

Insolvency of corporate trustees

Amelia Smith reports on *Carter Holt Harvey Woodproducts Australia Pty Ltd v The Commonwealth of Australia* [2019] HCA 20

The High Court has resolved a longstanding uncertainty as to the distribution of trust assets in the liquidation of an insolvent corporate trustee.

The High Court determined that:

- ‘property of the company’ for the purposes of the statutory priority rules in ss 433 and 556 of the *Corporations Act 2001* (Cth) (Act) includes the company’s proprietary rights to trust assets arising by operation of the trustee’s right of exoneration; and
- such property must be applied in accordance with the statutory priorities, but only in satisfaction of ‘trust creditors’.

Background

Amerind Pty Ltd (Amerind) carried on business solely as a trustee of a trading trust. It had a series of debt facilities, variously secured. After failing to meet its obligations to its lender, receivers were appointed. The receivers realised most of Amerind’s assets and discharged all of the lender’s debt, leaving a receivership surplus of approximately \$1.6 million. They were in a position to retire, save that they were confronted with competing claims in respect of the surplus.

Relevantly, there were two competing claimants to the surplus. The first was the Commonwealth, which had paid \$3.8 million in employee entitlements under a statutory scheme known as the Fair Entitlements Guarantee Scheme, and which sought, pursuant to s 560 of the Act, reimbursement at the same priority as the employees would have enjoyed under s 433 of the Act. Section 433 relevantly provides that a receiver either (a) appointed by a holder of debentures secured by a circulating security interest, or (b) who has taken possession of property subject to a circulating security interest, must pay out of the ‘property of the company’ certain amounts identified in s 433(3) (including amounts owed to employees) in priority to any claim for principal or interest under the debentures.

The second claimant was Carter Holt Harvey Woodproducts Australia Pty Ltd (Carter Holt), a creditor of Amerind, which submitted that the Commonwealth was not



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entitled to priority treatment.

Carter Holt advanced two principal arguments. First, it argued that the trustee’s interest in the trust assets arising from its right of exoneration was not ‘property of the company’, with the effect that the priority regime in s 433(3) did not apply. Secondly, it argued that although the right of exoneration itself could be described as property of the company, that right (as opposed to any consequential rights in the trust assets) was not subject to the circulating security interest, with the result that the pre-conditions to the operation of s 433(3) were not met.

The litigation focussed predominantly on the first argument. Three approaches had emerged in the case law on the question of whether a trustee’s right of exoneration comprised property of a corporate trustee to which the statutory priority regimes would apply:

- first, in *Re Enhill Pty Ltd* [1983] 1 VR 561, the Full Court of the Supreme Court of Victoria decided that the statutory priority regimes did apply, and the trust assets were to be divided between *trust and non-trust creditors* according to those statutory priorities;
- secondly, in *Re Suco Gold Pty Ltd (in liq)* (1983) 33 SASR 99, the Full Court of the Supreme Court of South Australia decided that the statutory regime did apply, but the trust assets were to be distributed according to those priorities *only to trust creditors*; and
- thirdly, in *Re Independent Contractor Services (Aust) Pty Ltd (in liq)* (No 2) [2016] NSWSC 106, Brereton J decided that the statutory regime did not apply, because trust property was not ‘beneficially owned’ by the trustee company. The property of the trust was therefore to be distributed to *trust creditors pari passu*.

In *Amerind*, the Victorian Court of Appeal held that ss 433, 555 and 556 of the Act did apply to the distribution of property constituted by a corporate trustee’s right of exoneration against trust assets: *Commonwealth v Byrnes (in their capacity as joint and several receivers and managers of Amerind Pty Ltd (receivers and managers appointed) (in liq))* (2018) 354 ALR 789. Since the only creditors of Amerind were trust creditors, the approaches in *Re Suco Gold* and *Re Enhill* did not produce different results, and it was unnecessary to decide between them. However, the Court of Appeal indicated that *Re Enhill* should continue to be followed in Victoria unless and until it was overturned: at [286].

Shortly after the Court of Appeal’s decision, the Full Federal Court’s delivered its decision in *Jones (Liquidator) v Matrix Partners Pty Ltd, in the matter of Killarnee Civil & Concrete Contractors Pty Ltd (in liq)* (2018) 260 FCR 310 (*Killarnee*). In that case, the Full Court held by majority that *Re Enhill* was wrong and that *Re Suco Gold* represented the correct approach.

The High Court decision

In three sets of reasons, the High Court unanimously dismissed the appeal, but in

doing so, affirmed the approach in *Re Suco Gold* and *Killarnee*, and said that the approach in *Re Enhill* was wrong: at [44] (Kiefel CJ, Keane and Edelman JJ), [92] (Bell, Gageler and Nettle JJ), [154] (Gordon J).

As to the first of Carter Holt's two principal arguments, Kiefel CJ, Keane and Edelman JJ noted that the exclusion of property held on trust from the property of an individual trustee in bankruptcy had long applied by undisputed analogy in the case of corporations, but said that that general principle did not apply to the extent that the trustee derived any personal benefit from the rights held on trust: at [26]-[28]. One means by which a trustee can benefit personally from the trust assets is through the trustee's power to use those assets to indemnify itself from liabilities. The existence of that 'right of indemnity' means that, to the extent of the power, the trust rights are 'no longer property held solely in the interests of the beneficiaries of the trust': at [28].

The Court held that where trust assets need to be sold to exonerate the trustee, the trustee holds a proprietary right to those assets (as opposed to a mere personal power in respect of them) that ranks ahead of the beneficiaries' beneficial interest: at [32] (Kiefel CJ, Keane and Edelman JJ), [81]-[82] and [95] (Bell, Gageler and Nettle JJ), [133] and [142] (Gordon J). Gordon J noted that having regard to the breadth of the definition of 'property' in s 9 of the Act, there could be no question that such proprietary rights fall within that definition: at [141].

Kiefel CJ, Keane and Edelman JJ stated further that a trustee's proprietary rights to trust assets are commensurate with the trustee's power to use those assets to discharge the trustee's personal liability for liabilities properly incurred as trustee: at [35]. It followed from this that the use of trust funds by a trustee was confined to the discharge of trust debts: at [44] (Kiefel CJ, Keane and Edelman JJ) and [156] (Gordon J). Nothing changes upon liquidation. Kiefel CJ, Keane and Edelman JJ approved the reasoning of Allsop CJ in *Killarnee* to the effect that the 'nature and character' of the power of exoneration, namely that it is exercisable only to pay trust creditors, is not altered in the hands of the liquidator or trustee in bankruptcy: at [35].

The conclusion that the trustee's rights in the trust assets comprised property in the company that was subject to the statutory priority regime, but available only to satisfy trust creditors, was found to be consistent with the underlying purpose of the relevant provisions. The Court said that it would be perverse if the Act operated to deny employee creditors a particular priority over the holders of a circulating security interest solely for the reason that the company which employed

them was trading as trustee. Moreover, the statutory priority schemes in ss 433 and 556 had been enacted in 2001 at a time when *Re Suco Gold* had stood for 17 years and was well-regarded: at [58] (Kiefel CJ, Keane and Edelman JJ citing Allsop CJ in *Killarnee* at [106]-[108]) and at [96] (Bell, Gageler and Nettle JJ); see also at [144] (Gordon J).

As to Carter Holt's second argument, the High Court found that the trustee's right of exoneration was not a circulating asset, but that it was enough that Amerind's property rights to the trust assets (to the extent that it had power to use them for its own benefit) were themselves circulating assets and were therefore 'property of the company' for the purposes of s 433: at [49], [50] (Kiefel CJ, Keane and Edelman JJ), [86]-[87] (Bell, Gageler and Nettle JJ) and at [108] (Gordon J).

Remaining questions

There are a number of issues which remain to be decided. In particular, there remains

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uncertainty about the correct order for the payment of trust creditors after the payment of priority creditors and about the marshalling of claims where a creditor has access to more than one fund. Complications might also be expected where a corporate trustee has carried on business as trustee for more than one trust, or as trustee of a trust and on its own account. Bell, Gageler and Nettle JJ and Gordon J suggested that a possible solution to this may be to construe s 556 as if the liquidator held separate funds, each for different groups of creditors: at [97], [160].

Another unresolved issue concerns the fact that, due to the 'shape' of the liquidator's interests in the trust assets, the liquidator is necessarily limited in how he or she can deal with those assets. The liquidator has no general power to sell trust assets, notwithstand-

ing that the core function of a liquidator is to get in the property and distribute it among the creditors: *Killarnee* at [89]; ss 474(1), 477(2)(c), 555 of the Act. In *Killarnee*, the Full Court decided that in circumstances where property rights were insufficient to support a sale of the underlying assets, the statutory powers of sale in s 477 could not be used to improve the liquidator's position: at [89]. This decision was contrary to previous authority. Instead the Full Court suggested that a liquidator could obtain orders for sale of the kind that would ordinarily be granted to the holder of an equitable lien over property, or apply for a parallel appointment as a receiver: *Killarnee* at [91], [98].

Another issue concerns how the unfair preference provisions in Part 5.7B of the Act will be applied to transactions involving trust assets. In *Amerind*, the Victorian Court of Appeal held, consistently with prior authority, that recoveries of unfair preferences initially made out of trust assets were repayable to the company and to be distributed between *all* creditors: at [69]-[77]. However, the normative rationale for the provisions, which is to augment the estate for the benefit of creditors is brought into sharp focus when the transaction in question has diminished the assets of the trust as opposed to the general pool. It may sit uncomfortably in a 'dual fund' situation.

Accordingly, notwithstanding the High Court's decision, there remain several opportunities for further litigation in this area.