations required.

The Scale of Fees provided an established benchmark against which creditors and the courts could assess what was reasonable.

In *Re Queensland Forest Ltd (in liq)*[8] the court accepted the Scale of Fees as an appropriate method for determining remuneration holding that:

> … the rates of professional organisations should generally be applied because reputable professional bodies are likely to fix a scale of charges that was reasonable.

Despite this, the Scale of Fees was often criticised for preventing competition and discouraging practitioners from exploring more flexible methods of calculating remuneration. Subsequent decisions have criticised the courts' earlier approach[9] and suggested that:

> … the courts, which took this approach, appeared to overlook completely the anticompetitive effect of adopting a scale. In effect the adoption of a scale undermined effective price competition. The structure of the scale, being as it is a tabulation of hourly rates based upon average costs, increasing the likelihood that it would attain a strong influence in the negotiation process and discourages price competition in the market.

Paradoxically, practitioners are required to annex their hourly scale of fees to consents to act as court appointed liquidators.

ASIC and remuneration

In April 2005, ASIC wrote to insolvency practitioners notifying them that it was ASIC's view that the only way administrators under a deed of company arrangement (DOCA) could fix their fees was by resolution of creditors at the second meeting of creditors,[10] a meeting convened to consider a variation or termination of the deed,[11] or by the court.[12]

ASIC expressed the view that the committee of creditors did not have the power to fix an administrator's fees or those of an administrator of a DOCA, and any resolution of creditors purporting to invest the committee with such power was void.

In August 2005, ASIC published an *Approach to Insolvency Practitioner Remuneration*. In attempting to overcome practical difficulties, ASIC suggested that external administrators had the option to:

- ask a committee, creditors or the court to 'fix' or 'determine' remuneration in a precise amount or according to a formula where all of the elements can be objectively determined;
- wait until the end of the external administration before fees are fixed or seek to have fees fixed at intervals;
- seek approval from a committee, creditors or the court to draw remuneration on an interim basis at intervals specified in the agreement,

> Remuneration may be fixed prospectively by reference to a sufficiently 'objective' formula based on time.

resolution or order, up to an agreed maximum amount; or
- at a later stage, ask the committee, creditors or the court to 'fix' or 'determine' the amount of remuneration in a precise amount.

If the amount fixed initially or adjusted by review of the court was less than the amount of the interim remuneration approved and drawn, the proper course would be for the practitioner to repay the excess amount.

ASIC further considered that prospective fee approval should only be sought in cases where a precise amount for the fee could be determined (for example, by a percentage of gross realisations).

If practitioners wanted to calculate a fee according to time spent on the work, this could be fixed retrospectively in a precise amount and any prospective element could be fixed on an agreed basis (that is, a fixed fee). In the latter case, committee members, creditors and the court should be fully informed of how that amount was calculated.

Approach of the profession

The profession addressed the difficulties raised in two ways — by:

- seeking orders of the court; and
- commencing a test case through an initiative of the IPAA.

Orders of the court were sought in several matters with slightly different approaches, including the following:

- *Re Motor Group Australia Pty Ltd (administrators appointed) (No 3);*[13]
- *Re CarLovers Carwash Ltd & Ors*;[14] and
- *McGrath; Re HWE Civil Pty Ltd (subject to deed of company arrangement) (ACN 106 551 302)*.[15]

In those matters, the administrators used s 447A to:

- hold the second meeting of creditors at which the creditors invested the committee of creditors with the power to fix the remuneration of the deed administrators subject to approval of the court (which approval was obtained);
- apply to the court for orders at the same time as an application for extension of the convening period;
- subsequently apply to the court to validate the power granted to the committee of creditors pursuant to the deed to fix the remuneration; or
- apply to the court.

Those methods have been effective in ensuring that the administrator's fees were properly fixed but require an application to the court to provide such relief.

The alternative is for administrators to convene meetings of creditors each time an administrator wants to draw remuneration. This is not an appropriate use of the assets of a company in the process of rehabilitation.

IPAA's test case

On 16 February 2006, the Federal Court of Australia handed down its judgment on Aliance Motor Body Pty Ltd[16] on the test case instituted by the IPAA (and in which ASIC participated) which addressed what were then controversial issues in relation to the fixing of remuneration of an administrator under a DOCA.

At the second meeting of creditors of Aliance Motor Body Pty Ltd, the creditors voted in favour of a DOCA. In addition, resolutions were passed purporting to fix the remuneration of the administrators according to an hourly rate and subject to a limit of $30,000.

The deed administrator sought a direction that he was justified in acting as administrator of the DOCA on the basis that his remuneration was properly fixed by the resolution of the creditors of the company.

The critical question to be determined in this case was whether the remuneration of an administrator under a DOCA could be fixed prospectively by a resolution at the second meeting of creditors where the remuneration was expressed:

- by reference to a scale of hourly rates to be applied to the time to be spent on the administration; and
- subject to a monetary limit or cap.

The Federal Court held that the remuneration of an administrator under a DOCA can be fixed prospectively by a resolution at the second meeting of creditors as long as:

- the person doing the work;
- that person's category; and
- the period spent doing the work;
- have been provided to the creditors, and the amount of the remuneration can be calculated definitely.

Remuneration may be fixed prospectively by reference to a sufficiently 'objective' formula based on time.

Whether a formula is objective must be assessed in light of established High Court authorities.

There are certain safeguards in place which counter the potential for abuse by the administrator in relation to charging time, including the following:

- remuneration can only be fixed by a resolution of creditors or by the court, not by the administrator; and
- an officer, member of creditor of the company may apply to the court for a full review of the remuneration.

The provision of a cap was not considered relevant by the judge in determining whether the remuneration was fixed.

Despite this, a monetary cap may be taken into account when determining whether remuneration is 'reasonable' in response to a challenge by an officer, member or creditor of the company to which remuneration is fixed.

In the light of the recent decisions in relation to fixing of fees, the benefit of further regulation seems unnecessary.

Conclusion

Although the passage of the Bill remains in doubt with an election later in the year, the majority of the changes envisaged by the Bill are welcomed by the profession (with a fair amount of 'fine tuning' required). ●

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Endnotes

1. 'The Legal Standard of Loyalty and Professional Guidelines', a paper by Justice R P Austin, Supreme Court of NSW <www.lawlink.nsw.gov.au/lawlink/Supreme_Court/ll_sc.nsf/pages/SCO_austin121006>.
2. Policy Statement 186 <www.asic.gov.au>.
3. From the IPAA website under links: The Profession, Regulating the Profession, Regulating our Members <www.ipaa.com.au>.
4. IPAA submission, 22 February 2007.
5. See <www.treasury.gov.au/documents/1022/RTF/Corporate_Insolvancy_Reform_attachment.rtf> at para 57.
6. None of those to whom I have spoken.
7. See *Mohamed v Hurstville Tower Medical Clinic Pty Ltd (in liq)* [2006] NSWSC 4; BC200600158.
8. [1966] Qd R 180.
9. *Korda; Re Stockford Limited (subject to a deed of company arrangement)* [2004] FCA 1682; BC200408930.
10. Section 439A.
11. Section 445F.
12. Section 447D.
13. (2005) 55 ACSR 34 (*Marsden's* case).
14. (2005) 54 ACSR 696.
15. [2005] FCA 1883; BC200511097.
16. *Gidley; Re Aliance Motor Body Pty Ltd (subject to deed of company arrangement) (ACN 109 860 899)* (2006) 150 FCR 345.

Deterring corporate misconduct in the Corporations Amendment (Insolvency) Bill 2007

Carolin Scalzi MINTER ELLISON

The exposure draft of the Corporations Amendment (Insolvency) Bill 2007 (draft Bill) includes a number of provisions to deter corporate misconduct. The provisions expand upon existing provisions in the *Australian Securities and Investments Commission Act* (ASIC Act) and the *Corporations Act 2001* (Cth) to further enhance the court's and ASIC's powers in deterring corporate misconduct, including provisions to:

- broaden powers to investigate liquidators' conduct generally;
- enable recovery for breach of condition or alteration of schemes of compromise or arrangement;
- empower ASIC to apply for court orders preventing company officers and others from avoiding liability;
- outline the procedure for the execution of warrants;
- remove the penalty privilege in relation to banning and disqualifications; and
- impose a six month time limit for the lodgment of liquidators' reports under s 533 of the *Corporations Act*.

Broadening powers to investigate liquidators' conduct

Section 13 of the ASIC Act sets out the circumstances in which ASIC may use its investigative powers for the purpose of inquiring into the conduct of liquidators. Those circumstances include investigation of a suspected contravention of the corporations legislation, or of a 'law of the Commonwealth, or of a state or territory' relating to the management or affairs of a body corporate or involving fraud or dishonesty.

The main limitation with s 13 as it currently exists is that it is not clear whether ASIC can use its full suite of investigative powers for the purposes of investigating the extent to which a registered liquidator has satisfied its duties. As is pointed out in the Explanatory Memorandum to the draft Bill, unlike directors' duties, the fiduciary duties of registered liquidators are not codified in the corporations legislation.

The draft Bill inserts a new s 13(3) into the ASIC Act, allowing ASIC to investigate the conduct of a registered liquidator where ASIC suspects that a liquidator has not, or may not have, faithfully performed his or her duties, including the extent to which a liquidator has complied with those fiduciary duties that are not codified in the corporations legislation.

Right of recovery for breach of condition or alteration of schemes of compromise or arrangement

Part 5.1 of the *Corporations Act* sets out a process by which a company may make agreements or arrangements with its creditors or members to:

- enter into a compromise with creditors as an alternative to liquidation;
- vary the share structure of the company;
- transfer assets to a new company in consideration for the issue of shares; or
- amalgamate with one or more companies.

Along with member or creditor approval, the scheme of compromise or arrangement must also be approved by the court. Under s 411(6), the court may grant its approval to a compromise or arrangement subject to such alterations or conditions as it thinks fit.

The proposed amendment contained in the draft Bill will expand upon the court's power to impose alterations or conditions under a scheme of compromise or arrangement and provide a right for a person to recover

compensation if they have suffered loss or damage due to breach by a body of a condition or alteration imposed by the court under s 411(6).

The amendment will only apply to those parts of the arrangement or compromise that are altered or added by the court (s 4116A).

If a breach of condition or alteration is made out, the court may make orders that it considers are just in the circumstances including, but not limited to, compensation or enforcement of the condition or alteration (s 411(6B) and (6C)).

ASIC to apply for court orders preventing company officers and others from avoiding liability

Under s 486A of the *Corporations Act* as it currently exists, only a liquidator or provisional liquidator can apply to court to make certain orders to prevent a company officer from avoiding their liabilities to a company that is being wound up.

In a case where an application to wind up a company has been made but the winding up has not commenced, there will not necessarily be any liquidator or provisional liquidator appointed, and therefore, no eligible party to make the application.

In order to ensure the protection of company assets before the a winding up order is made, the draft Bill contains a proposed amendment to s 486A which will allow ASIC to make an application to a court for an order preventing an officer or related entity from avoiding liability to a company.

Procedure for the execution of warrants

Section 486B of the *Corporations Act* sets out the court's power to issue a warrant for the arrest of a person in circumstances where the court is satisfied that the person is about to leave the jurisdiction to avoid any potential liability, or has destroyed, concealed or removed property of a company.

Unfortunately, there is nothing in the legislation as to the procedure for the execution of warrants, once issued. The proposed amendment in the draft Bill contains provisions for the arrest of a person subject to a warrant and the procedure after arrest, including the procedure where person has been released on bail.

Removal of penalty privilege in relation to banning and disqualifications

In *Rich v Australian Securities and Investments Commission* (2004) 220 CLR 129, the High Court held that a banning or disqualification order was penal in nature and, consequently, common law privileges attaching to proceedings which impose a penalty were invoked to prevent ASIC's use or access to information that may expose a person to a penalty. As a result, ASIC was not able to obtain discovery of documents or the filing and serving of affidavits by defendants in proceedings seeking a banning or disqualification order, and material obtained by ASIC during an investigation which was subject to the privilege against exposure to a penalty was not admissible in evidence in the proceedings.

This result was never the intention of the legislature, of which one of the main benefits of banning or disqualification orders was to allow for an expeditious response to corporate misconduct for the purpose of removing unwanted participants from the market, and thereby protecting the market.

In order to reverse the effect of the High Court's decision, the proposed amendments to the *Corporations Act* contained in the draft Bill make it clear that for the purposes of the law relating to privilege against exposure to penalty, that a cancellation or suspension of:

- a person from managing corporations under Pt 2D.6 (see s 206GB of the draft Bill); or
- the registration of an auditor or liquidator under Pt 9.2 Div 3 (see s 1299 of the draft Bill);

is taken not to be by way of penalty.

It is important to note that no other privilege is removed, abrogated or modified by the amendments.

Time limit for the lodgment of reports by liquidators

Section 533 of the *Corporations Act* requires liquidators to prepare reports if it appears to the liquidator that there have been offences committed by the company's officers or employees, or where the company is unable to pay its unsecured creditors more than 50 cents in the dollar. Currently, these reports are to be lodged with ASIC 'as soon as practicable'.

ASIC has previously issued guidelines recommending that the liquidator lodge the reports within two months. However, sometimes reports are lodged years after the commencement of the action, which is often too late to take any remedial action.

The proposed amendment in the draft Bill will provide that a liquidator must lodge a report under s 533 as soon as practicable and in any event by no later than six months from the date that a liquidator becomes aware of the potential commission of offence or the likely monetary outcome to creditors. This will help to ensure that ASIC is notified in a timely fashion, particularly in instances where there is a threat that funds may be dissipated or company property may be concealed, removed or destroyed.

Having regard to the proposed amendments outlined above, it is clear that they are intended to enhance the practical effect and overcome limitations of existing legislative provisions enacted in the ASIC Act and the *Corporations Act*, to deter corporate misconduct. ●

Unfortunately, there is nothing in the legislation as to the procedure for the execution of warrants, once issued.

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IN brief

Anthony Lo Surdo and **David Richardson**

ADAMS v LAMBERT
(2006) 225 ALR 396, 4 April 2006

Bankruptcy — Bankruptcy notices — Validity — Prescribed forms

Introduction

The issue in this appeal concerned the effect upon the validity of a bankruptcy notice of a misdescription of the statutory provision under which an amount of interest ($66.58) on a judgment debt was claimed. The bankruptcy notice referred to s 83A of the *District Court Act 1973* (NSW). That section deals with interest up to judgment. The notice should have referred to s 85, which deals with interest after judgment.

The resolution of the issue turns on the application of s 306 of the *Bankruptcy Act 1966* (Cth) (the Act), which provides that proceedings under that Act are not invalidated by a formal defect or an irregularity unless substantial injustice has been caused. There being no suggestion that any substantial injustice has been caused, the question is whether the error was a formal defect or an irregularity.

Facts

The appellant obtained judgment against the respondent in the District Court of NSW in the amount of $54,000. A bankruptcy notice was served on the respondent claiming as a debt due and payable the amount of $54,066.58, representing the judgment debt plus interest on that sum at court rates. The interest was incorrectly claimed under s 83A of the *District Court Act* 1973 (NSW) whereas it should have referred to s 85.

The respondent failed to comply with the requirements of the bankruptcy notice and a creditor's petition was subsequently filed. The matter came for hearing before Gyles J in the Federal Court of Australia on 1 July 2004. Gyles J found that the bankruptcy notice was invalid and dismissed the petition.[1] He was bound by the decision of the Full Court of the Federal Court in the indistinguishable case of *The Australian Steel Company (Operations) Pty Ltd v Lewis* (*Lewis*)[2] (a case in which Gyles J was part of a dissenting minority), which was followed by the Full Court in *Marshall v General Motors Acceptance Corporation Australia*.[3] An appeal to the Full Court from the decision of Gyles J was dismissed.[4]

All the members of the Full Court regarded the decision of the High Court in *Kleinwort Benson Australia Ltd v Crowl*[5] as laying down the principles to be applied, although the High Court noted that there was no uniformity by the Federal Court in the application of those principles.

In this case, the High Court took the opportunity to examine whether *Lewis* was correctly decided and to also examine the effect of s 306 of the Act.

Section 306

The act of bankruptcy identified in s 40(1)(g) of the Act depends upon service on a debtor of 'a bankruptcy notice under [the] Act'. Bearing in mind the consequences which the Act attaches to such a notice, the courts have long insisted upon 'strict compliance with the requisites of a bankruptcy notice'[6] if it is to be valid, subject, of course, to the express provisions of s 41. However, s 306(1) of the Act provides that:

> Proceedings under this Act are not invalidated by a formal defect or an irregularity, unless the court before which the objection on that ground is made is of opinion that substantial injustice has been caused by the defect or irregularity and that the injustice cannot be remedied by an order of that court.

In the event of a failure to comply with the Act, the first enquiry is whether the defect or irregularity is a formal defect or irregularity within the purview of s 306. If it is, then it

becomes necessary to consider whether substantial injustice has been caused by the defect or irregularity, and whether the injustice cannot be remedied by an order of the court. The questions whether the defect or irregularity is a formal defect or irregularity, and whether substantial injustice has been caused and cannot be remedied, are separate and distinct, the latter question arising only if the former is answered in the affirmative.

What is a formal defect or irregularity?

In a unanimous judgment, the High Court noted that in some cases the answer as to what is a formal defect or irregularity may be easy but that in others, a difficult question of judgment may be involved.

The question of construction raised by the words 'a formal defect or an irregularity' is one, according to the court, to be decided by reading s 306:

> ... in the context of the whole Act, informed by the general purpose of the legislation, and the particular purpose of the provisions relating to bankruptcy notices. (at [26])

The court concluded (at [27]) that the inquiry in respect of bankruptcy notices as to whether a defect is formal depends upon whether it has the effect of misleading:

> ... a debtor about what is necessary to comply with the notice. That kind of misleading ... takes an error outside the concept of a formal defect or irregularity. However, that is not the full extent of the exclusion.

The other exclusionary aspect of the expression 'a formal defect or an irregularity' in s 306 of the Act is a failure to meet a requirement made essential by the Act. The question raised in the context of this case was whether the legislation required that it was essential that there be no misdescription of the relevant section in the bankruptcy notice.

The High Court noted that in his dissenting reasons in *Lewis*, Lee J concluded:[7]

> Properly construed, the Act and Regulations do not express an intention to create a new regime of strict compliance imposed on a judgment creditor issuing a bankruptcy notice. The tenor of the Act and Regulations is not consistent with that conclusion. An attempt has been made to recast the process of issue of a bankruptcy notice in terms more understandable to a judgment debtor, but the essential requirements of a bankruptcy notice remain as they have been stated by bankruptcy legislation over many years.

The High Court accordingly concluded that, properly construed, the Act does not require strict compliance upon a creditor issuing a bankruptcy notice so that s 306 cannot be excluded from operation on the ground that the it fails to comply with the appropriate form.

The High Court accordingly concluded that, properly construed, the Act does not require strict compliance upon a creditor issuing a bankruptcy notice so that s 306 cannot be excluded from operation on the ground that the it fails to comply with the appropriate form.

Lewis

The High Court stated (at [34]) that:

> … the effect of the majority view in *Lewis* is to attribute to the legislature an overwhelming preference for form over substance. That should not be done. Given that s 306 relieves against the invalidating consequences of some mistakes in the preparation of bankruptcy notices, the mistake that was made in this case falls within its terms.

The High Court specifically overruled *Lewis*.

Conclusion

The appeal was allowed with costs.

Endnotes

1. *Adams v Lambert* [2004] FCA 928; BC200404428.
2.. (2000) 109 FCR 33.
3. (2003) 127 FCR 453.
4. *Adams v Lambert* [2004] FCAFC 322; BC200408450.
5. (1988) 165 CLR 71.
6. *James v Federal Commissioner of Taxation* (1955) 93 CLR 631 at 644.
7. (2000) 109 FCR 33 at 66.

HAMILTON v DONOVAN OATES HANNAFORD MORTGAGE CORPORATION LTD

[2007] NSWSC 10; BC200700174

Corporations — Administration — Lien of administrator — Remuneration and expenses

In this case, decided by Barrett J on 29 January 2007, the Supreme Court of NSW examined the nature of an administrator's lien for his remuneration and for debts owed to him together with the question of whether, in the circumstances of the case, any equitable lien to secure these moneys, if it existed, enjoyed priority over the interests of a legal mortgagee.

Facts

Perfection Developments Pty Ltd (the company) had undertaken a residential flat development. In December 2003, the company created in favour of Donovan Oates Hannaford Mortgage Corporation Ltd (DOHM) a mortgage over the development land (the land mortgage) and also granted to DOHM an equitable mortgage and floating charge (the general charge) over its assets generally.

In March 2006, a winding up order was made against the company and a liquidator was appointed. The liquidator appointed the plaintiffs to be voluntary administrators of the company. The company executed a deed of company arrangement in May

2006 and the plaintiffs thereupon became deed administrators and the deed was subsequently terminated.

In April 2006 DOHM took physical possession of the residential flat site. It subsequently began selling individual home units in exercise of its powers of sale consequent upon default by the company in meeting its obligations to DOHM. Under an agreement noted by the court on 24 July 2006, DOHM caused moneys to be isolated in a controlled moneys account pending determination of the plaintiffs' claim that they had a valid equitable interest by way of equitable lien over the funds in the account having priority over the interest of DOHM, the company and subsequent mortgagees. The amount in question was $18,968.58 consisting of remuneration for work undertaken by the administrators before they became administrators of the deed of company arrangement, and general out-of-pocket expenses.

In the proceedings, the administrators sought, among other things, a declaration that they had a valid equitable interest by way of equitable lien securing the sum of $18,968.58, having a priority over the interest of DOHM, the company and the subsequent mortgagees.

Is there an equitable lien?

The Judge said (at [8]) that the plaintiffs' claim to an equitable lien needed to be assessed in light of their undoubted entitlement, as Pt 5.3A administrators, to a statutory lien — and the first question to be addressed in considering that was whether the plaintiffs could have an equitable lien as distinct from their statutory lien under s 443F(1) of the *Corporations Act 2001* (Cth) (the Act).

In examining the work which the administrators had undertaken, the judge considered it to be clear that all such work was directed towards completion and marketing of the development property and, therefore, realisation of the benefits sought to be obtained from the company's development project. It followed that the administrators had a right of indemnity which was secured on the company's property by their statutory lien but, in accordance with the provisions of s 443F, only operative in priority to the company's unsecured debts and the debts of the company secured by the floating charge on the property of the company.

The difficulty for the administrators was that there was no property secured by the floating charge. However, the company's land was subject to the land mortgage. Accordingly, the administrators asserted that they had, in addition to the statutory lien, a separate equitable lien which extended over the whole of the company's property. Accordingly, it was necessary for the court to consider the question of whether the undoubted existence of the statutory lien precluded any meaningful assertion of an equitable lien arising at general law.

The judge examined (from [34]) a number of authorities and decided that none of them were on point. In describing the circumstances he said (at [38]):

> Having pithily summarised the position, the judge determined that an equitable lien cannot be recognised in the circumstances or, more precisely, that an equitable lien cannot be recognised as existing in a form which makes it capable of enjoying some ranking, in point of security, that did not (or may not) correspond with the ranking prescribed by s 443F(2).

> In the present case, there is no suggestion that the rights and monies secured by the equitable lien claimed by the plaintiffs are not the same rights and monies as are secured by the statutory lien. That being so, the question is whether both liens are independently available — the statutory lien with the ranking, as against DOHM's securities, dictated by section 443F(2) and the equitable lien with such ranking, as against DOHM's securities, as might be created by the general law apart from section 443F(2).

Having pithily summarised the position, the judge determined that an equitable lien cannot be recognised in the circumstances or, more precisely, that an equitable lien cannot be recognised as existing in a form which makes it capable of enjoying some ranking, in point of security, that did not (or may not) correspond with the ranking prescribed by s 443F(2).

He came to this conclusion because to recognise that an equitable lien may operate in relation to the rights secured by the statutory lien in a way that attracts some priority or ranking superior to that dictated by s 443F(2), would be to deny the intended operation of that statutory provision. The general law lien enjoyed by a Pt 5.3A administrator in respect of the company's property should be regarded, in the Judge's view, principally as a means of affording protection in respect of rights of recoupment not secured by the statutory lien.

Could the 'salvage principle' apply?

Having come to a conclusion which disentitled the plaintiffs to the relief which they sought, the judge nonetheless went on to consider the consequences of the view which he did not favour — that the statutory and equitable liens could operate as security for the same rights. In considering the position, his Honour referred to the judgment of the NSW Court of Appeal in *Dean-Wilcocks v Nothintoohard Pty Ltd* [2006] NSWCA 311; BC200609032, where that court considered the question of whether a receiver's right to be reimbursed for expenditures and remuneration was charged upon the property in his hands in such a way that his lien or charge enjoyed priority over a legal mortgage.

Beazley JA (with whom McColl JA agreed) referred in *Dean-Wilcocks* to 'the principle of salvage'. She quoted, in that connection, a passage in the joint judgment in *Shirlaw v Taylor* (1991) 31 FCR 222 (at 230):

> In addition to the anxiety of the court to protect the position of its officer, in particular lest there be in future an absence of persons willing to take such appointments, the claims of the officer under a court-appointed administration may be seen as in the nature of 'salvage'. The principle is that those taking the benefit of the administration should not escape the burden of the proper costs of it: see *In the Matter of Tharp* (1852) 2 SM & Giff: 65 ER 533 and *Re Berkeley Applegate (Investment Consultants) Ltd (In Liq); Harris v Conway* [1989] CH 32 at 51. In the latter decision, it was held (at 50–51) that there was:
>
> '... a general principle that where a person seeks to enforce a claim to an equitable interest in property, the court has a discretion to require as a condition of giving effect to that equitable interest that an allowance be made for costs incurred and for skill and labour in connection with the administration of the property. It is a discretion which will be sparingly exercised; the factors which will operate in favour of it being exercised include the fact that, if the work had not been done by the person to whom the allowance is sought to be made, it would have had to be done either by the person entitled to the equitable interest ... or by a receiver appointed by the court whose fees would have been borne by the trust property ...; and the fact that the work has been of substantial benefit to the trust property and to the persons interested in it in equity ....'

In *Dean-Wilcocks*, Beazley JA held (at [112]) that expenditures directed simply towards putting the receivers in a position where they might sell the property (which, in the long run, they did not do) were not within any relevant concept of salvage. In that case, as in the present case, a legal mortgagee eventually exercised its power of sale after a period during which it was contemplated that the receivers (or, in this case, administrators) might do so, and preparations were made accordingly.

Barrett J then examined the work undertaken by the administrators in this case. He came to the conclusion (at [66]) that none of the expenditure and effort of the administrators preserved or enhanced the company's property or created any benefit for DOHM in relation to that property, so as to make it unconscientious for DOHM not to acknowledge a right of the plaintiffs to be reimbursed and remunerated out of that property in priority to DOHM. The steps taken by the administrators were not such as to give rise to an expectation that DOHM should be beholding to them for benefit or advantage conferred.

The judge then considered the possibility of whether DOHM had in any way agreed to cede priority to the administrators for their costs and expenses, and concluded that there was no such agreement.

In the result, the plaintiffs' claim for declaratory relief was dismissed and the plaintiffs were ordered to pay the costs of DOHM. ●

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Insolvency
LAW BULLETIN

Trustbusters — asset protection and the art of the alter ego entity

Stephen Mullette ARGYLE LAWYERS

Main points

- Justice French reminds us all that in certain circumstances a court will look through a trust structure and find the beneficiary has a proprietary interest in the trust assets.
- It is the degree of control of the beneficiary over the distribution of the assets and income of the trust that may allow a court to identify this proprietary interest.
- In this case, the degree of control was sufficiently established from facts, such as that the beneficiary was the spouse of the appointor, or director of the trustee.

A significant question has been raised in recent months regarding the protection offered by discretionary trusts. In the decision of the *Australian Securities and Investments Commission (ASIC) v Carey (No 6)* [2006] FCA 814; BC200604846 (*Richstar*), Justice French in the Federal Court was prepared to look through a trust and see the discretionary objects of the trust having an interest justifying the appointment of receivers to the trusts.

The decision has caused some consternation among those who have long sought the shelter of discretionary trusts for the protection of assets from the reach of creditors. The discretionary trust is a widely used asset protection tool on the basis that the beneficiaries of the trust do not (at least on the face of it) have any interest in the assets or income of the trust until they are distributed by the trustee.

In one sense, the *Richstar* decision might be seen as a radical incursion into the private asset structuring arrangements of individuals. On the other hand, it could be argued that the decision merely makes it clear that, as in the case of sham transactions, the court will in certain circumstances look through the 'form' of asset protection arrangements. Either way, those seeking protection for assets by placing them in a discretionary trust should consider the decision in the context of their own circumstances.

Facts

In *Richstar*, the relevant facts were simple:

27 March 2006

ASIC commenced proceedings seeking the appointment of receivers to various property of companies and officers in the Westpoint Property & Finance Group pursuant to s 1323 of the *Corporations Act 2001* (Cth).

20 April 2006

Orders made for the appointment of receivers to the property of all defendants (apart from one already in receivership). Orders also made for the disclosure of the assets of the various defendants

8 June 2006

Application by ASIC to extend the receiver orders to bring into the scope of the orders:

> 3.6 property held by a Third Party, as trustee for a trust, where the Individual defendant is a beneficiary of the trust (including as a general beneficiary of a discretionary trust);
>
> 3.7 property held by a Third Party on behalf of a superannuation fund, where the Individual defendant is a beneficiary of the superannuation fund;[1]

The issue

Justice French in the Federal Court defined the issue raised by ASIC's

application as to whether it had power, under s 1323 of the *Corporations Act*, to appoint a receiver to property held by a third party on trust (discretionary or otherwise) of which the relevant person is a beneficiary. If so, a secondary question arose as to whether the court *should* make such an order in the circumstances of the present case.[2]

Analysis

The application by ASIC was brought under s 1323 of the *Corporations Act*. This section allows the court to make protective orders where an ASIC investigation or prosecution has begun, or indeed where any civil proceedings have been brought (by ASIC or otherwise).

The relevant parts of s 1323 are as follows:

> *Power of Court to prohibit payment or transfer of money, financial products or other property*
>
> (1) Where:
>
> (a) an investigation is being carried out under the ASIC Act or this Act in relation to an act or omission by a person, being an act or omission that constitutes or may constitute a contravention of this Act; or
>
> (b) a prosecution has been begun against a person for a contravention of this Act; or
>
> (c) a civil proceeding has been begun against a person under this Act;
>
> and the Court considers it necessary or desirable to do so for the purpose of protecting the interests of a person (in this section called an *aggrieved person*) to whom the person referred to in paragraph (a), (b) or (c), as the case may be (in this section called the *relevant person*), is liable, or may be or become liable, to pay money, whether in respect of a debt, by way of damages or compensation or otherwise, or to account for financial products or other property, the Court may, on application by ASIC or by an aggrieved person, make one or more of the following orders:
>
> ...
>
> (e) an order prohibiting a person holding money, financial products or other property, on behalf of the relevant person, or on behalf of an associate of the relevant person, from paying all or any of the money, or transferring, or otherwise parting with possession of, the financial products or other property, to, or to another person at the direction or request of, the person on whose behalf the money, financial products or other property, is or are held;
>
> ...
>
> (h) an order appointing:
>
> (i) if the relevant person is a natural person — a receiver or trustee, having such powers as the Court orders, of the property or of part of the property of that person; or
>
> (ii) if the relevant person is a body corporate — a receiver or receiver and manager, having such powers as the Court orders, of the property or of part of the property of that person;
>
> ...
>
> (2A) A reference in paragraph (1)(g) or (h) to property of a person includes a reference to property that the person holds otherwise than as sole beneficial owner, for example:
>
> (a) as trustee for, as nominee for, or otherwise on behalf of or on account of, another person; or
>
> (b) in a fiduciary capacity.
>
> (2B) Subsection (2A) is to avoid doubt, is not to limit the generality of anything in subsection (1) and is not to affect by implication the interpretation of any other provision of this Act.

Section 9 of the *Corporations Act* defines 'property':

> *property* means any legal or equitable estate or interest (whether present or future and whether vested or contingent) in real or personal property of any description and includes a thing in action.

Clearly, s 1323(1)(h) allows the appointment of a receiver over property of an individual or corporation. It does not authorise the appointment over property of third parties, unless the relevant person has an 'interest' in that property, and that interest falls within the definition of property in s 9.[3]

Justice French found that a fairly clear example of such an interest would be property held on behalf of the relevant person (such as an express trust). This gives rise to an equitable estate or interest in the property which falls within the s 9 definition of 'property' and may therefore be the subject of an order under s 1323.

Subject to the terms of the fund, the superannuation fund is an example, his Honour held, of a fixed or non-discretionary trust in which a relevant person would hold an interest capable of supporting the appointment of a receiver under s 1323. His Honour was therefore prepared to make the orders sought by ASIC against certain superannuation funds. This was 'subject to satisfaction about the nature of the individual defendant's interest in the relevant superannuation fund'.[4]

If the relevant person *holds* property on trust, then the title to the property so held will also clearly support the making of an order under s 1323. This is clear from s 1323(2A), and is so even though the beneficial interest in that property belongs to someone else.

So far so good.

But what of a relevant person who is merely one of a class of *potential* discretionary objects of a discretionary trust, who will receive nothing and has no claim in the event that the trustee decides to distribute the trust income and assets to any other beneficiary? His Honour agreed that this question was 'less straightforward'.[5] A number of cases have held that a mere 'expectancy' is not a proprietary interest.[6]

Discretionary trusts

By their very nature, a properly drafted discretionary trust grants a discretion to the trustee as to which of the objects of the trust are to receive the benefit of any distribution of income or capital.

However, as the High Court has said, and as Justice French has reminded us, the term 'discretionary trust' has 'no fixed meaning and is used to describe particular features of certain express trusts'.[7]

Justice French referred to the High Court's decision in *Federal Commissioner of Taxation v Vegners*[8] in which his Honour, Justice Gummow,

said that a discretionary trust is an express trust in which:

> … unlike a fixed trust, the entitlement of the beneficiaries to income, or to corpus, or both, is not immediately ascertainable.

A trustee of a discretionary trust may have either a:

- general power to distribute to any person including the trustee;
- special power to distribute to a fixed class of beneficiary; or
- hybrid power, which would allow distribution to anyone except a designated list of persons.

In *Vegners*, a general power of this kind was said to be 'tantamount to ownership of the property concerned'.

By analogy, Justice French observed (at [19]) that:

> A beneficiary who effectively controls the trustee of a discretionary trust may have what approaches a general power and thus a proprietary interest in the income and corpus of the trust.

With respect, his Honour is clearly correct in attributing to a controlling beneficiary the effective or de facto ownership of the assets of the trust. However, in such circumstances, the question begs whether there is a trust at all. A sham[9] trust is no trust at all, and a sham discretion is likewise subject to being ignored by a court in considering the legal effect of a purported discretionary trust. It may not always be necessary to apply a trust analysis to reach this conclusion. Instead, a court will see through, or go behind, the trust and find that in a particular instance the transaction did not have the effect displacing the legal ownership of the trust assets from the controlling beneficiary.

Discretionary trusts — an exhaustive analysis!

Justice French then proceeded to analysis the various types of trust arrangement that might fall within the description a discretionary trust.

His Honour pointed to a distinction between 'exhaustive' and 'non-exhaustive' trusts — depending on whether the trustee has power to withhold distribution of any (or no) part of the income or assets of the trust. The significance of this distinction was apparent from the fact that when the beneficiaries of an exhaustive trust came to the trustee, the trustee's:

> … discretion as to the method in which the whole of the fund shall be applied for the benefit of the particular person does not prevent that particular person from coming and saying: 'Hand over the fund to me'.[10]

His Honour also distinguished between 'closed' and 'open' classes of beneficiaries, depending on whether the beneficiaries of the trust were a defined (closed) group of persons or, alternatively, an at-large (open) group.

By way of example, his Honour referred to the case of *Re Nelson,*[11] where a trustee was bound to apply certain income of a trust fund (that is, an exhaustive trust) for the benefit of three individuals (that is, a closed class). The court held that even though the trustees decided how much of a trust fund each of the individuals received, a mortgage by the three beneficiaries was still a valid mortgage of real interests in the trust fund.

The point, Justice French found, was that a closed class of beneficiaries of an exhaustive discretionary trust could together require the trustee to deal with the trust assets — as effectively as if the beneficiaries were the absolute owners (at [25]).

In the end, however, Justice French held (at [29]) that:

> … in the ordinary case the beneficiary of a discretionary trust, other than perhaps the sole beneficiary of an exhaustive trust, does not have an equitable interest in the trust income or property which would fall within even the most generous definition of 'property' in s 9 of the Act and be amenable to control by receivers under s 1323. I distinguish the 'ordinary case' from the case in which the beneficiary effectively controls the trustee's power of selection. Then there is something which is akin to a proprietary interest in the beneficiary.

Next, his Honour considered ASIC's submissions that beneficiaries of a discretionary trust have a 'contingent interest', which is 'property' for the purposes of s 9 of the *Corporations Act*, and which could therefore be the subject of an order under s 1323. Such was argued to have been the view of the High Court in *Craig v Federal Commissioner of Taxation*[12] where McTiernan J held that:

> In its ordinary or popular sense, the word 'interest' as applied to property may include a contingent interest.[13]

His Honour described a contingent interest:

> … broadly as the possibility that a right of a proprietary character will come into existence at a future time is some event occurs …

Justice French also had regard to the comments of Nourse J on this issue:

> A contingency is an event which may or may not happen. If there is no real possibility that it will not happen, so that it is as good as certain that it will, it is a contingency without reality and substance and no contingency at all. But a real possibility is not the same thing as a probability. It may be highly improbable that an event will happen, but there can still be a real possibility that it will. If there is that possibility, however remote it may be, the contingency is one of reality and substance.[14]

His Honour disagreed with ASIC's argument (at [36]):

> I am inclined to think that a beneficiary in such a case at arms length from the trustee, does not have a 'contingent interest' but rather an expectancy or mere possibility of a distribution. … On the other hand, where a discretionary trust is controlled by a trustee who is in truth the alter ego of a beneficiary, then at the very least a contingent interest may be identified because, in the words of Nourse J, 'it is as good as certain' that the beneficiary will receive the benefits of distributions either of income or capital or both.

French J went on, in the next paragraph, to repeat his earlier observations that a beneficiary who controls a trustee's power of distribution (including because of the power of appointment of a new trustee) has something 'approaching a general power and the ownership of the trust property.' He developed this analysis with reference to family law cases in which the Family Court has considered corporations which are controlled by one or other of the parties to the marriage.

The significance of his Honour's reference to control and the alter ego cases is that it is this principle which allowed him to see through the trust structures set up by the defendants, rather than any novel treatment of discretionary trust principles. His Honour seems to be saying that the law will not be fooled be devices which attempt to mask the 'real' ownership of assets.

The question is: How do you know when you are dealing with such a situation?

Perhaps, if anything, his Honour's judgment is significant in the indicia relied upon by his Honour to identify control over the trust assets. Without going through all of the trusts being considered by ASIC, Justice French reviewed several of the trust structures in which the defendants were either:

- the trustee of the trusts;
- the director and/or shareholder of the corporate trustee; or
- the appointor (or the spouse of the appointor) of the trust.

In each of these cases his Honour was satisfied that a combination of these factors *of itself* was sufficient control to give the defendants an interest ('at the very least a contingent interest' (at [36])) in the assets of the discretionary trust. This in turn allowed his Honour to appoint a receiver to this 'property'. It is interesting to note that his Honour appears to assume that a spouse, in this case Mrs Beck, would exercise her power of appointment in the financial interests of her husband. As has been noted elsewhere, the facts in the *Richstar* decision meant that his Honour did not have to decide whether the same would apply in reverse — that is, that a husband would be presumed to exercise trustee powers in favour of his wife.[15]

It is important to remember that his Honour was not prepared to make an order in the very general nature ASIC had requested, extending to all trust assets of which the defendants were beneficiaries. It is not the case that his Honour ignored the existence of the discretionary trusts entirely. However, his Honour was prepared (at [46]) to:

> … consider a proposal for orders to be made in relation to trusts of which the relevant defendant is the effective controller, thereby enjoying at least a contingent interest, if not effective ownership, of the trust property. This will require specification of the trusts to be affected.

How are such trusts to be identified, let alone specified? His Honour considered the problem of trying to establish which trusts were of a kind which would be caught by his Honour's consideration of the relevant principles. Justice French was prepared to make orders under s 23 of the *Federal Court Act 1976* (Cth), which provides that:

> The Court has power, in relation to matters in which it has jurisdiction, to make orders of such kinds, including interlocutory orders, and to issue, or direct the issue of, writs of such kinds, as the Court thinks appropriate.

Significantly, therefore, his Honour was prepared to make orders under s 23 which:

- authorised the receivers to require the defendants to provide information to identify trusts in respect of which they are beneficiaries;
- required the defendants to provide, using their rights as beneficiaries, information relating to the trust documents and the managements of the trusts, including their distribution history (at [47]); and
- authorised the receivers to obtain information from the trustees, including as to the terms of the trust, the classes of its beneficiaries and its distribution history (at [47]).

In allowing information to be gathered in this way, ASIC and the receivers would be able to identify the particular trusts which fell within the necessary degree of control by the beneficiary.

Implications in bankruptcy

The implications of the *Richstar* decision for bankruptcy have been briefly considered by another Federal Court judge, Justice Branson, in a paper delivered to the Sixth ITSA Bankruptcy Congress on 27 July 2006. In her Honour's paper entitled 'The bankrupt, his or her spouse and the family trust: a consideration of Part VI Div 4A of the *Bankruptcy Act'*, Justice Branson observed the close similarity of the definitions of property in s 9 of the *Corporations Act*, and s 5 of the *Bankruptcy Act 1966* (Cth).

In 2006 the Federal Government passed amendments to Pt VI Div 4A of the *Bankruptcy Act* in 2006 squarely aimed at assets held by a third party from which a bankrupt retains a benefit. Branson J queried whether the

effect of the *Richstar* decision meant that these reforms were less necessary than had previously been thought. ●

Practical implications

- One should not lose sight of the fact that each matter will be considered on its own facts, each trust on its own terms, and each question of control and ownership in light of its own circumstances.
- For asset protection purposes, the message is clear. Only by clearly removing control of the appointor, trustee, and ensuring the trust is non-exhaustive, can any discretionary trust be seen to avoid the risk of being the subject of a particular beneficiaries control.
- But is this practical? Should all discretionary trusts now be controlled by truly independent people who are above being influenced to assume the 'alter ego' of another person?
- This answer of course is that the most appropriate structure will, as it always does, depend on the circumstances. What does the trust do? What do the individuals benefiting from the trust do? What are their legal areas of risk exposure?
- For insolvency practitioners, it would not be safe to say that *Richstar* creates a landmark decision upon which insolvency practitioners will now rely to launch a wave of litigation against assets held in discretionary trusts.

However it would not be unfair to conclude that insolvency practitioners will take some comfort from the willingness of the court to look behind the mere fact that assets were held in a discretionary trust as a complete protection of those assets. Insolvency practitioners will also look more closely at the way in which discretionary trusts operate to see whether there is a degree of control over the trust equivalent to a proprietary interest.

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Endnotes

1. *ASIC v Carey (No 6)* [2006] FCA 814 at [8] per French J.
2. Above at [12].
3. Above at [16].
4. Above at [5], see also [17].
5. Above at [19]
6. See the useful list in Powers L 'Breaking down the walls around discretionary trusts' (2006) 17 *JBFLP* 214 at 215.
7. *Commissioner of Stamp Duties (NSW) v Buckle* (1998) 192 CLR 226 at [8]; quoted by French J in *ASIC v Carey (No 6)* at [19].
8. (1989) 90 ALR 547 at 552 per Gummow J.
9. '"Sham" is an expression which has a well-understood legal meaning. It refers to steps which t ake the form of a legally effective transaction but which the parties intend should not have the apparent, or any, legal consequences': per the High Court in *Equuscorp Pty Ltd v Glengallen Investments Pty Ltd* (2004) 211 ALR 101 at [46].
10. *Re Smith* [1928] Ch 915 per Romer J at 918 cited by French J in *Richstar* at [22].
11. [1928] Ch 920.
12. (1945) 70 CLR 441.
13. Above at 454 cited in *Richstar* at [33].
14. Nourse J in *Inland Commissioners v Trustees of Sir John Aird's Settlement* [1984] Ch 382 at 940. Justice French noted that Nourse J's decision was overturned on appeal, though not in respect of this portion of the judgment at first instance.
15. Justice Branson 'The bankrupt, his or her spouse and the family trust: a consideration of Part VI division 4A of the *Bankruptcy Act*', paper delivered at the Sixth ITSA Bankruptcy Congress, 27 July 2006 p 15.

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