



LONSDALE CHAMBERS

**Insolvent Trustees of Trading Trusts:  
How many slices? How many pies?**

**by  
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# Synopsis

- For decades, intermediate appellate courts in Australia and many single judges, State and Federal, have grappled with the legal difficulties posed when the insolvent trustee of a trading trust is wound up (in the case of a company) or made bankrupt (in the case of an individual).
- Liquidators and Trustees in Bankruptcy have generally been awarded their remuneration and expenses out of trust property; but what is the juridical basis for this?
- Often the Commonwealth or State is a personal creditor of the trustee, but the trustee's only asset is the right indemnity (by exoneration and/or recoupment) from trust property; and, whether the trust creditors can be paid in full or not, will either or both those rights avail non-trust creditors?



# Creditors' Rights

- Even if all a trading trustee does is trade in its/his/her capacity as trustee, not all debts incurred while so trading will be amenable to recoupment or exoneration out of trust property; for example some taxes assessed to the trustee personally and debts incurred in breach of trust.
- The trading trustee will be indemnified re most trading debts; but what about creditors who enjoy priority over ordinary unsecured creditors; for example the Commonwealth for *Fair Entitlements Guarantee* (FEG) or for *Superannuation Guarantee Charge* (SGC)?



# Basic Trust Principles

- *Octavo Investments v Knight* (1979) 144 CLR 360 at p.367, 369, 370 and 371:
- The trading trustee is personally liable for debts.
- If the debts are incurred consistently with trust powers, the trading trustee has a right of indemnity:
  - a right of exoneration re unpaid debts; and
  - a right of recoupment re paid debts. [In the rare instance where the trading trustee has used personal, non-trust money to pay trust debts, money recouped from trust assets will be the trustees' own money and will be distributed to creditors according to the statutory priorities].
- Trust creditors are subrogated to the trustee's rights.
- Those rights trump the rights of the beneficiaries.



# How Indemnification Works

- If the trading trustee becomes insolvent, the creditors are obliged to share “slices” of “pies”: non-trust creditors are confined to the trustee’s personal assets; trust creditors are entitled to share the trust assets and, if they are insufficient, to access the personal assets as well.
- However, if there are no, or insufficient, personal assets, should the trust assets bear the remuneration and expenses of an Insolvency Practitioner?
- One thing is clear: early in every case, the Court (and therefore lots of lawyers) must be involved.



# A Short History

- *Re Byrne Australia* [1981] NSWLR 394 and *Re Byrne Australia (No. 2)* [1981] 2 NSWLR 364: Needham J held that *Octavo* was not authority for the proposition that remuneration and expenses unrelated to administration of the trading trust could be recovered from the proceeds of realisation of trust assets.
- *Re Enhill* [1983] 1 VR 561 went the other way. The Full Court held that proceeds of the right of indemnity (exoneration re trust liabilities) could be shared by Insolvency Practitioners and all creditors according to the statutory priorities [now CA s.556 and BA s.109]. Lush J fell back on the Salvage Principle.
- *Grime Carter & Co. v Whytes Furniture (Dubbo)* [1983] 1 NSWLR 158: McLelland J preferred *Enhill*.
- *Re Suco Gold Pty Ltd (in liq)* (1983) 33 SASR 99 seemed to supply clarity: Insolvency practitioners' remuneration and expenses recoverable from trust assets (a) because trust assets must bear the cost of administration of the trust, including its winding up to pay creditors or (b) because of the Salvage Principle. [*Enhill* was relied on for IP priority but not for creditor priority!]



# *The Salvage Principle*

- *Re Universal Distributing Co Ltd (in liq)* (1933) 48 CLR 171: Expenses “reasonably incurred in the care, preservation and realisation of [trust] property”. *Buchler v Talbot* [2004] 2 AC 298 is to like effect.
- *Re Berkeley Applegate (Investment Consultants)* [1989] Ch 32; [1988] 3 WLR 95: Insolvency practitioner remuneration is also covered by the principle. (Not mentioned in *Buchler v Talbot*).
- The principle has now been extended to include almost all conceivable insolvency practitioner activities; *IMF v Meadow Springs* [2009] FCAFC 9, *Stewart v Atco Controls Pty Ltd (in liq)* (2014) 252 CLR 307, *Freelance Global Ltd (in liq) v Benstead* [2016] VSC 181 (Riordan J) at [87] and *Re Mamounia Pty Ltd (in liq)* [2017] VSC 230 (Robson J).

# History (Resumed)

- *Re Indopal* (1987) 12 ACLR 54 and *Re GB Nathan & Co. Pty Ltd* (1991) 24 NSWLR 674 (McLelland J) and *Re Matheson* (1994) 121 ALR 605 (Spender J) generally followed *Suco Gold*.
- *13 Coromandel Place v CL Custodians* (1999) 30 ACSR 377: Finkelstein J held that work in the nature of general liquidation work is in a different category and is not properly charged against trust property, unless it can be shown that the liquidation is necessary for the proper administration of the trust.



## History (Continued)

- *Bastion v Gideon Nominees* [2000] NSWSC 939: Austin J acknowledged the distinction between general costs of winding up and costs of administration of the trust, but allowed payment of the former out of trust assets.
- *ASIC v Rowena Nominees* (2003) 45 ACSR 424: Pullen J approved an application by a liquidator, made before commencing work, for permission to recoup remuneration and expenses from realisation of trust property.
- Application to Court for directions re trading trust administration is now the norm; e.g. *Georges re Sonray Capital Markets* [2010] FCA 1371 (Finkelstein J).



# History (Concluded)

- *Caterpillar Financial Services* [2011] FCA 677: Gordon J not only pre-approved recoupment of future remuneration and expenses from the proceeds of trust property, but also conferred a *Trustee Act* power of sale and QUAERE authorised the payment of statutory priorities from the proceeds of trust property.
- *Re North Food Catering* [2014] NSWSC 77: Brereton J went further than Finkelstein J in *13 Coromandel Place*.
- *AAA Financial Intelligence* [2014] NSWSC 1004 (Brereton J), *Freelance Global Ltd (in liq) v Benstead* [2016] VSC 181 (Riordan J) and *Re Mamounia Pty Ltd (in liq)* [2017] VSC 230 (Robson J) establish that trust assets will bear all Insolvency Practitioner costs where the trustee has no assets and that otherwise, in the Court's discretion, there will be apportionment.

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# Statutory Priorities

- *Re Independent Contractor Services* (2016) 305 FLR 222: Brereton J declined to follow *Suco Gold* (despite Gordon J having followed it in *Caterpillar Financial Services*) and held that proceeds of realisation of the trustee's right of exoneration must be distributed to creditors according to trust law and not according to statutory priorities applicable to the trustee's own assets.
- Robson J agreed in *Amerind* [2017] VSC 127; but an appeal has been heard by the VSCA.



# Conceptual Problem

- True it is that the trading trustee's right of exoneration is available to the insolvency practitioner administering the winding up or bankruptcy of the trustee; but it is probably inconsistent with *Octavo* (and certainly, *Suco Gold*) to go further (as Brereton J and Robson J have done) and treat the right of exoneration as a “trust asset” (and therefore not an asset of the trustee amenable to the priority provisions).
- Although both judges correctly recognised that the right of exoneration is only available for the satisfaction (in whole or *pari passu*) of trust creditors; their reasoning does not disclose a convincing juridical foundation for their conclusions.



# Unifying Theory

- *Lane ATF Lee (Bankrupt) v CoT* [2017] FCA 953 (see also *Lane ATF Lee (Bankrupt) v CoT (No 2)* [2017] FCA 1112): Derrington J, in a scholarly and readable judgment, concluded (at [107]-[111]) that the trustee's right of exoneration (with its concomitant equitable lien) is not a "trust asset" but an asset of the trustee "subject to equities". Those "equities" require that the trust property be realised and distributed to trust creditors according to trust law (which effectively charges the trust property with payment *pari passu* to trust creditors), not the statutory priorities.
- Derrington J also commented (at [154]-[187]) on the recent expansion of the Salvage Principle and (despite *Suco Gold*, etc.) found that principle to be "a surer [juridical] foundation" for payment of Insolvency Practitioner remuneration and expenses out of trust property.
- His Honour sets out at [5] a very useful executive summary of all the relevant principles.

