Insolvent Trusts: Implications of Buckle and CPT Custodian*

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1 A trustee acting within its powers is entitled to be indemnified out of the trust assets in respect of liabilities properly incurred in execution of the trust. The right of indemnity is either a right of recoupment from the trust assets if the trustee has already paid the debt out of its own moneys, or a right of exoneration from the trust assets if the debt or other liability is unpaid.

2 This article is in two parts. The first part deals with what was decided in Chief Commissioner of Stamp Duties (NSW) v Buckle and CPT Custodian Pty Ltd v Commissioner of State Revenue as to the nature of a trustee’s right of indemnity and, correlative, the nature of a beneficiary’s interest in trust property where the trustee has a right of indemnity. The second part proceeds on the assumption that the analysis in the first part is correct. In summary, I suggest that where a trustee, acting within power, incurs debts in the proper execution of the trust, the trustee is entitled by virtue of his legal ownership to satisfy himself out of the trust estate against such liabilities and the rights of the beneficiaries are deferred to the trustee’s prior right, which is a preferred beneficial interest. If this is correct, it should follow that where the trustee has incurred debts in the proper execution of the trust, the trust creditors, who are subrogated to the trustee’s right of indemnity, are entitled to the benefit of that right, even if the trustee has committed other unrelated breaches of trust.

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1 A Judge of Appeal of the Supreme Court of New South Wales.


Part One

Trustee’s Right of Indemnity is not an Encumbrance on the Trust Assets

3 In *Buckle* the High Court held that a trustee’s right of indemnity out of trust assets was not an encumbrance upon the trust assets.\(^4\) Section 66(1) of the *Stamp Duties Act 1920* (NSW) provided that:

> “Subject to the provisions of this Act every conveyance is to be charged with ad valorem duty in respect of the unencumbered value of the property thereby conveyed.”

“Conveyance” was widely defined and included a resettlement of trust assets. The High Court said that the word “unencumbered” in s 66(1) was not used in a loose sense but referred to:

> “… security interests in, or charges or other liabilities which attach to, the property in question”\(^5\)

4 It has been said in many cases that a trustee’s right of indemnity is in the nature of a charge or lien over trust property.\(^6\) That description is at least anomalous where the trustee with the right of indemnity still holds legal title to the assets.\(^7\) In *Octavo Investments Pty Ltd v Knight*\(^8\) the plurality (Stephen, Mason, Aickin and Wilson JJ) added that where a trustee was entitled to be indemnified from the trust assets in respect of liabilities properly incurred:

> “In such a case there are then two classes of persons having a beneficial interest in the trust assets: first, the cestuis que trust, those for whose benefit the business was being carried on; and secondly, the trustee in respect of his right to be indemnified out of the trust assets against personal liabilities incurred in the performance of the trust. The latter

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\(^5\) Ibid at [44].
\(^6\) See, eg, *Octavo Investments Pty Ltd v Knight* (1979) 144 CLR 360 at 367.
\(^7\) *Agusta Pty Ltd v Provident Capital Ltd* [2012] NSWCA 26 at [41].
\(^8\) (1979) 144 CLR 360 at 367.
interest will be preferred to the former, so that the cestuis que trust are not entitled to call for a distribution of trust assets which are subject to a charge in favour of the trustee until the charge has been satisfied: Vacuum Oil Co Pty Ltd v Wiltshire.”

In Buckle, the High Court held that the trustee’s preferred beneficial interest was not an encumbrance on the trust assets and that:

“A court of equity may authorise the sale of assets held by the trustee so as to satisfy the right to reimbursement or exoneration. In that sense, there is an equitable charge over the ‘trust assets’ which may be enforced in the same way as any other equitable charge. However, the enforcement of the charge is an exercise of the prior rights conferred upon the trustee as a necessary incident of the office of trustee. It is not a security interest or right which has been created, whether consensually or by operation of law, over the interests of the beneficiaries so as to encumber them in the sense required by s 66(1) of the Act. In valuing the interests of beneficiaries which are conveyed by an instrument, there is no encumbrance which the Act requires to be disregarded.” (emphasis added).⁹

The characterisation of the right as being in the nature of a lien or a charge is apt where there has been a change of trustee or the trustee’s office has been terminated, e.g. by an insolvency event, so that the trustee with the right of indemnity no longer has ownership or possession of the trust assets, or no longer has authority to deal with them, and cannot satisfy itself out of them by exercising the rights of legal ownership. It was in that context that in Bruton Holdings Pty Ltd (In Liq) v Federal Commissioner of Taxation¹⁰ the High Court described a former trustee’s right to recoupment or exoneration as being supported by a lien over the whole of the trust assets which survived its loss of office as trustee.¹¹ The characterisation is also an apt description of the right of a creditor entitled by subrogation to exercise the trustee’s right, the creditor being entitled to the remedies of the appointment of a receiver and order for sale.

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⁹ Buckle at [50], 247.
¹¹ Ibid at [42]-[43].
Otherwise, the description of the right as a lien or charge is apt to mislead. It suggests that the trustee’s right of indemnity is a security interest in property belonging to others (the beneficiaries). It was so described by the Victorian Court of Appeal in *Arjon Pty Ltd v Commissioner of State Revenue*,¹² and by Brereton J in *Lemery Holdings Pty Ltd v Reliance Financial Services Pty Ltd, Re Stansfield DIY Wealth Pty Ltd (In Liq)*¹³ and *Re Independent Contractor Services (Aust) Pty Ltd (In Liq) (No. 2)*.¹⁴ In *Lemery Holdings* his Honour said:¹⁵

“The starting point is that it is universally accepted that the nature of the trustee’s interest is that of an equitable lien — that is, an equitable security interest arising not by agreement of the parties but by operation of law. It is also universally accepted that the only remedy of the trustee against the trust assets is judicial sale or appointment of a receiver. That is consistent with the nature of an equitable lien as a mere hypothecation.”

With respect, those propositions are not universally accepted and are inconsistent with the High Court’s reasoning in *Buckle*.⁸

Writing extra-judicially, Chief Justice Allsop said:

“Recently, in *Lemery Holdings Pty Ltd v Reliance Financial Services Pty Ltd*, Brereton J said that the starting point of any analysis was ‘that it is universally accepted that the nature of the trustee’s interest is that of an equitable lien.’ The view (which, with respect, must be right) that the interest is not one of ownership but a form of security must, however, be reconciled with *Buckle* and *CPT Custodian*. Mr Hyde Page in his article suggests that *Buckle* is only authority for the right not being an encumbrance under the former Stamp Duties Act; and that it was directed to the value of the beneficiaries’ right, not its character. It is perhaps sufficient to say that how the equitable interest arising under equitable principle and statute operates to qualify the interest or value of the interests of beneficiaries will be affected by the terms of any relevant statute and by the recognition that the trustee’s right is in priority to that of the beneficiaries, proprietary in nature,

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¹³ [2008] NSWSC 1344; (2008) 74 NSWLR 550 at [16], 553 (‘*Lemery Holdings*’).
enforceable in execution by action of a court of equity and not otherwise
and in the nature of a protective security interest.”

In the article referred to, “CPT Custodian and the effect of trustee recoupment
rights on the taxation of beneficiaries”, Mr Hyde Page took issue with the
analysis of McPherson J (with whom Andrews J agreed) in Kemtron
Industries Pty Ltd v Commissioner of Stamp Duties (Qld) of the
interrelationship between the rights of beneficiaries and the trustee’s right
of indemnity. McPherson J quoted Lush J in Re Enhill Pty Ltd that the
rights of beneficiaries are reduced to the extent of the trustee’s right of
indemnity and added (at 586-587):

“A case which was not cited, but which more than any other seems to me
to carry Mr. Jackson’s point, is the decision of the Full Court of Victoria
in Daly v. Union Trustee Company of Australia Ltd. (1898) 24 V.L.R. 460. The defendant was the trustee of a settlement of land in trust
for the plaintiff and her children. The land had, before the settlement was
made, been transferred by way of mortgage and, in order to save the
estate from foreclosure or sale, the defendant trustee paid off the mortgage
and directed a transfer to a nominee. That involved the defendant in
expenditure for which it was entitled to indemnity from the trust estate.
The expenditure was not reimbursed and, with a view to its recovery by
sale of the land, the defendant commenced proceedings to eject the
plaintiff from the land. In an action brought by the plaintiff to restrain
those proceedings the Full Court held that she was not entitled to such
relief. The judgment of the Court was delivered by a’Beckett J. who,
speaking of the defendant’s expenditure, said (24 V.L.R. 460, 469):

‘Under those circumstances their duties as trustees are
suspended by reason of the right which they have to be
indemnified, which is incidental to their assumption of the
duties as trustees, under which a state of things has arisen
which should have been contemplated at the outset — that
they might have to pay to save the estate.’

I read those remarks as meaning that, as regards its own beneficial
interest in the land the subject of the settlement, the defendant trustee
was under no fiduciary obligation to the beneficiaries; or, in other words,
that to the extent of the right to be indemnified the land was not trust

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16 (The Nature of the Trustee’s Right of Indemnity and Its Implications for Equitable Principle at [38].)

17 (2011) 40 AT Rev 165.


property. That view of the matter is supported by the remark of a'Beckett J. in argument, reported at p. 467 of the report and repeated at the following page, that ‘the trust is of property after the mortgage is satisfied’.

In my view that decision and the other judicial statements referred to represent authority for the view that, in any case in which the trustee is entitled in respect of liabilities properly incurred to his indemnity and lien over assets vested in him as trustee, the trust property (which means the property to which the beneficiaries are entitled in equity) is confined to so much of those assets as is available after the liabilities have been discharged or at least provided for. There is an analogy with the interest of a partner in the partnership assets prior to winding up, as to which see Federal Commissioner of Taxation v. Everett (1980) 143 C.L.R. 440, 446. Obviously a matter of accounting and usually also of valuation may be involved; but it is the duty of a trustee to be constantly ready with his accounts: Re Craig (1952) 52 S.R. (N.S.W.) 265, 267, and the fact that a valuation may be required for accounting purposes merely serves to emphasize that the right of the beneficiaries is limited to the balance remaining after the liabilities are paid or provided for out of the assets once their value is determined. It is therefore not correct to say, as Mr. Davies Q.C. submitted for the Commissioner, that the trustee’s lien at all times attaches to all of the assets. That would have the consequence that the trustee could, as against the beneficiaries, insist upon retaining all the assets in the exercise of his right of indemnity even though the liability in respect of which that right was exercised was trivial in amount. Such a conclusion would be surprising particularly where, for example, the assets consisted entirely of cash and the liabilities were fixed and their amount capable of precise and immediate determination in money.”

10 Mr Hyde Page argued that there are “… highly authoritative decisions which say that the general law of indemnity does not confer an ownership interest in the assets of a trust estate” citing Octavo Investments and Buckle.20 The latter was said to have “affirmed that a trustee’s right of indemnity has the nature of an equitable charge”.21

11 He argued that:

“The suggestion that Buckle has some impact beyond the valuation of the interests for stamp duty purposes and construction of the statutory word ‘unencumbered’ rests only on inference, and it is an inference that is inconsistent with the authorities which say that the trustee indemnity does not confer an ownership interest. A court intending to
overturn a number of decided cases can be expected to express its intention more clearly."

However, in *Buckle*, the High Court made it clear that the trustee’s right of indemnity was not a security interest. It was a charge in the sense that a court of equity could order a sale of trust property to satisfy the right of recoupment or exoneration. If the trustee does not need to sell trust assets it can enforce the right against trust moneys without recourse to a court of equity. In most cases where the trustee uses trust moneys to pay trust debts it incurs (the right of exoneration), or to reimburse itself for trust debts it has paid, it simply exercises its right as legal owner. Even where there is not an express power to pay properly incurred debts from trust assets, it would be absurd to say that a trustee is required to approach a court of equity for the appointment of a receiver to enforce its right of indemnity every time it needs to access the trust bank account. If the trustee needs to sell trust assets to enforce its right of indemnity, and has possession of the trust assets then, at least where the trust deed or statute confers a power of sale, there is no need to have recourse to the assistance of a court of equity. Consistently with *DKLR Holding Co (No. 2) Pty Ltd v Commissioner of Stamp Duties* quoted below at [24] and *Buckle*, it may be that, the position is the same, whether or not the trust deed or statute provides a power of sale. In *Buckle* McPherson J’s analysis in *Kemtron* that the beneficiaries’ entitlement is confined to so much of the assets as is available after the properly incurred liabilities are discharged or provided for was specifically approved.

Nonetheless, the question whether the trustee’s right is only a security interest remains a live debate. Consider the following. In *Arjon Pty Ltd v Commissioner of State Revenue* Phillips JA, with whom Buchanan and Eames JJA agreed, said:

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22 [1980] 1 NSWLR 510 at 518-521
23 *Buckle* at [48].
Thus, having reviewed the cases to which we were referred, I can only conclude that what was said by the majority in Baker v Archer-Shee remains good law: namely, that the beneficial ownership by the beneficiary of an asset of the trust when vested in interest is unaffected by any right of recoupment that the trustee may have from time to time, even if that right entitles the trustee to have resort for a limited purpose to the assets in priority to the beneficiary. One cannot deny, since Octavo Investments, that the trustee has a “beneficial interest” in the trust assets to enforce his ‘charge or lien’, but given the ambivalence attaching to the use of the term ‘beneficial interest’, I do not see that as denying equitable ownership to a beneficiary who is otherwise entitled, immediately and absolutely, to the trust assets – or in the case of the Broadmeadows land, to all of the units in the unit trust of which that land is an asset. That such ownership should be treated as subject to an uncertain right in the trustee, varying from time to time in amount and effect, is one thing; that that variable right should actually deny equitable ownership to the beneficiary in whom the trust fund is otherwise presently vested in interest and possession is an altogether different matter and one that, in my opinion, should be rejected.

That reasoning was applied by the same court in Commissioner of State Revenue v Karingal 2 Holdings Pty Ltd. But that decision was reversed on appeal in CPT Custodian Pty Ltd v Commissioner of State Revenue.

The reasoning in Arjon was not consistent with Buckle, which it attempted to dismiss in a single sentence as involving simply the valuation of the subject matter of a settlement. The High Court’s decision in CPT Custodian that allowed the appeal in Karingal 2 Holdings means that the reasoning in Arjon is not binding, nor persuasive: Newcastle Airport Pty Ltd v Chief Commissioner of State Revenue.

In Re Independent Contractor Services (Aust) Pty Ltd (In Liq) (No. 2) Brereton J said:

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27 Arjon at [59].
28 [2014] NSWSC 1501 at [74]-[96].
"[S]uch right of indemnity is secured by an equitable lien over the trust assets which arises by operation of law and confers a proprietary interest, in the nature of a security interest, in the trust property, and has priority over the claims of beneficiaries."

17 In contrast, in Commissioner of State Revenue (Vic) v Pioneer Concrete (Vic) Pty Ltd [30] the High Court said of Buckle: [31]

"An acceptance of the need, in some cases, to look outside an instrument of conveyance or transfer to identify the property conveyed is consistent with the decision of this court in Commissioner of Stamp Duties (NSW) v Buckle. There the dutiable instrument was a supplemental deed varying a deed of settlement under a discretionary trust. In identifying, for valuation purposes, the interests vested by the supplemental deed, the court held that they must reflect the structure created by the deed of settlement, and accepted the argument that the property conveyed by the supplemental deed, which comprised certain beneficial interests in remainder, was to be valued taking into account liabilities which were incidents of the underlying trust property. The court decided that, in valuing the interest of beneficiaries vested by the supplemental deed, there was no ‘encumbrance’ which the statute required to be disregarded; the trustee’s right to be indemnified out of the assets bound by the trust was a right conferred by law and was a prior proprietary interest to that of the beneficiaries rather than an encumbrance upon that interest."

18 In Vopak Terminals Australia Pty Ltd v Commissioner of State Revenue, [32]Ormiston JA, with whom Warren CJ and Buchanan JA agreed, said: [33]

"The High Court in Buckle, after analysing the nature of the right in some detail, held that the right to make such a claim was not strictly a lien or security interest, and was merely one which entitled a trustee to treat its claim in priority to those of the beneficiaries, so that its claim ought to be satisfied before the remaining funds were applied for the benefit of the beneficiaries."

19 In Lemery Holdings Brereton J said that the trustee’s equitable lien plainly extends to all the trust assets. [34] By contrast in Kemtron in the passage

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33 Ibid [66].
34 (2008) 74 NSWLR 550 at [40], 559
quoted at [9] above McPherson J said that it is not correct that the trustee’s lien at all times attaches to all of the assets.

The better view is that the trustee is entitled to reimbursement or exoneration from the assets in respect of debts properly incurred in the execution of the trust by virtue of its legal ownership. The rights of beneficiaries are deferred to the right of the trustee as legal owner to reimburse itself from or to be exonerated out of the trust assets. In Buckle the High Court said:35

“Until the right to reimbursement or exoneration has been satisfied, ‘it is impossible to say what the trust fund is’ (Dodds v Tuke (1884) 25 Ch D 617 at 619). The entitlement of the beneficiaries in respect of the assets held by the trustee which constitutes the ‘property’ to which the beneficiaries are entitled in equity is to be distinguished from the assets themselves. The entitlement of the beneficiaries is confined to so much of those assets as is available after the liabilities in question have been discharged or provision has been made for them (Kemtron Industries Pty Ltd v Commissioner of Stamp Duties [1984] 1 Qd R 576 at 587). To the extent that the assets held by the trustee are subject to their application to reimburse or exonerate the trustee, they are not ‘trust assets’ or ‘trust property’ in the sense that they are held solely upon trusts imposing fiduciary duties which bind the trustee in favour of the beneficiaries (Octavo Investments Pty Ltd v Knight (1979) 144 CLR 360 at 370)”.

With the greatest respect to those who take a different view, it is not possible to say that the High Court’s considered observations are confined to the construction of a phrase in the Stamp Duties Act 1920 (NSW), since repealed (viz. “the unencumbered value of the property thereby conveyed”) and affects only the assessment of the valuation of beneficial interests. Rather, the High Court approached the construction of that phrase by recourse to a general law analysis of the nature of the trustee’s right of indemnity. It noted that in the provision in question the word “unencumbered” was not used in a loose sense but referred to “… security interests in, or charges or

other liabilities which attach to, the property in question”.

It held that the right of indemnity of a trustee who had not been removed from office was not such an encumbrance, that is, it was not a security interest in, nor a charge which attached to the trust assets.

It would be wrong to become fixated about what is meant by a “security interest”. That expression is ambiguous and its meaning depends on context, just as the word “encumbrance” is ambiguous. The important point is that the High Court has determined that the trustee’s right of indemnity is not a security interest or charge that attaches to the trust assets, but a beneficial interest in those assets that is preferred over the beneficiaries’ interest. In Thomas and Hudson, The Law of Trusts 2nd ed, the learned authors take issue with the characterisation of the trustee’s right of indemnity as a right giving the trustee a beneficial interest in the trust assets. They say that this is unwarranted and unnecessary. That view is not open in this country. Nor is it correct, for the reasons at [24]-[26].

In CPT Custodian Pty Ltd v Commissioner of State Revenue, the High Court held that on the terms of the particular trust deed in that case, even where there was only one unitholder of the trust, that unitholder did not have an interest amounting to ownership. The High Court rejected the proposition that where property is held on trust, somebody other than the trustee must be the owner of the equitable estate. One reason it was held that the sole unitholder of the unit trust did not have an interest amounting to equitable ownership of trust property and was not entitled to bring the trust to an end by calling for a transfer of the trust property was that the

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36 Buckle at [44].
38 Buckle at [43]-[44], 244-245.
41 Ibid [25], 112.
trustee had an unsatisfied right of indemnity out of the trust fund in respect of liabilities incurred in the execution of the trust. The High Court said:

“[50] The classic nineteenth century formulation by the English courts of the rule in Saunders v Vautier did not give consideration to the significance of the right of the trustee under the general law to reimbursement or exoneration for the discharge of liabilities incurred in administration of the trust. In Wharton v Masterman [1895] AC 186, Lord Davey approached the rule in Saunders v Vautier from the viewpoint of the law respecting accumulations of income for an excessive period; if no person had any interest in the trust other than the legatee, the legatee might put an end to the accumulation which was exclusively for the benefit of that person and as a result there was no effective or enforceable direction for any accumulation ([1895] AC 186 at 198–200). However, his Lordship's discussion of the authorities ([1895] AC 186 at 200–201) does indicate that the rule in Saunders v Vautier could not apply if, by reason of the charging of legacies on the fund and accumulations, the persons seeking to put an end to the accumulations were ‘only entitled to an undetermined and uncertain surplus (if any) which might be left of the fund after payment of the legacies’ ([1895] AC 186 at 201).

[51] In the present case, the unsatisfied trustees' right of indemnity was expressed as an actual liability in each of the relevant accounts at each 31 December date and rendered applicable the sense of the above words of Lord Davey. Until satisfaction of rights of reimbursement or exoneration, it was impossible to say what the trust fund in question was (Chief Commissioner of Stamp Duties (NSW) v Buckle (1998) 192 CLR 226 at 246 [48]).”

Equitable interests are engrafted onto, not carved out of, the legal estate

24 Underlying the analyses in Buckle and CPT Custodian is a fundamental notion about the nature of trusts and the nature of beneficiaries’ interests in a trust. It was explained in DKLR Holding Co (No. 2) Pty Ltd v Commissioner of Stamp Duties. Hope JA said:

Ibid [50], [51].

These essential features of interests arising under private trusts are thus described in Jacobs' Law of Trusts, 3rd ed, p 109:

‘... the trustee must be under a personal obligation to deal with the trust property for the benefit of the beneficiaries, and this obligation must be annexed to the trust property. This is the equitable obligation proper. It arises from the very nature of a trust and from the origin of the trust in the separation of the common law and equitable jurisdictions in English legal history. The obligation attaches to the trustees in personam, but it is also annexed to the property so that the equitable interest resembles a right in rem. It is not sufficient that the trustee should be under a personal obligation to hold the property for the benefit of another, unless that obligation is annexed to the property. Conversely, it is not sufficient that an obligation should be annexed to property unless the trustee is under the personal obligation.’

Several consequences follow. Firstly, an absolute owner in fee simple does not hold two estates, a legal estate and an equitable estate. He holds only the legal estate, with all the rights and incidents that attach to that estate. If he were to execute a declaration that he held the land in trust for himself absolutely, the declaration would be of no effect; it would give him no separate equitable rights; he would remain the legal owner with all the rights that a legal owner has. At least where co-extensive and commensurate legal and equitable interests are concerned, ‘... a man cannot be a trustee for himself.’: Goodright v Wells (10a), per Lord Mansfield. ‘You cannot have a legal estate in trust for yourself.’: Harmood v Oglander (11a), per Lord Eldon. Secondly, although the equitable estate is an interest in property, its essential character still bears the stamp which its origin placed upon it. Where the trustee is the owner of the legal fee simple, the right of the beneficiary, although annexed to the land, is a right to compel the legal owner to hold and use the rights which the law gives him in accordance with the obligations which equity has imposed upon him. The trustee, in such a case, has at law all the rights of the absolute owner in fee simple, but he is not free to use those rights for his own benefit in the way he could if no trust existed. Equitable obligations require him to use them in some particular way for the benefit of other persons. In illustrating his famous aphorism that equity had come not to destroy the law, but to fulfil it, Maitland, op cit, at p 17, said of the relationship between legal and equitable estates in land:

‘Equity did not say that the cestui que trust was the owner of the land, it said that the trustee was the

44 Ibid [15], [16].
owner of the land, but added that he was bound to hold the land for the benefit of the *cestui que* trust. There was no conflict here.”

(Emphasis added.)

25 Where a trustee has a right of indemnity in respect of debts properly incurred, the beneficiaries cannot compel the trustee to use his legal ownership for their benefit until the right of indemnity is satisfied or provided for. To characterise the trustee’s right of indemnity as a security interest involves treating the beneficiaries as having an equitable estate carved out of the legal ownership over which the security, by way of lien or charge, can be exercised. That is not the right way of analysing the beneficiaries’ interest.

26 In *Re Transphere Pty Ltd*, McLelland J summarised the position as follows:

“It is important to recognise the true nature and incidents of legal and equitable estates in property subject to a trust. They are clearly and succinctly described in the judgment of Hope JA in *DKLR Holding Co (No 2) Pty Ltd v Commissioner of Stamp Duties* [1980] 1 NSWLR 510 at 518-520. (His Honour’s analysis is not affected by the decision of the High Court in that case — see 149 CLR 431.) I would not wish to detract from the value of Hope JA’s exposition by trying to summarise it. But what is significant for present purposes is the imprecision of the notion that absolute ownership of property can properly be divided up into a legal estate and an equitable estate. An absolute owner holds only the legal estate, with all the rights and incidents that attach to that estate. Where a legal owner holds property on trust for another, he has at law all the rights of an absolute owner but the beneficiary has the right to compel him to hold and use those rights which the law gives him in accordance with the obligations which equity has imposed on him by virtue of the existence of the trust. Although this right of the beneficiary constitutes an equitable estate in the property, it is engrafted onto, not carved out of, the legal estate. Hope JA (at 519) illustrates the point by the following quotation from Maitland — Lectures on Equity 2nd ed (1949) at 17:

‘... Equity did not say that the *cestui que* trust was the owner of the land, it said that the trustee was the owner of the land, but added

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45 (1986) 5 NSWLR 309.
46 Ibid 311.
that he was bound to hold the land for the benefit of the *cestui que*
trust. There was no conflict here.”

27 The principle that an equitable interest is engrafted onto, not carved out of, the legal estate, has application in a wide range of situations. In *Re Transphere Pty Ltd* itself, it was held that s 573(1)(h) of the *Companies (NSW) Code* that empowered the Court to make an order appointing a receiver of property of a person included power to appoint the receiver to property that the person held on trust for others. In *Re Indopal Pty Ltd*,47 the same principle was applied so that the directors of a company that held property on trust were required to provide a report as to affairs in respect of the trust of which the company was trustee. In *Perpetual Trustee Co Ltd v Commissioner of State Revenue*,48 and in *Sportscorp Australia Pty Ltd v Chief Commissioner of State Revenue*,49 the principle was applied to defeat claims for exemption from stamp duty on the grounds that the transfers in question were merely transfers of a bare legal estate. In *GPT RE Ltd v Lendlease Real Estate Investments Ltd*50 and *Lendlease Real Estate Investments Ltd v GPT RE Ltd*,51 it was held that a right of pre-emption, which was triggered if a party disposed of its interest or part of its interest in a shopping centre, was not triggered by the grant of a conditional call option because the conditional interest of the optionee was imposed on, not carved out of, the grantor’s legal ownership of the shopping centre and operated as an imposition on its title, not as a subtraction from it.

28 The principle was not applied by the Court of Appeal of England and Wales in *Federal Bank of the Middle East Ltd v Hadkinson*52 where it was held that a freezing order prohibiting the defendant from disposing of “*his assets*” did not apply to assets held by the defendant on trust because such

51 [2006] NSWCA 207.
assets were not “his assets”. The Court of Appeal assumed that if assets were held by the defendant on trust for others, they did not “belong” to the trustee, but only to the persons or persons beneficially entitled. This was based on the erroneous conception that where property is held by a person on trust for others, the beneficial interest is carved out of the property held by the trustee such that (for some unexplained reason) the property no longer “belongs” to the trustee. 53

It follows from CPT Custodian that where the trustee has an unsatisfied right of indemnity the beneficiaries’ rights do not amount to equitable ownership. It does not follow that the beneficiaries have no proprietary interest in the trust assets, e.g. sufficient to support a caveat. Whether they do or do not will depend on the terms of the trust deed. 54

Other Authorities

In Apostolou v VA Corporation of Australia Pty Ltd 55 a corporate trustee was wound up. The beneficiaries alleged that it had been replaced as trustee. One of the issues was whether the liquidators had power to sell trust property pursuant to s 477(2)(c) of the Corporations Act which gives a liquidator of a company power to “sell or otherwise dispose of, in any manner, all or any part of the property of the company”. Finkelstein J found that the liquidator had such a power without recourse to the section, but that the section provided a separate authority for the liquidators to sell as the trust assets were property in which the company in liquidation had both the legal title and an equitable interest by reason of its right of indemnity. 56 This decision was followed in Kitay, Re South West Kitchens (WA) Pty Ltd, 57 in circumstances where the effect of the trust deed was to preclude the

53 Australian Securities and Investments Commission v Sigalla (No. 4) [2011] NSWSC 62; (2011) 80 NSWLR 113 at [137]-[140].
54 Jonsue Investments Pty Ltd v Balweb Pty Ltd [2013] NSWSC 325; (2013) 9 ASTLR 460.
56 Ibid [48].
company from continuing to act as trustee after the appointment of the liquidator. It retained legal ownership of the property and an equitable interest by reason of its right of indemnity.

31 In *Re Stansfield DIY Wealth Pty Ltd* Brereton J declined to follow *Apostolou* and *Kitay*. The trustee was in liquidation. It was entitled to be exonerated out of the trust assets in respect of unsatisfied liabilities. There was an express power of sale in the trust deed. Brereton J dealt with both a scenario where it remained trustee and where it did not. In the former case there was no issue that the liquidator could administer the trust assets to pay trust creditors and wind up the trust.\footnote{[2014] FCA 670, [29]-[33].} In the latter case his Honour held that s 477(2)(c) did not empower the liquidator to sell trust assets because they were not “property of the company”. All that the s 477(2)(c) authorised the liquidator to sell was the former trustee’s interest in the assets, which was a bare legal title and an equitable interest by way of charge to secure its right of indemnity.\footnote{[2014] NSWSC 1484, [9].} His Honour held that while the company remained trustee of the superannuation fund it had power to administer the trust, pay trust creditors and wind up the trust, it would commit offences against Commonwealth legislation regulating superannuation funds were it to do so. He ordered that the liquidator would be justified in causing the company to resign as trustee and in applying to be appointed as receiver with the powers of a liquidator to enforce the company’s right of indemnity.

32 It is unnecessary for my purposes to express an opinion on these matters. The points of difference concerned the construction of a section of the *Corporations Act* where a corporate trustee in liquidation no longer held office as trustee. In such a case the trustee, although it still held legal title, may be constrained in the exercise of its powers as legal owner and its

\footnote{Ibid [17]-[19].}
right of indemnity may be aptly described as supported by an equitable lien.\textsuperscript{60}

In \textit{Newcastle Airport Pty Ltd v Chief Commissioner of State Revenue}\textsuperscript{61} the question was whether the company operating the Newcastle Airport on behalf of two councils was exempt from payroll tax. Section 58 of the \textit{Payroll Tax Act 2007} (NSW) exempts from payroll tax wages that are paid or payable by a council within the meaning of the \textit{Local Government Act 1993}. I found that Newcastle Airport Ltd (“NAL”) (as it was called in the documents) was entitled to the benefit of the exemption because it acted as delegate of the two councils and I held that by reason of s 49(6) of the \textit{Interpretation Act 1987} the wages were taken to have been paid and payable by the councils. The taxpayer raised an alternative argument. In a belts and braces approach NAL had also declared a trust in favour of the two councils declaring that it held all property of any kind that it might hold on trust for the councils absolutely. NAL argued that because the wages were paid from the property held by it on trust for the councils the wages were paid by the councils within the meaning of the exemption. The premise of the argument was that the moneys used to pay the wages were the moneys of the two councils. I rejected that premise. I applied \textit{Kemtron Industries} and \textit{Buckle}. I rejected the reasoning of the Victorian Court of Appeal in \textit{Arjon} as being inconsistent with \textit{Buckle} and \textit{CPT Custodian}, and held that the moneys used to pay wages were NAL’s moneys, not those of the councils. Admittedly this was obiter.

Before moving to the central theme of this paper, I will make two further comments in relation to \textit{Apostolou} and \textit{Re Stansfield}.

\textsuperscript{60} \textit{Bruton Holdings Pty Ltd (In Liq) v Federal Commissioner of Taxation} (2009) 239 CLR 346; [2009] HCA 32, [42]-[43].

\textsuperscript{61} [2014] NSWSC 1501.
In *Apostolou* Finkelstein J held that where a trustee has legal title to property coupled with a power of sale contained in the trust deed or by statute, then the trustee can have recourse to the power of sale to get in funds against which to exercise the right of indemnity without the need to apply for an order for judicial sale. In my view, this is clearly right. However, Finkelstein J said that if the trust instrument does not include a power of sale, then, if there are insufficient liquid funds which can be applied in exercise the right of reimbursement or exoneration, the trustee would not have the power to sell because the trustee’s right of indemnity was secured by an equitable lien or charge which by itself does not grant title nor confer a power of sale, so that it would be necessary to obtain an order for judicial sale. Other authorities to the same effect are cited in *Apostolou* and *Re Stansfield*. That may be supported by what was said in *Buckle* quoted at [5] above. However, it is not necessarily right. There is a considerable argument to the contrary based on the principle that where the trustee has legal title to the trust property it can exercise its right as legal owner to satisfy its right to be reimbursed or exonerated in respect of liabilities properly incurred in execution of the trust. The beneficiaries cannot compel it to use its legal ownership for their benefit until the right of indemnity is satisfied or provided for. The absence of any express power of sale in the trust deed would be immaterial, unless construing the trust deed as a whole, it appeared that the trustee had relinquished such a right. It is unnecessary to pursue this question further at this stage.

The second comment is that both *Apostolou* and *Re Stansfield* follow *Re Suco Gold Pty Ltd (In Liq)* in saying that where a corporate trustee is wound up its right of indemnity passes to its liquidator. That is wrong.

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64 [2010] FCA 64; (2010) 77 ACSR 84, [48].
65 [2014] NSWSC 1484, [6].
The right of indemnity is property of the company. It can be enforced by the liquidator as agent of the company.\textsuperscript{67}

37 The rest of this paper assumes that the High Court meant what it said in Buckle and CPT Custodian, and examines the implications of that for the rights of creditors to have recourse to trust assets where the trustee is insolvent.

38 In Buckle the High Court said that:\textsuperscript{68}

\begin{quote}
...no issue arose, in the submissions concerning the trustee’s lien, as to the subrogation of creditors of the trustee to the rights of the trustee. Nor was there any issue as to the personal right of a trustee against beneficiaries which in some circumstances may arise under the principles considered in Hardoon v Belilos."
\end{quote}

39 In what follows I suggest that when the true nature of the beneficiaries’ rights to trust property, as expounded in Buckle and CPT Custodian, are appreciated, there is a solution to the problem of beneficiaries’ obtaining an unmerited windfall by creditors being denied recourse to trust assets by subrogation to the trustee’s right of indemnity because of a trustee’s unrelated breach of trust.

\textbf{Part Two}

\textbf{Inability of a judgment creditor of a trustee to execute against trust assets}

\textsuperscript{67} Re Sutherland; French Caledonia Travel Service Pty Ltd (In Liq) (2003) 59 NSWLR 361 at [201]; Glazier Holdings Pty Ltd (In Liq) v Australian Men’s Health Pty Ltd (In Liq) [2006] NSWSC 1240 at [40].  
\textsuperscript{68} (1998) 192 CLR 226; [1998] HCA 4, [42].
I propose to consider whether Buckle and CPT Custodian, particularly the former, have any implications for two settled principles concerning the rights of creditors against trustees. One principle is that a judgment creditor cannot levy a writ of execution against trust assets, even though the debt was properly incurred in the performance of the trust. His only recourse to trust assets is by subrogation to the trustee’s right of indemnity. The second is that the right of indemnity may be lost if the trustee is liable to compensate the trust fund by reason of a breach of trust, even though the breach is unrelated to the incurring of the debt. Buss JA of the Western Australian Court of Appeal provided a succinct summary of the present state of the authorities in Franknelly Nominees Pty Ltd v Abbrugiato. His Honour said:

“[211] A creditor of a trustee, without security over the trust assets, does not have a direct remedy against those assets. For example, the trust assets may not be taken in execution. See Savage v Union Bank of Australia Ltd [1906] HCA 37; (1906) 3 CLR 1170, 1186 (Griffith CJ); Octavo Investments (367). However, a creditor of a trustee is entitled to be subrogated to the trustee’s right of indemnity out of the trust assets. See Re Evans; Evans v Evans (1887) 34 Ch D 597, 601 (Cotton LJ), 602–603 (Lindley LJ); Octavo Investments (367–368); Custom Credit (53). This right is derivative in character. The creditor’s right, by way of subrogation, will therefore exist only if the trustee has a right of indemnity. See Strickland v Symons (1884) 26 Ch D 245, 247–248 (Earl of Selborne LC). Further, the creditor cannot claim, by way of subrogation, more than the trustee’s entitlement. See Re Johnson (1880) 15 Ch D 548, 554–557 (Sir George Jessel MR).”

In RWG Management Ltd v Commissioner for Corporate Affairs, Brooking J upheld the decision of the Commissioner for Corporate Affairs requiring a high level of liquidity for a stockbroker who sought a licence and was to be a trustee. This was because his Honour held the rights of creditors of a trading trustee were materially less valuable than the rights that would be enjoyed by creditors of a company carrying on the same business, but that

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69 [2013] WASCA 285 at [211].
beneficially owned the assets employed in the enterprise. Notwithstanding this, Australia has seen the promotion of managed investment schemes now regulated by Chapter 5C of the Corporations Act 2001 (Cth) that attract investment in the same way as companies, although the responsible entities of such schemes are trustees for their members.\textsuperscript{71} In his article, “The Unsecured Creditor’s Perilous Path to a Trust Asset: Is a Safer, More Direct US-style Route Available?”,\textsuperscript{72} Mr Nuncio d’Angelo observed that:\textsuperscript{73}

“The trust has evolved into a collective investment vehicle for risk-taking business activities where the trustee holds property acquired with equity and debt funds invested by arm’s length commercial parties which is functionally equivalent to a trading corporation, and which is thus vulnerable to insolvency in the same way as a trading corporation.”

A trustee is personally liable for the debts incurred in execution of the trust, although such liability can be limited by express contract with the creditor. It is well settled that a judgment creditor cannot execute the judgment against trust assets, even if the debt for which judgment is obtained was incurred in the proper execution of the trust.\textsuperscript{74} What is the rationale for this well-established rule?

It is also established by high authority that the unsecured creditors’ only recourse to trust assets is by subrogation to the trustee’s right of indemnity.\textsuperscript{75}

The reason originally given as to why trust property could not be seized by an execution creditor of the trustee was that such property was not beneficially owned by the judgment debtor (the trustee). In \textit{Re Morgan};

\textsuperscript{71} Corporations Act 2001 (Cth), s 601FC(2).
\textsuperscript{72} (2010) 84 ALJ 833.
\textsuperscript{73} Ibid 835.
\textsuperscript{74} Savage v Union Bank of Australia Ltd (1906) 3 CLR 1170 at 1186; Octavo Investments Pty Ltd v Knight (1979) 144 CLR 360 at 367; Re Morgan; Pillgrem v Pillgrem (1881) 18 Ch D 93 at 101; Jennings v Mather [1901] 1 QB 108 at 111; [1902] 1 KB 1 at 5.
\textsuperscript{75} Re Johnson (1880) 15 Ch D 548; Vacuum Oil Co Pty Ltd v Wiltshire (1945) 72 CLR 319 at 335-336.
Pillgren v Pillgren, Fry J said: 76

“The moment it is found that this property was really trust property in his hands, execution on a judgment against him could not be levied upon it. The argument in support of the summons has almost gone the length of suggesting that trust property in the hands of a trustee may be seized by his execution creditor. In my judgment nothing is plainer than this, that the property which can be taken under an execution is only that property to which the execution debtor is beneficially entitled, and that no property of which he is only a trustee can be taken.”

In Jennings v Mather, Kennedy J said: 77

“...if the goods seized are trust goods, there is no sort of title to them in the execution creditor. He had no business when trading with Mather to seek to get satisfaction of a debt incurred by Mather out of property which Mather held as a trustee. The basis of the decisions on this question is to be found in Dowse v. Gorton, where it was held that assets as they are acquired, whether by an administrator, an executor, or a trustee, who, in conformity with his trust, is carrying on a business, are not the property of the administrator, executor, or trustee, but form part of the trust property - that is, they are property to which those to whom the administrator, executor, or trustee incurs debts in trading have no right to look in the sense of being able to seize them in execution, because they are not the goods of the trader, but are the goods of the trust.”

In the Court of Appeal in that case, Collins MR said: 78

“Goods which formed part of the trust estate under the deed clearly were not liable to be taken in execution upon a judgment for a debt due from him personally. The execution creditor, Jennings, having obtained judgment against Mather for a debt due from him, was only entitled to have taken in execution on that judgment goods of which Mather was the beneficial owner, and not goods which, like those in question, were only his subject to a trust.”

This rationale cannot stand with the reasoning in Buckle. Until the trustee has satisfied his right of indemnity against trust assets in respect of the liability properly incurred, it is impossible to say that the beneficiaries have the sole beneficial interest in the asset proposed to be taken by way

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76 (1881) 18 Ch D 93, 101.
77 [1901] 1 QB 108, 111.
78 Jennings v Mather [1902] 1 KB 1, 5.
of execution. The trustee is the legal owner of the asset and beneficially entitled to it in preference to the beneficiaries of the trust for the satisfaction of the liability properly incurred.

A second rationale for the principle that a judgment creditor of the trustee cannot levy execution against trust assets was identified in *Agusta Pty Ltd v Provident Capital Pty Ltd*, namely, that seizure by an execution creditor would destroy the trustee’s preferred beneficial interest in the trust property which comes from the right of indemnity out of that property.79

There, Barrett JA said:80

“[55] These cases show that, as a matter of general principle, a creditor obtaining judgment against a trustee who, in the normal way, is entitled to be indemnified out of trust property for debts including the judgment debt may be restrained from enforcing the judgment by levy of execution against trust property. The trustee’s preferred beneficial interest in the trust property which comes from the right of indemnity out of that property in respect of all debts incurred would be destroyed if creditors were able to levy execution against the trust property. In *Lemery Holdings Pty Ltd v Reliance Financial Services Pty Ltd (2008) 74 NSWLR 550; [2008] NSWSC 1344; BC200811095* at [49], the unavailability of trust property to answer a writ of execution was said to be explicable on that basis.”

One may query whether allowing a judgment creditor to execute against a trust asset would be to destroy the trustee’s right of indemnity. Rather, a creditor entitled by subrogation to the trustee’s right of indemnity would be enforcing that right in respect of the particular asset for the creditor’s benefit.

It was held in *Agusta Pty Ltd v Provident Capital Ltd* that the creditor could have enforced its rights through subrogation to the right of indemnity out of the trust assets. Sackville A JA said:81

79 *Agusta Pty Ltd v Provident Capital Pty Ltd* [2012] NSWCA 26, [55]-[57].
80 Ibid [55].
81 Ibid [103].
“[103] Provident could have lodged a caveat to protect its proprietary interest in the Kings Park land at any time during the period Agusta was registered as the proprietor of the land. As the High Court explained in Octavo Investments v Knight, Provident’s interest arose by way of subrogation to Agusta’s right of indemnity from trust assets. And as Barrett JA has explained (at [80]), Provident could have enforced its interest in the Kings Park land by securing the appointment of a receiver and the sale of the trust asset.”

51 Barrett JA said:82

“[80] Provident and other trust creditors were entitled by subrogation to the benefit of Agusta’s preferred beneficial interest. Equitable execution by way of the appointment of a receiver and sale of trust assets held by Agusta would have been available for the benefit of trust creditors. After the trust assets had passed into the hands of Riva as successor trustee, Agusta’s preferred beneficial interest (and the rights accruing to Agusta’s creditors by subrogation) continued to subsist in those assets and the same remedy could have been obtained in relation to trust property in Riva’s hands.”

52 Sackville AJA did not suggest that if the creditor obtained the equitable remedies of the appointment of a receiver and an order for sale that the proceeds would be held for the benefit of all trust creditors. If equitable execution at the instance of a creditor is seen as the enforcement of the trustee’s right of indemnity, why should execution by levy of a writ be regarded differently?

53 On the other hand, Barrett JA contemplated that equitable execution would be for the benefit of trust creditors generally.83 That is consistent with Lord Macnaghten’s description of the creditor’s right in Dowse v Gorton84 as being a right “… to see that the executors get in the estate and apply it in due course in payment of debts, and he may sue in equity … to enforce that right”. In an administration action the receiver appointed to get in the

82 Ibid [80].
83 At [57], [74]-[75].
estate would be ordered to “pay balances which may be certified to be due from him as the judge shall direct”.85

54 But if execution against a trust asset by a creditor could be seen as depriving the trustee of his right of indemnity against that asset for the benefit of all creditors, it is not clear why the trustee is entitled to have his right of indemnity so preserved. To do so might be to the benefit of the trustee’s creditors as a class, but that is true of claims of creditors generally. In the case of an ordinary judgment debt, the fact that, in the absence of bankruptcy, the execution of a judgment debt against a judgment debtor’s assets will reduce the assets available to other creditors is not a sufficient reason for denying a judgment creditor the right of execution. It is not clear why a trustee should be in a better position merely because his assets are held on trust, or why trust creditors, as a class, should be in a better position than ordinary creditors of a debtor who is not a trustee.

55 A third reason why a judgment creditor cannot levy execution against trust assets may be the suggested rule that a trustee is only entitled to enforce a right of indemnity against trust assets if the trustee has a clear account, or, to put it another way, that if the trustee is liable to compensate the beneficiaries for breach of trust or otherwise to restore moneys to the trust fund, he must bring that liability to account and can only enforce the indemnity after he has made good his default for any balance due to him after allowance is made for his default.86 There is significant authority to this effect, notwithstanding that the breach of trust is unrelated to the transaction which gave rise to the right of indemnity, and notwithstanding that it is the creditors through subrogation to the trustee’s right of exoneration that are seeking to enforce that right.

84 [1891] AC 190, 208.
85 Seton’s Judgment and Orders, 7th ed, pp 735 ff.
There is an element of circularity here if the “clear accounts” rule is propounded as the reason a judgment creditor for a properly incurred debt cannot execute against trust assets. Creditors would not need to proceed by way of subrogation if they were entitled to execute against assets held by their judgment debtor on trust for debts properly incurred in the execution of the trust. The reason they might be entitled to do so as a matter of principle is that the beneficiaries do not have an interest in such an asset that could stand in opposition to the right of indemnity, in other words, they have no interest that can be imposed on the trustee to qualify his legal ownership to the extent that his legal ownership is being availed of to satisfy liabilities properly incurred.

Another and better reason for not permitting a judgment creditor to execute against trust assets may be that the beneficiaries would be entitled to be heard on the question whether the judgment debt was incurred in the proper execution of the trust, and if it were, whether the trustee would be acting properly if it sought to realise the particular asset against which execution was sought to be levied. Although a trustee will be entitled to satisfy itself out of trust assets for a debt properly incurred in execution of the trust, it still owes a fiduciary duty to beneficiaries as to how that is done (Beck v Henley). Thus it could be a breach of trust for a trustee to sell a trust property in which a beneficiary resided under a life tenancy to satisfy a right of indemnity if there were money in a bank account that could have been so applied. The procedures for execution of judgment debts are not adapted to deal with such issues. That is not to say that they could not be so adapted.

The authorities that the creditors’ rights arise only by subrogation to the trustee’s right of indemnity and that a judgment creditor cannot execute

against trust assets are too well-established to be overturned by any court below the High Court. But the prohibition on execution by a trust creditor against trust assets was originally based upon the notion of ownership of trust assets by the beneficiaries that cannot stand with the principle established in Buckle. The alternative explanation proffered in Agusta v Provident Capital Limited has its own difficulties.

**Trustees’ unrelated breaches as a bar to right of indemnity**

There remains the question as to whether the “unrelated breaches” bar to indemnity is consistent with the nature of the indemnity explained in Buckle.

It is this suggested principle that the right of indemnity may be lost by breaches of trust unrelated to the transaction in which the creditor’s debt was incurred that is of most concern. Mr d’Angelo described the “Clear Accounts” rule and the “Unrelated Breaches” rule as “The Creditors’ Bête Noire”. It is a risk against which creditors cannot protect themselves. He gives the example of a trustee purchasing Blackacre for $1.2 million, with an unsecured loan of $200,000 and thereafter committing breaches of trust by appropriating rent to the value of $200,000 for its personal purposes. If the rule is sound and if the creditors’ only right is by subrogation to the trustee’s right of indemnity, then the creditor will be left only with a personal claim against what may now be the insolvent trustee and cannot have recourse to Blackacre. The beneficiaries would not be obliged to repay the $200,000 out of the trust fund and any personal obligations of indemnity might be excluded by the trust deed or might be unavailable for other reasons, e.g. if the beneficiaries are not sui juris. The beneficiaries, having had the benefit of the loan, enjoy the remaining income out of Blackacre and its capital appreciation. It is the innocent creditor and not
the innocent beneficiaries who suffer from the trustee’s unrelated breach of trust.

61 Jacobs’ Law of Trusts in Australia, 8th ed, says:88

“But what of defaults by the trustee dehors the transaction in respect of which the indemnity is claimed? The better view is that the right is not lost by any such breach of trust for so to deprive the trustee, is, as Sir George Jessel MR put it, ‘a violent exercise’.89

However, the authorities cited do not support the proposition.

62 In Re Johnson, Jessel MR said:90

“If the right of the creditors is, as is stated by Lord Justice Turner, [in Ex parte Edmonds (1862) 4 De GF & J 488; 45 ER 1273] the right to put themselves, so to speak, in the place of a trustee, who is entitled to an indemnity, of course, if the trustee is not entitled, except on terms to make good a loss to the trust estate, the creditors cannot have a better right. They do get some additional benefit so as to avoid a supposed injustice; but the injustice to be avoided is the injustice of the cestui que trust walking off with the assets which have been earned by the use of the property of the creditor: but where the cestui que trust does not get that benefit, there is no injustice as between him and the creditors, and there is no reason for the Court interfering at the instance of the creditors to give them a larger right than that they bargained for, namely, their personal right against the trustee. It appears to me, therefore, that if the trustee has no such right in such a case, they have none here.” (My emphasis.)

63 It is curious that Re Johnson should have been regarded as authority that a trustee’s liability to account for any unrelated breach of trust can be set off against the right of indemnity. In the example of the Blackacre trust referred to above, the beneficiaries would walk off with the assets earned by the use of the creditors’ money. Indeed, in every case in which a debt is

88 Jacobs’ Law of Trusts in Australia, 8th ed, [21-04].
89 Citing Re Chennell (1878) 8 Ch D 492 at 502; Corrigan v Farrelly (1896) 7 QLJ 105 at 111-112; Re Staff Benefits Pty Ltd [1979] 1 NSWLR 207 at 215.
90 (1880) 15 Ch D 548, 555-556.
properly incurred in execution of the trust, the beneficiaries will benefit from the money, property or services provided by the creditor.

Notwithstanding the doubt expressed in *Jacobs* in the passage quoted at para [61] above, the strong burden of authority is that a defaulting trustee is not entitled to enforce his right of indemnity against trust assets except if the default is made good or the amount for which the trustee is liable is deducted from the amount to which he is entitled by way of indemnity, notwithstanding that the default does not relate to the incurring of expense in the execution of the trust. In *Smith v Dale*,\(^{91}\) Jessel MR held that an executor who, if not in default, would be entitled to have his costs of an administration action paid out of the estate would not be so entitled if in default. Jessel MR said:\(^{92}\)

> “But the defaulting executor would have been entitled to no costs until he had made good his default. That would be the strict punishment inflicted on him for his default. No doubt the Court recognises the rule by which he is allowed to set off his costs against the sum due from him, and thus make payment by anticipation. But the result either way is to deprive him while he is in default of the whole or a part of his costs.”

In *Staniar v Evans*, North J said that:\(^{93}\)

> “The usual form of order, where a trustee is in default, provides that he cannot receive any costs out of the trust estate, and cannot even take any part of his own share, if any, in the trust estate, till that default has been made good.”

In *Re Evans*, Cotton LJ said at 601:\(^{94}\)

> “Where a business is carried on by a trustee with proper authority, and he buys for the business goods for the price of which he is personally liable, the cestuis que trust cannot say to the trustee: ‘These goods belong to us and we will take them without regard to your right to

\(^{91}\)(1881) 18 Ch D 516.

\(^{92}\)Ibid 518.

\(^{93}\)(1886) 34 Ch D 470, 473.

\(^{94}\)(1887) 34 Ch D 597, 601.
indemnity.’ But have the creditors any claim against the goods on that ground? The goods now in question were acquired for the purposes of the business, and went into the business. The infant child of the intestate claims them as belonging to the estate, and in my opinion he has a right so to claim them, subject to the right of the widow to be indemnified out of them against all claims in respect of them so far as she has not lost such right by being a debtor to the estate, and whether she has lost that right is a question depending on the result of the general account.” (My emphasis.)

67 In *Edgar v Plomley*, the Privy Council observed that if the defaulting trustee of a will was a debtor to the estate, inquiry should have been directed and care taken that he not receive any part of the estate until his debt was made good. In *Re Frith; Newton v Rolfe*, Kekewich J said:

“The creditor has no right whatever against the estate, but he has a right to sue the trustee who has incurred the debt. If the trustee on his part has a clear account, and has a right of indemnity against the estate, the creditor is subrogated to that right, and for that purpose the creditor is allowed to intervene. He may sue the trustee, and he may claim the benefit of the indemnity to which the trustee is entitled out of the estate. If, on the other hand, the trustee is in default and has not got that right, then no doubt the creditor can get nothing, because he is relying on an equity which does not exist. The Court prevents a trustee from insisting upon that right unless he comes in with clear accounts; but if he comes in with clear accounts he is not the less entitled to be indemnified because he has a co-trustee who has run away with certain moneys.”

68 In *Re British Power Traction and Lighting Co Ltd*, it was determined that a trustee had properly incurred liabilities totalling £900 to certain trade creditors, but the trustee had a balance of £400 in his hands that he was directed to pay into court. The trustee did not do so and became bankrupt. Swinfen Eady J held that the loss of the £400 was to fall on the creditors who gave credit to the trustee as they could have no higher rights than the trustee against the estate and could only claim what he himself could claim. If the trustee had paid the creditors the £900 they were owed, he could only come against the estate for the difference between the £900 he owed and the £400 in his hands, namely, £500. That

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95 [1900] AC 431.
96 Ibid 439.
97 [1902] 1 Ch 342, 345, 346.
was the only amount to which the creditors were entitled to indemnity out of the estate.

In Jacobs v Rylance,\(^99\) Doering v Doering\(^{100}\) and In re Dacre; Whitaker v Dacre,\(^{101}\) the defaulting trustees were entitled either directly or derivatively to a share, as beneficiary, of the trust estate. The trustees were not entitled to the whole of their shares, except after making good the default. In In re Dacre, Sargant J said of the two earlier decisions:\(^{102}\)

> “These two decisions indeed are founded on the somewhat technical view that a defaulting trustee must be deemed to have already paid himself to the extent of his default. But the result must be the same on the much broader principle of Cherry v. Boulbee (4 My & Cr 442) and In re Akerman ([1891] 3 Ch 212), that a person entitled to participate in a fund and also bound to contribute to the same fund, cannot receive the benefit without discharging the obligation.”

On appeal,\(^{103}\) the same result was reached on the ground that the Court would treat the defaulting trustee as if he had received his share of the estate by advance or in anticipation. The trustee is not allowed to aver that he has misappropriated money if by any possibility he could be treated as having paid himself legitimately.\(^{104}\)

It has been held that this principle applies even if the trustee has assigned his beneficial share in the trust estate and even if the default occurs after the assignment,\(^{105}\) although the latter proposition has been doubted.\(^{106}\)

In Re Staff Benefits Pty Ltd and the Companies Act Needham J said:\(^{107}\)

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\(^{98}\) [1910] 2 Ch 470.

\(^{99}\) (1874) LR 17 Eq 341.

\(^{100}\) [1889] 42 Ch D 203.

\(^{101}\) [1915] 2 Ch 480.

\(^{102}\) Ibid 483, 484.

\(^{103}\) In re Dacre; Whitaker v Dacre [1916] 1 Ch 344.

\(^{104}\) Ibid 348.

\(^{105}\) Ibid at 347.

\(^{106}\) Derham, The Law of Set Off, 3rd ed at [14.70].

\(^{107}\) [1979] 1 NSWLR 207, 214.
“Where the trustee is in default, and is not entitled to an indemnity without making good the default, the creditors are in a similar position. In my opinion, it is not every breach of trust which will debar the trustee from indemnity—the breach must be shown to be related to the subject matter of the indemnity. In the present case, if the employment of the consultant were a breach of trust, it has not been shown that any damage to the general fund was caused by the breach.”

In RWG Management Limited v Commissioner for Corporate Affairs, Brooking J said:108

“The principle of these decisions shows that a balance is to be struck, with the result that the trustee will still have the right of indemnity to the extent to which the liabilities properly incurred exceed the compensation due to the estate. For it is clear that the rule that a defaulting trustee cannot claim a share in the estate unless and until he has made good his default is founded on the principle that where there is an aggregate fund in which the trustee is beneficially interested and to which he owes something, he must be taken to have paid himself that amount on account of his share. …

The rule has been applied not only where the trustee has a beneficial interest in the estate by reason of a disposition by will, but also where the beneficial interest exists by virtue of his right of indemnity and a creditor claims by subrogation: Re Johnson (1880) 15 Ch D 548 …”

Notwithstanding the doubts expressed in Jacobs,109 the rule is thus well-established. But what is the underlying principle? Is that principle compatible with the analysis that the beneficiaries’ interest in trust property is subordinate to the trustee’s right to be indemnified out of trust property by reimbursement or exoneration in respect of debts properly incurred?

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109 Jacobs’ Law of Trusts in Australia, 8th ed, [2104].
It is sometimes said\(^{110}\) that the principle is based upon the rule in *Cherry v Boultbee* \(^{111}\) described by Sargant J in *Re Peruvian Railway Construction Co Ltd*\(^ {112}\) that:

"Where a person entitled to participate in a fund is also bound to make a contribution in aid of that fund, he cannot be allowed so to participate unless and until he has fulfilled his duty to contribute."

But the fund to which a defaulting trustee is liable to contribute is not the same fund as the fund from which the trustee is entitled to be paid in reimbursement or exoneration of debts properly incurred. The fund to which the defaulting trustee is required to contribute is the fund to which the beneficiaries are entitled. It follows from *Buckle* that that fund can only be ascertained once the trustee’s right of indemnity has been satisfied or provided for.

The notion that the trustee is taken to have paid himself out of the amount for which he is liable to compensate the trust for his default is a fiction. It should not deprive trust creditors of their right to subrogation to the trustee’s right of exoneration.

Nor can the principle be justified on the ground of set-off. This is not a case of set-off of mutual debts. The burden of the trustee’s right to obtain satisfaction out of the trust estate for debts properly incurred in performance of the trust will fall on the beneficiaries, but no debt is thereby incurred. The beneficiaries might or might not be under a personal liability to indemnify the trustee in respect of such debts, but that is a separate question. Interestingly, it was held in *Reed v Oury*\(^ {113}\) that a demand by a trustee against beneficiaries personally would not constitute

\(^{110}\) Derham, *The Law of Set Off*, 3\(^{rd}\) ed at [14.67]; *In re Dacre* quoted at [69]; *RWG Management Ltd v Commissioner for Corporate Affairs* quoted at [73].

\(^{111}\) (1839) 4 My & Cr 442; 41 ER 171.

\(^{112}\) [1915] 2 Ch 144 at 150.

\(^{113}\) [2002] EWHC 369.
a set-off against a beneficiary’s claim for repayment of misappropriated trust money.

79 If the beneficiaries sought to rely upon equitable set-off against a defaulting trustee as the answer to a demand by the trustee, or a creditor claiming by subrogation, to realise a trust asset to satisfy a properly incurred debt, the question would be whether the claim of the beneficiaries against the trustee for its default impeached the title of the trustee or those claiming through him. Because the beneficiaries’ entitlement to trust property is subordinated to the trustee’s right to use the property to satisfy the right of indemnity, the trustee’s title would not be impeached.

80 In his article, Mr D’Angelo makes the point\textsuperscript{114} that where the indemnity to be enforced is the right of exoneration, as distinct from a right of reimbursement, the right must be exercised for the benefit of the trust creditors.\textsuperscript{115} As the benefit of the right of exoneration is held for the trust creditors there is no proper basis for denying those creditors the benefit of the indemnity because of the trustee’s unrelated breaches of trust.\textsuperscript{116}

81 Whichever way the issue is analysed, the question remains: if the trustee has a preferred beneficial interest in trust property to satisfy a right of indemnity so that the beneficiaries’ interest in that property is subordinated to that right, and if the creditors are subrogated to that preferred right, why are the beneficiaries’ interests preferred to the interests of creditors when the beneficiaries have had the benefit of the money, property or services provided by the creditors? The answer provided in the authorities is that the loss arising from the trustee’s default

\textsuperscript{114} (2010) 84 ALJ 833 at 864.

\textsuperscript{115} In re Richardson; Ex parte Governors of St Thomas’s Hospital [1911] 2 KB 705; Re Byrne Australia Pty Ltd [1981] 2 NSWLR 394 at 398-399; Re Suco Gold Pty Ltd (In Liq) (1983) 33 SASR 99 at 108; In the matter of Independent Contractor Services (Aust) Pty Ltd (In Liq) (No. 2) [2016] NSWSC 106 at [23]-[24].

\textsuperscript{116} See also D’Angelo, Commercial Trusts, 2014 LexisNexis Butterworths at 5.121-5.133.
“must fall on those who gave credit to him”\textsuperscript{117} and that “… there is no reason for the Court interfering at the instance of creditors to give them a larger right than that they bargained for, namely, their personal right against the trustee”.\textsuperscript{118} But that only means that the creditors must look to the trustee’s property for recovery of their debts. Once it is appreciated that the beneficiaries’ equitable interests in trust property are only to be ascertained once the right of indemnity is allowed for, there seems no good reason as a matter of principle why the loss arising from the defaulting trustee’s having committed an unrelated breach of trust should fall on the creditors rather than the beneficiaries.

\textsuperscript{117} In re British Power Traction and Lighting Co Ltd at 476.
\textsuperscript{118} In re Johnson at 555-556.