



27/06/2019

The insolvent corporate trustee's right of indemnity

On 19 June 2019, the High Court delivered its decision in *Carter Hold Harvey Wood Products Australia Pty Ltd v The Commonwealth* [2019] HCA ("the Amerind decision").

In doing so, the High Court has now provided clarity and certainty about whether s 433 of the Corporations Act 2001 (Cth) ("the Act") applies to trust assets in circumstances where the insolvent company is acting as trustee for a single trust.

A link to the High Court's decision online can be found [here](#).

In three separate judgments, the High Court unanimously dismissed the Appeal by Carter Holt Harvey.

In summary:-

1. The High Court unanimously held that, in the winding up of a corporate trustee, the "property of the company" available for payment of creditors includes so much of the trust assets as the company is entitled, in exercise of its right of indemnity, to apply in satisfaction of the claims of creditors, but that proceeds from an exercise of the right of exoneration may be applied only in satisfaction of trust liabilities to which the right relates.
2. The High Court also held that s 433(3) required the receivers to pay the debts in accordance with the statutory priorities in a winding up.
3. The majority reasoned that Amerind's right of indemnity was not "property [of the company] comprised in or subject to a circulating security interest", but the inventory itself was such "property of the company" and the receivers were, as Amerind would have been, entitled to apply the proceeds of its realisation in satisfaction of the claims of trust creditors.



Background facts

Amerind Pty Ltd (“the Company”) manufactured and distributed decorative and architectural finishes as the trustee of a trading trust. The Company used the trust money to pay trust creditors directly – it did not pay creditors out of its own funds and then seek reimbursement from the trust. The company also had no non-trust creditors.

Administrators were appointed after the Company’s bank cancelled its facilities. The bank appointed receivers the same day, and later the company was voted into liquidation. In the course of the liquidation, the Commonwealth advanced under the FEG Scheme, nearly \$4m for wages and entitlements to the Company’s former employees.

After they were appointed, the receivers traded on and generated surplus of around \$1,600,000.

The receivers sought directions on the issue of whether, in distributing the receivership surplus, they were required to comply with the statutory priority regime applied by s 433 of the Act. That provision required that a receiver must pay out of property coming into their hands debts in accordance with the statutory priorities in s 556 of the Act.

If the statutory priority regime did not apply, the Company’s trust creditors would be paid before the Commonwealth, which would be left out of pocket for the amounts it had paid to former employees for wages and entitlements.

The central issue depended in turn on 2 questions:

- Was the insolvent corporate trustee’s right of indemnity from trust assets “property of the company” for the purposes of s 433 of the Act?
- Did the receivership surplus fall within the ambit of property which is secured by a “circulating security interest”?



Original decision

In his decision at first instance, Justice Robson held that s 433 of the Act did not apply because Amerind had no assets of its own, only a right of indemnity in respect of trust liabilities, which right was neither “property of the company” nor “comprised in or subject to a circulating security interest” within the meaning of that section.

Put another way, Justice Robson held that Amerind’s right of indemnity from trust assets did not constitute “property of the company” and therefore the payment waterfall regime outlined in ss 433 and 556 of the Act did not apply to proceeds from those assets. As a consequence, employees of Amerind (and the Commonwealth’s Fair Entitlement Guarantee Scheme on their behalf) did not enjoy a preferred priority position under s 433.

His Honour’s decision was consistent with other recent decisions such as that of Brereton J in *Re Independent Contractor Services*[1], and Farrell J in *Woodgate*, *In the matter of Bell Hire Services Pty Ltd (in liq)*, which were to the effect that the priority regime in s 556 did not apply to trust assets. Justice Robson’s decision had the effect of altering (for corporate trustee employers), the longstanding legal and public policy position, that employees should enjoy a priority position.

Appeal

The Commonwealth appealed the decision of Robson J on a number of grounds. The issue for the Court came down to whether the statutory insolvency regime applied to the distribution of assets that are subject to a right of indemnity held by an insolvent corporate trustee, and if so, how, if at all, do trust principles apply in that situation.

In allowing the Commonwealth’s Appeal, the Court of Appeal held that Amerind’s right to be indemnified out of the assets of the trust was “property of the company” and that ss 433, 555 and 556 therefore necessarily applied to the distribution of the surplus. The Court of Appeal further held that, because the proceeds of realisation of the inventory were property of Amerind subject to a circulating security interest, and of which the receivers had taken possession or assumed control, s 433(3) required the receivers to pay the claims in s 556(1)(e) in priority out of those proceeds.



Summary of statutory regime

the company” subject to a “circulating security interest”, the receiver must pay certain entitlements to employees in preference to other unsecured creditors in accordance with the s 556 statutory priority regime.

S 560 provides that, if the company pays employees as a result of a third party advancing money for the purposes of making that payment, then the third party (in Amerind it was the Commonwealth) has the same right of priority as the employees who received the payment.

A corporate trustee’s rights over trust property include a right of indemnity being a right of recoupment allowing it to use trust assets to indemnify itself for trust debts it has paid, and a right of exoneration allowing it to use trust assets to pay trust debts.

The right of indemnity is a proprietary interest over trust assets ranking ahead of the rights of beneficiaries.

Trust creditors are entitled to be subrogated to that right, but subrogation is a remedy, not a right. The Court of Appeal held that the above statutory priority applied to Amerind’s rights of exoneration as it was “property of the company”.

For a corporate trustee, the “property of the company” does include the proprietary rights of indemnity for recoupment and exoneration. These rights are available for distribution to creditors subject to the statutory priority regime.

The Court of Appeal preferred South Australian (Suco Gold^[3]); and Victorian (Re Enhill^[4]), appellate authority which suggested that in the case of a shortfall of trust assets over trust liabilities, proceeds of the exoneration right were to be applied first in paying employees and other priority creditors. The Court further said that under various High Court decisions, the right of exoneration gave a beneficial interest in trust property ahead of the beneficiaries.



On this basis, the Court of Appeal overturned the decision of first instance (Robson J's decision) and declined to follow the recent line of authority starting with the NSW decision of *Independent Contractors*[5], where it was held that in the case of a shortfall, trust assets are applied equally among trust creditors, including employees.

As Amerind had only trust creditors, it was not necessary for the Court of Appeal to decide whether the proceeds of the right of exoneration were divisible among all creditors or trust creditors only, an issue on which authorities are divided. However, the Court of Appeal noted that it preferred the view propounded in *Re Enhill*, the trust assets could be applied to meet personal non-trust liabilities, not just trust creditors who were subrogated to them.

Outcome of the Appeal

Accordingly, the Court of Appeal allowed the Appeal and overturned Robson J's decision. The Court of Appeal examined the history of authorities regarding the application of the statutory regime in a trust context, noting various inconsistencies between the authorities (some of which it did not resolve).

In particular, the Court of Appeal noted that the High Court judgment in *Octavo*[6] was authority for the propositions that:

- An insolvent trustee company's right of "exoneration" from trust assets, for liabilities properly incurred in the performance of the trust, is proprietary interest which passes to the liquidator; and
- The respective statutory regime must apply to the disposition of that property;

Robson J's conclusion that the corporate trustee's right of indemnity was not "property of the company" could not be sustained in light of the High Court's decision in *Octavo*;

The Court of Appeal accepted the reasoning in *Re Enhill* and *Re Suco Gold*, and held that if the right of indemnity is property of the Company, the statutory insolvency regime must apply to it, such that ss 433, 555 and 556 apply.



Importantly, the Court of Appeal clarified that whether an asset is a “circulating asset” is to be determined based on its characteristics as at the time the receiver is appointed, not when the security interest is granted.

In Amerind’s case, the property to which the receivers had recourse in generating the receivership surplus were “circulating assets” under s 340 of the PPSA – such as cash in a trade account, funds advanced under debtor finance facilities, and the proceeds of inventory realisation.

Therefore, the receivership surplus had to be distributed according to the statutory priority regime. Much of this would be expected to go to the Commonwealth, which had paid more than \$4m to former employees for wages and entitlements.

By grant of special leave, Carter Holt appealed to the High Court.