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PERSONAL LIABILITY FOR DIRECTORS OF CORPORATE TRUSTEES

The effect of a recent decision of the South Australian Full Court is to make directors of Trustee Companies personally liable for all of the debts of the Trust.

Unless this decision is overturned on appeal (or the legislation is amended) the consequence of this decision is to dramatically detract from the value of trust company structures. Indeed, by effectively making directors of the trust company personally liable for all of the debts of the Trust, they have effectively become guarantors for the obligations of the Trust even if there was no such intention in the first place.

The decision involved an interpretation of section 197 of the Corporations Act which imposes liability on director's of corporate trustees in circumstances where the trustee company is not entitled to be fully indemnified against the liability, out of the trust assets. In the case of *Hanel v O'Neill*, a two to one majority of the Court held that if there were no, or insufficient, underlying assets in the Trust then there was no "entitlement" for the purpose of indemnifying the trustee company – and in the result the director concerned was held to be personally liable to meet the unpaid debt – even though the trustee company had not lost its actual right of indemnity, in the legal sense.

This is a far higher level of personal liability than that to which directors of other companies are exposed, where liability is normally limited to the situation where directors allow their company to trade whilst insolvent.

Until the position is clarified, no director of a trustee company can safely allow the Trustee to incur any liability (even if completely solvent at the time) if there is the slightest risk that the Trustee may not be in a position to meet the liability (for example a lease liability, as in this case) at some future date.

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