



## Précis Paper

### Breach of Duty by a Superannuation Trustee

A discussion of the civil liabilities arising from a breach of duty by a superannuation trustee

#### Discussion Includes

- Duties of trustees
- Application of the *Superannuation Industry (Supervision) Act 1993* (Cth)
- Superannuation complaints legislation
- Indemnification
- Right of compensation for loss caused by a trustee's dereliction of duties

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## Breach of Duty by a Superannuation Trustee

In this edition of BenchTV, The Hon. Joe Campbell (Adjunct Professor – Sydney University) and Michael Vrisakis (Partner – Herbert Smith Freehills, Sydney) discuss the Hon. Joe Campbell's recent paper from the *Australian Bar Review* which focuses upon the general law and statute law that surrounds civil liabilities arising from breach of duty by a superannuation trustee.

### Duties of Trustees

1. Trustees' duties are generally expressed in terms that are quite incomplete. Generally speaking trustees have a duty to know the terms of the trust, to hold the balance fairly between different classes of beneficiaries, to take proper care in exercising the discretions that the trust has, and so on. However, you cannot truly know what the trustee's duties are without knowing what the terms of the particular deed are that the trustee is administering.
2. The trustee has a duty to bona fide exercise the office that is created by the deed. There are various obligations imposed on trustees both through statute and general law. However, all of the statutory obligations and nearly all of the general law obligations can be changed by the terms of the deed.
3. *Cowan v Scargill* [1985] Ch 270 is a good example of the way that it is not just the terms of the trust deed, but also the circumstances in which the trust comes to be administered that influences what a trustee is supposed to do. The issue in this case was what should the investment policy of the superannuation trust be? In this case there was the Miners Union on one side wanting to use the trust funds to prop up the ailing British Mining industry, and employer representatives on the other side arguing that they wanted to exercise their investment discretions on a basis that was much broader and that took into account more conventional investment criteria, to better suit a broader range of beneficiaries of the trust. This case is a good example of the practical context in which the trustees come to administer their obligations and their office, which is very important in determining the ultimate outcome.
4. There must be a public policy interest in having protections available because many people would not want to be a trustee. There are two default rules about the right of trustees to indemnity:
  1. The trustee is entitled to be indemnified from the trust assets for any liability that has been properly incurred in the administration of the trust
  2. The trustee has the right to be indemnified personally by the beneficiaries' for expenses he has properly incurred in administering the trust.

5. If a trustee has distributed the trust property and an unexpected expense appears out of the blue, in that circumstance the same reason as to why the trustee has the right to be indemnified from the trust asset applies. If a trustee has incurred a particular liability at the request of a beneficiary, the trustee is entitled to be indemnified by that beneficiary as well. Some indemnities may exist under the state and territory pieces of legislation, and it is possible for the general law right of indemnity to be excluded.
6. The general law rights of indemnity, whether from the trust assets or from the beneficiaries, are default rules for the institution of a trust. Some state statutes have decided it is not possible to exclude the right of indemnity that is conferred by state legislation. This has been of practical importance in situations where a trustee has been a two dollar company facing a huge liability and seeks not to meet the liability by having the trust deed amended to exclude its right of indemnity. The South Australian case of *Moyes & Anor v J & L Developments Pty Ltd & Anor* (No 2) [2007] SASC 261 held that it was not possible for the state indemnity to be excluded in that way.
7. In a superannuation fund some of the deeds are constructed as agreements between an employer, for example, who is agreeing to contribute to a fund and a trustee who is agreeing to take those contributions and invest them. The property becomes the contribution either of the employer and/or the members of the fund. The fact that the superannuation trust may contain different divisions is often quite typical when dealing with master funds or master trusts where there are multiple employers contributing.
8. When the Superannuation Industry (Supervision) Act 1993 (Cth) (SIS legislation/the Act) was introduced, it injected itself into the content of the governing rules of the superannuation fund. Superannuation trust deeds have traditionally taken a form that is unconventional for other trust deeds. They are usually very short deeds under which the trust deed does little more than promise that it will hold the property on trusts that are declared by a separate document called 'the rules'. The rules set out the way the trust is going to work.
9. The SIS legislation operates by deeming there to be in the governing rules of every regulated superannuation fund a series of covenants. In the case of a corporate trustee, there were also covenants by each director of the corporate trustee and these covenants were ones which were unexcludable. The point of these covenants was to provide a measure of consumer protection and a measure of ensuring that superannuation funds were run in a way that was sensible and honest. The covenants are very relevant because they are incorporated into the governing rules and they cannot be excluded.
10. One of the covenants that has received a lot of focus by the regulators and the courts is the covenant to act in the best interests of beneficiaries and members. The point of debate and

conjecture of this covenant has been about what the covenant means in the context of a trustee's duties in the interest of the beneficiaries. Does it create an additional obligation, or is a duty that is centered upon outcomes or process? In *Invensys Australia Superannuation Fund Pty Ltd v Austrac Investments Ltd* [2006] VSC 112, Justice Byrne described the duty of best interests as an amalgam of a duty of loyalty and a duty of care.

11. The case of *Manglicmot v Commonwealth Bank Officers Superannuation Corporation Pty Ltd* [2011] NSWCA 204 decided that statutory covenants went no further than the general law duties, and the point of having the statutory covenants was to make them unexcludable. In 2013 there was a wholesale replacement of statutory covenants. It is important to be wary of relying upon any pre 2013 decisions on construction of the covenants for the purpose of construing the statutory covenants that have been in place since 1 July 2013.
12. Whenever you have a problem in trust law, the essential question is what is this person supposed to do to comply with his legal obligations, which is always very fact dependent. In terms of analyzing the landscape, one of the things that is possibly useful to do is to work out whether the duties of a trustee in a superannuation fund are exactly the same as the duties of a conventional trustee.
13. The case of *Finch v Telstra Super Pty Ltd* [2010] HCA 36 was a consideration of whether the duties of the trustee were more intense. There has been a body of case law that has looked at superfunds in the employer-employee context involving people who are not volunteers which has said that when a trustee is exercising its powers and discretions, it cannot exercise them in an irrational or unfair way, recognizing that they are not volunteers. They have paid for their consideration, either in the context of employer-employee relationship by the work product, or in the context of a public offer fund by actually paying their contributions in.

#### Application of the Superannuation Industry (Supervision) Act 1993 (Cth)

14. As far as indemnities are concerned, the SIS legislation makes a difference to the way in which a trustee's right of indemnity from the assets is concerned. It requires a trustee to have a right of indemnity from the assets and makes that right of indemnity one that is unexcludable.
15. One of the consequences of this is that one of the general law aspects of a trustee's right of indemnity is excluded. Ordinarily under the general law, a trustee is only entitled to an indemnity from the fund assets for whatever is the net balance that the fund owes to him. Therefore, if there is some liability that the trustee has to fund, that gets set off against any

amount that the trustee is entitled to claim from the fund; this is often referred to as the clear accounts rule.

16. It is a consequence of the way section 56 of the SIS Act works that the clear accounts rule does not apply in relation to rights of indemnity from the assets. The SIS legislation has put constraints on the ability to be indemnified in terms of things like failure to act honestly, intentional or reckless failure to exercise the requisite degree of care and diligence, and a number of other checklist items. These things mentioned are intended to be a constraint on the amendments that can be made to a trust deed.
17. The trustee is forbidden to have a right of indemnity in the circumstances that are set out in section 56(2) of the SIS Act. It is possible sometimes to remove a trustee's liability for certain breaches of trust, but s 56(2) provides circumstances where it is absolutely impossible for the trust deed to remove the trustee's liability.
18. There is a definition of governing rules which makes clear that the expression 'governing rules' includes terms of the trust deed and any rules of general law that apply to the trust deed. The Commonwealth nature of the legislation effectively overrules any inconsistent State legislation as per s 109 of the Australian Constitution.
19. The right of a trustee to indemnity from the trust assets is recognised by the general law as a right that has priority to any claim that the beneficiaries have to the trust assets. The trustee ought to be entitled to be paid whatever the expenses are of running the trust for the benefit of the beneficiaries. The logic of this requires that the trustee's right of indemnity have priority over any beneficial rights that the beneficiaries have in the trust fund.
20. The SIS legislation provides indemnity for a trustee when acting as a trustee. As a matter of construction of that phrase, it goes wider than the trustee acting properly. Most situations where there has been a breach of trust are ones where a trustee is trying to act properly, but just gets it wrong. The Act requires that the trustee should have a right of indemnity in that situation, even if getting it wrong amounts to a breach of trust.
21. One of the interesting aspects of the super fund framework is the interconnection between the disclosure regime under the *Corporations Act 2001* (Cth). That regime talks about disclosing things that are material to the investment decision.
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- The right of indemnity of a trustee from the beneficiary, at least for publicly offered funds, is one that is completely inappropriate, and is not dealt with by the legislation. It should be.
23. Under the general law there is some real doubt about the extent of recovery that is possible for breach of a trustee's covenant. It seems to be well accepted that if a trustee breaches one of the covenants in a deed then it is possible for a beneficiary to sue the trustee for breach of trust. However, under the general law it is quite problematic as to the extent to which it is possible for the beneficiary to receive compensation for consequential loss. There is no case that says that any kind of compensation for what the common law would treat as general damages is recoverable from an act of a trustee.
  24. The way in which the cases that have decided that there is a right of equitable compensation for breach of trust have put it, it has been cast in very wide language. The context of the litigation in which that wide language has been used has not been one that has really called to attention these particular difficulties relating to the extent of consequential loss that is recoverable.

#### Superannuation complaints legislation

25. The Superannuation Complaints Tribunal has jurisdiction in relation to treatment consideration and addressing decisions of the trustees which may be considered unfair or unreasonable. The Tribunal does have the power to make orders that are designed to correct the unfairness of a decision of a trustee.
26. In a recent case heard in the Tribunal, *Superannuation Complaints Tribunal Determination D15-16\140*, a superannuation trustee received an inquiry from a woman who was about to retire, asking what her retirement benefit would be and she was told a specific sum. She thought she could afford to go for an overseas holiday and did so, but the trustee was wrong and she was entitled to much less. It was held that the decision to not compensate her for this was unfair and that she was entitled to be reimbursed the amount she had spent on her holiday that she otherwise would not have spent.
27. Section 37(5) of the *Superannuation (Resolution of Complaints) Act 1993* (Cth) provides that the Tribunal has the powers of a trustee under the trust deed. This raises a question whether trustees' duties in the superannuation context are capable of growth through pieces of legislation if one works on the proposition that if there is a remedy it creates a correlating duty.
28. One of the duties that has been imposed under one of the statutory covenants from the time the SIS Act was first there, was a duty to exercise care. Under the version of the covenant that has been in place since 2013, the degree of care that is required for the

trustee of a fund that is not self-managed is the degree of care that would be exercised by a professional superannuation trustee.

29. The statutory covenant to take reasonable care has come to include an obligation to take reasonable care to make decisions that are not unfair or unreasonable. Unless the government decides it is going to scrap this remedy for unfairness or unreasonableness in the upcoming reform of the Superannuation Complaints Tribunal, then it will continue to be relevant.

#### Indemnification

30. Before the 2013 changes, the statutory right of indemnity had a fairly undesirable effect. It meant that if there was a breach of one of the statutory covenants, then it would be possible for the person who had been hurt as a consequence of that breach to recover compensation. However, unless the trustee was acting in the way that was dishonest, or one of the other forms of bad behaviour that fall within s 56(2), the trustee would be entitled to indemnity for the amount paid to a particular person. In effect this would mean that the consequences of the trustee's breach would end up being borne by the members as a whole.
31. In 2013 there were changes made to alter the way indemnity worked, and these changes arose from the requirement for there to be operational risk reserves that are established in superannuation funds and are managed in a particular way. In these circumstances it is necessary for there to be operational risk reserves established.
32. Sometimes it is possible for a trustee to have resource to an operational risk reserve that is in the fund itself, rather than in the trustees own assets to meet a particular liability. However, there are obligations on the trustee to run these operational risk reserves in a way that is overall fair. To require the members to end up paying for the trustee's own mistakes is not what people would ordinarily think was fair.
33. Even if the fund assets can be resorted to in the first instance to meet a liability as sometimes might be necessary if there is a large liability, there are obligations on the trustee to top up the fund assets in a way that means that for these funds that are not self-managed, it is the trustee that ends up paying for its own mistakes.

#### Right of compensation for loss caused by trustees dereliction of duties

34. Section 55 of the *Superannuation Industry (Supervision) Act 1993* (Cth) sets out the right of compensation for loss caused by trustees dereliction of duties. Subsection 55(1) of the Act

contains an obligation for a person not to convene a covenant that is in the governing rules. A 'person' could be a trustee if it is a trustee's covenant you are talking about, and it could be a director if it is a director's covenant you are talking about.

35. Subsection 55(3) provides that a person who suffers loss or damage as a result of conduct of another person that was engaged in a contravention of ss 55(1) can recover the amount of loss or damage against the person who contravened, or any other person involved in the contravention. Subsection 55(3) of the Act provides a much broader basis for claiming against people involved in a contravention.
36. There is quite a body of litigation that explains how this section works. It is not just the beneficiary of the trust or the member who is able to sue, it is any person who suffers loss as a consequence of a breach of duty. The notion of loss or damage is one that is perfectly general, it is any sort of bad consequence that befalls a person. It does cover the kinds of consequential loss discussed earlier that are problematic for the recovery of equitable compensation, for example pain and suffering.
37. The scope of damages that are recoverable under this statutory action is wider than the scope of damages that are recoverable for breach of the equitable duty simple. The action may be brought against anyone who was involved in the contravention, so if somebody has, for example, persuaded the trustee to engage in a breach of trust, there is possibility of an action being brought against the person who did the persuading.
38. The general law has some concepts that would extend the liability to people according to *Barnes v Addy* (1874) LR 9 Ch App 244, or to people who have been participating dishonestly. Under the general law, if somebody has been involved in a breach of trust and they then become a trustee de son tort. They can be liable if they have received the trust property. They may be liable under the first limb of *Barnes v Addy*, even if they have disposed of the property. Under the second limb of *Barnes v Addy*, a person who has assisted a trustee in a dishonest scheme can be liable.
39. A person who has dishonestly induced a trustee to engage in a breach of trust can be liable even if the trustee is just a dupe in carrying out the breach. It is also possible for there to be tracing remedies against people who have received property as volunteers. Lastly, it is also possible to have rights against someone who received trust property as a volunteer and then disposed of it after they had acquired notice that it was trust property, as seen in *Heperu v Belle* [2009] NSWCCA 252.



## **BIOGRAPHY**

### The Hon. Joe Campbell

Adjunct Professor – Sydney University, NSW

The Honourable Joseph Campbell was a judge of the Supreme Court of New South Wales from 2001 until his retirement in 2012. He sat as a first instance judge in the Equity Division 2001-2006, and as a judge of the Court of Appeal 2007-2012. In 2013 he was elected as a Fellow of the Australian Academy of Law. Also in 2013 he became an Adjunct Professor at the University of Sydney Law School, where each year he has taught in the subjects of Equity and Legal Interpretation. Additionally, he is Deputy Chair of the Electoral Commission of NSW, and has sat occasionally as an Acting Judge in the NSW Court of Appeal.

### Michael Vrisakis

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Michael practises in financial services specifically investment funds, funds management, superannuation and insurance. He is widely recognised as a market leader and authority in the area of non-contentious regulation and is regularly at the forefront of debating and developing new law, nominated as a leading practitioner in this space and quoted in the financial press. His advice is routinely sought in relation to strategic management of regulatory matters, including liaising with APRA and ASIC. He was most recently named as a leading practitioner in the area of regulation in *Best Lawyers 2015* and *Best Superannuation Lawyer* in 2014. Furthermore, in 2017, *Acritas Stars* – an independent report commissioned by a global panel of General Counsels – listed Michael as one of 23 'stand-out' lawyers globally.

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## Legislation

*Superannuation Industry (Supervision) Act 1993* (Cth) s 56, s 55

*Commonwealth of Australia Constitution Act 1901* (Cth) s 109

*Corporations Act 2001* (Cth)

*Superannuation (Resolution of Complaints) Act 1993* (Cth)

*Trade Practices Act 1974* (Cth)

## Other

[J.C. Campbell, 'Some aspects of civil liability arising from breach of duty by a superannuation trustee' \(2017\) 44 \*Australian Bar Review\* 25](#)