

# Tension between the application of principles of trust law and insolvency law has been resolved by the High Court (for now)

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## Summary

There have been conflicting authorities as to how creditors of insolvent trustees the subject of external appointment (under the Bankruptcy or Corporations legislation) should be treated: does the law of trusts apply or are their claims subject to the operation of legislation governing insolvency. The payment of those creditors rests on the right of indemnity of the insolvent trustee. In *Carter Holt Harvey Woodproducts Australia Pty Ltd v The Commonwealth*<sup>1</sup> the High Court has clearly stated that while the nature of property that falls under the control of an external insolvency administrator does not change upon such appointment, the results of the exercise of that administrator's right of indemnity are affected by the relevant statutory priority regime.

## Background

Amerind Pty Ltd (receivers and managers appointed) (in liquidation) ('Amerind') carried on a business. It did so exclusively as the trustee of a trading trust. In so doing, Amerind maintained a number of credit facilities with a bank. Following default, the bank terminated those facilities, demanded repayment and ultimately appointed receivers and managers to Amerind pursuant to a general security interest that it held over the property in the trust. Subsequent to that the creditors of Amerind resolved to wind up the company in insolvency. Following their appointment the receivers traded on the business of Amerind for a time and ultimately realised all the assets of the business and found themselves with a surplus, after paying the bank and their fees.

There were competing claims to the surplus.

The Commonwealth had advanced accrued wages and entitlements to Amerind's former employees pursuant to the Fair Entitlements Guarantee scheme. The Commonwealth claimed that it was entitled to be paid out of the surplus, pursuant to sections 433(3), 556(1)(e) and 560 of the Corporations Act, in priority to other creditors<sup>2</sup>. Section 433 obliges a receiver appointed by a holder of a circulating security interest to observe the order of priorities which applies to preferential creditors in a winding up. It requires a receiver to pay out of that property any debt or amount that, in the event of the company being wound up, would be payable out of the proceeds of realisation of that property pursuant to section 556(1)(e) for example. Given the amount advanced and the size of the surplus, this would mean that the Commonwealth would be paid to the exclusion of all ordinary unsecured creditors.

An ordinary unsecured creditor contested this interpretation which gave effect to the insolvency regime under the Corporations Act with respect to an asset sourced from trust property. It submitted that given the operation of the trust and the application of trust law, section 433 did not afford any priority to the Commonwealth with the effect that all unsecured creditors were entitled to a proportionate share of the surplus according to the size of their respective debts.

## Principles

The High Court reviewed conflicting authorities concerning the intersection of trust law and insolvency law. The following principles may be distilled from the case:

- An external administrator who assumes control of the property of an insolvent entity takes that property subject to equities and accordingly must deal with

assets held by the entity as trustee in accordance with the terms of the trust<sup>3</sup>. This applies in the case of bankruptcy and corporate insolvency<sup>4</sup>.

- Where the trustee (and for ease of reference, a corporate trustee is the example chosen in this paper), acting within its powers, contracts with a third party in the course of the administration of the trust, although the trustee is ordinarily personally liable to the third person on the contract, the trustee is entitled to indemnity out of the trust estate. If the trustee has discharged the liability out of its own property, the entitlement is one of reimbursement; if the trustee has not discharged the liability, then it is entitled to apply the trust property to so discharge the liability and such entitlement is one of exoneration<sup>5</sup>.
- To the extent that the company has a beneficial interest in the trust assets, as it has by reason of the company's right of indemnity in respect of properly incurred trust obligations, the trust assets are property of the company available for payment to creditors<sup>6</sup>.
- Exercising its right of indemnity to reimburse itself for what it has already paid from its own estate (should it have acted on its own account as well as trustee), the trust property to which the trustee may have regard is an asset available to all creditors of the trustee being general creditors (should they exist) and trust creditors<sup>7</sup>.
- Exercising its right of indemnity for exoneration, because it can have regard to trust property under such indemnity for debts it incurred in its capacity as the trustee of such trust, the only creditors who can obtain the ultimate benefit of the right are those who are creditors of the trust<sup>8</sup>.
- In the distribution of the proceeds of the exercise of a trustee's right of indemnity, the statutory order of priorities should be followed<sup>9</sup>.

The High Court generally endorsed the views expressed by Allsop CJ in *Jones (Liquidator) v Matrix Partners Pty Ltd, in the matter of Killarnee Civil & Concrete Contractors Pty Ltd (in liq)*<sup>10</sup> – see our July 2018 TurkAlert '[Are we there yet?](#)'.

The surplus constituted an asset which was property of Amerind. The receivers were in possession of it. As a consequence of the winding up it was property of Amerind available for payment of creditors in accordance with the insolvency regime under the Corporations Act.

In the result, by application of the principles outlined above, the Commonwealth prevailed.

## Implications

The analysis in *Killarnee* (and before that in the case of *In re Suco Gold Pty Ltd (in liq)*<sup>11</sup> now endorsed by the High Court, allows one to navigate between the shoals of what constitutes trust property, rights of indemnity and the claims of creditors upon externally administered insolvent trustees. It is not so much a case of preferring one body of law to another but understanding that the principles of trust law and the statutory insolvency regimes mesh together.

<sup>1</sup> [2019] HCA 20

<sup>2</sup> *Carter Holt Harvey Woodproducts Australia Pty Ltd v The Commonwealth* [2019] HCA 20 (Judgment) at paragraphs [61-63]

<sup>3</sup> Judgment at paragraph [94]

<sup>4</sup> Judgment at paragraph [95]

<sup>5</sup> Judgment at paragraph [29]

<sup>6</sup> Judgment at paragraph [95]

<sup>7</sup> Judgment at paragraph [92]

<sup>8</sup> Judgment at paragraph [95]

<sup>9</sup> Judgment at paragraphs [95 - 96]

<sup>10</sup> [2018] FCAFC 40

<sup>11</sup> [1983] 33 SASR 99

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