

'Are we there yet?'

The intersection of trust law and statutory insolvency regimes continues to tantalise but the prospect of the settlement of principles now appears closer

Pieter Oomens | July 2018 | Commercial Disputes & Transactions

Summary

The Full Court of the Federal Court (not sitting as an appellate court but at first instance on referral from a single judge) has recently considered the interrelationship of trust law and the insolvency regime under the *Corporations Act 2001* (Cth) (the 'Act'). The case of *Jones (Liquidator) v Matrix Partners Pty Ltd, in the matter of Killarnee Civil & Concrete Contractors Pty Ltd (in liq)*¹ ('*Killarnee*') has been the subject of considerable interest and comment² and has been followed in two Federal Court decisions³. It was a split decision and has not altogether settled the law. The High Court is expected to provide further guidance on the vexed issues referred to in *Killarnee*⁴. In the writer's opinion, the judgment of the Chief Justice of the Federal Court in *Killarnee* does however give the clearest guide as to how liquidators should conduct relevant aspects of the liquidation of insolvent trustee companies to which they have been appointed. The judgment draws upon decisions of the Full Court of the South Australian Supreme Court⁵ and, crucially, the High Court⁶.

Background

Killarnee concerned a case where the liquidators of a company which had acted as a trustee of a trading trust sought directions. At issue was how the liquidators should account to creditors of the company consequent upon the realisation of trust assets.

The case of *Re Independent Contractor Services (Aust) Pty Ltd (in liq) (No 2)* [2016] NSWSC 106, sparked considerable interest among liquidators and their advisors. It led to liquidators seeking their appointment as receivers of trust assets to ensure that they had appropriate authority to realise those assets and distribute their property.

Moreover, it advanced the proposition that if a trustee is in liquidation then the rights of creditors of the trust are regulated by general law and not the Act such that they are treated *pari passu* and not pursuant to the priority regime established under sections 555, 556, 560 and 561 of the Act.

Principles

In *Killarnee*, Allsop CJ (with whom Farrell J generally agreed, although with different reasoning in some aspects of the judgment) stated (or more accurately, re-stated) a number of principles:

- If a trust instrument provides that in the event of a corporate trustee ceasing to hold office on its liquidation, the company may be considered a bare trustee⁷.
- Subject to any provision of a contract, the trustee is personally liable for debts or liabilities incurred in the execution of its duties and powers in the business or affairs of the trust and while there is no direct access by the creditors to the assets of the trust, in Equity the creditors may be subrogated to the rights of the trustee against the trust assets⁸.
- Subject to the terms of the trust, the trustee is entitled to be indemnified against the debts and liabilities incurred in the proper execution of its duties and powers under the trust out of the assets of the trust. Subject to the terms of the trust, such right of indemnity has priority over the claims of beneficiaries, and is secured by a lien. If the trustee has used its own funds to pay the debt or meet the liability, the entitlement of access to the trust assets is a personal asset of the trustee, unattended by equitable

obligations arising from the trust. If the trustee has not paid the debt, it has a right of exoneration from the trust assets; that is a right to use the trust assets to exonerate itself from the debt or liability which was incurred in carrying out the role of trustee⁹.

- A trustee may exercise its right of indemnity without judicial intervention where property is not required to be sold, but the lien attending that right of indemnity does not of itself confer a power of sale, and if sale is necessary, a Court order or appointment of a receiver to sell is required¹⁰.
- It is important to distinguish the right of indemnity by way of reimbursement or recoupment and the right by way of exoneration. If a trustee has used its own funds to pay the trust debt, the right of reimbursement is its personal asset which falls to its general estate without any equitable obligation attaching to it and if the trustee happens to be insolvent, that personal asset is available for all creditors not limited to creditors for the trust. On the other hand, if the trustee has not paid the debt or liability from its own money before seeking to exercise the right, and is availing itself of the right of exoneration, then the nature of the right and its relationship with creditors' needs is different¹¹. In the case of the right of exoneration, that is an asset available for creditors of the trust.¹²
- If a person (including a company) is a trustee of more than one trust or owns property in his, her or its own right as well as being a trustee of a trust, those assets that are impressed with a particular trust can only be used for the purposes of that trust. Accordingly, to use proceeds from the exercise of the right of exoneration to pay the creditor of another trust would be to use an asset impressed with one trust for the benefit of another trust which would be impermissible¹³.
- The trustee's interest in the trust property by way of its right of indemnity amounts to a proprietary interest. The 'trust property' is no longer held solely in the interests of the beneficiaries of the trust and the trustee's interest in that property will pass in bankruptcy or liquidation as the case may be, for the benefit of creditors of the trust should bankruptcy or liquidation occur¹⁴.
- Although the trustee's right of indemnity (whether for reimbursement or exoneration) constitutes a personal proprietary interest of the trustee taking priority over the interests of beneficiaries, that right is constrained or shaped in its content by an equitable obligation to use it to pay creditors¹⁵. In the case of an indemnity arising from a right of exoneration, the equitable obligation is owed to the creditors of the trust.
- While the Act does not change the nature of the property that falls under the control of the liquidator or of the results of or proceeds from the exercise of that property (that is, the right of indemnity which is personal property of the corporate trustee), the results of the trustee's right of indemnity are affected by the priority regime under the Act. In those circumstances the Act governs how the property of the company (including the results of the realisation of the exercise of the right of indemnity) is to be distributed¹⁶.
- The liquidator's costs are payable out of the trustee's right of indemnity¹⁷.
- A corporate trustee is still constrained by its equitable obligations and notwithstanding that the liquidator has the suite of powers afforded to him or her under section 477 of the Act, the liquidator is also affected by the company's overarching equitable obligation.¹⁸

As to the final point, it is for this reason that a corporate trustee in liquidation and acting as a bare trustee would be obliged to obtain Court sanction to permit the sale of a trust asset, including a trust asset over which the trustee has a lien to support a right of indemnity.

Implications

While insolvency practitioners and their advisors await the outcome of the application for leave to appeal *Amerind* (and the subsequent appeal if leave be granted) the decision of Allsop CJ in *Killarnee* provides the best guide as to how liquidators are to proceed in dealing with the notions of trust property, rights of indemnity and the claims of creditors of a company which acted as trustee.

In response to the question framed in the title to this paper, the answer is, 'Nearly'.

¹ [2018] FCAFC 40

² See for example the article on the ARITA website 'Full Federal Court decision on Corporate Trading Trusts', posted 22 March 2018; and 'Recent Developments in Corporate Law', Commercial Law Association June Judges Series 8 June 2018, a presentation by his Honour Justice Black of the Supreme Court of New South Wales.

³ *Deputy Commissioner of Taxation v Fairsales Pty Limited, in the matter of Fairsales Pty Limited* [2018] FCA 499 and *Federal Commissioner of Taxation v Darwin Joinery Pty Limited* [2018] FCA 753.

⁴ Leave to appeal has been filed in *Commonwealth v Byrnes and Hewitt in their capacity as joint and several receivers and managers of Amerind Pty Limited (receivers and managers appointed)(in liquidation)* [2018] VSCA 41.

⁵ *In re Suco Gold Pty Ltd (in liq)* (1983) 33 SASR 99

⁶ *Octavo Investments Pty Ltd v Knight* [1979] HCA 61

⁷ Paragraph 33 *Killarnee* judgment.

⁸ Paragraph 34 *Killarnee*.

⁹ Paragraph 35 *Killarnee*.

¹⁰ Paragraph 44 *Killarnee*. It should be noted that in the context of this case, the trustee in question was a bare trustee. A bare trustee can hold trust assets but only for use in payment of trust liabilities. A bare trustee is at personal risk if it overreaches that role. While a bare trustee has a lien to secure its rights it must obtain court sanction before enforcing the right to realise the secured assets so as to meet its claim to indemnity. See for example, *Ng v Van Der Velde* [2011] FCAFC 35 and *Theobald, in the matter of Finplas Pty Ltd* [2014] FCA 31.

¹¹ Paragraph 45 *Killarnee*.

¹² Paragraph 62 *Killarnee*.

¹³ Paragraphs 51-61 *Killarnee*.

¹⁴ Paragraph 62 *Killarnee*.

¹⁵ Paragraphs 67-79 *Killarnee*.

¹⁶ Paragraph 97-102 *Killarnee*.

¹⁷ Paragraph 105 *Killarnee*.

¹⁸ Paragraphs 85 – 91 *Killarnee*

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