

# DIRECTORS OF CORPORATE TRUSTEES FURTHER EXPOSED

**April 2004**

The recent South Australian full Court decision of *Hanel & Anor -v- O'Neill* ((2004) 22 ACLC 274) is a further example of the lifting of the corporate veil and our erosion of the concept of the distinction between the corporate enterprise and its directors and consequently the benefit of limited liability in conducting an enterprise through a corporate trustee.

The case involved the interpretation of section 197 of the *Corporations Act*. That section provides as follows:

- “(i) A person who is a director of a corporation when it incurs a liability while acting, or purporting to act, as trustee, is liable to discharge the whole or a part of the liability if the corporation:
  - (a) has not, and cannot, discharge the liability of that part of it; and
  - (b) is not entitled to be fully indemnified against the liability out of trust assets.

This is so even if the trust does not have enough assets to indemnify the trustee. The person is liable both individually and jointly with the corporation and anyone else who is liable under this subsection.

- (ii) The person is not liable under subsection (i) if the person would be entitled to have been fully indemnified by one of the other directors against the liability had all the directors of the corporation been trustees when the liability was incurred.”

In summary the corporate trustee (Daroko Pty Limited) was accused of breaching its lease arrangement and the lessor (O'Neill) was awarded damages. However the damages judgment was unable to be satisfied as the corporate trustee had no assets. The assets of the corporate trustee had been distributed to the beneficiaries.

In the end, the director was not held personally liable, not because of the Court's view on the application of section 197 of the *Corporations Act* but on the way the litigation was handled. With respect to section 197 of the *Corporations Act*, the majority of the Court concluded that the intention of the section was that a director of a corporate trustee is required to discharge the liability of the corporate trustee where the corporate trustee is not fully indemnified out of the assets of the trust. That includes where there are no assets in the trust from which the right to be indemnified can be satisfied.

The Court held that whether the trustee is entitled to be fully indemnified against the liability out of trust assets is not simply a question of law but a combination of a question of law and a question of fact.

Mullighan J put the matter in the following light:

“It would be a strange result if section 197(1)(b) was to be interpreted so that a director could escape personal liability by reason of that provision merely by ensuring that was contained in the trust deed and could thereby operate as a shield against personal liability, even though the director causes to the trust to be without funds to avoid paying the debt”.

Debelle J disagreed with his fellow judges and highlighted the importance of the question before the Court and whilst disagreeing with his fellow judges, acknowledged that the issue before the Court was of such importance that it should go to the High Court.

If the decision of the South Australian full Court stands as authority for the correct interpretation of section 197 of the *Corporations Act*, the practise of conducting any enterprise through a corporate trustee as a means of limiting liability whilst giving flexibility in terms of distribution of the returns from the enterprise will need to be reconsidered. Trust structures (both unit and discretionary trusts) are commonly used to conduct enterprises. Many family businesses are conducted through the use of a discretionary trust. This is because they allow flexibility for income splitting and the ability to pass tax preferred amounts to beneficiaries. In addition, the 50% general discount and the various small business CGT concessions are available to trusts.

### **Further information**

If you have any questions regarding this case or the implications for you and your business, contact **Norman Donato, Partner** on **9233 9031** or by email at [ndonato@makdap.com.au](mailto:ndonato@makdap.com.au).

### **Disclaimer:**

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