# CURRENT LEGAL ISSUES RELATING TO LENDING TO TRUSTS AND PARTNERSHIPS

## QUESTIONS AND ANSWERS

### Question – Quentin Hay (Bell Gully Buddle Weir, Wellington, New Zealand):

You have said that an unsecured creditor effectively loses its rights against the assets of the trust where there is an antecedent breach of trust by the trustee and as a result the trustee loses the benefit of its indemnity. You suggest that a secured creditor would not be similarly affected in the same circumstances because of the existence of the security. But, if there is no indemnity, what obligation does the security secure?

### Response – The Hon Mr Justice John Lehane (Speaker):

I suppose my answer would be that it should not matter because you do not actually need the secured creditor unless the value of his security is inadequate. There is access to other trust property via the trustee's right of indemnity. The fact that the indemnity may be diminished, however, as there is not a claim to which the lender can usefully be subrogated, does not mean that the trustee's own personal liability is in any sense diminished. The debtor is still the trustee. A trust deed may give a power to the trustee to grant a mortgage over a particular item of trust property. The effect of that transaction is to give the lender an interest which, because of the authority in the trust deed, has priority over the interests of the beneficiaries. In a sense, I suppose that, although there is not an entirely accurate analysis, it is not unlike a third party security in some way. There is a debt. It is the debt of the trustee. It may be a debt in respect of which the trustee itself has no indemnity against trust assets, but it is nevertheless a debt which the creditor is entitled to enforce because of its prior interest in the particular item of trust property over which it has security by recourse to that security by the ordinary means of enforcement against that property. I hope that that is at least attacking the question.

### Question – Graham Mouat (Rudd Watts & Stone, Wellington New Zealand):

In New Zealand, lenders have the benefit of the provisions of section 22 of the Trustee Act 1956 which, in relation to mortgages, provides that, except on the ground of fraud, a mortgage will be binding on the trustee notwithstanding lack of due authorisation or breach of duties. Do you have an equivalent provision in Australia?

### Response – The Hon Mr Justice John Lehane (Speaker):

No, not unless I have missed it. But I do not think we have such a provision in the trust deed legislation of any of our States. My immediate reaction is: aren't New Zealand banks lucky.

## Response – Ian Osborne (Commentator):

I suppose that we do get some help from our Torrens Title legislation which is that, once a mortgagee becomes registered, it takes that interest free and clear of all other interests and that would include equitable interests. So I guess we get part of the way there anyway.

## Question – From the Floor:

The question was not picked up by the recording equipment, but the question which was asked was to this effect: A provision is commonly included in trust deeds that a third party dealing with the trustee is not bound to enquire about the powers of the trustee. Would any of the commentators care to comment on that sort of provision?

## Response – Ian Osborne (Commentator):

I think I would be very suspicious of provisions of that sort. I do not see how such a provision could be of much comfort to an unsecured creditor who is in the end in any event dependent on the trustee's own solvency or access to the trustee's right of indemnity. If the trustee, for some possibly extraneous reason, has lost the right of indemnity, then it is gone and no amount of provisions of that sort is going to help. I suppose it may be of some help around the edges where the terms of a provision conferring power are ambiguous and there is a suggestion that perhaps provisions of that sort might be construed a bit more broadly than they otherwise would be. But again, if the transaction is in fact entered into without power, then because the trustee has no indemnity it is a bit difficult to see where the clause takes you. My impression of a number of clauses of that sort – and you see them in a variety of forms – is that they are somehow drawn in the hope that they will exclude a second aspect of the trustee's fiduciary obligation to which I referred and for the reasons I gave. I suspect, if that is what they are trying to do, they simply do not work.

That sort of clause it seems to me is quite similar to the type of clauses that the judge talked about in his paper – the conflict of interest clause. I suppose you would have to say, as the judge did say, that you cannot hide behind that clause, that is the conflict of interest clause, because it does not mean that the trustee can disregard the fundamental purpose for which the trustee is there. I think the same principle applies to that. At the end of the day, as an unsecured creditor you are setting liability by the trustee's right of indemnity and, if that falls away, then the creditor falls away as well.

## Question – From the Floor:

The question was not picked up by the recording equipment, but the question which was asked was to this effect: Are the partners in a joint venture trustees for each other?

## Response – Bill Napier (Commentator):

This is, I guess, a partial answer to the question. I have always thought they give it in their individual capacity and in respect of their own non-severable beneficial interest in the property. Separately from that, and this is why I made the suggestion, it would best be done in one document. They would as a group of partners collectively charge their beneficial interest in the partnership, the whole of the partnership property. Now your question is whether they in fact would do that, at least that latter part, as trustees for each other. I have got to say I am not sure, I do not know any cases on point. I am not sure why they would necessarily be trustees for each other in that situation.

## Response – The Hon Mr Justice John Lehane (Speaker):

I suppose if the partnership property is held at all by the trustee (let us assume that the property is a parcel of land and let us assume the partners are registered as joint tenants), then in that case I suppose the answer would be at least technically yes. I suppose there would be no problem with it because it is likely to be a bare trust and the fact that they are all joining in the documents is likely to get you where you need to go. But I suppose the answer is that it all depends on where the legal title to the partnership property is.

## Response – Ian Osborne (Commentator):

If there is no trust base to the title that is being held, I do not see why there would need to be one imputed at that point in terms of getting security.

## Question – Jonathan Ross (Chairman):

I have one question of my own for the judge. We heard him say that the fundamental aspect of the fiduciary obligation of a trustee is to act in the best interests of the beneficiaries – obviously. But then he went on in a footnote in his paper (which you in the audience today will not yet have seen) to say that there is a confusing reference in an English case to an obligation to act in the "best" interests of the beneficiaries, which I believe (again from a footnote in the paper) can pose difficulties in the context of some regulations and legislation here in Australia. My question is this – what is the test? Is it just to act in the interests of beneficiaries or is it to act in the "best" interest? What is the formulation?

## Response – The Hon Mr Justice John Lehane (Speaker):

I suppose my objection to *Cowan v Scargill* is that it tends to confuse the issue. What the principle is directed to is not so much doing the "best" you can for the beneficiaries who are depending on your efforts. What are the considerations relevant to the exercise of the power? The considerations relevant to the exercise of the power are the interests of the beneficiaries. Not, for example, something else. If you add the word "best" in there, it tends to suggest that you are asking a different question and it also tends to confuse that issue with related issues such as whether the trustee has acted in the exercise of a particular power in accordance with its duty of reasonable care and prudence. For example, by adding the word "best" to the formulation of the relevant consideration of the duty, these somehow add new terrors to a trustee who acts with reasonable care and prudence but with all the advantages of hindsight can be seen to have missed an opportunity to do slightly better for the beneficiaries than it could have. That really is my objection to the use of "best" – it is almost an irrelevant word in relation to the test as it has traditionally been formulated and it suggests other things that it probably is not meant to suggest really in relation to other aspects of the trustee's duty. And that is why I think it has been misguided to import that as part of the implied covenants, as I think they are, in certain of the Corporations Regulations.