CURRENT LEGAL ISSUES RELATING TO LENDING TO TRUSTS AND PARTNERSHIPS

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Federal Court of Australia

TRUSTS

This is a topic on which there is little in the way of new law:[1] the issues which cause trouble in practice arise, generally, from the need to apply established principle in the relatively new environments in which trusts find themselves and in the context of the relatively new uses to which trusts are put.

POWERS OF TRUSTEES

Lenders have for many years understood that, if a transaction with a trustee is proposed, it is necessary to enquire as to the trustee's powers. What it means to say that a trustee has power to enter into a particular sort of transaction is, however, a question which receives little attention, with the result that things which are in principle straightforward are thought difficult and even, unnecessarily, become controversial.

The administrative powers of a trustee – including powers to carry on particular kinds of businesses, to borrow, to guarantee and to mortgage – are not in any ordinary sense powers to do those things. A natural person who is a trustee has power, or capacity, to do any of them no matter what the trust deed provides. So, usually, has a corporate trustee, under sections 160 and 161 of the Corporations Law. That may be obvious; but the significance of saying that a trustee has power to enter into a transaction is that the trustee may by the transaction give persons other than beneficiaries interests in, or relating to, the trust property which will have priority over the interests of beneficiaries. So to say that a trustee has power to mortgage means that the trustee may, by mortgaging trust property, give the mortgagee an interest which ranks ahead of the claims of beneficiaries. To say that a trustee has power to carry on a business means that the trustee, in carrying on that business, may employ trust property – in particular, may apply trust property in paying debts incurred in the business or in recouping the trustee's own funds used to pay the debts (which are, of course, debts for which the trustee is personally liable): in other

[1] And it is one on which a good deal has been written: the ground breaking article by Professor HAJ Ford, "Trading Trusts and Creditors' Rights" (1981) 13 *MULJ* 1 and (among others) RP Meagher "The Insolvency of Trustees" (1979) 53 *ALJ* 648; DR Williams "Winding up Trading Trusts: Rights of Creditors and Beneficiaries" (1983) 57 *ALJ* 273; The Hon Mr Justice BH McPherson "The Insolvent Trading Trust" in PD Finn, ed, *Essays in Equity* 1985, 142; HAJ Ford and IJ Hardingham " The Trading Trust: Rights and Liabilities of Beneficiaries" in PD Finn, ed, *Equity and Commercial Relationships* 1986, 48.

words, the exercise of the power creates in the trustee personally an interest in the trust property (to the extent necessary to indemnify the trustee against the business liabilities) which ranks in priority to the interest of the beneficiaries.[2] Similarly, to say that a trustee has power to borrow or to guarantee means that if the trustee does so (in circumstances permitted by the terms of the trust and without breach of trust) the beneficiaries' interests are postponed to the right of the trustee to use trust property to discharge the liability.

Once that is seen, it follows, it is suggested, that controversy about whether it is possible, by express provision in a trust instrument, to exclude the trustee's right of indemnity or recoupment from trust property, for liabilities properly incurred, is virtually meaningless. Because the conferral of "power" does nothing more than give a right of recourse to trust property, in priority to beneficiaries, to provide that there is no indemnity is the equivalent of saying that there is no power.[3] To say that a trustee has power to carry on a business can mean only that the trustee may apply trust property in doing so, particularly in discharging business liabilities. Similarly, to say that a trustee has power to borrow, or to guarantee, can mean only that trust property may be applied in meeting liabilities arising from the borrowing or guarantee and that the trustee, exercising that power, acquires rights (including an interest in the trust property) which have priority over the beneficiaries.

There is one obvious qualification. The trust instrument may provide that particular powers may be exercised only in relation to particular trust property or (which is the same thing) that the trustee's right of indemnity or recoupment, for particular liabilities, applies only to a specified part of the trust property.[4] That qualification is, of course, entirely consistent with the basic principle.

Whether the trustee's right of indemnity against beneficiaries can, in circumstances where it would otherwise be available, be excluded by a provision in the trust instrument is a quite different question. That right of indemnity is not a necessary consequence of the conferral of power to enter into particular kinds of transactions. It does not apply to all trusts: it is available (apart from cases where particular beneficiaries have authorised the carrying on of a business or the incurring of particular liabilities)[5] only when all beneficiaries are *sui juris* and are together entitled to the entire beneficial interest in the trust property.[6] There is no reason in principle why the instrument may not effectively exclude this indemnity.[7]

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2 Some of the cases in which the nature of this interest is considered are discussed under "Trustee's Insolvency: Creditors' Rights" below.

3 Compare, eg, HAJ Ford and IJ Hardingham "Trading Trusts: Rights and Liabilities of Beneficiaries" in PD Finn, ed, *Equity and Commercial Relationships* 1986 48 at 83 with BH McPherson "The Insolvent Trading Trust" in PD Finn, ed, *Essays in Equity* 1985 142 at 149, 150.

4 See *Re Ballman; ex parte Garland* (1803) 10 Ves 110; 32 ER 786; RA Hughes "The Right of a Trustee who Carries on Business to Indemnity out of Trust Property" (1991) 19 *Aust Bus Law Rev* 5 at 8ff; see also *Octavo Investments Pty Ltd v Knight* (1979) 144 CLR 360.

5 *Vacuum Oil Co Pty Ltd v Wiltshire* (1945) 72 CLR 319.

6 *Hardoon v Belilios* [1901] AC 118; *JW Broomhead (Vic) Pty Ltd v JW Broomhead Pty Ltd* [1985] VR 891.

7 Ford and Hardingham loc cit at 83; but for the reasons given above I respectfully disagree with their suggestion (despite the support it has in dicta in *RWG Management Pty Ltd v Commissioner of Corporate Affairs (Vic)* [1985] VR 385) that the right of indemnity out of trust property may be excluded also. BH McPherson loc cit at 149, 150 supports the view expressed in this paper. Observations of Young J in *McLean v Burns Philp Trustee Co Pty Ltd* (1985) 9 ACLR 926 at 940 should not, it is suggested, particularly given the actual decision in the case, be taken as intended to cast doubt on the proposition that the indemnity against beneficiaries personally may be excluded.

BREACH OF TRUST AND THE LENDER

Two distinct circumstances must be considered: one is where the trustee, in entering into a borrowing, commits a breach of trust; the other is where, though the borrowing involves no breach, the trustee is already, or before repayment becomes, liable to make good losses caused by other breaches.

Borrowing as Breach

The borrowing may amount to a breach of trust for any of a number of reasons. Although most have become familiar territory, it is worthwhile mentioning the main reasons.

The first is that the apparent express trust may not have been properly constituted. In New South Wales, at least, the most common failure used to be lack of compliance with the rule against perpetuities. Because of the Perpetuities Act 1984 that is a much reduced problem for trusts created after 31 October 1984.[8] But it should be remembered that, if there is an intention to create a trust but the intended express trust fails, there will be a resulting trust; and neither the trustee nor those dealing with the trustee can rely, as against the beneficiaries of the resulting trust, on the express powers set out in the deed.

Secondly, the trustee may not have power (in the sense discussed above) to borrow or to enter into the particular financing transaction which is proposed. It is well known that a trading trustee does not have the benefit of the wide powers given to most companies by section 161 of the Corporations Law. The only safe assumption is that the trustee has no power to enter into the transaction proposed unless the instrument gives power expressly to enter into transactions of that kind. That is certainly so in relation to the power to carry on a business[9] and therefore to enter into transactions in the course of a business. It cannot be assumed that provisions conferring power will be construed broadly (for the benefit of the trustee and those dealing with the trustee) rather than narrowly (as a court might think, for the protection of the beneficiaries); to take a trite example, a power to borrow might not include power to raise money by other means.[10]

Thirdly, though the power exists, entry into the transaction may be an improper use of it. That may be because there is a conflict of interest: the trustee may, for instance, derive some personal benefit from the transaction. If so, the transaction will involve a breach of trust (and the trustee may not have a right of indemnity on which the lender can rely) unless the trust instrument permits the trustee to undertake transactions in which it has an interest.[11] There is

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8 But not a problem which has been completely eliminated: questions may arise where there is trust property in a number of jurisdictions: in relation to land, it may be unwise to take *Augustus v Permanent Trustee Co (Canberra) Ltd* (1971) 124 CLR 245 at face value. There is much to be said for the view that the applicable rule in relation to land is that of the law of the place where the land is, not that of the "proper law" of the trust, if it is different: *Gray on Perpetuities* 4th ed 1942 para 259.1 at 283; Morris and Barton Leach, *The Rule Against Perpetuities* 2nd ed 20-22. Equally, in relation to pre 31 October 1984 trusts, s 11 of the Perpetuities Act should not be embraced with excessive enthusiasm: what does "during the subsistence of a beneficial interest in the trust property" mean?

9 *Vacuum Oil v Wiltshire* supra.

10 As the familiar moneylending cases remind us: *Talcott Factors Ltd v G Seifert Pty Ltd* (1963) 81 WN (NSW) Pt 1 47; *Chow Yoong Hong v Choong Fah Rubber Manufactory* [1962] AC 209; *Re Securitibank Ltd (No 2)* [1976] 2 NZLR 138; *Willingale v International Commercial Bank Ltd* [1978] AC 834; *Handevel Pty Ltd v Comptroller of Stamps (Vic)* (1985) 157 CLR 177 at 194, 195; cf *Brick and Pipe Industries Ltd v Occidental Life Nominees Ltd* [1992] 2 VR 279.

11 Such a provision, dealing with another category of fiduciary, the director, is commonplace in articles of association, though strictly construed: *Re Efron's Tie and Knitting Mills Pty Ltd* [1932] VLR 8; there seems to be no reason why what is possible generally for fiduciaries – to attenuate the conflict

authority for the proposition that the directors of a corporate trustee do not owe fiduciaries directly to beneficiaries[12] but it should not be thought that the proposition is unqualified: in principle, in the absence of an authorising provision, it should be just as much a breach for a corporate trustee to contract where one of its directors is interested as it is where the trustee itself is interested.[13] But there is an additional caveat. To provide that a trustee may enter into a contract even if it or its directors are interested is not to enable the trustee to do so disregarding another fundamental aspect of its fiduciary obligation – its duty to act in the interests of its beneficiaries, without regard to extraneous considerations.[14] That duty cannot, it is suggested, be excluded by a provision in a trust instrument because to do so would be antithetic to an essential element of a trust: the essence of being a trustee is that one holds property, and is entrusted with powers, for the benefit of beneficiaries. There is apparently no direct authority establishing the proposition that this aspect of a trustee's fiduciary duties cannot be excluded, but it seems clear in principle and has some support in what I have described elsewhere as the prevailing orthodoxy about the extent to which it is possible to modify the trustee's duty to exercise care and prudence.[15]

Because the rights of a lender (or any other person contracting with a trustee) are personal rights against the trustee only, and confer no interest in the trust property, the lender's only recourse to trust property, as is well known, is by subrogation to the trustee's own right of reimbursement or indemnity for liabilities properly incurred.[16] If because the transaction involved a breach of trust the trustee has no right to be indemnified, or its right of indemnity is impaired, the lender's recourse to the trust property is equally non-existent or impaired. It is important to recognise that this result does not depend on the lender having any form of notice of the breach: it depends entirely on the extent of the trustee's rights against the beneficiaries. Of course, if the lender does have sufficient notice of the breach no doubt it is possible that the lender will be liable to the beneficiaries under the *Barnes v Addy*[17] principle as well.

Unrelated Breach

This is perhaps the situation which best illustrates the danger that lending to trustees (or any dealing with trustees) may entail. The trustee's right of indemnity for liabilities properly incurred may be subject to a set-off on account of the trustee's liability to indemnify the trust estate for loss arising from breaches of trust. The breaches may have nothing to do with the loan transaction; they may precede it or may be committed later, before the loan is repaid. In each case the trustee has no right of reimbursement or indemnity except subject to its obligation to compensate for its breaches; again the lender is in no better position than the trustee and it does

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rule by a provision in the document governing the relationship with the principal – should not be possible in the case of trustees.

12 The leading case is still the (majority) judgment of the Court of Appeal in *Bath v Standard Land Co Ltd* [1911] 1 Ch 618; see also *Hurley v BGH Nominees Pty Ltd* (1962) 1 ACLC 387.

13 This view of the position in principle has some support in *Re James* [1949] SASR 143. Although it may offer little direct comfort to lenders, there can be little doubt that where a corporate trustee breaches its trust, a director participating in the breach may be liable under the principle in *Barnes v Addy* (1874) LR 9 Ch App 244: Ford and Hardingham loc cit 64-68.

14 See *Cowan v Scargill* [1985] Ch 270 in which Sir Robert Megarry V-C perhaps somewhat confusingly added the word "best" to the traditional formula, thus expressing the duty as one to act in the best interests of the beneficiaries: a formulation adopted, with a result which may be less than clear, in the Corporations Regulations reg 7.12.15(f)(i) and in para 52(2)(c) of the Superannuation Industry (Supervision) Act 1993.

15 "Delegation of Trustees' Powers and Current Developments in Investment Funds Management" (1995) 7 *Bond Law Rev* 36 at 39; see RP Austin "The Role and Responsibilities of Trustees in Pension Plan Trusts: Some Problems of Trusts Law", in TG Youdan ed *Equity, Fiduciaries and Trusts* 1989 111 at 128, 129; Ford and Hardingham loc cit at 56-58.

16 See *Octavo* at 367.

17 Supra.

not matter that the lender had neither notice nor the means of making an enquiry likely to produce a certain result.[18]

Once the principle has been stated, there is little more that can usefully be said. Suggestions are sometimes made that equity should, in appropriate cases, allow trust creditors direct access to trust property rather than access which depends on the trustee's rights. There would be little difficulty about the mechanism of access: the trustee against which a judgment is obtained has (trust) property in its hands which could easily enough be reached by execution; in the end, it is really a question of priorities. The difficulty is formulating a principle of direct access is, however, at least twofold. First, if the law says that a trustee may not apply trust property in discharging a particular liability, on what basis is it to say that nevertheless the property may be made available directly to satisfy that very liability? It may be misleading to suppose that the problem is the interposition of the trustee. Secondly, what the suggestion really seeks is a particular basis on which, in some circumstances, people having personal claims against a trustee may acquire an interest in (or perhaps in relation to) trust property which (even though in the circumstances the trustee has no interest which does so) may have priority over the beneficiaries' interest. Even in these adventurous days, it is unlikely that such a principle could be discovered fully fledged. Nor is anything apparent to which feathers could readily be incrementally attached.[19]

Secured Debt

The position of the secured lender is a good deal easier. That lender need not be concerned, except so far as its security is inadequate, about possible deficiencies in the trustee's rights of reimbursement and indemnity. The security itself, if created within power and properly (and in some circumstances even if not), gives the lender a direct proprietary interest in trust property which ranks ahead of beneficiaries. A legal mortgage taken for value and without notice of the trust is likely to confer priority whether the borrowing and mortgage are within power or not.[20] A Torrens title mortgage will have the benefit of the indefeasibility and priority provisions of the Torrens legislation. As for equitable securities, the lender will suffer the consequences of the ordinary principle that the earlier interest of the beneficiaries prevails (and the particular principle for which *Shropshire Union Railways v R*[21] stands) if the security is not authorised by the instrument or is created in breach of trust. But if it is created in accordance with an express power and otherwise without breach, the security will prevail over the beneficiaries: their interests were acquired on the basis that the trustee might create prior ranking securities.[22] Thus, in practical terms, the secured lender is not relieved of the need, when the security is taken, to satisfy itself that the trustee has adequate power and that the proposed exercise of it is proper; but the security is not affected by extraneous breaches of trust.

There is no reason why a trustee should not, if authorised by the deed and if it can be justified having regard to the interests of the beneficiaries, create a general charge – including a floating charge – over trust property present and future. It is, of course, essential that the document make it clear that trust property, not just the trustee's own property, is charged. There are also matters against which, also, the lender will wish to have at least what contractual protection it can get: the distribution of corpus, for example, or the exercise of a power to bring forward the time at which

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18 *McEwan v Crombie* (1883) 25 Ch D 175; *RWG Management Ltd v Commissioner of Corporate Affairs* supra; the suggestion of Needham J in *Re Staff Benefits Pty Ltd* [1979] 1 NSWLR 207 that the indemnity is excluded only when the breach is related to the transaction for which indemnity is sought cannot safely be relied on.

19 *Chapman v Chapman* [1954] AC 429 at 444 per Lord Simonds LC.

20 In practical terms, this may offer little comfort: usually the lender will have notice of the trust – a glance at a set of accounts will reveal it – and there is then no advantage, and a good deal of risk, in refraining from enquiring into its terms.

21 (1875) LR 7 HL 496 at 507-509.

22 See Meagher, Gummow and Lehane, *Equity: Doctrines and Remedies* 3rd ed 1992 para 812.

the trust will come to an end and the trust property will be finally distributable. It must also be remembered that the received analysis is that an assignment – including a charge – for value of future property operates in equity as a contract to assign.[23] The contracting party under the charge is, of course, the trustee who executes it. If later there is a change of trustee the charge will not, without a novation, affect property (not already charged when the change happens) acquired by the new trustee.

TRUSTEE'S INSOLVENCY: CREDITORS' RIGHTS

In *Octavo Investments Pty Ltd v Knight*[24] Stephen, Mason, Aickin and Wilson JJ, having noted that trust creditors' recourse to trust property is by subrogation to the trustee's indemnity, continued:

> "These principles lead naturally to the conclusion that the beneficial interests which, by subrogation, the creditors whose claims arise from the carrying on of the business have in the assets held by a bankrupt trustee form part of the property of the bankrupt divisible amongst his creditors ... The definitions of both 'property' and 'property of the bankrupt' in section 5 of the Bankruptcy Act are apt to include such an interest ...
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> Property which is an asset of a trading estate carried on by a trustee is properly described as trust property ... However ... that does not mean that the *cestuis que trustent* are necessarily entitled to call for the delivery of the property. If the trustee has incurred liabilities in the performance of the trust then he is entitled to be indemnified against those liabilities out of the trust property and for that purpose he is entitled to retain possession of the property as against the beneficiaries. The trustee's interest in the trust property amounts to a proprietary interest, and is sufficient to render the bald description of the property as 'trust property' inadequate. It is no longer property held solely in the interests of the beneficiaries of the trust and the trustee's interest in that property will pass to the trustee in bankruptcy for the benefit of the creditors of the trust trading operation should the trustee become bankrupt."

In a series of cases arising shortly after *Octavo* was decided courts grappled with two questions thought to arise, where a trustee is bankrupt or wound up, from the proposition that the right of indemnity is the trustee's own property. One is, may the costs of the winding up or bankruptcy be paid from trust property? The other, more radical, is, may (or perhaps must) trust property be applied in discharging all the trustee's liabilities, whether incurred as trustee of the trust concerned, as trustee of some other trust (obviously relevant where a trustee company is wound up) or "privately" – ie, not as trustee at all? Needham J held that the answer to both questions was "no".[25] His Honour held that since neither question arose in *Octavo* that case offered no particular assistance as to the answers. In *Re Enhill Pty Ltd*,[26] a case where only the former of the questions arose, the Full Court of the Supreme Court of Victoria held that Needham J had correctly perceived that *Octavo* did not govern the case before him, but that his Honour had answered both questions incorrectly. Young CJ said at 564:

> "But the High Court did recognize that the trustee's right to indemnity gave him a proprietary interest which on his bankruptcy passed to his trustee in bankruptcy or where the trustee was a company came under the control of the liquidator. No limitation was

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23 Among the well known authorities are *Holroyd v Marshall* (1862) 10 HLC 191; *Tailby v Official Receiver* (1888) 13 App Cas 523; *Palette Shoes v Krohn* (1937) 58 CLR 1; *Akron Tyre Co v Kittson* (1951) 82 CLR 477; *Re Lind; Industrial Finance Syndicate Ltd v Lind* [1915] 2 Ch 345.

24 Supra at 367, 368.

25 *Re Byrne Australia Pty Ltd* [1981] 1 NSWLR 3394; *Re Byrne Australia Pty Ltd (No 2)* [1981] 2 NSWLR 364.

26 [1983] 1 VR 561.

> expressed upon the purposes for which the trustee in bankruptcy or the liquidator might apply the proceeds of the right. Moreover, the reasoning of the majority of the High Court and the authorities on which their Honours rely suggest that no such limitation was intended. ... In these circumstances to hold that a trustee in bankruptcy could only apply the proceeds of the right of indemnity towards some only of the bankrupt's creditors, viz. creditors of the trust business, would deny the very purpose of the right to indemnity which is to exonerate the trustee's personal estate. In a case like the present therefore the proceeds of the trustee's lien are available for division among the bankrupt's creditors generally, not only among creditors of the trust business, and in the case of a company in liquidation are subject to the control of the liquidator under section 292."

The statements in *Re Enhill* that trust property may, in the insolvency of the trustee, be applied in meeting all the trustee's debts, whether properly incurred in the administration of the trust or having nothing to do with the trust, are obiter and, with respect, "fragile".[27] It is, after all, a strange conclusion that, once a trustee is bankrupt or in liquidation, the trust property may be (or is required to be) applied in breach of trust. It is not surprising that the Full Court of the Supreme Court of South Australia rejected that conclusion in a case where, because the insolvent trustee was trustee of two trusts, the question directly arose.[28]

It may be noted, before turning to the question of payment of the costs of the administration, that confusion is certain to be the result if the distinction between indemnity and recoupment is not kept in mind. If all that *Re Enhill* had said was that the benefit of a trustee's right of recoupment, for trust debts already paid out of its own pocket rather than the trust fund, was available for distribution among the trustee's private creditors, it would have stated the unexceptionable and obvious. There, no question arises of the application of the fund in breach of trust. The trustee has a right to get back from the fund (in priority to beneficiaries) what it has paid with its own money. The problem is that the observations in *Re Enhill* go further: they are to the effect that if, for instance, the trustee has borrowed, properly exercising its powers as trustee, the trustee's right of indemnity for the loan is available for distribution among all creditors. Trust property, therefore, equal in value to the amount of the loan, is to be distributed not to the lender (or to the lender and other trust creditors) but among all creditors in accordance with the Corporations Law. The lender thus substantially loses the benefit of its right of subrogation to the trustee's right of indemnity and the trust fund is applied for what, under trust law, are unauthorised purposes. That is why the decision in *Suco* on this issue seems, with respect, clearly right.

The question about payment of the costs of the administration is rather more difficult. On that point the South Australian Full Court followed *Enhill* rather than *Byrne*. There were, it considered, strong policy reasons for following in this respect the highly persuasive authority of the Victorian Full Court. King CJ plainly saw difficulties in theory with the conclusion, but his Honour justified it with the following reasoning:

> "There are clearly strong practical considerations in favour of such a course. Unless that course can be followed, the liquidation of a trustee company without assets of its own cannot proceed. It seems to me that that course can be justified by reference to the obligations of the trustee company arising out of the carrying out of the business authorized by the trusts. It is part of the duty of the trustee company to incur debts for the purposes of the trust businesses and, of course, to pay those debts. Upon winding up those debts can only be paid in accordance with the provisions of the Companies Act. This requires necessarily that there be a liquidator and that he incur costs and expenses and be paid remuneration. ... As the company's obligation as trustee to pay the debts incurred in carrying out the trust cannot be performed unless the liquidation proceeds, it seems to me reasonable to regard the expenses mentioned above as debts of the company incurred in

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27 Sir Anthony Mason's word: "Themes and Prospects" in Finn, ed, *Essays in Equity* 1985 at 250.

28 *In Re Suco Gold Pty Ltd* (1983) 33 SASR 99.

discharging the duties imposed by the trust and as covered by the trustee's right of indemnity."[29]

That, with respect, may be questionable. The court is perfectly capable of administering an insolvent trust, whether or not the trustee is bankrupt or in liquidation. Why should beneficiaries pay for the insolvent administration of their trustee? If the trustee had assets of its own, it is difficult to believe that it would be suggested that they should. But if it has no assets of its own, why should it not be replaced as trustee and then be wound up (or simply struck off the register)? If the trust fund is sufficient to discharge trust liabilities properly incurred, to take any other course is in those circumstances to make the beneficiaries pay for the trustee's unsuccessful private or unauthorised adventures. If, on the other hand, the assets of the trust are insufficient to discharge trust liabilities, it might be expected that distribution would be in accordance with the rules applied by the court in the administration of trusts, not those applicable, in the winding up of a company (or the bankruptcy of an individual), to the distribution of the company's (or individual's) own property.[30]

That leads to what may be suggested to be a further difficulty with the reasoning in both *Enhill* and *Suco*. As has been seen, both cases proceed on the basis that if there is insufficient trust property to satisfy trust liabilities, the property is applied in meeting those liabilities is the order provided by the Corporations Law for distribution in a winding up. But, again, the appropriate rules may rather be those which the courts apply in the administration of trusts.

It cannot be said that the present state of the authorities is completely satisfactory, and it may be hoped that the High Court will have a further opportunity to consider this area of the law. In *Chief Commissioner of Stamp Duties v Buckle*[31] the New South Wales Court of Appeal had to consider, for stamp duty purposes, whether the trustee's right of indemnity should be taken into account in ascertaining the unencumbered value of an interest in a trust estate. The court dealt with the matter principally as a matter of construction of the revenue legislation (particularly as to whether the trustee's interest under the indemnity is an "encumbrance" for stamp duty purposes) and did not express any view on the difficult questions arising from *Enhill* and *Suco*. The High Court has granted special leave to appeal, but the appeal has not yet been heard.

PARTNERSHIPS AND JOINT VENTURES

Again, this is a topic on which a good deal has been written.[32] The starting point is the nature of a partner's interest in partnership property. In *FCT v Everett*[33] that interest was described as an equitable chose in action: particularly an equitable interest rather than a legal one. It may be said in passing that while that description was sufficient for the purpose of the case, it could hardly have been intended as a complete description of the interest of a partner: obviously there are as well contractual rights against the other partners and (unless property is vested in a trustee for the partnership) no doubt a partner will own it (at law, if the property is legal) jointly with the other partners.

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29 *Suco* at 110. See also *Re ADM Franchise Pty Ltd* (1983) 7 ACLR 987.

30 See the Hon Mr Justice BH McPherson "The Insolvent Trading Trust" in Finn, ed, *Essays in Equity* 142 at 154, 155; Sir Anthony Mason, loc cit at 249.

31 (1995) 38 NSWLR 574.

32 The Hon Mr Justice BH McPherson "Joint Ventures" and RA Ladbury's commentary in PD Finn ed *Equity and Commercial Relationships* at 19 and 37 respectively; Ladbury provides an exhaustive list of earlier writings, loc cit at 37 fnn 1 and 2. See also JD Merralls "Mining and Petroleum Joint Ventures in Australia: Some Basic Legal Concepts" (1988) 62 *ALJ* 907; JRF Lehane "Joint Venture Finance and some Aspects of Security and Recourse" in RP Austin and Richard Vann eds *The Law of Public Company Finance* 1986 at 515; KM Hayne "The Need for a Joint Venture Code" (1990) *AMPLA Yearbook* 362.

33 (1979) 143 CLR 440 at 447.

In *Canny Gabriel Castle Jackson Advertising Pty Ltd v Volume Sales (Finance) Pty Ltd*[34] the High Court gave this description:

> "The nature of a partner's interest in the partnership property has often been explained. The partner's share in the partnership is not a title to specific property but a right to his proportion of the surplus after the realization of assets ant the payment of debts and liabilities. However, it has always been accepted that a partner has an interest in every asset of the partnership and this interest has been universally described as a 'beneficial interest', notwithstanding its peculiar character. The assets of a partnership, individually and collectively, are described as partnership property ... This description acknowledges that they belong to the partnership, that is, to the members of the partnership."

In that case, a party entitled to the benefit of certain contracts assigned an interest in them so that, the court held, the assignor and the assignee became partners and the benefit of the contracts partnership property. Later, the assignor created an equitable charge over its property, including its interest in the contracts. The court held that the interest of the assignor's partner, being earlier in time, prevailed over that of the equitable chargee: it did not matter that the chargee had no notice of the partnership or of the partner's interest:

> "The appellant submitted that the nature of a partner's interest was analogous to that of a residuary beneficiary in an unadministered estate. There is some similarity between the two cases in that the residuary legatee and the partner each have the right to insist on due administration, the former of the estate and the latter of the partnership's assets and liabilities, and the precise entitlement of each must await the due course of administration. Nevertheless we think that the interest of the partner in an asset of the partnership is sui generis ... It is, as we have said, recognized as a beneficial interest.
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> As such it constitutes an equitable interest and is not a mere equity to set aside or rectify a transaction by means of a court order ... Consequently it prevails over the subsequent equitable charge held by Canny Gabriel, despite that company's ignorance of the prior equitable interest at the time when the equitable charge was granted."[35]

The result of that reasoning is, in general terms, that, in the winding up of a partnership, partnership creditors (secured or unsecured) will be paid from partnership property in priority to a separate creditor of a partner who has a mortgage (which must necessarily be equitable) or charge over the partner's interest in the partnership property or in any specific partnership asset. It should be noted, however, that this is so not because a partnership creditor has a proprietary interest in any of the partnership property: it is a result of an application of equitable priority principles as between the partners' interests and interests created later.[36]

It must be remembered also that property owned by one or more partners and used in the partnership business is not necessarily partnership property. The Partnership Acts do not say so in so many words, but they assume it. Thus, subsection 20(1) of the Partnership Act 1892 (NSW) provides:

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34 (1974) 121 CLR 321 at 327.

35 At 328.

36 Section 110 of the Bankruptcy Act 1966 (Cth) provides, in effect, that partnership creditors have, in bankruptcy, prior access to partnership property, separate creditors prior access to separate property. This rule can have serious consequences for partnership creditors where there is little partnership property of any value: see PFP Higgins and KL Fletcher *The Law of Partnership in Australia and New Zealand*, 4th ed 1981 at 251 ff. See also Bankruptcy Act ss 141, 142. It seemed to have been established that, because of s 438 of the Companies Code and the predecessors of that section, the bankruptcy rules applied to corporate partners: *Re Brisbane Meat Agencies Pty Ltd* [1963] Qd R 525; *Anmi Pty Ltd v Williams* [1981] 2 NSWLR 138. In the light of the revised Corporations Law provisions about external administration, however, it is by no means clear that this is still so; probably it is not. See particularly s 553, the successor of s 438 of the Code

> "All property, and rights and interests in property, originally brought into the partnership stock or acquired, whether by purchase or otherwise, on account of the firm or for the purposes and in the course of the partnership business, are called in this Act partnership property, and must be held and applied by the partners exclusively for the purposes of the partnership, and in accordance with the partnership agreement."

Subsection (3) provides:

> "Where co-owners of an estate or interest in any land, not being itself partnership property, are partners as to profits made by the use of that land or estate, and purchase other lands and estate out of the profits to be used in like manner, the land or estate so purchased belongs to them, in the absence of agreement to the contrary, not as partners, but as co-owners for the same respective estates and interests as are held by them in the land or estate first-mentioned at the date of purchase."

Finally, section 21 contemplates an effective contrary agreement:

> "Unless the contrary intention appears, property bought with money belonging to the firm is deemed to have been bought on account of the firm."

The necessary conclusion is the agreement between partners as to the way property is to be owned is all important. It is their agreement which determines whether particular property is brought into the partnership stock or acquired on account of the partnership. Looked at from the perspective of the reasoning in *Canny Gabriel*, there is nothing surprising in this. It is the equitable interest of Partner A in partnership property which prevails over the mortgagee of Partner B's interest in it and brings about the result that partnership creditors are paid from the property before the mortgagee; but there is no reason why, with the agreement of Partner A, the priorities should not be reversed. It may be that a necessary effect of such a reversal is the exclusion of the property, to the extent of the mortgagee's interest, from the partnership "stock".

However that may be, the point for present purposes is that to a considerable extent lenders may regard the controversy as to whether joint ventures, or particular joint ventures or sorts of joint ventures, are partnerships as an academic disputation: interesting, but not necessarily of great practical relevance. If a joint venture agreement makes it clear that venturers hold property, used for the venture, as tenants in common in specified shares and that that property does not form venture "stock", there is no reason why the *Canny Gabriel* principle or the Bankruptcy Act (where it applies) should be thought to prevent a venturer giving a first ranking security over its separate interest in the property. Of course, matters are unlikely to be quite so simple: the joint venture agreement may impose restrictions on assignments of separate interests, and it is possible that the terms of the agreement will, whether or not the venture is to be regarded as in law a partnership, give rise in each venturer to an equitable interest in the separately owned shares of the others. Certainly that will be so where the joint venture obligations are supported by cross-charges.[37] But there is no reason to doubt that a lender to a participant in such a joint venture, taking a security in a way which the agreement permits, will have under the security the priority contemplated by the documents. Particularly, it is suggested, there is no sound reason to fear that, if the venture were held to be a partnership, a different result would follow.

If a joint venture is in fact a partnership then, of course, the venturers will owe each other (subject to the terms of the agreements between them) the fiduciary duties of partners.[38] The converse, however, is not universally true. It is quite possible – indeed it may be likely – that a joint venture will give rise to fiduciary duties even if it is not, in law, a partnership. It was not

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37 See generally JD Merralls "Mining and Petroleum Joint Ventures: Some Basic Legal Concepts" (1988) 62 *ALJ* 907 especially at 912 ff.

38 *United Dominions Corporation Ltd v Brian* (1985) 157 CLR 1; cf *Lac Minerals Ltd v International Corona Resources Ltd* (1989) 61 DLR (4th) 14; see also *Fraser Edmiston v AGT (Qld) Pty Ltd* [1988] 2 Qd R 1.

necessary, it is suggested, to the conclusion in *Brian* that the proposed joint venture would have been a partnership: the point was that the High Court saw the relationship as at least analogous to partnership. The essence of a fiduciary obligation, in this context, is that a person owing it may not, within the scope of the relationship giving rise to the obligation, prefer his or her own interest to the joint or common interest. Breach of such a duty may take a variety of forms. One such form is competing with the partnership (or venture, if the duty applies) within the scope of its business.[39] In *Brian* the breach was the use, as security for a venturer's debts unrelated to the venture, of property agreed to be used for the purposes of the venture. It is true that it is of the essence of the typical mining or petroleum joint venture that the venturers are pursuing separate profit and not (at least in some senses) any joint interest. No doubt it is true also that the greater the extent to which the relationship between parties is governed by comprehensive and detailed contracts the less likely it is that fiduciary obligations will be found to arise, and the narrower their scope is likely to be if they do. It is clear that parties may, by contract, modify or eliminate a duty, which would otherwise arise, to prefer the common interest[40] and there is no reason in principle why such a provision is any less effective in partnership cases than in others. In short, whether a joint venture is a partnership or not, the scope of any fiduciary duties which may arise can only be ascertained having regard to the terms of the contracts between the venturers.

How far the existence, and possible breach, of fiduciary obligations need concern a lender taking a security over a venturer's interest in property used for the venture is another question. Where joint venture documents provide in detail for the giving of such securities, and a security is taken in accordance with the provisions, there should be little cause for concern. At the other end of the spectrum, where (as in *Brian*) the security is created in breach of duty and the lender has clear notice of the relevant circumstances (the lender in *Brian* was itself a venturer) the security will doubtless be voidable. If the venture is a partnership and the property is partnership property the *Canny Gabriel* principle (reinforced by the Bankruptcy Act where applicable) will in any event apply. In other cases, outcomes may depend on priority rules, legal and equitable, where other venturers may be held to have a proprietary interest in the borrowing venturer's property, and (in relation to the principles about participation in breaches of fiduciary duty) on whether the lender has sufficient notice of the duty and its breach.[41] Clearly what is essential, in every case, is a careful study of the joint venture documents.

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39 *Aas v Benham* [1891] 2 Ch 244; *Birtchnell v Equity Trustee Executors and Agency Co Ltd* (1929) 42 CLR 384.

40 See eg Meagher Gummow and Lehane *Equity – Doctrines and Remedies* 3rd ed 1992 para 536 at 150,151.

41 A topic on which there is a great deal of law, but on which the leading Australian authority is still *Consul Development Pty Ltd v DPC Estates Pty Ltd* (1975) 132 CLR 373.