SUPREME COURT OF QUEENSLAND

CITATION:	*Menkens & Anor v Wintour* [2011] QCA 201
PARTIES:	**LEO IGNATIUS GEORGE MENKENS** (first appellant) **REID MATTHEW MENKENS** (second appellant) v **SHARON MARY-ELLEN WINTOUR as trustee for the RDP WINTOUR DISCRETIONARY TRUST** (respondent)
FILE NO/S:	Appeal No 2454 of 2011 SC No 1975 of 2006
DIVISION:	Court of Appeal
PROCEEDING:	General Civil Appeal
ORIGINATING COURT:	Supreme Court at Brisbane
DELIVERED ON:	19 August 2011
DELIVERED AT:	Brisbane
HEARING DATE:	26 July 2011
JUDGES:	Fraser JA and Boddice and Dalton JJ Separate reasons for judgment of each member of the Court, each concurring as to the order made
ORDER:	**Appeal dismissed with costs**
CATCHWORDS:	EQUITY – TRUSTS AND TRUSTEES – POWERS, DUTIES RIGHTS AND LIABILITIES OF TRUSTEES – where a business was acquired and carried on by a unit trust – where there was an arrangement to pay the previous owner of the business a sum of money known as the "Preferential Draw" – where one of the trustees of the unit trust was removed and the appellants exercised an option to acquire that trustee's units – where the units to be acquired by the appellants had to be valued according to the Trust Deed – where at the time the option was exercised the "Preferential Draw" was in "deficit" – where the appellants contended that the unpaid amount had to be taken into account in valuing the units – where the trial judge found that the parties intended the "Preferential Draw" to be an agreement for the distribution of net profits of the business rather than a liability which was due – whether the trial judge erred in finding that the unpaid amount was not a liability of the trustees in respect of the Trust and should not be taken into account in valuing the units

Hawkins v Bank of China (1992) 26 NSWLR 562, cited
Lemon v Austin Friars Investment Trust Ltd [1926] Ch 1, distinguished
Menkens & Anor v Wintour & Anor [2011] QSC 7, affirmed

COUNSEL: S S W Couper QC, with M R Hodge, for the appellants
C Wilson for the respondent

SOLICITORS: Hawthorn Cuppaidge & Badgery for the appellants
Herbert Geer for the respondent

[1] **FRASER JA:** The Menkens and Associates Unit Trust ("the Trust") was created by a Trust Deed dated 11 September 2001. The trustees were the appellants, Mr Leo Menkens and Mr Reid Menkens, and Mr Wintour. (Wintour was originally the respondent to the appeal. By an order made by consent at the hearing of the appeal, Sharon Mary-Ellen Wintour as trustee for the RDP Wintour Discretionary Trust was substituted as the respondent. She had replaced Wintour as the trustee of that trust.) Each of the three trustees held ten of the 30 units in the Trust. During the relevant period the "Unitholders Deed", dated 12 December 2001, gave Leo Menkens control of the Trust's business, including power to dismiss a trustee. He exercised that power by dismissing Wintour on 24 October 2005. In that situation, the Unitholders Deed conferred upon the appellants the option to purchase Wintour's units at a price to be determined by valuation. They exercised that option on 25 October 2005.

[2] One of many issues at the trial concerned the value of Wintour's units. Under the Trust Deed Leo Menkens was given an entitlement, on terms and conditions to be specified by resolution, to be paid $1,930,000 by annual instalments of $386,000. That entitlement was called the "Preferential Draw". When Wintour departed, there was an unpaid balance of the Preferential Draw of $385,823. The appellants contended that the unpaid amount was a liability of the trustees in respect of the Trust. If so, it was to be taken into account in calculating the value of Wintour's units, with the result that they had no value.

[3] The trial judge found that the unpaid amount of the Preferential Draw was not a liability of the trustees in respect of the Trust and valued Wintour's units at $120,534.[1] The issue in this appeal is whether that finding was correct.

[4] Before I discuss the parties' submissions on that issue I will refer to the factual background, the relevant deeds and resolutions, and the trial judge's reasons.

Background

[5] Menkens and Associates Pty Ltd as trustee for the Menkens Family Trust ("MFT"), which Leo Menkens controlled, carried on a financial planning business. In 2000, that business was acquired by the appellants and Wintour in partnership. The terms of that acquisition were not recorded in any document and nor were they clearly described in evidence at the trial, but it was common ground that the proceeds of the partnership business were to be used to pay a total amount of $1,930,000 for MFT's goodwill. The trial judge accepted Reid Menkens' evidence that the partners agreed that instead of making a capital payment "up front", which neither Reid Menkens

1 *Menkens & Anor v Wintour & Anor* [2011] QSC 7 at [40].

nor Wintour had the capacity to make without borrowing a large sum, the amount would be paid from the "pre tax" dollars of the partnership business. As to the identity of the payee, Reid Menkens gave evidence that:

> "… there was flexibility as to whether or not - the terms that were particularly used were so that as long as ... the old trust ... got the benefit ... ".

The trial judge remarked that Reid Menkens' reference to "the old trust" was a reference to MFT, and his reference to "pre tax dollars" was to the way in which the partners treated the payments in their accounts.

[6] A payment of $242,190.40 was made to MFT when the business was conducted by the partnership in the year to 30 June 2001. In the partnership accounts that payment was recorded as "commissions transferred", it was deducted from the partnership income of $639,725.67, and "total income" was reported as $397,535.27.

[7] The same approach was adopted in the partnership accounts for the part of the year to 30 June 2002 before the Trust took over the business: $99,601.30 as "commissions transferred" to MFT was deducted from the partnership's gross income. There was no document which recorded the terms by which the Trust acquired the business and the oral evidence on that topic, to which I will return, was not very helpful. The Trust accounts for the rest of the year to 30 June 2002 recorded $233,678 as "commission transferred" to MFT as a deduction from gross income, so that the total "commissions transferred" for that year was $333,279. There were similar entries in the Trust's accounts in the 2003, 2004, and 2005 years, and in the 2006 year between 1 July 2005 and the exercise of the option to purchase Wintour's units on 25 October 2005.

[8] In truth the items recorded as "commissions transferred" were payments of the Preferential Draw. The trial judge found that the parties "intended that the Preferential Draw would be treated in the accounts as it was … : by adopting the fiction that the amount so paid to the MFT was not part of the income which had been derived by the business but was instead 'commission transferred'. But the amounts so 'transferred' were in every respect income derived by the Menkens & Associates Unit Trust. No amount 'transferred' could be identified with a transaction for which the MFT might have had some claim to a commission or fee which had been payable and paid to Menkens & Associates."[2]

[9] Between 2001 and 2006, the total sum of $1,544,177 was paid to MFT or Leo Menkens ostensibly as "commissions transferred", but in truth as part payments of the Preferential Draw of $1,930,000, leaving an unpaid balance of $385,823.

[10] The accounts of the partnership for the year ended 30 June 2002 and the accounts of the Trust for each of the four years to 30 June 2005 recorded that income (after the deduction of "commissions transferred") equalled expenses. There was no challenge to the trial judge's finding that "what was paid by way of the Preferential Draw was in truth the amount of the net profit of the Trust, which should have been disclosed as such in the profit and loss statements."[3]

---

2 [2011] QSC 7 at [27].

3 [2011] QSC 7 at [29].

The deeds and resolutions

[11] By cl 8.14.4 of the Unitholders Deed, the price for the units was to be calculated on the basis set out in cl 8.13. Clause 8.13.1 provided:

> "The price of units in the Trust shall be determined in accordance with the provisions of the Trust Deed and as if the Unitholders had requested the Trustees to make a determination of the value of the units, but subject to the basis of valuation as set out under Clause 10 of this Deed".

[12] The required valuation was of "the Trust Fund less all liabilities of the Trustee in respect of the Trust Fund". Clause 12 of the Trust Deed provided:

> "12. VALUATION OF THE FUND
>
> The Trustee may at any time and shall if requested by an Ordinary Resolution of the Unitholders cause a valuation of the property and assets of the Trust Fund to be made by such competent valuers or experts as the Trustee may decide and the value of a Unit shall be determined by dividing the value of the Trust Fund less all liabilities of the Trustee in respect of the Trust Fund by the number of Units (excluding Special Units) on issue at the date of valuation."

[13] The basis of valuation in cl 10 of the Unitholders Deed regulated the method of valuing some of the assets of the Trust. It provided:

> "10. **VALUATION**
>
> 10.1 Unless specific provisions of this Agreement specifically provide to the contrary, the value of each unit, for the purpose of calculating the value of Sale Interests shall be the value determined on the following basis:
>
> 10.1.1 The value of goodwill of the Business shall be equal to the net profit of the Business (after Trustees' remuneration, if any) for the preceding Financial Year.
>
> 10.1.2 The value of plant and equipment shall be its depreciated value under the Income Tax Assessment Act as recorded in the accounts of the Trust.
>
> 10.1.3 The value of interests under leases of plant and equipment from banks or finance companies or from the Australian Institute of Management - Queensland Division shall be the depreciated value of that plant and equipment under the Income Tax Assessment Act as if the Trustees were the owner of the plant and equipment and had claimed deductions for depreciation in the same

manner as they had for plant and equipment owned by it less the payout obligations under the lease as if the lease was paid out at the time of calculation.

10.1.4 To the extent that the value of debtors of the Business and of entitlements to payment in respect of recoverable work in progress of the Business (after allowing for creditors of the Business) are or will be reflected in net income of the Trust, that value shall be included from the value of the ordinary units."

[14] The Preferential Draw was provided for in the Unitholders Deed. It defined "Preferential Draw" in cl 1.1.7 as "[t]he annual drawings to which LIGM shall be entitled to receive for the Preferential Draw Period as described in Clause 4.6." The "Preferential Draw Period" was defined in cl 1.1.8 as "[t]he period of time calculated in years over which LIGM shall be entitled to receive the Preferential Draw as detailed in Clause 4.6." Clause 4 provided:

"4. **ACCOUNTING**

4.1 The net profits and losses of the Trust shall be calculated in accordance with the provisions of the Trust Deed.

4.2 Subject to the provisions of Clause 4.6 below, the net profit as determined in accordance with the Trust Deed shall, subject to available cash and to the working capital needs of the Trustees, be distributed quarterly in each Financial Year, such payments to be made as close as practical to the last days of January, April, July and October of each year in respect of the quarter ending on the relevant prior month.

4.3 In the event of the Trustees incurring a loss, subsequent net profit shall be used to redeem the loss before further distributions.

4.4 Nothing in this Deed shall affect the present entitlement of the Unitholders to the income of the Trust for the purposes of Division 6 of the Income Tax Assessment Act.

4.5 Nothing in this clause shall restrict the right of the Trustees to determine to accumulate income under the Trust Deed.

4.6 Notwithstanding the provisions of this Clause 4 or any other contrary provisions of this Deed and the Trust Deed, the parties record and agree that LIGM shall be entitled

to receive the Preferential Draw for the Preferential Draw Period, the exact terms and conditions of which are to be mutually agreed between the parties and recorded by way of Trustees Resolution. Further terms of the Preferential Draw are as follows:

4.6.1 the annual Preferential Draw of LIGM shall not be less than $386,000.00 (three hundred and eighty six thousand dollars) per annum;

4.6.2 the Trustees, by unanimous agreement, shall have the power to extend the Preferential Draw Period;

4.6.3 that in the event of the death of LIGM, the Preferential Draw shall automatically cease and all rights pertaining thereto shall be extinguished forthwith inclusive of any right of the Legal Personal Representative of the estate of LIGM for any balance of the Preferential Draw for the year in which the death of LIGM occurred, it being agreed by the Trustees that the Preferential Draw to be received by LIGM shall only be calculated up to and including the date of death of LIGM."

[15] A "Resolution of Trustees of the Menkens & Associates Unit Trust" dated 6 February 2002 and signed by each of the three Trustees provided:

"**TRUST INCOME DISTRIBUTION:**

IT WAS NOTED that:

1. The trustees are trustees of the Menkens & Associates Unit Trust ('the Trust'), as constituted by Deed of Trust dated 11th Sept, 2001 ('the Trust Deed').

2. The unitholders of the Trust have consented in terms of Clause 14.10 of the Trust to the trustees exercising their discretion under Clauses 14.3.1 or 14.4. 1.

3. Under the Trust Deed, the trustees have the discretion to make interim distributions of net income at any time during any year.

4. In terms of Clause 4.6 of the Unitholders Deed ('the Deed') the trustees and unitholders shall mutually agree the terms and conditions of the Preferential Draw due to Leo Ignatius George Menkens ('LIGM'), or his nominee.

IT WAS RESOLVED, that pursuant to the power in the Trust Deed to make income distributions from the Trust;

5. to make the discretionary distributions of income as per paragraphs 14.3 and 14.4 of the Trust Deed;

6. that LIGM will be paid the sum of $386,000 as at 30th June 2001 2001 [sic] which sum shall be deemed to be the Preferential Draw due to LIGM in terms of the Deed;

7. that the sum referred to in Clause 6 above shall be deemed to be the (first, second, third, fourth, fifth, sixth) (*delete ~~whichever is not applicable~~*) annual payment due to LIGM in terms of the Deed."

[16] Under the Trust Deed, the trustees were obliged to pay trust liabilities out of "gross income" and distributions of income to unitholders might be made only out of "net income". Clause 13.2 of the Trust Deed provided that the trustee should pay out of the gross income of the Trust "all costs and disbursements commissions fees taxes including land tax and income tax amounts payable by the Trustee and other proper outgoings …". Clauses 14.3 and 14.4 conferred power upon the trustees to make distributions to unitholders of the Trust's "net income" or "additional tax income" by a determination "prior to the expiration of any year" with respect to the income of the Trust "of such year". (Clause 1.1 defined "additional tax income" as any amount by which the "net income" as determined under s 95 of the *Income Tax Assessment Act* 1936 (Cth) exceeded the net income "in accordance with ordinary income concepts" (cl 14.2).)

[17] The effects of the 6 February 2002 resolution and a resolution made in August 2004 were pleaded in paragraph 36 of the appellants' statement of claim (which was admitted in Wintour's defence):

"36. The First and Second Applicants [Leo and Reid Menkens] and the First Respondent [Wintour] in their capacities as trustees of the Trust and as Unitholders agreed and resolved that:

(a) The total Preferential Draw would be $1,930,000 calculated as $386,000 over a five year period.

(b) The Preferential Draw Period:

(i) As determined in February 2002 during which the sum of $1,930,000 was to be paid as six years.

(ii) As determined in August 2004 be extended to allow the Trust to meet the deficits in payment of the Preferential Draw for the years ending 30 June 2001, 30 June 2002, 30 June 2003, 30 June 2004 and 30 June 2005.

(c) The year ended 30 June 2001 which predated the commencement of the Trust would be taken as the first year of the Preferential Draw period."

[18] The appellants submitted that cl 20.2 of the Unitholders Deed made the trustees liable for payment of the unpaid balance of the Preferential Draw. Clause 20 provided:

> "20. **RELATED LOANS**
>
> 20.1 Save for the provisions of Clause 20.2, in respect of any moneys owing by the Trustees to any of the ordinary unitholders or to parties associated with them:
>
> [The interest free terms and other conditions of such loans were specified.]
>
> 20.2 Notwithstanding the provisions of Clause 20.1 the Parties record and agree that for the Preferential Draw Period, no loans, other than that of LIGM, as referred to in Clause 20.1, shall be entitled to be called up, it being understood by the Parties that LIGM shall have preference to the payment of the Preferential Draw for the Preferential Draw Period and any further period that the Preferential Draw may be due but yet unpaid. In this regard:
>
> 20.2.1 any part of the Preferential Draw which is due but unpaid shall be subject to the provisions of Clause 20.1 and shall remain at call without the right to accrue interest;
>
> 20.2.2 any part of the Preferential Draw which is due but unpaid shall be a liquidated debt due by the Trustees to LIGM or his nominee."

The trial judge's reasons

[19] The trial judge first discussed the question whether the Preferential Draw should be taken into account by way of deduction in ascertaining "the net profit of the Business … for the preceding Financial Year" in valuing the goodwill of the Trust business under cl 10.1.1 of the Unitholders Deed. The trial judge held that the parties "accurately recorded the true nature of the Preferential Draw" in cl 4.2 of the Unitholders Deed, which "prescribed the terms for the distribution of net profit, which they expressed to be subject to cl 4.6."[4] The trial judge held that: the Preferential Draw should not be taken into account under cl 10.1.1 because the expression "the net profit of the Business … for the preceding Financial Year" meant "the true net profit, rather than whatever profit was represented in the accounts which were presented to the Commissioner of Taxation"; the true net profit was unaffected by the Preferential Draw; and the goodwill was to be valued by the true net profit, which was the same as the "commissions transferred" paid to MFT.[5] At the commencement of the hearing of the appeal the appellants abandoned any challenge to that conclusion.

[20] In relation to the issue in this appeal, the trial judge held that the unpaid $385,823 of the total Preferential Draw of $1,930,000 was not one of the "liabilities of the Trustee in respect of the Trust Fund" in terms of cl 12 of the Trust Deed for the following reasons:[6]

---

4 [2011] QSC 7 at [30].
5 [2011] QSC 7 at [31].
6 [2011] QSC 7 at [32]-[37].

"… The balance sheets for the Trust contain no reference to anything for the Preferential Draw. But again, they are not determinative.

Clause 20.2 of the Unitholders Deed … was an agreement that any part of the Preferential Draw which was 'due but unpaid' was to be a debt due by the trustees to Leo Menkens, payable at call but without interest. This suggests that such part of the Preferential Draw which was not 'due but unpaid' was not to constitute a debt of the trustees. But what was meant by 'due but unpaid'?

This was an agreement for the drawing or distribution of net profits. Accordingly, nothing became due to Leo Menkens except to the extent of the net profit of the Trust. Because the net profit in no year reached the agreed sum of $386,000, Mr Menkens was entitled to all of the net profit year by year. But he was paid the net profit for each of the four years commencing with the year to June 2002 (which was the first of the years of the conduct of the business of the Trust). Accordingly, so far as cl 20.2 was concerned, there was no amount which became due to Mr Menkens but which remained unpaid.

The plaintiffs [the appellants] argued that what should be brought into account here is such part of the agreed sum of $1,930,000 which was not paid by the partnership or the Trust. However, that balance had not become due to Leo Menkens. Any liability to pay any of that balance would have come into existence only upon the derivation of further profits. I would accept that 'liabilities of the trustee' would include a prospective liability, in the sense of existing liability to be discharged at a future date. But I am not persuaded that 'the liabilities of the Trustee in respect of the Trust Fund', as at October 2005, should be quantified by including an amount which might never have become payable.

Moreover, the Preferential Draw was not in any way incurred by any of the three principals *as a trustee of the Trust*, and in particular a liability incurred in the course of conducting the Trust's business. Rather, it was an agreement between the three *as unitholders* for the distribution of profits, if and when derived. The 'liabilities of the Trustee' were liabilities incurred only in the capacity as trustees of the Trust.

The inclusion of this balance of $385,823 would be inconsistent with the apparent intention of cl 12 of the Trust Deed which, it should be noted, was not limited to the present circumstance of a valuation of units under cl 8.13.1 of the Unitholders Deed. The purpose of cl 12 was to facilitate at any time a valuation of the units, but more particularly a valuation according to the then assets and liabilities of the Trust. At least arguably, it might have been relevant to consider this potential liability (for the Preferential Draw out of further profits) if valuing the units held by Reid Menkens or Mr Wintour, because in one sense, their units might have been less valuable than those of Leo Menkens whilst he was entitled to that preference in the drawing of profits. But cl 12 of the Trust Deed did not distinguish between units or unitholders. Clause 12 required a particular method

> of valuation of a unit, which was one upon what might be described as a net assets basis. In turn, that was the method of valuation required in the present context by the Unitholders Deed (subject to certain other matters being assessed according to cl 10.1 of that instrument)." (footnote omitted) (emphasis in original)

The arguments

[21] The respondent submitted that the trial judge's analysis was correct. The appellants submitted that the evidence did not support the trial judge's finding that the parties' agreement concerned only the distribution of the profit of the Trust. They submitted that the evidence was instead to the effect that a total amount of $1,930,000 was to be paid by five annual instalments of $386,000. They argued that: the trial judge did not refer to any evidence in support of those critical findings; they were contrary to admissions in the pleadings; they were contrary to the resolutions which acknowledged that there was a "deficit" for each of the years between 2001 and 2004; and the trial judge failed to take into account both the specific agreement as to the period time of five years over which the $1,930,000 was to be paid and the provision in cl 4.6.1 of the Unitholders Deed that each annual payment should "not be less than" $386,000. The appellants further argued that the trial judge erred by treating the trustees' obligation as one to distribute an amount up to a maximum, rather than a minimum, of $386,000. In the appellants' submission, regardless of how the payments were characterised, cl 20.2 of the Unitholders Deed imposed upon the trustees a liability to make the Preferential Draw provided for in cl 4.6: cl 4.6 conferred upon Leo Menkens an entitlement to be paid not less than $386,000 as the annual Preferential Draw, no other provision and nothing in the evidence detracted from that entitlement, and the unpaid balance of $385,823 was therefore a liability of the trustees as trustees.

[22] The appellants submitted that references in the parties' resolutions and in the pleadings to "deficits" in payment of the Preferential Draw were inconsistent with it being payable only out of profits. (Wintour admitted Leo and Reid Menkens' allegations in paragraphs 37 and 38 of the statement of claim that on 12 August 2004 the trustees and unitholders resolved and acknowledged that the Preferential Draw as at 30 June 2004 "was in deficit in the amount of $440,445 for the years ended 30 June 2001 to 30 June 2004"; "[t]he Preferential Draw outstanding was $826,000, comprising the deficit of $440,445 and the amount of $386,000[7] for the year ending 30 June 2005"; and "[a]s at 25 October 2005 the Preferential Draw remained in deficit".) The respondent submitted that the word "deficit" did not connote a liability which was due.

Consideration

[23] The appellants' submission that the trial judge did not refer to any evidence in support of the finding that the agreement concerned only the distribution of profit overlooked the fact that the question was essentially one of construction of the agreement. The trial judge construed the agreement in [30] of his Honour's reasons:

> "In the Unitholders Deed, cl 4.2 prescribed the terms for the distribution of net profit, which they expressed to be subject to cl 4.6. The parties there accurately recorded the true nature of the Preferential Draw."[8]

---

7 It was common ground that the correct figure was $385,823.

8 [2011] QSC 7 at [30].

[24] Because cl 4.6 applied "[n]otwithstanding the provisions of this Clause 4 or any other contrary provisions …", it is arguable that cl 4.2 did not itself necessarily require the Preferential Draw to be paid by way of distributions of net profit, but the trial judge's construction is put beyond doubt by reference to the 6 February 2002 resolution. As cl 4.6 required, that resolution specified the "exact terms and conditions" of the Preferential Draw. The agreement was not that the trustees owed Leo Menkens or MFT the total amount of the Preferential Draw or that they were liable to pay that total amount by five annual payments of $386,000. Instead, the resolution required the Preferential Draw to be paid "pursuant to the power in the Trust Deed to make income distributions from the Trust". Those words, read with the reference in cl 5 to the provisions of the Trust Deed which empowered the trustees to make distributions of net income year by year, unequivocally identified the "Preferential Draw due to LIGM in terms of the Deed" in cl 6 as a distribution of the net income of the Trust for the year to 30 June 2001. Although the business was in fact conducted by the partnership in that year and in part of the following year, the resolution required each instalment of the Preferential Draw to be paid out of the net income of the Trust. Clause 7 then treated cl 6 as an exemplar of subsequent distributions of net income of the Trust. (Clause 7 contemplated that there were to be six annual payments of $386,000 but that must be treated as a mistake, since it was common ground that at that time the parties contemplated five payments and a total of $1,930,000.)

[25] In that way, the resolution, completing the incomplete agreement in cl 4.6, constituted the Preferential Draw as year by year distributions of $386,000 out of the Trust's net income (or "profit", as the trial judge called it in conformity with cl 4.2). It inevitably followed that the amount of the net income in a particular year was the maximum amount of the payment of the Preferential Draw in that year.

[26] It is true that the provision in cl 4.6.1 that the annual Preferential Draw should "not be less than" $386,000 is not easy to reconcile with the limitation that the Preferential Draw was payable only out of net income, but that provision is also inconsistent with an agreement for five annual payments each fixed at $386,000. There was no provision which clearly explained what was to occur if the net income in a particular year was less than $386,000, but the combination of the reference in cl 4.2 to the distribution of profit and the emphatic requirement in the resolution for distribution of the Preferential Draw out of the net income of the Trust implied that any shortfall could be remedied only by a distribution out of net income in a subsequent year. That conclusion is also consistent with cl 4.6.2, which contemplated that the trustees might unanimously resolve to extend the Preferential Draw Period.

[27] In the result, the amount which MFT or Leo Menkens would be paid for the goodwill of MFT's business depended upon the amount of net income earned by the Trust during the Preferential Draw Period of five years, or during a longer period if Leo Menkens could secure the other trustees' agreement to an extension. Such an agreement was not as surprising as it might otherwise seem when it is recalled that the Unitholders Deed gave Leo Menkens effective control of the business of the Trust during the Preferential Draw Period, including the power to dismiss a trustee.

[28] I accept the respondent's submission that the word "deficit" in various resolutions and pleadings did not connote a liability which was due. It merely referred to the shortfall between the net income of a particular year and $386,000. The use of the word "deficit" was understandable in circumstances in which the parties

contemplated that the shortfall might be remedied by a distribution out of net income in a subsequent year during the Preferential Draw Period, or that period as extended by unanimous resolution under cl 4.6.2.

[29] The Preferential Draw, being payable only by distribution out of the Trust's net income, was not one of the liabilities of the Trust, that is, the "costs and disbursements commissions fees taxes including land tax and income tax amounts payable by the Trustee and other proper outgoings", which cl 13.2 of the Trust Deed obliged the trustees to pay out of the gross income of the Trust. Rather, the Preferential Draw was an entitlement to distributions of net income in preference to the other unitholders. Because the Preferential Draw was payable only as a distribution of the net income of the Trust in a particular year, it could only become due to the extent of the Trust's net income in that year; but in each year of the Preferential Draw Period the whole net income was distributed towards payment of the Preferential Draw.

[30] It follows that the unpaid balance of the Preferential Draw was not due or payable at any time. It was not a "conditional but unavoidable obligation to pay a sum of money at a future time."[9] This case is also distinguishable from *Lemon v Austin Friars Investment Trust Ltd*,[10] in which it was held that a stock certificate which stated that the company was indebted in a certain amount which was payable only out of three fourths of the net profits of the company each year was an acknowledgement of a present debt by a company. As the trial judge held, the unpaid balance was not "due" within the meaning of cl 20.2 of the Unitholders Deed and it was not a liability within the terms of cl 12 of the Trust Deed.

[31] The passages in the oral evidence upon which the appellants relied do not justify departure from the effect of the parties' written agreement. The evidence was mostly equivocal upon the question whether any deficit in an annual payment of $386,000 was subsequently to be made up only out of profits or whether it was a debt of the Trust. Similarly, the references in evidence to five annual payments of $386,000 did not make it clear whether the agreement was that the Trust incurred a liability to make those payments or whether the payments were to be made only as distributions of available net profit of the Trust.

[32] Leo Menkens gave the following evidence:

> "Tell me about those discussions, please?-- At that time the partnership - the new partnership wasn't making much profit. We had discussions as to whether we should - whether the commencement of the preferential draw period should be delayed, which we agreed to, and - but the purpose of it - the intention was not to - not to put it - move out the end date, to try to maintain a six-year end date, but to delay the start for six years and what we agreed we would - it would be 386 for five periods.
>
> Let's take this in stages. There was a discussion about pushing the start date of the preferential draw period back; is that right?-- That's correct.
>
> Was there agreement between you and Mr Reid Menkens and Mr Wintour on what that start date would become?-- Yes, there was.

---

9 cf *Hawkins v Bank of China* (1992) 26 NSWLR 562 at 572 per Gleeson CJ.

10 [1926] Ch 1.

> And what was that date?-- 1st of July 2000.
>
> All right. And was there discussion about whether the end date would move?-- Yes, there was.
>
> And what was that discussion?-- We would - we decided we wouldn't move the end date. We would try - we believed we had the capacity to maintain the end date.
>
> All right. And was there a discussion about what the – how many years the preferential draw will be paid for then?-- Five.
>
> All right. And was that agreed between the three of you?-- Yes, there was.
>
> And was there discussion about what the preferential draw figure would become for each of those five years?-- Yes, there was.
>
> And what was that figure?-- $396,000.
>
> And how was that figure arrived, do you recall?-- It was a discounted figure. I don't - I couldn't say exactly how it was done. It is less than the original figure."

[33] The appellants submitted that this evidence unequivocally referred to a Preferential Draw to be paid over five years. However the evidence did not justify a conclusion that the Preferential Draw was agreed to be a Trust debt. The statement that "we believed we had the capacity to maintain the end date" suggested instead that the total Preferential Draw would only be paid within five years if the Trust generated sufficient profit to do so within that period. This was also consistent with his agreement during cross-examination that the Trustees were required to distribute to him $386,000 "or so much as could be distributed".

[34] The appellants referred to the following passage in Leo Menkens' cross-examination:

> "All right. And $386,000 across five years was going to be 1.93 million dollars?--That's correct.
>
> And that was – I'll put it to you that was the purchase price of the business?--That's correct, the deal.
>
> Yes. And as it were, the three trustees, you, Reid and Mr Wintour, were paying you that sum to bring - to buy that business into the new structure?-- Including the revenue of that business as well.
>
> Yes?-- Yes."

[35] The description of the payments which became the Preferential Draw as "the purchase price of the business" provided some support for the appellants' case that the Preferential Draw was intended to be a Trust debt, but in other evidence Leo Menkens denied that the business had been sold to the Trust:

> "The arrangement?-- Yeah, we had a business and I had - and I was earning profit out of it.
>
> And you sold that business to the - to the partnership-----?-- It wasn't a sale.

> -----which then became the unit trust?-- It wasn't a sale.
>
> It wasn't a sale?-- No, we - we had this agree - arrangement where we did it over a five-year period.
>
> You did what?-- We - I had a preferential draw agreement-----
>
> Yes?-- -----to take $386,000 a year-----
>
> Yes?-- -----and at the end of that time, the business - all business would - would reside in the unit trust.
>
> Yes. So each of those $386,000 was a proportion of that payment?-- That's correct.
>
> Yet you're showing it as commission received?-- It's revenue. I had to pay tax on it.
>
> You had to pay tax. You mean you declared it as income?-- Yes.
>
> You didn't declare it as a capital-----?-- No.
>
> -----a payment of capital?-- No, it was declared as an income."

[36] The parties' characterisations of the payments in their discussions were not conclusive, but Leo Menkens plainly disavowed a simple purchase transaction under which it might be implied that the Trust incurred a liability for the purchase price of the business as a debt.

[37] The appellants referred to a ruling during the course of the trial in which the trial judge noted that there was an understanding by September 2001 that "there could be a preferential draw in favour of Mr Menkens Sr of $386,000 per year effectively to allow him a total of five by $368,000." That was common ground between the parties, but it was in issue whether the money was to be paid only out of the profits of the Trust.

[38] The appellants referred to Reid Menkens' evidence in which he agreed that it was common ground that "the preferential draw payment was intended to be $386,000 per year over a five-year period, a total of $1.93 million". That reference to the parties' intention was not directed to the issue whether the payments were to be made in discharge of a debt of the Trust or rather by way of distributions of the net profit of the Trust. The same is true of Wintour's evidence in chief that Leo Menkens said that "he would be happy to get $386,000 for five years, or about $1.93 million, and that if Reid or I left prior to him being paid that total amount, well, then Reid and I would not be entitled to any of the value that he brought to the partnership at the start."

[39] The evidence was given in terms which were too general to be of assistance upon the present issue, which ultimately turns upon an objective analysis of the parties' written agreement.

Order

I would dismiss the appeal with costs.

[40] **BODDICE J:** I have read the reasons for judgment prepared by Fraser JA. I agree with those reasons, and the proposed order.

[41] **DALTON J:** I have read the reasons for judgment prepared by Fraser JA. I agree with those reasons, and the proposed order.