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Implications of Breach of Trust by Superannuation Trustees

The Hon. Justice Arthur R. Emmett

Court of Appeal, NSW Supreme Court

Nature of Superannuation Schemes

1 A superannuation scheme will almost invariably be structured as a trust. A trust is not a legal entity, and should not be analysed in terms of contractual promises. A trust exists when the owner of an interest in property, whether a legal interest or an equitable interest, is bound by an obligation to hold that interest for the benefit of another or others, being the beneficiary or beneficiaries, being an obligation that is recognised by, and enforced in, a Court of Equity.[1] Thus, in the context of a superannuation scheme, the trustees of the scheme will own the property of the scheme and will have powers in respect of that property. However, the trustees will be bound by obligations to deal with that property for the benefit of the beneficiaries under the scheme. Those obligations will arise from the terms of the deed of trust or other instrument establishing the superannuation scheme, and the

general law, as enforced in Courts of Equity. More and more, however, statute now plays a highly significant part in the affairs of superannuation schemes.

2 The *Superannuation Industry (Supervision) Act 1993* (Cth) (**the Supervision Act**) and the *Superannuation Industry (Supervision) Regulations 1994* (**the Supervision Regulations**) now provide for the regulation and supervision of superannuation schemes by the Australian Prudential Regulation Authority (**APRA**), the Australian Securities and Investments Commission (**ASIC**) and the Commissioner of Taxation (**the ATO**). APRA is responsible for the prudential supervision of superannuation schemes in general. ASIC is responsible for promoting market integrity and consumer protection in relation to superannuation schemes. The ATO administers taxation laws affecting superannuation, together with self-managed superannuation funds. The interest of the ATO arises because of the taxation concessions that are provided in favour of superannuation schemes conducted in accordance with the Supervision Act and the Supervision Regulations. The Supervision Act and the Supervision Regulations impose additional duties on trustees, which are backed by a wide variety of civil remedies and sometimes by civil penalty provisions and criminal sanctions.

3 In addition to the Supervision Act, the *Corporations Act 2001* (Cth) (**the Corporations Act**) will impose obligations where a **financial service** is provided. Under s 766A, a person provides a financial service by providing financial product advice, dealing in a financial product, or operating a registered scheme. **Financial product advice** means a recommendation or statement of opinion that is intended

[1] JD Heydon and MJ Leeming, *Jacobs' Law of Trusts in Australia* (7th ed, Butterworths, 2006) [101].

to influence a person in making a decision in relation to a particular financial product.[2] A **financial product** is a facility through which a person makes a financial investment, manages financial risk or makes non-cash payments.[3] A person makes a financial investment if the investor gives money or money's worth (**contribution**) to another person and the other person uses the contribution to generate a financial return or other benefit, the investor intends that the other person will use the contribution to generate a financial return or other benefit or the other person intends that the contribution will be so used and the investor has no day-to-day control over the use of the contribution to generate the return or benefit.[4] Generally, the provision by a trustee company of a traditional trustee company service constitutes the provision of a financial service. The operation of a superannuation scheme will attract those provisions.

4 Where there is a breach of the obligations and duties owed by the trustees of a superannuation scheme, the beneficiaries will have available to them remedies under the general law as well as under statute. In addition, by reason of the provisions of the Supervision Act, the trustees of certain superannuation schemes also have statutory obligations to report or notify breaches to APRA or to ASIC, both of which have powers to take steps against the trustees. Further, the trustees themselves will have obligations to rectify their breach. Before speaking about the consequences of breaches of trust, it is desirable to say something about the duties and obligations of trustees.

[2] See s 766B.
[3] See s 763A.
[4] See s 763B.

Powers, Duties and Discretions of Trustees

5 The duties of trustees of a superannuation scheme under the general law include the following:[5]

- to be acquainted with the terms of the scheme;
- to adhere to and to carry out the terms of the scheme;
- to act impartially between beneficiaries;
- to invest the scheme property properly;
- to keep and render proper accounts and to give full information when required;
- to exercise reasonable care;
- to pay and transfer the scheme property to the right persons;
- not to purchase scheme property;
- not to deal with scheme property otherwise than for the benefit of the beneficiaries;
- not to make a profit directly or indirectly out of any scheme property.

6 Section 52 of the Supervision Act then provides that, if the rules governing the establishment of a superannuation entity, as defined, do not contain covenants to the effect of the covenants set out in s 52(2), the rules are to be taken to contain covenants to that effect. Further, s 52A provides that, if the rules governing the establishment of a superannuation entity of which the trustee is a body corporate do not contain covenants to the effect of the covenants set out in s 52A(2), those

rules are taken to contain covenants by each director to that effect. The description of the deemed inclusion in the rules of "covenants" is curious. Technically, a covenant is a promise given under seal. As I have said, a trust is not a contractual arrangement. It may not be entirely clear who has the benefit of the "covenants" that are taken to be included in the rules of a superannuation scheme. It may be that the effect of the relevant provision is to impose on the trustees duties over and above those imposed by the general law such that the additional duties would be enforced in a Court of Equity as though they were duties of the trustees under the general law. The "covenants" on the whole make express the obligations imposed on trustees and directors by the general law.

7 The "covenants" set out in s 52(2) include covenants by the trustees:

- to act honestly in all matters concerning the superannuation scheme;
- to exercise, in relation to all matters affecting the superannuation scheme, the same degree of care, skill and diligence as a prudent superannuation trustee would exercise in relation to a scheme of which it is trustee and on behalf of the beneficiaries of which it makes investments;
- to perform the trustees' duties and exercise the trustees' powers in the best interests of the beneficiaries;
- where there is a conflict between the duties of the trustee to the beneficiaries, and the duties of the trustee to any other person, to give priority to the duties to the beneficiaries over the duties to and interests of other persons;

[5] See *Jacobs' Law of Trusts*, above n 1, ch 17.

- to keep the money and other assets of the fund separate from any money and assets, respectively, that are held by the trustee personally;
- to act fairly in dealing with classes of beneficiaries;
- to allow a beneficiary of the scheme access to any prescribed information or any prescribed documents;
- not to enter into any contract, or do anything else, that would prevent the trustees from, or hinder the trustees in, properly performing and exercising their functions and powers.

8 The "covenants" set out in s 52A(2) include covenants by the directors:

- to act honestly in all matters concerning the superannuation scheme;
- to exercise, in relation to all matters affecting the superannuation scheme, the same degree of care, skill and diligence as a prudent superannuation trustee director would exercise in relation to scheme of which it is trustee;
- to perform the director's duties and exercise the director's powers in the best interests of the beneficiaries;

9 In the administration of a superannuation scheme, as with any trust, there are some things that trustees are obliged to do or to refrain from doing. They are duties. There are other things that the trustees may do if they think fit. They are powers. Finally, there are some things that the trustees must do, but as to which they have a discretion as to when and how they will do them.[6] In any particular case, the question of whether the trustees of a superannuation scheme have a duty to perform a particular act, or merely a power to perform or not perform, as the

trustees think fit, must be determined by the provisions of the instrument establishing the scheme.[7]

10 Trustees are under a duty to do or to refrain from doing acts the commission or omission of which would constitute a breach of trust. That duty will be breached irrespective of whether the trustees have been careful or negligent, or honest or dishonest, in doing or refraining from doing the acts.[8]

11 Trustees have power in relation to an act if the act is one in respect of which they have a discretion whether to perform the act or not. That includes all acts that the trustees may do in the administration and management of the scheme, whether the authority to do the acts is derived expressly from the trust instrument or is implied by statute. Where trustees have a duty to do an act, they will be bound to do the act, even though in their view, it would be wise not to do it. If the trustees fail to perform such an act, the Court will compel them to do so or will do the act on their behalf. However, in the case of a power, the trustees are not bound to act, but are required to exercise judgment, actively and honestly, as to whether they should do or refrain from doing the act. Powers must be exercised fairly and honestly for the purposes for which they are conferred and not so as to accomplish an ulterior purpose, whether for the benefit of the trustees or otherwise.[9]

12 A Court will not control trustees in the exercise of a purely discretionary power, unless the trustees are acting in bad faith or under a misconception as to the nature

[6] *Jacobs' Law of Trusts*, above n 1, [1601].
[7] Ibid [1605].
[8] Ibid [1602].

of the discretion. While trustees may exercise a discretion by deciding not to perform a discretionary act, they must, in fact, exercise the discretion before doing the discretionary act. If the trustees decide that a discretionary act should be done, they are bound to do it. It follows that both a power and a discretion give rise to obligations that are just as real and binding as the obligation inherent in a duty. The essential difference between powers or discretions, on the one hand, and duties, on the other, is in the nature of the act that the trustees are obliged to do.[10]

13 Sometimes, an imperative duty is coupled with a discretionary power, such as where a discretionary power is limited to the time or manner of doing an act that the trustees are obliged to do at some time or in some manner. That needs to be contrasted with a mere power, which provides the trustees with an initial discretion whether to do the act or not. Where the trustees have an imperative duty, coupled with a discretionary power, the Court will compel the trustees to perform the duty, since any refusal to perform the duty would be a repudiation of the power or discretion coupled with it. However, if the trustees are willing to perform the duty, the Court will not interfere with their decision as to how the power is to be executed. Where there are two or more trustees and they cannot agree as to the exercise of the power, the duty prevails.[11]

14 The trustees of a superannuation scheme will normally be under obligations to distribute to those who fall within particular definitions in the rules of the scheme. For example, if the rules of a scheme provide for the provision of a benefit to a

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[9] Ibid [1606].
[10] Ibid.
[11] Ibid [1616].

member who falls within a particular category defined in the rules, the trustees will be under a duty to distribute to any person who falls within that category. Further, the trustees will also be under a duty not to distribute to a person who does not fall within that category. Rules sometimes provide for payment of a benefit if the trustees are **of the opinion that** a member satisfies certain criteria. Forming such an opinion is not a matter of discretionary power on the part of the trustees to think one thing or another. It is an ingredient in the performance of the duty owed by the trustees to the member beneficiaries under the scheme.

15 In such a case, the beneficiaries are not the objects of a discretionary power of appointment. A beneficiary will either fall within the definition or will not. While the precise form and quantum of a particular beneficial interest may be contingent upon particular events, a member nevertheless has such a beneficial interest. In considering whether to reach an opinion, the trustees do not make a discretionary decision, any more than a judge in conventional litigation about whether a contract of employment has come to an end makes a discretionary decision.[12]

Investment of Scheme Property

16 The duty to invest scheme property properly is of primary importance. Trustees will be under a duty to invest the scheme property in accordance with the instructions contained in the rules of the scheme or as the law provides. Trustees

[12] *Finch v Telstra Super Pty Limited* (2010) 242 CLR 254, 270 [29]-[30].

may lawfully invest trust funds in the manner and upon the securities authorised by:[13]

- the trust instrument;
- any appropriate legislation, such as the *Trustee Act 1925* (NSW) and the Supervision Act;
- any other statute giving a trustee authority to invest trust funds;
- the Court, where the power to authorise investment is given to the Court by statute.

17 The trustees' first duty is to obey the directions of the trust instrument concerning investment. If the trust instrument contains no such direction, statutory powers will apply. Trustees who have doubts as to the prudence of obeying instructions to invest in particular securities can apply to the Court for directions, although they would be under no obligation to do so.

18 Trustees of a superannuation scheme are bound to exercise their powers in the best interests of the present and future beneficiaries under the scheme. Where there are different classes of beneficiaries, the trustees must balance the scales impartially between the different classes. Subject to complying with their obligations arising from the various sources just mentioned, the trustees must put the interests of the beneficiaries first. When the purpose of a superannuation scheme is to provide financial benefits for the beneficiaries, the best interests of the beneficiaries will normally be their best financial interests. Thus, a power of investment must

[13] *Jacobs' Law of Trusts*, above n 1, [1801].

normally be exercised so as to yield the best return for the beneficiaries, judged in relation to the risks of the investment in question.[14]

19 Under the trusts of a superannuation scheme, many, although not necessarily all, of the beneficiaries are those who, as members, contributed funds to the scheme with the intention that, in due course, in accordance with the rules of the scheme, they would receive benefits. It is all the more important, therefore, that the interests of the beneficiaries should be paramount, so that they receive the benefits for which they have in part paid themselves.[15] The trustees of a superannuation scheme must take advantage of the full range of investments authorised by the terms of the instruments applicable to the scheme. It would be contrary to their duty to narrow the range of investment by reference to principles other than prudential criteria.[16]

20 Where a trust instrument merely authorises investments of a class not authorised by statute, as distinct from directing such investments, trustees are required to exercise a high degree of prudence before making a particular investment. Special investment clauses are construed strictly. Clauses enlarging the powers of trustees to invest beyond the class of investment authorised by the general law are also construed strictly.[17]

21 Generally, uniform legislation in Australia, derived from the *Trustee Amendment Act 1988* (NZ), indicates which provisions are subject to the trust instrument and

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[14] *Cowan v Scargill* [1985] Ch 270, 286-7.
[15] *Cowan v Scargill* [1985] Ch 270, 290-1.
[16] *Cowan v Scargill* [1985] Ch 270, 295.

which operate notwithstanding what is in the trust instrument.[18] The uniform legislation provides that trustees may, unless expressly forbidden by the instrument creating the trust, invest funds in any form of investment. Trustees may, at any time, vary an investment.[19]

22 If the trustees' profession, business or employment is, or includes, acting as a trustee, or investing money for other persons, then the trustees must, in exercising a power of investment, exercise the care, diligence and skill that a prudent person engaged in that profession, business or employment, would exercise in managing the affairs of other persons.[20] The uniform legislation emphasises that trustees must, in exercising a power of investment, comply with the provisions of the instrument creating the trust that are binding on the trustees.

23 A number of statutes, both State and Federal, contain sections expressly empowering trustees to invest in funds and investments of the type created by the particular statutes. For example, such provisions are contained in the *Commonwealth Inscribed Stock Act 1911* (Cth) and the *Treasury Bills Act 1914* (Cth). The *Public Authorities (Financial Arrangements) Act 1987* (NSW) empowers trustees to invest trust funds in a range of specified public authorities, subject to the instrument creating the trust.[21]

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17 *Jacobs' Law of Trusts*, above n 1, [1802].
18 Ibid [1807].
19 Ibid [1808]. See *Trustee Act 1925* (NSW) s 14; *Trustee Act 1925* (ACT) s 14; *Trusts Act 1973* (Qld) s 21; *Trustee Act 1958* (Vic) s 5; *Trustee Act 1936* (SA) s 6; *Trustees Act 1962* (WA) s 17; *Trustee Act 1898* (Tas) s 6; *Trustee Act 1980* (NT) s 5.
20 *Jacobs' Law of Trusts*, above n 1, [1809]. See *Trustee Act 1925* (NSW) s 14A(2); *Trustee Act 1925* (ACT) s 14A(2); *Trusts Act 1973* (Qld) s 22(1); *Trustee Act 1958* (Vic) s 6(1); *Trustee Act 1936* (SA) s 7(1); *Trustees Act 1962* (WA) s 18(1); *Trustee Act 1898* (Tas) s 7(1); *Trustee Act 1980* (NT) s 6(1).

24 The primary duty of trustees in investing scheme property is owed to the beneficiaries as a whole, even where fulfilment of a duty may disadvantage one beneficiary and favour another. Generally, however, the trustees must act with impartiality as between different beneficiaries. The duty to act impartially refers to the rights of a beneficiary *qua* beneficiary and not, for example, to the rights of a beneficiary as a debtor of the trust. The trustees are bound to exercise powers for the purposes for which they are given, by giving proper consideration to relevant matters and excluding irrelevant matters. The observance of the duty of impartiality involves the proper disposition and employment of the trust property so as to avoid benefiting one beneficiary or a set of beneficiaries at the expense of another. The question whether trustees have discharged the duty to act impartially must be considered in the light of circumstances existing at the time when a particular act is done.[22]

25 Trustees of relevant superannuation schemes must also bear in mind the limitations imposed by Pt 7 and Pt 8 of the Supervision Act. Under Pt 7, the trustees of a regulated superannuation fund must ensure that the fund is maintained solely for the core purposes set out in s 62(1)(a) or for one or more such core purposes and for one or more of the ancillary purposes set out in s 62(1)(b). Part 8 sets out rules about the level of the in-house assets of regulated superannuation funds. Subject to certain exclusions, an in-house asset is an asset that is a loan to, or investment in, a related party of the fund, an investment in a

[21] *Jacobs' Law of Trusts*, above n 1, [1823].
[22] Ibid [1711].

trust related to the fund or an asset of the fund subject to a lease or lease arrangement between a trustee of the fund and a related party of the fund.[23]

26 In addition, the trustees of a superannuation scheme must be aware of s 109, which prohibits investment by trustees unless the trustees and the other party to the relevant transaction are dealing with each other at arm's length in respect of the transaction. That prohibition, however, does not extend to a transaction where the trustees and the other party are not dealing with each other at arm's length in respect of the transaction, provided that the terms and conditions of the transaction are no more favourable to the other party than those that it is reasonable to expect would apply if the trustees were dealing with the other party at arm's length in the same circumstances.[24] Further, if trustees of a superannuation entity invest in that capacity and at any time during the term of the investment the trustees are required to deal in respect of the investment with another party that is not at arm's length, the trustees must deal in the same manner as if the other party were at arm's length with the trustees.[25] There are penal sanctions for contravention of s 109.[26]

Remedies for Breach of Trust

27 Any beneficiary under a superannuation scheme who has reason to suppose that trustees are about to do an act that is not authorised may apply for an injunction to

[23] See s 71.
[24] See s 109(1)(b).
[25] See s 109(1A).
[26] See s 109(2).

restrain the act.[27] Where trustees are intending to perform an act that would constitute a breach of trust, the Court will, on the application of a beneficiary, grant an injunction restraining the trustees, even though the consequences of the proposed act may not be irremediable and sometimes even if the act is beneficial. The right to an injunction can be defeated only if the trustees can show one of the traditional equitable defences such as *laches* or unclean hands.[28]

28 Failure by the trustees to carry out a particular duty will be a breach of trust. Any one of the beneficiaries is entitled to institute proceedings to compel the performance by the trustees of their duty and to protect the beneficial interest of the beneficiaries in the property of the scheme, even though that interest is only contingent. If the breach is sufficiently serious, it may afford grounds for the removal of the trustees and the appointment of new trustees.[29]

29 So long as the trustees are ready and willing to take the proper steps to protect scheme property, such as by commencing proceedings against a third person, a beneficiary cannot maintain a suit against the trustees.[30] On the other hand, where trustees refuse to take steps to get in scheme property, a beneficiary may institute proceedings either in the beneficiary's own name or in the name of the trustees.[31]

30 The Court also has jurisdiction to appoint a receiver of trust property. A receiver may be appointed on the application of one of the trustees or any beneficiary where the appointment is required for the safety of the trust property. The basis of

[27] *Jacobs' Law of Trusts*, above n 1, [1603].
[28] Ibid [2304].
[29] Ibid [2303].

the jurisdiction is the jeopardy of the property. Thus, an appointment might be made if the trustees fail to get in any scheme property or if they cannot agree in circumstances where the disagreement might endanger the scheme property.[32]

[30] *Alexander v Perpetual Trustees WA Ltd* (2004) 216 CLR 109, 129 [55]
[31] *Jacobs' Law of Trusts*, above n 1, [2303].
[32] Ibid [2305].

Equitable Compensation

31 Where loss occurs as a result of a breach of trust, the trustees will have a civil liability to make good the loss and an obligation to put the scheme into the same position as if the breach had not been committed. A Court of Equity has inherent power to grant relief for breach of trust in the form of monetary compensation. This remedy of equitable compensation is different from an order for an account of profits. In the former case, the loss to the plaintiff is the measure of relief. In the latter case, the gain to the defendant is the measure of relief. The taking of accounts is not the appropriate procedure for determining whether the trustees have a liability to the beneficiaries. It proceeds on the basis that the beneficiaries are entitled to whatever is found to be due. The account is simply to determine how much is due.[33]

32 There are three important features of equitable compensation for breach of trust. **First**, a plaintiff will be required to elect between equitable compensation and an account of profits. Where the plaintiff elects for equitable compensation, the monetary sum awarded to the plaintiff will normally be computed by reference to the detriment suffered by the plaintiff, since the primary purpose of equitable damages is compensation. However, the amount can occasionally be computed by reference to the profit that has been made by the wrongdoer, where that profit is considered to be a fair estimate of the loss suffered by the plaintiff.

[33] RP Meagher, JD Heydon and MJ Leeming, *Meagher Gummow & Lehane's Equity Doctrines and Remedies* (4th ed, Butterworths, 2002) [25-025].

33 **Secondly**, the obligation to pay imposed by Equity is not fettered by the usual common law notions that serve to diminish the quantum and award of damages at common law. The obligation imposed by Equity is of a more absolute nature than the common law obligation to pay damages for tort or breach of contract. Thus, the obligation is not limited or influenced by common law principles governing remoteness of damage, foreseeability or causation. While foreseeability is not a concern in assessing equitable compensation, it is essential that the losses that are to be made good are only those that, on a common sense view of causation, were caused by the breach. While the plaintiff will not be required to mitigate the loss, as that term is used in a common law claim in tort or breach of contract, losses resulting from clearly unreasonable behaviour on the part of the plaintiff will be regarded as flowing from that behaviour and not from the breach. There must be a direct link between the breach and the loss.[34] In calculating the loss, Equity does not allow trustees to set off a profit made on one investment or transaction against a loss made on another. However, there are certain circumstances where profits and losses from different transactions may be set off against each other where they arise from the same wrongful course of conduct.[35]

34 Defaulting trustees will be liable for loss, notwithstanding that the loss was ultimately occasioned by something that was not a direct and immediate consequence of the breach by the trustees. If the trustees have been guilty of negligence, they will be held responsible for any loss to the scheme, whatever may

[34] Ibid [23-020].
[35] *Jacobs' Law of Trusts*, above n 1, [2205].

be the immediate cause, if it is shown that the scheme would not have been in a situation to sustain the loss but for the negligence.[36]

35 **Thirdly**, no element of penalty is involved. Where interest is allowed, it will be allowed at a mercantile rate as a means of recovering profit received or presumed to have been received by the defaulting trustees as a result of misapplication of trust funds. However, a higher rate is not awarded by way of penalty. Rather, the defendant is charged with the interest that he has received, or that which the Court is justly entitled to say he ought to have received, or which it is fairly to be presumed that he did receive.[37]

Statutory Compensation

36 Both the Supervision Act and the Corporations Act establish procedures for recovery of compensation. The trigger for compensation is a contravention of the provisions of the relevant statute.

37 Division 5 of Part 21 of the Supervision Act provides for compensation for loss suffered by a superannuation entity. Under s 215(1), if, on an application for a civil penalty order against a person in relation to a contravention, the Court is satisfied that the person committed the contravention and the relevant superannuation entity has suffered loss or damage as a result of the act or omission constituting the contravention, the Court may order the person to pay to a trustee of the entity or, if the person is a trustee of the entity, to pay to the entity compensation of such amount as the order specifies. Under s 215(2), a trustee of a

[36] *Re Dawson* (1966) 84 WN (Pt 1) (NSW) 399, 404.
[37] *Meagher Gummow and Lehane*, above n 33, [23-020].

superannuation entity may intervene in an application for a civil penalty order against the person in relation to the contravention, unless the application was made under Division 4, which deals with the effect of criminal proceedings on an application for a civil penalty order. A civil penalty order is an order made under s 196. Under s 196, where the Court is satisfied that a person has contravened a civil penalty provision, the Court must declare that the person has contravened that provision. The Court may also make an order against the person that the person pay a monetary penalty. However, the Court is not to make such an order unless it is satisfied that the contravention is a serious one.

38 A similar regime applies under Pt 9.4B of the Corporations Act. Under s 1317E, if a Court is satisfied that a person has contravened any of certain provisions of the Act, the Court must make a declaration of contravention. Under ss 1317H and 1317HA, the Court may order a person to compensate a registered scheme for damage suffered by the scheme if a person has contravened one of those provisions in relation to the scheme and the damage resulted from the contravention.

Tracing

39 While loss occasioned by breach of trust may be recouped by a personal right of action against the trustees, a personal right may be of little use if the trustees are insolvent or bankrupt. The beneficiaries may also, in some circumstances, have a personal claim against a third party who is sufficiently implicated in the breach of

trust.[38] Such claims, however, are also claims *in personam* and if the third party is insolvent, the claim will be worthless.

40 In certain circumstances, beneficiaries will also have a proprietary claim under the doctrine of tracing, in that the owner of property that has been converted into a different form may, in certain circumstances, be treated as being the owner of the new form. Thus, a beneficiary under a superannuation scheme may trace scheme property from one hand to another, and from one form to another, so as to claim the scheme property, or property that represents the original scheme property, in the hands of a third person. Tracing might also be available for replacement trustees. However, where scheme property has been misapplied inadvertently, for example, as a consequence of a mistake on the part of the trustees, the existing trustee may wish to trace property in the hands of a recipient, such as a beneficiary who was given a benefit under a misapprehension on the part of the trustees.

41 At common law, the owner of property, such as the trustees of a superannuation scheme, may follow that property by an action in conversion or detinue where the property is something other than money. It may be unlikely, but certainly not impossible, that trustees of a superannuation scheme may wish to follow specific property in the form of chattels. It may be more likely that the property involved will be frozen in action, such as shares or bonds. Where money is paid under a mistake, the trustees may have a quasi-contractual claim for restitution if it would be unconscionable for the recipient of the payment to retain the payment. For some 2,000 years, legal systems distinguished between the consequences of a

[38] See *Barnes v Addy* (1874) LR 9 Ch App 244.

payment made under the mistake of law, on the one hand, and a payment made under a mistake of fact, on the other.[39] However, that distinction is no longer recognised in Australia.[40] Nevertheless, if the recipient of a payment has changed position such that it would not be unconscionable for the payment to be retained, that circumstance may constitute a defence to a claim by the trustees. In that case, the trustees would themselves be required to make good the loss occasioned by the mistaken payment.

42 There is no action for conversion in relation to money consisting of coins or notes, being currency of the Realm. When money in that sense is passed from hand to hand, not only possession passes, but also ownership. The transfer of money constitutes an exception to the maxim *nemo dat quod non habet*. A plaintiff has no title to money in the hands of a third party. On the other hand, whenever the wrongdoer exchanges the plaintiff's money for some other chattel, the plaintiff could claim the chattel as the product of, or substitute for, the original thing, so long as it can be ascertained as such. That right ceased when the means of ascertainment failed, such as where the chattel was itself turned into money and mixed and confounded in a general mass of the same description.[41]

43 Four circumstances can be identified in which tracing might be available as follows:[42]

- Where the trust property still remains in substance in the hands of the defaulting trustees;

[39] See *Digest* 22.6.
[40] See *David Securities Pty Limited v Commonwealth Bank of Australia* (1992) 175 CLR 353.
[41] *Jacobs' Law of Trusts*, above n 1, [2702].

- Where the trust property has been mixed with the property of the trustees, so as to make its identification impossible;
- Where the trust property has been mixed with other trust property, so as to make its identification impossible; and
- Where the trust property has been transferred to third persons, being either beneficiaries or strangers to the trust.

It is convenient to deal with the circumstances separately.

44 **Where trust property remains in substance in the hands of defaulting trustees**, a beneficiary has the right to follow it into the hands of the trustees, even though the trustees have changed its nature, so long as it can be identified in its changed form. Where trustees hold shares of a company, some of which were beneficially owned by the trustees and some of which were held on trust, the fact that precise identification of the trust shares is not possible would not preclude the making of an order for a transfer of shares by the trustees to the beneficiary. Where trustees wrongfully dispose of trust property and apply the proceeds in purchasing property, the beneficiary has a right to elect either to take the property purchased or to hold it as a security for the amount of the proceeds paid out in the purchase. In effect, the beneficiary has the option of claiming beneficial ownership of the property or to assert a charge or lien on the property for the amount of the proceeds. That charge or lien will be enforced by a sale order.[43]

[42] Ibid [2701].
[43] Ibid [2704].

45 **Where trust property is mixed with the trustees' own property**, the rules appear to be as follows:[44]

- If the trustees draw upon trust property, and then subsequently pay in further moneys, the beneficiary's claim will not extend to the further moneys paid in, unless the intention of the trustees was to replenish the trust property. There is no presumption that trustees, having manifestly committed a breach of trust, intend by their subsequent acts to remedy the breach of trust;
- Where a bank account of trustees is overdrawn, the bank is entitled to discharge the overdraft out of money first paid in by the trustees, unless the bank has notice, at the time when the money was paid in, that it was trust money;
- Where assets have been acquired by the trustees with money withdrawn from the trust account but there is no balance remaining in the trust account, there will be a presumption that the trustees intended the purchase of the assets to be for the benefit of the trust, irrespective of the order of withdrawals.
- Where trustees improperly create a mixed fund, consisting partly of the credit in a mixed account and partly of assets purchased with drawings from the trust account, the beneficiary will have a charge over each of the accounts and the assets to the full value of the claim, such that the beneficiary may exhaust either before recouping the balance out of the other. At worst, the beneficiary would have a charge over each, proportionate to its value;

[44] Ibid [2707].

- Where a trustee wrongfully uses trust property to provide part of the cost of acquiring an asset, the beneficiary is entitled, at the beneficiary's option, either to claim a proportionate share of the asset or to enforce a lien upon it to secure the claim against the trustees personally for the amount of the misapplied money. Where property purchased with unmixed funds is specifically severable, as with shares or livestock, the beneficiary will have a charge on the severable property. Where there is no such claim, the beneficiary may claim a proportionate interest in the property itself, rather than merely a charge over it. Of course, if the value of the asset falls, the quantum of the charge will remain constant and thus the charge may be the more attractive remedy;
- Where a profit arises from an investment made with a mixture of the trustees' and the beneficiary's money, the beneficiary will be entitled to a proportionate share of the profits. However, that will not always be so. The entitlement of the beneficiary both to the property and to the profits derived from the property may exceed the share representing the direct contribution of trust money to the acquisition of the property in question;
- Where trustees purchase an asset with funds provided partly from their own independent resources and partly with mixed funds, but so as to leave in the mixed fund a residue insufficient to recoup the beneficiary in full, and the asset increases in value, the beneficiary will have a charge in the amount of the beneficiary's money over the funds left in the account and over the asset bought with the money withdrawn from the account. The beneficiary could exhaust either of them before turning on the other for any deficiency. Alternatively, the beneficiary may claim that proportion of the value of the

asset that the amount withdrawn from the trust bears to the total amount applied in purchase of the asset.

46 **Where the trust property has been mixed with other trust property, so as to make its identification impossible**, the rule in *Clayton's Case* has no application as between the beneficiaries whose property has been mixed. *Clayton's Case* is a rule of common law applicable to determine the rights of a creditor as against debtor, but not applicable to determine the competing equitable proprietary rights of the beneficiaries in trust property. Where trustees of mixed funds purport to apply money on behalf of one of the beneficiaries, but use the money not for the beneficiary, but for the trustees' own purposes, then the money should be regarded as that beneficiary's, because the matter depends upon the intention of the trustees. Where it is not possible to attribute particular investments to the funds of a particular beneficiary, the Court would ordinarily apportion the available funds rateably.[45]

47 **Where the trust property has been transferred to third persons, being either beneficiaries or strangers to the trust**, the principles governing the right of a beneficiary to trace property into the hands of a third party may be summarised as follows:[46]

- If the property has been transferred to someone who takes with notice, the property will be held on behalf of the beneficiary, whose rights will persist;

[45] Ibid [2709].
[46] Ibid [2711].

- If the property has been transferred to someone who has taken the legal estate for value without notice of the claim, the property cannot be followed;
- If the transfer is to a volunteer who takes without notice, and there is no question of mixing, the property is held on behalf of the beneficiary, whose equitable right persists;
- If the transfer is of money to a volunteer who innocently mixes it with money of his or her own, special rules apply designed to balance the interests of the claimant and the volunteer.[47]

Duty of Trustees to Rectify a Breach

48 Superannuation trustees have positive obligations, once they become aware of a breach, to take steps to rectify the breach. Trustees must be proactive, and not merely reactive. They undertake a duty to look after the affairs of the superannuation scheme. Those duties extend to remedying the consequences of any breach of trust. It is a further breach of trust by trustees to do nothing once they become aware of a breach of trust, albeit an inadvertent breach of trust. Trustees should not simply wait until the beneficiaries get wind of a breach. In most circumstances, the beneficiaries would have no way of knowing that there has been a breach. The desirability of informing beneficiaries of a breach is adverted to below.

49 Trustees are under a duty not to commit a breach of trust. Depending upon the nature of the breach, trustees will be under a continuing duty. For example, if

[47] Special rules apply to this case: see ibid.

trustees have parted with trust property, the duty to get in trust property will require them to exercise whatever powers are available to recover the trust property. Trustees will have a liability for any loss suffered as a result of a breach of trust. Insofar as the breach of trust gives rise to a secondary obligation, enforceable by an action in a Court of Equity, the trustees will be compelled to rectify the breach. Where the failure to rectify a breach results in greater loss than would have been suffered had the trustees rectified the breach, the trustees will be liable for that additional loss. It may not much matter whether that liability is characterised as a duty to rectify the breach or merely the remedy conferred as a consequence of that further breach. Of course, tracing may become important in such circumstances if the trustee is insolvent.

Duties to Notify Significant Breaches to a Regulator

50 Under s 912D of the Corporations Act, a financial services licensee commits an offence if the licensee does not, as soon as practicable, and, in any case, within ten days after becoming aware of certain breaches or likely breaches of its obligations under s 912A or s 912B, lodge a written report on the matter with ASIC. Their reporting obligation, however, only arises where the breach or likely breach is "significant", having regard to the matters listed in s 912D(1)(b). Under s 912D(1A), a financial services licensee is "likely to breach" an obligation if, and only if, the licensee is no longer able to comply with the obligation. A report will be taken to have been lodged with ASIC if the licensee is regulated by APRA and the report is received by APRA in accordance with the terms of an agreement

between APRA and ASIC under which APRA acts as ASIC's agent to receive such reports.[48]

51 Section 912A of the Corporations Act imposes obligations on a financial services licensee that include the following:

- do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly;
- have in place adequate arrangements for the management of conflicts of interest;
- comply with the conditions on the licence;
- comply with the provisions of Ch 5C, 5D, 6, 6A, 6B, 6C, 6D or 7 of the Corporations Act, the provisions of Div 2 of Pt 2 of the ASIC Act or any other Commonwealth, State or Territory legislation that covers conduct relating to the provision of financial services;
- have available adequate resources to provide the financial services covered by the licence, unless the licensee is a body regulated by APRA; and
- maintain the competence to provide those financial services.

52 Section 912B of the Corporations Act imposes further obligations on financial services licensees to have arrangements for compensating persons to whom the licensee provides a financial service as a retail client for loss or damage suffered because of breaches of the obligations imposed by Ch 7. The arrangements must

[48] See s 912D(1C).

satisfy the requirements specified by the Regulations or must be approved in writing by ASIC.

53 Section 29JA of the Supervision Act is an analogue of s 912B. Under s 29JA(1), if an RSE licensee becomes aware that the licensee has committed or will commit certain breaches of conditions imposed on its licence, the licensee commits an offence if the licensee does not give APRA written notice about the breach as soon as practicable, and in any case, no later than ten business days, after becoming aware of the breach. The notification obligation only arises where the breach is or will be "significant", having regard to any one or more of the factors specified in s 29JA(1A). That criterion will be discussed further below.

54 Under s 29J of the Supervision Act, it is an offence for a person to be a trustee, or act as a trustee, of certain superannuation schemes unless the person holds an RSE licence. Section 29E of the Supervision Act imposes conditions on all RSE licences. The conditions may be summarised as follows:

- The licensee must comply with the provisions of the Supervision Act, the Supervision Regulations, the prudential standards promulgated by APRA and certain provisions of the Corporations Act listed in s 38A(b) of the Supervision Act that deal with disclosure obligations, the *Financial Sector (Collection of Data) Act 2001* (Cth), the *Financial Institutions Supervisory Levies Collection Act 1998* (Cth), and any other provisions of any other law of the Commonwealth specified in the Supervision Regulations;
- The duties of the trustee in respect of each registrable superannuation entity of which it is an RSE licensee must be properly performed;

- The RSE licensee and each registrable superannuation entity of which it is an RSE licensee must have an ABN;
- The RSE licensee must notify APRA of any change in composition of the RSE licensee;
- The RSE licensee must comply with any other conditions prescribed by Regulations.

There are other specific conditions according to whether the RSE licensee is a constitutional corporation or a group of individuals.

55 As mentioned above, the obligation of a financial services licensee to lodge a report only applies in relation to a breach or likely breach that is **significant**, having regard to the factors specified in s 912D(1)(b) of the Corporations Act. Similarly, the obligation of an RSE licensee to give notice only applies in relation to a breach that is **significant**, having regard to the any one or more of the factors specified in s 29JA(1A) of the Supervision Act. The criteria for determining what are significant breaches are similar.

56 Under both s 912D(1)(b) and s 29JA(1A), the question of whether a breach will be significant must be assessed having regard to:

- the number or frequency of similar previous breaches;
- the impact of the breach on the licensee's ability to provide the financial services covered by the licence or to fulfil its obligations as trustee;
- the extent to which the breach indicates that the licensee's arrangements to ensure compliance with those obligations are inadequate;

- the actual potential financial loss to clients of the licensee or the beneficiaries under the scheme, or to the licensee itself, arising from the breach; and
- any other matters prescribed by regulation.

57 Thus, a one-off breach may not be significant, but repeated breaches may be of significance such that, at some stage, a breach that would otherwise not have been regarded as significant becomes significant simply because there have been previous insignificant breaches of the same kind. It is both number and frequency that determine whether a repeat breach is significant.

58 The period within which the report or notice must be lodged or given starts on the day when the licensee becomes aware that a breach or likely breach is significant.[49] That is to say, it is the time of becoming aware that a breach or likely breach is significant that is critical for the commencement of the period. That is to say, it is possible that a significant breach may have occurred without the licensee's being aware of its significance at the time that the breach occurs. It would be irrational to require reporting or notification of a breach that was not, in good faith, regarded as significant. That possibility, however, emphasises the need for diligence on the part of trustees in considering any breach for the purposes of determining whether or not it should be characterised as significant.

59 Whether a breach or likely breach is significant may depend upon the nature, scale and complexity of the operations of the licensee. The nature, scale and

complexity of the operations of the licensee would have a bearing on all of the factors. For example, the impact of a breach on a licensee's ability to provide services or to fulfil obligations as trustee would very much depend upon the nature, scale and complexity of the licensee's operations. Further, the adequacy of a licensee's arrangements to ensure compliance with its obligations would also be determined by reference to the operations of the licensee. Again, the significance of a potential loss to a licensee would depend upon the nature, scale and complexity of the licensee's operations.

60 Consideration of whether a breach or likely breach is significant must be undertaken diligently and in good faith. While it is doubtless desirable to err on the side of caution in reporting or giving notice of a breach or likely breach, the consequences of doing so may be serious. There may be an admission of guilt involved in reporting or giving notice of a breach. Care should therefore taken, in appropriate cases, to make clear that any report is given for more abundant caution and not necessarily by way of acknowledgement that there has been a breach. On the other hand, if there is no real doubt as to whether there has been a breach, it would be undesirable to play down its significance.

61 Apart from statutory requirements to report a breach or likely breach, or to give notice of a breach, there will also be the obligation arising under the deemed covenant under s 52 to allow access to any prescribed information or any prescribed documents. Further, trustees would have a duty under the general law to account in a thorough manner to beneficiaries under the superannuation

[49] See s 912D(1B) of the Corporations Act and s 29JA(1) of the Supervision Act. For ASIC's interpretation of this issue, see its Regulatory Guide 78, particularly 78.26 – 78.27.

scheme. That carries with it a corresponding entitlement on the part of the beneficiaries to information regarding the management of the scheme and the scheme property.[50] On the assumption that a significant breach is inadvertent and that the trustees have acted honestly, it may be prudent for responsible trustees who become aware of a breach to inform members of the breach, together with the steps being taken to rectify the breach. On the other hand, circumstances could arise where it may be damaging to the superannuation scheme for the fact of breaches to be made publicly known, so long as the trustees are taking appropriate and adequate steps to rectify and remedy the consequences of any breach.

62 All States and Territories contain the equivalent of s 85 of the *Trustee Act* (NSW),[51] which provides that, where trustees may be personally liable for a breach of trust, the Court may relieve the trustees from personal liability for the breach, either wholly or partly. Such relief will not be given unless it appears to the Court that the trustees have acted honestly and reasonably, and ought fairly to be excused for the breach of trust.[52] Such relief, of course, would not extend to the obligations to report or give notice imposed by statute.

63 Trustees who are in doubt as to specific questions of construction of a scheme instrument or specific questions arising in the administration of the scheme may apply to the Court for judicial advice in relation to such questions.[53] Normally, such an application would be made *ex parte* by summons and affidavit. However, where there is a dispute of fact, the Court would normally require a contradicter

[50] *Waterhouse v Waterhouse* (1998) 46 NSWLR 449, 494.
[51] See *Trustee Act 1925* (ACT) s 85; *Trusts Act 1973* (Qld) s 76; *Trustee Act 1958* (Vic) s 67; *Trustee Act 1936* (SA) s 56; *Trustees Act 1962* (WA) s 75; *Trustee Act 1898* (Tas) s 50; *Trustee Act 1980* (NT) s 49A.
[52] *Jacobs' Law of Trusts*, above n 1, [2214].

and the issues of fact should be defined by pleadings and determined by oral evidence.[54]

64 There would be a question as to whether obtaining judicial advice would affect statutory obligations to report or give notice. While trustees who act in accordance with judicial advice will normally incur no liability for breach of trust in doing so, where there are penal sanctions involved, some further step may be necessary. Section 1318 of the Corporations Act might be a source of relief. Part 9.5 confers on the Court powers to grant relief in limited circumstances even if relief were not available under those provisions. The fact that trustees had obtained judicial advice before acting would clearly be a relevant factor to be considered in the imposition of any penalty by a court for contravention of an obligation to report or give notice of a breach.

Conclusion

65 The critical matter for trustees who are concerned about breaches of trust is to be aware of the obligations and duties that the trustees have assumed by accepting appointment of their position. The obligations that arise from breach will depend upon the nature of the breach, and that will depend upon the terms of the rules governing the scheme, the general law and the increasing intervention of statute.

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[53] In NSW, see *Uniform Civil Procedure Rules 2005* r 54.3 (formerly *Supreme Court Rules 1970* Pt 68 r 2).
[54] Ibid [2307].