TOPIC: INVESTMENT DUTIES

Structuring Answer

1. Look at the deed – what is our power of investment (s 5)?
2. What is the standard of prudence (s 6)?
3. Go through each investment decision chronologically & assess:
    - was it impartial?
    - was it in the best interests?
4. If relevant:
    - Did [T] make speculative investments?
    - Did [T] obtain advice?
    - Did [T] undertake an annual review of investments?
5. Defences?

DUTIES

1. Duty to invest (& only in investments that are authorised by the trust deed).
2. Duty to invest with reasonable prudence.
    a. Acting in the best financial interests.
    b. Acting impartially between beneficiaries.
3. Duty to not make speculative investments.
4. Duty to take advice.
5. Duty to annually review the performance of trust investments.

STEP 1: Is there a valid trust

STATE: The **three certainties** — intention, subject matter, and objects (*Knight)*— are likely satisfied. The trust deed demonstrates clear intention to create a trust, the subject matter (trust property) is defined, and the objects (beneficiaries) are ascertainable under the appropriate test (*IRC v Broadway Cottages*; *McPhail v Doulton*). Accordingly, this is a [fixed/discretionary] trust created inter vivos trust by transfer (during lifetime).

STEP 2: Are these investments authorised?

STATE: A trustee must only undertake investments that are authorised by the trust deed, legislation, or the court (*Jacobs*; Trustee Act 1958 (Vic) s 6(2)). If the deed is silent, s 5 TA imposes a modern positive duty to invest trust property so as to obtain income and preserve capital value (*Byrnes*). Section 6 provides the default investment powers, which may be expanded or limited by the deed (s 7(1)).

STATE (no authority to invest): The Trust Deed does not provide an express authority to invest. However, trustees are still under a duty to invest. In Byrnes v Kendle, Heydon and Crennan JJ stated that a trustee is under a duty to obtain income from property that can produce it. Where there is no express investment power in the trust instrument, section 5 (TA) confers a broad statutory power of investment. X can therefore rely on these authorities for (a) permission to invest the trust property and (b) a duty to invest.

OUTLINE TRUSTEE: Here, [X] is not a professional trustee and will be held to the standard of a prudent lay trustee, whereas [Y], being a solicitor, is a professional trustee and will be held to a higher standard of prudence. Just because a solicitor does not mean they have accounting knowledge and will not be held to the same standard of a professional investment/ accountant.

WHAT COUNTS AS AN INVESTMENT:
The courts adopt a broad construction: an "investment" applies where a trustee expends money or effort with an expectation of profit (*Cheyne*).

WHAT DOES NOT COUNT:

- A transfer of funds into superannuation was held not to be an investment because there was no return (*Cheyne* per Edelman J).
- An unsecured loan is unlikely to be considered an investment (*Jacobs*).
- The purchase of property for beneficiaries to occupy as a residence may not qualify as an investment (*In the Will of Sherriff*).

TOPIC: DUTY TO INVEST PRUDENTLY

STATE: A trustee is under a core positive duty to act prudently and take care in managing the trust/trust affairs (s 7 Trustee Act (Vic) preserves general law duties). The standard expected of trustees has evolved with economic conditions and investment practice, as recognised in *Nestle*. Today, the dominant approach is Modern Portfolio Theory (MPT).

STATE: A trustee must approach investment decisions with the same caution and prudence that a 'reasonably prudent businessperson investing for those for whom they felt morally obliged to provide' (Speight; Bartlett) and this is in s6 TA.Section 6 TA sets out the default standard of care, though this can be altered by the terms of the trust deed (s 7(1) TA)X's role is not to speculate but to grow the wealth of the trust in a careful and considered manner, as emphasised in *AS Nominees.*

ORDINARY: For an ordinary trustee, the duty is to exercise the care, diligence, and skill that a prudent person would apply in managing the affairs of another (s 6(1)(b) TA).

However, here the trustee's profession, business, or employment involves acting as a trustee or investing on behalf of others, X will be held to the higher standard of a prudent professional in that field, applying the care, diligence, and skill reasonably expected of someone with that specialised expertise (s 6(1)(a) TA).

CORPORATE TRUSTEE: T is a corporate trustee, and is an entity created for the whole/ dominant purpose of managing trust. Therefore, T is held to a higher standard of exercising the care, diligence and skill that a prudent person engaged in that profession, business or employment would exercise in managing

the affairs of another (s 6(1)(a) TA).

Standard of care- 'former trustee'

STATE: Danny was a 'former trustee' of an ethical investment trust. This will not attract the higher threshold of section 6(1)(a), as that provision is expressed as requiring the profession, business or employment to be current. Currently, he is a manager of an organic farm. This would indicate that the lower, non-professional threshold should apply: s 6(1)(b).

Standard of care - 'self styled'

STATE: X is a 'self-styled' ethical investments advisor. Because she is 'self-styled' this raises an issue of whether or not she is engaged in the profession, business or employment of investing on behalf of others. First, it could be assumed that her profession, business or employment includes investing money on behalf of others. If so, she would be required to satisfy the professional threshold: s 6(1)(a). Alternatively it could be concluded that because she is referred to as 'self-styled' she is really not engaged in the profession, business or employment and is therefore subject to the non-professional standard.

Standard of care - lawyers

STATE: The standard of care varies with context. Lawyers acting as trustees are not always held to the higher professional standard, as special rules already govern handling trust money. For multiple trustees, the duty to act unanimously suggests the same standard applies across co-trustees, though remedies may differ depending on conduct. Here, lawyer-trustees will usually judged as ordinary trustees unless their legal expertise is directly relevant.

Multiple trustees: Co-trustees share collective responsibility, but liability may be apportioned differently, e.g. a passive trustee who failed to supervise may still be liable, though to a lesser extent.

Section 8 factors

**GST liability, did not pay tax

STATE: In deciding whether [trustees] have acted prudently and met their s 6 standard, regard must be had to the s 8 investment factors. The purpose of the trust is to [provide income to X and then capital to Y]. [Trustee's] will argue they had regard to the purpose of the trust as the [investments] provided [housing, rental income, dividend income] as well as good capital growth (s 8(1)(a)).

- On the other hand, [beneficiaries] will argue that [safe investment] provided negligible capital growth and income and therefore did not have regard to the purpose of the trust (s 8(1)(a)).
- Arguably, [trustees] did not have regard to the desirability of diversifying trust instruments (s 8(1)(b)). Although the assets were invested across [property, term deposits, shares, bank account, countries/industries], arguably the fund was not well diversified (¼ of trust assets put in one place), meaning they couldn't maximise returns while minimising risk as is required by modern portfolio theory (Bartlett; HLB).

The [safe investment] provided extremely low return low and therefore should have been better diversified. Further, although there was some diversity in the [property, term deposits, shares, bank account, countries/industries], only having shares in [number] industries is arguably not adequately diversified, as demonstrated by the decreased value of the [investment]. Therefore, [trustees] did not have regard to s 8(1)(b). Failing to maintain the capital and income of the investment (s 8(1)(d)), resulted in income loss and capital depreciation (s 8(1)(e)) vs the potential gain (s 8(1)(f) TA. Given the spectualtoive nature of the investment, the risk of loss is high.

- Here, they did not look at the probability and timing of income return (s 8(1)(g).
- Further, had they reviewed the existing trust instrument they would have known that [income] was an important element of the income of the trust and should be maintained (s 8(1)(o)). They never reviewed the existing trust investments.
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The [proposed investment] lacked sufficient liquidity and marketability, meaning the trustees could not readily sell or adjust the investment as conditions changed, contrary to s 8(1)(j). Further, they failed to consider the corrosive effects of inflation on the value of the investment, despite clear recognition of the risk (*Re Mulligan -life tenants*), which breached s 8(1)(m).

- The investment also created an unfavourable tax burden for the trust, reducing overall returns and thereby conflicting with s 8(1)(l).
- Finally, the trustees overlooked the high costs associated with entering into and maintaining the investment, contrary to s 8(1)(n).
- Collectively, these failures indicate that the trustees did not act prudently or in accordance with their statutory obligations.
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Thus, they did not have regard to the s 8 factors and have breached the duty to act prudently when investing, in line with the care and skill required under their s 6 standard.

TOPIC: Duty to Diversify Investments

STATE: The [investment strategy] was wholly concentrated in [low-risk fixed interest securities / limited industries], meaning the trust estate was not adequately diversified under s8(1)(b) TA. A prudent business person, applying Modern Portfolio Theory, would have spread risk across multiple asset classes to mitigate potential loss (*Nestle; Re Mulligan; HLB*). By failing to diversify, the trustees exposed beneficiaries to unnecessary risk and acted unfairly in balancing the interests of income and capital beneficiaries, contrary to the duty of impartiality (*Nestle*). Importantly, the trust would not have suffered the [loss/depreciation] but for the trustees' failure to diversify, as confirmed in *Re Dawson* and *Youyang*.

ANALOGY:
- Like *Nestle*, D may argue that there is no automatic breach simply for failing to diversify, and beneficiaries must still prove that the lack of diversification caused the loss.
- However, as in *Re Mulligan*, where trustees confined investments to fixed-interest securities and failed to protect against inflation, D similarly exposed the trust to foreseeable risks by failing to diversify.
- Further, in *HLB*, where a professional trustee was held liable for investing all trust funds in a low-return managed fund without diversification despite volatile market conditions, D's failure to spread investments shows the same disregard for prudent investor standards. Accordingly, the lack of diversification here points strongly to a breach.

TOPIC: Duty to Take Advice *(s 7(2)(d); s 7(4); s 8(2)(a); s 8(2)(b))*
- a Spiritual advisor is not reasonably believed to be competent to give adequate financial advice.

STATE: Under s 7(2)(d) *TA*, trustees appear to be under a mandatory duty to take advice, whereas s 8(2)(a) suggests it is discretionary, requiring advice only where appropriate and reasonably required. There is no clear positive duty, but whether advice was sought and relied upon from a competent person can affect liability (s 12D and s 12C TA). A professional trustee is less likely to be obliged to seek advice, as they are presumed to have the necessary expertise, while a lay trustee is more likely to be under a positive obligation to do so.

Here, [trustee] did not seek professional advice regarding [investment/transaction], despite lacking expertise (investment in a new competitor).. Non-professional trustees may have a greater need for advice. While the meaning of "independent" is unclear, advisors cannot be related parties, and impartiality may be compromised if the beneficiary or trustee provides advice. Trustees should consider obtaining independent, impartial, and competent advice for the s 12C defence. Reasonable costs can be paid from trust funds under s 7(4) and 8(2)(b). Non-professional trustees with limited financial knowledge are likely obligated to seek advice. However, if the advisor lacks independence, impartiality, or necessary qualifications, trustees may be restricted from using trust funds for advice. This impacts their ability to rely on the section 12C defence.

STATE: As a lay trustee, they arguably had a stronger obligation to obtain external advice to ensure decisions were prudent. Their failure to do so increases the risk of being found in breach. However, failure to take advice is not automatically actionable liability only arises if the failure can be linked to a demonstrable loss. Courts apply the “but for” test: the trust asset would not have suffered loss but for the trustee’s failure to seek advice (*Re Dawson; Youyang*).

ANALOGY: Like *Re Dawson* and *Youyang*, where trustees were liable because loss flowed from their failure to act prudently, [trustee]’s omission to obtain advice likewise created a causal link to the loss. This distinguishes situations where advice may not have altered the outcome.

CONCLUSION: It is likely the trustee will be found in breach for failing to take advice, particularly as their inexperience placed them under a heightened obligation to do so. If professional, the breach would instead turn on whether they exercised their own skill appropriately.

TOPIC: DUTY TO NOT MAKE SPECULATIVE INVESTMENTS

- New competitor in the market (red flag)

STATE: There is a limit to how risky any single investment can be, even under Modern Portfolio Theory (*Debeljak*). Trustees must ensure that investments are not speculative to the point of endangering trust assets. In *Bartlett*, trustees holding a near-total shareholding in a property company failed to adequately supervise its activities, leading to exposure to extremely risky projects. Trustees must maintain sufficient oversight and an adequate flow of information to protect trust assets.

STATE: Here, [trustee] invested heavily in [specific asset/company] without ensuring appropriate monitoring or diversification. This exposed the trust to excessive risk beyond what a prudent investor would tolerate. Their failure to maintain proper oversight and information flows worsened the vulnerability of the assets.

ANALOGY: Like in *Bartlett*, where the trustee did not sit on the board and relied only on annual financial reports, [trustee] failed to properly supervise or stay informed about the risks inherent in the investment. As in *Debeljak*, even if diversification principles allow some risk, this level exceeded what is permissible for prudent management.

Here, the trustee is likely in breach for permitting an overly speculative investment and risky, failing to exercise adequate supervision. Liability arises because the loss would have been avoided if they had acted prudently.

OVERALL CONCLUSION: Here, there is a breach of the standard of prudence in the investment.

TOPIC: DUTY TO UNDERTAKE ANNUAL REVIEW

STATE: Trustees are under a statutory duty to review the performance of the trust investments both individually and as a whole at least once annually (TA s 6(3)). In addition, s 8(1)(b) requires that each time a power of investment is exercised, trustees must have regard to the results of prior reviews. This reflects the general duty to invest prudently. OTF, [trustee] has failed to review the portfolio, thus breaching their s 6 standard of prudence. Further, this failure resulted in the portfolio suffering a loss through [facts], which could have been avoided had the investments been reviewed more regularly.

A mere failure to review is not actionable in itself; it must be connected to a demonstrable loss. Liability arises where the trust would not have suffered a loss but for the trustee's failure to review (Re Dawson; Youyang).

After meeting for the first time in mid-2013, Danny and Mindy decided to vary some of the investments. This indicates that at the very least they have failed to satisfy the annual review requirement. Danny and Mindy ought to have reviewed the investments each time a new investment was made. In particular, s8(1)(m) refers to a trustee taking into account the results of a review of existing trust investments, when making new investments. This was not satisfied on the facts.

ANALOGY:

- In *HLB,* the court held that annual reviews were insufficient during a period of market volatility and that speculative investments required closer attention than ordinary investments. In *Nestle*, the standard of prudence was assessed by reference to the prevailing economic climate at the time of the investment.
- In *Bartlett*, the court stressed that trustees must keep the flow of information alive and could not adopt a passive approach to supervision.

- Links with s 8(1)(o): for each exercised power of investment, [trustee] must have regard to results of a review of existing investments.

STATE: Where trustees fail to review appropriately and loss results (e.g., foregone rental income, missed interest, collapse of speculative shares), this constitutes a breach of duty. Trustees will be required to compensate the trust to place it in the position it would have been in absent the breach. Applying *Re Dawson* and *Youyang*, trustees will be required to compensate the trust fund to the position it would have been in had the reviews been properly conducted and acted upon.

TOPIC: DUTY TO OBTAIN ADVICE

STATE: While the duty to obtain advice is not positive, OTF [trustee] likely should have sought independent advice (s 7(2)(d)) from a person [he/she] *reasonably believes* to be competent to give that advice' (s 8(2)). This made include a financial advisor.

IF PROFESSIONAL (e.g solicitor): As [T] is a professional trustee, it is unlikely that a prudent person in his position would seek independent advice. Thus, it is unlikely that [T] will be in breach of seeking advice s 7(2)(d).

- Co-trustee or beneficiary cannot count as independent or impartial so are ruled out.

- The reasonable costs of obtaining this advice are payable out of the trust fund (s 7(4)).

STATE (new competitor in the market) - Even though there is no positive duty to take advice, given this is an investment in a new competitor, a prudent trustee should have taken advice, particularly given the

advice is paid by the trust fund.