



**Australian Government**

**Insolvency and Trustee Service Australia**

## **INSPECTOR-GENERAL PRACTICE DIRECTION No 12**

### **Controlling Trustees Roles and Duties**

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## Introduction

1. The purpose of this document is to outline the Inspector-General in Bankruptcy's expectations of the requirements placed on a controlling trustee through the current legislation, relevant case law and Schedule 4A Performance Standards.

## Who can be a Controlling Trustee?

2. The term "controlling trustee" is defined in section 187(1) of the Bankruptcy Act ("the Act") as: "Controlling trustee", in relation to a debtor whose property is subject to control under Division 2, means the person who is the controlling trustee under section 188 or 192.
3. A registered trustee, a solicitor or the Official Trustee becomes a controlling trustee as a result of:
  - (a) A debtor signing an authority pursuant to subsection 188(1) (which pursuant to regulation 10.01 must be in accordance with approved Form 13 in favour of a registered trustee, a solicitor or the Official Trustee; and
  - (b) A registered trustee, solicitor or the Official Trustee consenting in writing to exercise the powers conferred on them by the authority.
4. A person who is a registered trustee with no conditions on their registration prohibiting them from involvement in Part X matters is entitled to become a controlling trustee.
5. The Official Trustee only becomes a controlling trustee if the Official Receiver has given the debtor written approval to name the Official Trustee in the authority.
6. Regulation 8.35 of the Bankruptcy Regulations prescribes the circumstances in which a person other than a trustee (eg a solicitor) is ineligible to act as a controlling trustee. Essentially a solicitor controlling trustee will have to be a full member of the Insolvency Practitioner's Association of Australia or have satisfactorily completed a course in insolvency approved by the Inspector-General. For further detail please refer to Inspector-General Practice Direction 8 at this [link](#).

## Legislative Framework

7. The relevant statutory powers and duties of a controlling trustee are primarily contained in sections 189A, 190, 190A and 196 of the Act. Minimum level acceptable standards of conduct and performance are set out in Parts 2 and 5 of the Schedule 4A Performance Standards for Trustees.
8. It should be noted that pursuant to section 210 the provisions of Part VIII of the Act, which covers Trustee registration, Remuneration, keeping Accounts, Audits and Control over Trustees by creditor resolution and the Courts, applies also to controlling trustees subject to modifications set out in regulation 10.07 and Part 3 of Schedule 6.

9. It should also be noted that pursuant to subsection 211(1), sections 77, 77A, 77C, 77D, 77E, 77F, 78 (other than paragraphs 78(1)(a), (b) and (c)) and 81 apply also to controlling trustees subject to modifications set out in regulation 10.08 and Part 4 of Schedule 6.

### **Legal Impact of a section 188 Controlling Trustee authority**

10. A trustee or solicitor approached by a debtor to become their controlling trustee should establish that the debtor is eligible to have their affairs dealt with under Part X of the Act. In that regard the solicitor or trustee should ascertain that:
- the debtor satisfies the requirements of section 188(1). A debtor may only give a controlling trustee authority if they are personally or ordinarily resident in Australia, have a house or business in Australia, carry on business in Australia or they are a member of a partnership carrying on business in Australia;
  - the debtor is insolvent in the sense that they are not able to pay all their debts as and when they become due and payable (subsections 5(2), 5(3), 187(1) and 187(1A));
  - the debtor has not signed a previous authority within 6 months of signing the current authority without leave of the Court to do so (subsection 188(4));
  - the debtor is not an undischarged bankrupt (see *Re Hawkes; Ex p Bird*<sup>1</sup>).
11. Pursuant to section 188(2AA) of the Act and Regulation 10.02 the controlling trustee must inform the debtor proposing to execute the s188 authority of the effects of same and the alternatives to Part X.
12. A section 188 authority will be void where it fails to name the person being authorised by the debtor<sup>2</sup>.
13. On signing the authority the debtor commits an act of bankruptcy (subsection 40(1)(i)).
14. An authority becomes effective once the controlling trustee accepts the appointment by signing the controlling trustee authority form and, pursuant to section 188(2C) of the Act the debtor has provided the controlling trustee with a statement of affairs and a proposal for dealing with the debtor's affairs. In accordance with section 188(2E) the proposal must include a draft personal insolvency agreement (PIA).
15. Once an effective authority is in place it cannot be revoked by the debtor (subsection 188(3)).
16. The controlling trustee acquires control over the debtor's property (subsection 189(1)) and may exercise powers in relation to it (subsection 190(2)), until one of the events detailed in section 189(1A) occurs. Under subsection 190(2), the controlling trustee is empowered:
- (a) *to take immediate control of the debtor's property and affairs;*
  - (b) *to make such enquiries and investigations in connection with the debtor's property and examinable affairs as the trustee considers necessary;*

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<sup>1</sup> *Re Hawkes; Ex p Bird* (1984) 1 FCR 24

<sup>2</sup> In *Cervantes PL v Moutidis* [2004] FMCA 1023 (14 December 2004), it was stated that 'it is an essential requirement of (an) authority that the person authorised should be clearly named and that person ought to be a person specified by s.188, namely a registered trustee, a solicitor or the official trustee'.

- (c) *to carry on a business of the debtor if, in the opinion of the trustee, it will be in the interests of the creditors to do so; and*
  - (d) *to deal with the debtor's property in any way that will, in the opinion of the trustee, be in the interests of the creditors.*
17. However the debtor's property does not vest in the controlling trustee as it does with a trustee of a bankruptcy. Subsection 190(4) provides that the controlling trustee can act in the name of the debtor as if they had been duly appointed as their lawful attorney, see also *Re Reynolds*<sup>3</sup>, and confirmed in *Borck v Williamson*<sup>4</sup>.
18. A charge is created over the debtor's property subject to control (s189AB).
19. The debtor's responsibility and rights in relation to their property become subject to the limitations set out in subsection 189(2). These include:
- (a) *not removing, disposing of or dealing with any of his or her property except with the consent of the controlling trustee;*
  - (b) *furnishing to the controlling trustee such information with respect to any of the debtor's examinable affairs as the controlling trustee requires; and*
  - (c) *complying with any direction given to him or her by the controlling trustee with respect to his or her property or affairs.*
20. The debtor may commit an offence if, inter alia, the debtor has within 12 months of signing the authority, disposed of, or created a charge on, any property with intent to defraud their creditors (subsection 268(7)).
21. Where there is a creditor's petition on foot and a controlling trustee authority given by the debtor becomes effective, proceedings in respect of the creditor's petition are stayed pursuant to section 189AAA of the Act. The stay remains in place until a meeting of creditors called under the authority is concluded or adjourned, whichever is sooner.

## **Documents to be provided to the debtor and creditors and filed with Official Receiver**

22. A controlling trustee's Official Receiver filing requirements are clearly outlined on page 12 of the Official Receiver's Practice Statement which may be accessed at this link ["Setting up a Personal Insolvency Agreement."](#)
23. Within two working days of the authority becoming effective, pursuant to subsection 188(5) the controlling trustee must file with the Official Receiver the controlling trustee authority form and the debtor's statement of affairs.
24. Pursuant to Regulation 10.04, at least 10 days before the first meeting of creditors is held, the controlling trustee must give to the Official Receiver, the debtor and each of the creditors:

<sup>3</sup> *Re Reynolds* (1976)12 ALR 439

<sup>4</sup> *Borck v Williamson* (1994) 49 FCR 16

- (a) *notice in writing of the date, time and place of the meeting;*
- (aa) *a copy of the proposal given by the debtor;*
- (b) *a copy of the controlling trustee’s report prepared pursuant to section 189A. In accordance with subsection 189A(3) this is to include the controlling trustee’s written declaration of relationships stating whether the debtor is a related entity of the controlling trustee or a related entity of the controlling trustee;*
- (c) *a copy of the controlling trustee’s statement under section 189B in relation to special resolutions expected to be passed at the meeting;*
- (d) *notice of the basis and method on which the controlling trustee seeks to be remunerated and if appropriate, an estimate of the amount of that remuneration;*
- (e) *if the controlling trustee claims remuneration calculated by reference to an hourly rate – a notice stating:*
  - (i) *the type of work undertaken by the trustee and the trustee’s staff;*
  - (ii) *the number of hours charged by each person;*
  - (iii) *the hourly rate charged for each person; and*
  - (iv) *the total remuneration claimed;*
- (f) *notice informing the debtor and each creditor of their right, within 28 days of receiving notice of a controlling trustee’s claim for remuneration, to request that the claim be taxed.*

25. In accordance with Regulation 10.06, after the meeting a copy of any special resolution under section 204 is required to be filed with the Official Receiver within 7 days after the date on which the resolution was passed. The consent of the personal insolvency agreement (“PIA”) trustee is also to be filed should creditors resolve to accept the proposal.

26. Pursuant to section 189(1B) of the Act, within seven days of a trustee becoming aware of an event that causes the control period to end, the trustee must file with the Official Receiver a written notification that the control has ended.

## **Meeting Requirements**

27. The controlling trustee must call a meeting of creditors to consider the debtor’s proposal (subsection 190(1)).

28. Pursuant to section 194 of the Act, the meeting must be held not more than 25 working days after the relevant consent or approval was given (30 working days if the authority was effective in December to allow for Christmas).

29. The controlling trustee, whether or not they are the president, determines a person's entitlement to vote (subsection 64ZA(8)). In accordance with Part 5.6 of Schedule 4A Performance Standards a controlling trustee must discharge this function with propriety having regard to the merits of a creditor's claim and act impartially and independently without regard to the debtor's wishes.
30. Pursuant to section 196 the meetings procedures are set out in division 5 of the Act, with some modifications prescribed by Part 10 of the Bankruptcy Regulations and schedule 6. For further detail please access this [link](#) on the ITSA internet.

## **Advertising**

31. Notice of the meeting must be advertised by publishing the following detail, as a minimum, within a national daily newspaper and a regional daily newspaper:
  - the fact the meeting is being called to consider a proposal for a Part X Personal Insolvency Agreement;
  - creditors must be advised of Part X information available from ITSA;
  - the name of the debtor, their address, occupation and business name;
  - the name of the controlling trustee and their address;
  - the date and time of the meeting;
  - the place and address of the meeting and
  - contact details of the controlling trustee.

The Inspector-General has [approved](#) the above requirements for publication of a notice, and its contents, of the first meeting of creditors for the purposes of paragraph 64A(2)(a) and subsection 64A(3) of the *Bankruptcy Act 1966*, as modified by Schedule 2 and Part 2, Schedule 6 of the *Bankruptcy Regulations 1996*.

## **The Duty to Investigate and Report**

32. As creditors are generally not in a position to obtain information they rely almost exclusively on the controlling trustee to provide the relevant information in the report. In carrying out investigations however the controlling trustee is limited by time (see s194 and Reg 10.04) and the information available to them.
33. It is difficult to prescribe the extent of investigations needed to meet the requirements. The extent of the controlling trustee's inquiries will depend on the individual circumstances and complexity of the debtor's affairs.
34. Parts 5.3 and 5.4 of Schedule 4A Performance Standards outline the minimum detail to be investigated and matters to be included in a controlling trustee's report to creditors pursuant to section 189A of the Act.
35. Pursuant to subsections 189A(1)(a) to (c) the controlling trustee's report must include the following content:

*(a) summary and comment on the information about the debtor's affairs that is available to the controlling trustee; and*

*(b) stating whether the controlling trustee believes that the creditor's interests would be better served:*

*(i) by accepting the debtor's proposal for dealing with his or her affairs under this Part; or*

*(ii) by the bankruptcy of the debtor; and*

*(c) naming each creditor who was identified as a related entity of the debtor in the debtor's statement of affairs.*

36. Controlling trustees may utilise sections 77,77A, 77AA, 77C & 81 to empower adequate investigations.
37. Part 5.3 of Schedule 4A Performance Standards prescribe the minimum standards for controlling trustees when investigating the debtor's property and income.
38. In accordance with Part 5.3(2) of Schedule 4A, if the debtor's property includes significant real estate, company structures or motor vehicles, the controlling trustee must search the appropriate registries for information about the property and obtain independent expert advice about the value of the property.
39. Pursuant to Part 5.3(3) of Schedule 4A, if the debtor was or is involved in significant corporate or trust activity, the controlling trustee must take appropriate steps to identify the assets of the debtor that will be subject to the PIA, including making inquiries of third parties such as solicitors, accountants, creditors, associated entities and financial institutions, to establish whether there is any divisible property or antecedent transactions.
40. In addition to that stipulated in paragraphs 23 and 34 of this Inspector-General Practice Direction, it is prescribed in Parts 5.2 and Part 5.4 of Schedule 4A Performance Standards that the following information must also be included in the section 189A report as a minimum:
- Debtor's name, date of birth, address and occupation;
  - Information about each matter mentioned in subsection 188A(2) of the Act ie the proposed elements or required contents of the PIA;
  - An outline and kind of matters investigated by the controlling trustee and whether any other matters need to be investigated;
  - The reasons for the controlling trustee's opinion as to whether they believe that creditor's interests would be better served by accepting the proposal or by the bankruptcy of the debtor. (subsection 189A(1)(b)).
41. It is also expected as part of Best Practice that the following information be included in section 189A reports:
- Comparison of the estimated dividend under the PIA proposal and bankruptcy;
  - A list of all creditors and the amount of each debt;
  - Details of the controlling trustee Authority including the relevant dates and its effect;

- Brief financial history of debtor including cause of insolvency.
42. Four main cases that provide parameters on what is expected of controlling trustees' investigations and reports are *McDougall*<sup>5</sup>, *Messina*<sup>6</sup>, *Moustafa*<sup>7</sup> and *Wong*.<sup>8</sup>

### **The McDougall Case**

43. In *McDougall* the controlling trustee had identified the existence of a family trust, set out a number of the trust's activities and made it clear in the report that in the event of bankruptcy the trustee would most likely have access to trust assets pursuant to Section 139D of the Act.
44. The Controlling Trustee's report recited the debtor's description of how his financial difficulties had arisen and his explanation of the circumstances in which specific debts disclosed by his statement of affairs had been incurred. The report noted that the debtor had no immediate prospects of being able to pay his debts and had therefore submitted a proposal for consideration by his creditors. The report, recommended that creditors not accept the proposal.
45. The primary judge Goldberg J examined whether the trustee's report set out sufficient information. It was submitted by the applicant that "the report showed that the Trustee had not made enquiries in relation to the Debtor's family trust". Goldberg J's conclusions however were as follows:

*It is apparent from the report that the Trustee had identified the existence of the family trust company and the report set out a number of its activities and affairs. Further, the Trustee made it clear in paragraph 19 of the report that in the event of bankruptcy of the Debtor, the Trustee "would most likely have access to the assets of The Stuart McDougall Family Trust pursuant to provisions of Section 139D of the Act". I therefore reject the submission that the report shows that the Trustee had not made all necessary enquiries in relation to the Trust within the time available to him. In any event, upon the proper construction of s 189A(2)(b) the Trustee was only obliged to set out such information relevant to the affairs of the Debtor as was available to him. His only obligation to set out such information as was necessary to give a true and fair view of the Debtor's affairs was if that information was, in fact, available to him.*

46. When the matter went to appeal on other grounds Ryan, Whitlam and Marshall JJ went on to highlight and confirm comments made in *Re Burlock*;<sup>9</sup> namely:

*"A controlling trustee has marked advantages over the general body of creditors. His position as controlling trustee gives him access to the business and financial records of the debtor (s 189(1)). The debtor is required to furnish him with such information with respect to any of the debtor's examinable affairs as the*

<sup>5</sup> *McDougall; Ex p Policy Nominees Pty Ltd & Thomas* [1997] 197 FCA

<sup>6</sup> *Re Messina; Ex p Westpac Banking Corp* (unreported 17 April 1998)

<sup>7</sup> *Cobbs Hill (Tas) Meat Supplies Pty Ltd & Others v Moustafa El Moustafa & Others* [1998] 838 FCA also (1998) 83 FCR 403

<sup>8</sup> *Wong v Inspector-General in Bankruptcy* [2008] AATA 487.

<sup>9</sup> *Re Burlock; Deputy Commissioner of Taxation v Burlock* (1994) 49 FCR 522

*controlling trustee requires, and to comply with any directions given to him by the controlling trustee (s 189(2)). .....”*

*“The controlling trustee may, with the consent in writing of the debtor, obtain such advice or assistance as he thinks necessary (see s 190(5A)).”*

*“The controlling trustee can explore the possibility that there may be antecedent transactions by the debtor which may be set aside, to the benefit of the creditors, in the course of the administration of his estate, if an order of sequestration were made.”*

47. *McDougall* then is a useful guide, particularly where companies and trusts are involved, supporting the view that enquiry is necessary to ascertain and report on their activity, their worth, the debtor’s involvement and major transactions involving the debtor; in order to allow the trustee to comment on the effect of bankruptcy, particularly in respect to sections 139D, possible deeming of income and contributions, and possible voidable transactions.

### **The Messina case**

48. In *Messina*<sup>10</sup> Goldberg J (who also was the primary judge in the *McDougall* matter) had to firstly decide whether a creditor was entitled to vote at the meeting. He decided that the creditor, a related entity, was not a creditor and not entitled to vote. He was then asked to decide whether the controlling trustee had failed in his duty by admitting the creditor to vote purportedly without adequately investigating the debt. Goldberg J stated as follows:

*“.....Although the trustee made a number of mistakes in relation to the work he undertook, I am satisfied that the information supplied to Mr Burridge and the trustee and the circumstances surrounding that information was such that the trustee did not act in breach of such duty as was imposed on him by s 190(2)(b) of the Act to make enquiries and investigations in connection with the debtor's property and examinable affairs.....”*

*.....It must be remembered that the trustee has a limited time within which to make the enquiries and carry out the investigations as the creditors' meeting must be held not later than 35 days after the authority is signed by the debtor: s 194(1)(a) of the Act.*

*The trustee does not have the time, and is not under an obligation, to undertake an audit of the debtor's affairs. As Olney J said in *Re Horne; Ex parte Deputy Commissioner of Taxation v Horne and Pratt*<sup>11</sup> (supra):*

*"What is clear is that the legislation does not require the controlling trustee to audit the debtor's statement of affairs and to certify to the creditors the correctness or otherwise of the statement. His power to inquire and investigate is limited to matters he considers necessary. In every case it will be for the*

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<sup>10</sup> *Re Messina; Ex p Westpac Banking Corp* (unreported 17 April 1998)

<sup>11</sup> *Re Horne; Ex parte Deputy Commissioner of Taxation v Horne and Pratt* (unreported, 10 May 1996)

*controlling trustee consistent with his duty to the creditors to determine what inquiries and investigations are necessary. The trustee's ultimate function is to ensure that he can express the opinion required by s 189A(3) with such a degree of authority that the creditors can confidently act upon the opinion if they so desire."*

49. The controlling trustee made enquiries of the debtor and his accountant, who was also the accountant for the family company claiming to be a creditor, asked for evidence from the accountant and prior to the meeting saw a company balance sheet. The Court thought this to be sufficient enquiry into those particular issues and appropriate reporting.

### **The Moustafa Case**

50. In *Moustafa*<sup>12</sup> Marshall J outlined the powers and responsibilities of a controlling trustee. This case puts the court's views quite firmly in relation to what is expected of a controlling trustee's report. The extract reads:

*"The purpose of the controlling trustee's report is to fully apprise the creditors as to the debtor's affairs so that the creditors can make an informed decision on whether their best interests would be served by accepting the debtor's proposal or by bankruptcy of the debtor. It is essential for the controlling trustee to ensure that all facts material to the debtor's affairs are brought to the attention of the creditors in the report and that the statement of belief of the controlling trustee is properly based."*

### **The Wong Case<sup>13</sup>**

51. As a result of repeated errors identified by ITSA Regulation across a range of personal insolvency matters including the failure to adequately investigate and report on debtor's affairs in section 189A reports, the Inspector-General in Bankruptcy convened a committee pursuant to section 155H of the Act to consider Mr Luke Ching Wong's ongoing registration as a registered trustee.
52. By Committee Report dated 5 September 2006 it was decided that Mr Wong should cease to be registered as a trustee under the Act.
53. Mr Wong appealed the Committee's decision to the Administrative Appeals Tribunal where it was argued, on behalf of Mr Wong, that as controlling trustee under Part X, there was limited time and ability to make full enquiries.
54. In upholding the Committee decision that Mr Wong be deregistered, Mr B H Pascoe, Senior Member of the AAT stated at paragraph 12,

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<sup>12</sup> *Cobbs Hill (Tas) Meat Supplies Pty Ltd & Others v Moustafa El Moustafa & Others* [1998] 838 FCA also (1998) 83 FCR 403

<sup>13</sup> *Wong v Inspector-General in Bankruptcy* [2008] AATA 487

*“It is accepted that a trustee under the Act has an onerous duty. Particularly in Part X arrangements, the trustee has limited time and limited coercive powers. However as stated in Muir v Bradley (1984) 57 ALR 155:*

*“a trustee in bankruptcy is a person who must command and **retain** the confidence of the court, of the creditors and debtors in bankruptcy proceedings and of the general community. His competence must be, and **remain**, of a high order.”*

And at paragraph 14, Mr Pascoe concluded:

*“ ... having fully considered the report of the Committee, the acceptance of the factual findings of that Committee and the number of breaches relative to the number of files inspected it would be inappropriate to allow Mr Wong to retain his registration.”*

## **Investigation & Reporting Principles**

55. We can conclude that a controlling trustee is required to carry out investigations and report to creditors pursuant to section 189A in a relatively short time frame and that the report is critical to the course of the Part X administration. A controlling trustee should use the powers available to them to undertake some enquiries, and both *McDougall* and *Messina* provide a useful guide as to what enquiries might be expected and what should be reported to creditors.

56. A number of fundamental principles can be drawn from these cases:

1. *The fiduciary duty owed to creditors by the controlling trustee must inform preparation of the section 189A report. A controlling trustee must act in an impartial and independent manner and be impartial to the wishes of the debtor. This includes when investigating the debtor’s affairs, reporting to creditors and ruling on the admission of creditors’ proofs of debt for voting purposes.*

2. *The purpose of the section 189A report is to apprise the creditors as to the debtor’s affairs so that creditors can make an informed decision on whether to accept the debtor’s proposal.*

3. *The report should be fair and unbiased and summarise the material information available to the controlling trustee.*

4. *The controlling trustee is not required to audit the debtor’s statement of affairs and to certify to the creditors the correctness or otherwise of the statement. Their power to inquire and investigate is limited to matters considered necessary. The controlling trustee has a duty to the creditors to determine what inquiries and investigations are necessary. The trustee’s ultimate function is to ensure that he can express the opinion*

*required by subsection 189A(3) with such a degree of authority that the creditors can confidently act upon the opinion if they so desire.*

57. What is considered necessary and material is subject to the judgment of the controlling trustee. However it is the Inspector-General's expectation that the "reasonable person" test should apply. For example where the debtor is director and shareholder of a private company operating the family business it is not reasonable to only report the existence of the company and that the debtor holds 1 \$1 share. A reasonable person would consider that material information would include the assets in the company, a summary of its activities and the debtor's involvement, whether loans and gifts have been investigated for possible antecedent transactions and whether income contributions were possible.

## **Fiduciary Duties Principles**

58. The provisions of the Bankruptcy Act and Regulations relating to trustees' duties are supplemented by the common law duties of a trustee, which are well established. Several important bankruptcy cases and the principles that can be drawn from them are worth noting.

### ***Adsett and Berlouis case***

59. The findings of Northrop J in *Adsett and Berlouis*<sup>14</sup> whilst relating to the conduct of a registered trustee has some aspects which have some bearing on controlling trustees. The particular principles that can be drawn from this case are:

*1. A trustee is bound to administer that estate in accordance with the Bankruptcy Act and Bankruptcy Rules.*

*2. A trustee has a dual function: first, to administer the estate in the interests of the creditors and the bankrupt; second, to exercise, as a public duty and for the public welfare, certain powers given, and duties imposed, under the Act.*

*3. A trustee in bankruptcy who acts for remuneration is under a duty of care greater than that of a gratuitous trustee.*

*4. The trustee is required to bring reasonable skill to the performance of their duties.*

### ***Alafaci case***

60. In *Alafaci*<sup>15</sup> Riley J stated at page 285:

*In order for a trustee to be removed and make good the losses it must be established that the Trustee has been guilty of a breach of duty to act diligently and prudently in regard to the business of the Trust.*

<sup>14</sup> *Adsett and Berlouis* (1992) 37 FCR 201

<sup>15</sup> *Re Alafaci; Registrar in Bankruptcy v Hardwick* (1976) 9 ALR 262

This decision illustrates the following principle:

5. *A trustee is required to act with reasonable prudence and diligence and is required to safeguard trust property.*

## **The Moustafa Case**

61. In *Moustafa*<sup>16</sup> Marshall J outlined the powers and responsibilities of a controlling trustee. Marshall J states:

*“...it is a fundamental duty of a controlling trustee to act in an impartial and independent manner. Anything else would undermine public confidence in the administration of a Part X arrangement..... The controlling trustee must be impartial to the wishes of the debtor. In this respect, the role or function of the controlling trustee is the same regardless of whether the controlling trustee is a solicitor or registered trustee”.*

62. Principles from the *Moustafa*<sup>8</sup> decision:

6. *A controlling trustee must act in an impartial and independent manner and be impartial to the wishes of the debtor.*

7. The controlling trustee is charged with the function of ruling on any entitlement of any person to vote at a meeting of creditors (see section 196 and subsection 64ZA(8)). A controlling trustee must discharge this function with propriety having regard to the merits of a creditor's claim and without regard to extraneous considerations.

63. Principles 6 and 7 above are confirmed by Part 5.6 of the Schedule 4A Performance Standards.

## **Remuneration and costs of controlling trustee**

64. Sections 161B to 162 apply to controlling trustees in the same way as they apply to trustees of bankruptcies. See section 210, regulation 10.07 and Part 3 (para 1.1) of Schedule 6.

65. Funds may come into a controlling trusteeship from various sources including:

- (a) Advances from debtor or third party specifically to pay controlling trustee's remuneration;
- (b) Sale of perishables or carrying on of debtor's business and or;
- (c) Completion of contracts entered into by debtor prior to commencement of controlling trusteeship; eg debtor enters into contract to sell house before commencement of controlling trusteeship. The sale is settled during the controlling trusteeship and the controlling trustee takes control of the proceeds.

<sup>16</sup> *Cobbs Hill (Tas) Meat Supplies Pty Ltd & Others v Moustafa El Moustafa & Others* [1998] 838 FCA also (1998) 83 FCR 403

66. Controlling trustees have no authority other than section 162 to draw remuneration from funds held in a controlling trusteeship. It should be noted that once a controlling trusteeship ends because one of the events outlined in section 189(1A) has occurred, resolutions by creditors approving the former controlling trustee's remuneration are not effective. In that regard note the following extract from *Re Borck*<sup>17</sup>:

*“The problem about the argument put by counsel for Mr Williamson is that, when the creditors passed the resolution fixing his remuneration, he was no longer trustee of the appellant's estates. He lost that status at the moment the creditors decided that the debtors' property be no longer subject to control under Division 2; that is, when they passed the first resolution. The creditors could not thereafter validly exercise a power (under s.162) which depended in its application to this case on the relevant trustee being a controlling trustee.”*

67. It is noted that some controlling trustees, in particular solicitors who become controlling trustees, receive funds from debtors or third parties before the commencement of the relevant controlling trusteeship. Those funds are intended as remuneration for work performed pre and post the commencement of the controlling trusteeship. As mentioned above the portion of those funds applied as remuneration for the controlling trustee must be fixed in accordance with section 162 of the Act (see section 165(1)). Normally that would require a resolution in terms of section 162(1). The receipt of the funds for remuneration of controlling trustees should also be recorded in accordance with section 173.
68. If no funds have been received in a controlling trusteeship before it ends pursuant to section 189(1A) the controlling trustee can claim for remuneration in the subsequent bankruptcy if one results (see section 109 (1)(b)). The controlling trustee ranks behind the trustee of the bankruptcy for remuneration and costs.
69. It can be concluded from *Re Borck* that if a debtor's proposal fails, the debtor does not become bankrupt and there are no funds to pay the controlling trustee's remuneration the controlling trustee is a creditor of the debtor and can look to the debtor for payment of their fees and costs.
70. Section 165 should also be noted as it provides that controlling trustees should not profit nor accept any benefits other than approved remuneration nor make arrangements for giving up part of their remuneration. The latter prohibits arrangements to pay parties a commission or percentage of the controlling trustee's fee for referring work to them.

## **Controlling trustees accounts**

71. Section 210 of the Act applies the general trustee provisions in Part VIII of the Act to controlling trustees with the modifications prescribed by Regulation 10.07 and Part 3 of Schedule 6. See also Division 2.7 and clause 5.5 of Part 5 of Schedule 4A Performance Standards which apply to controlling trustees.
72. Section 173 applies to controlling trusteeships and requires controlling trustees to keep records in respect of all transactions involving a controlling trusteeship.

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<sup>17</sup> *Borck v Williamson* (1994) 49 FCR 16

73. Controlling trustees are required to bank all monies received on account of a controlling trusteeship into bank accounts opened in accordance with sections 168 and 169 and are required to pay the realisation charge and interest charge in respect of those monies. This includes monies received from the debtor or third parties specifically for the controlling trustee's remuneration. However the charge does not initially apply to an advance made by a third party to be held in trust by the controlling trustee and later to be applied in the debtor's PIA should creditors accept the debtor's proposal. The charge is payable on these funds should the proposal be accepted, but by the trustee of the PIA.
74. The advances for remuneration must be dealt with as remuneration under section 162 and they must be brought into the controlling trusteeship accounts to reflect a full and correct account of the administration of the controlling trusteeship as required by section 173. See also section 165 as mentioned in paragraph 69 above.
75. Controlling trusteeships are separate administrations from the PIA which may ensue from them. Consequently even in cases where a registered trustee is initially the controlling trustee of the debtor's property and then becomes trustee of an ensuing PIA separate records and bank account should be kept for each administration. See Part 5.5 of the Schedule 4A Performance Standards.
76. Controlling trustees must hand to the debtor, third party or trustee of the debtor's PIA or bankruptcy, as appropriate, any property, including balances of bank accounts opened in accordance sections 168 and 169, remaining when the controlling trusteeship ends. It ends on the occurrence of one of the events detailed in section 189(1A). Once the controlling trusteeship has ended the controlling trustee has no right to deal with any of the debtor's property previously under the controlling trustee's control.

## **Application of the Bankruptcy Estate Charges Act**

77. By virtue of amendments effective as of 3 July 2002, the Bankruptcy Estate Charges Act (BECA), applies to controlling trustees.
78. Generally, funds received by a controlling trustee after 3 July 2002 are subject to realisations and interest charges (see section 6(1) of the BECA).
79. This requires controlling trustees to annually remit (for each financial year 1 July to 30 June) to ITSA:
- 3.5% of any "amounts realised" in their capacity as controlling trustee (see BECA sections 6A, 7 and 8 for definition and basis of calculation); and
  - any interest earned on moneys held.
80. The receipt of funds to cover controlling trustee's remuneration are subject to BECA.
81. Part 15A of the Bankruptcy Regulations are the provisions relating to the Bankruptcy Estate Charges Acts. They deal with the mode of payment of the charge or penalty, overpayments, information to accompany documents and lodgement of requests for remission.

## Creditors Trusts

82. There have been cases where a PIA proposal calls for the creation of a creditor's trust whereby the debtor's obligations to creditors are transferred to the trust. Those creditors then become beneficiaries of the trust. A trustee of the trust is appointed which in the case of a PIA would normally be the trustee of the PIA.
83. The principal reason behind a creditors trust in a PIA is to free the debtor from his obligations and insolvent status and thus allow him to be in a position to continue to manage a corporation.
84. Essentially the PIA is completed once the debtor fulfils his obligation to create the trust and upon the PIA being executed. Creditor's rights are then converted to rights as unit holders under the trust and not under the PIA. Creditors lose statutory protection of the Bankruptcy Act.
85. It is incumbent upon a controlling trustee to ensure that their section 189A report makes creditors aware that their rights against the debtor are extinguished upon execution of the PIA and that they may have less or no legal rights if the creditor's trust obligations are not fully complied with by all relevant parties.
86. In the recent case of *Parkview Constructions Pty Limited* [2009] NSWSC 186, the Court was critical of the situation that resulted from the implementation of a creditors' trust. In that case, Parkview, a creditor applied to set aside the Deed of Company Arrangement ("DCA") of Sydney Civil Excavation Pty Limited (Sydney Civil).

The Court ultimately found that it was unable to assist Parkview given the DCA had already been terminated and replaced with the creditors' trust. The Judge considered it a matter of concern that the *"protective aspects of Pt 5.3A...can be avoided by the creation through a deed of company arrangement of a parallel but essentially unregulated regime of administration."*

The Court further provided a clear warning to Administrators about their disclosure obligations when recommending a DCA that will lead to a creditors' trust. Administrators *"bear a heavy burden of explaining to creditors the implications of the shift from a regime incorporating a court administered scheme of creditor protection to one in which creditors become passive trust beneficiaries."*

87. The same principles can be drawn out of the Parkview case and have equal application to controlling trustees reporting to creditors on draft PIA proposals involving the creation of a creditor's trust.

## Controlling Trustee errors identified by ITSA Regulation

88. ITSA Regulation's role in monitoring controlling trustees is outlined in [Inspector-General Practice Statement 11](#) in paragraphs 37-59. This includes reviewing documentation filed by the controlling trustee prior to the meeting as well as attendance at meetings when considered appropriate or requested to by a relevant stakeholder.

89. Please note these are the most common errors identified by ITSA Regulation in the course of its proactive monitoring and meeting attendances. These are listed with a view to provide guidance to controlling trustees as they can be costly and fatal to the success of the administration. This is not meant to be an exhaustive list but controlling trustees are encouraged to be mindful of them when consenting to act.

### ***Lack of referring of Offences to ITSA Enforcement***

90. Controlling trustees are reminded of their duties in subsections 190A(1)(d) and (e) regarding their obligation to consider whether the debtor has committed an offence against the Act and if so referring the appropriate evidence to ITSA Enforcement or the relevant law enforcement authorities.

### ***Not giving effect to the Section 188 authority***

91. There have been occasions where a debtor has not given the "controlling trustee" a statement of affairs and/or a proposal for dealing with them *before* the controlling trustee consents to exercise the power under the authority. As a result the controlling trustee authority is ineffective pursuant to section 188(2C). This invalidates the Controlling Trusteeship and by implication any resolutions passed at the meeting and any subsequent actions taken.
92. Where an ineffective authority is identified prior to the meeting being held, or if the meeting is held prior to the PIA being signed, the debtor and creditors should be advised and the process started again. In these circumstances a debtor would not be prevented from signing another authority for 6 months in accordance with section 188(4).
93. Where an ineffective authority is identified after the PIA is signed the PIA trustee would need to seek legal advice and take steps which may involve applying to the court for approval or directions.
94. The costs associated with the ineffective authority, including the controlling trustee's and PIA trustee's costs and remuneration together with any court costs in these cases can not to be charged to the estate.
95. This demonstrates the importance of ensuring that the debtor completes a statement of affairs and draft proposal prior to the Controlling Trustee signing a section 188 authority.

### ***Not holding the meeting within 25 working days of the authority becoming effective***

96. On occasion a controlling trustee has either convened or held the meeting outside the 25 working day period from when the authority became effective. This invalidates any resolutions passed at the meeting and necessitates the controlling trustee making application to the court for approval to extend the 25 working day period. The costs associated with the application to court and the further meeting to begin the process again to rectify this error are not to be charged to the estate.

### ***Inadequate investigations leading to incomplete section 189A reports***

97. On occasion controlling trustees have sent section 189A reports to creditors that do not contain a complete picture of all material matters concerning the debtor's affairs. These matters, amongst other things, normally concern:

- Assets not disclosed by the debtor on their statement of affairs. Independent asset searches undertaken by the controlling trustee would have identified these assets;
- Income incorrectly disclosed by the debtor on their statement of affairs. Obtaining the most recent payslip would have verified the true income of the debtor.
- Antecedent transactions not investigated.

98. The result of an incomplete section 189A report is that creditors are not fully informed to make a decision as to the debtor's draft PIA proposal. In these cases ITSA Regulation will request the controlling trustee to provide a supplementary 189A report to bring creditors fully up to date at no further cost to the estate. It is likely this will also necessitate the adjourning of the meeting, again at no further cost to the estate.

99. Controlling trustees are also reminded of their duty pursuant to subsection 189A(1)(b) to state whether they believe that the creditors' interests would be better served by accepting the debtor's draft PIA proposal or by the bankruptcy of the debtor. It is expected that this belief is stated without qualification.

### ***Determining voting entitlements at the meeting***

100. It is important that the voting entitlements of various creditors, particularly related party claims, are investigated as much as possible before making a final determination as to the validity of the claim. Where sufficient doubt exists as to a claim's validity the determination of which could influence the outcome of the PIA proposal, consideration should be given to adjourning the meeting to give the controlling trustee sufficient time to further investigate the merits of the claim. Paragraph 5.6 in Part 5 of the Schedule 4A Performance Standards is relevant in this regard.

### ***Not obtaining consent of the PIA trustee prior to the meeting***

101. Controlling trustees need to ensure that the consent of the proposed incoming PIA trustee is obtained prior to the meeting in accordance with section 215A of the Act. That provision renders the resolution to nominate the PIA trustee void unless consent is given prior to the meeting. However, where the appropriate consent is not obtained:  
 -the Court may, on application of the nominated person/s/ interested party, declare the resolution to nominate the PIA trustee not to be void (subsection 215A(2)); and  
 -pursuant to subsection 306(2), any act done by the PIA trustee in good faith is not invalidated by reason of this 'irregularity'.<sup>18</sup>

## **Conclusion**

102. This paper outlines a broad principles based framework which is aimed at clarifying the roles and duties that the Inspector-General expects of controlling trustees, including the Official Trustee.

103. When it is found that a controlling trustee has erred and not properly performed their duties or exercised their powers or the principles embodied in both the ITSA

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<sup>18</sup> *Hugh David Ramsay v Official Receiver in Bankruptcy* Federal Magistrates Court 26 November 2009.

Regulation error category system<sup>19</sup> and the Schedule 4A Performance Standards are a guide as to what the Inspector-General will consider namely:

- (a) the importance of the duty or power exercised incorrectly;
- (b) the seriousness and impact of the action, including the impact the failure to comply has on a particular estate or related parties and on the integrity of the personal insolvency system; and
- (c) a controlling trustee's performance history - whether the controlling trustee has previously failed to comply, been advised and continues to make the same errors.

104. Action which may be taken depends upon the seriousness of the breach. One off errors in judgment of little importance or impact, breaches that are minor and temporary and technical errors that have little or no impact on the quality of the administration or parties are to be dealt with through reporting, discussion, persuasion, guidance, education and training.

105. In the most serious matters where controlling trustee conduct demonstrates a pattern of indifference to the legislative requirements, a lack of knowledge of the law and a disregard for standards published as a guide to practitioners, such conduct is inconsistent with the high standard expected of a controlling trustee and would not be tolerated by the Court, nor should the Inspector-General tolerate such conduct. This is so even where there is no bad faith or dishonesty on the trustee's part. In such cases strong disciplinary action will be taken.

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<sup>19</sup> Refer [IGPS 11 paragraph 30](#)