THE LAW IS NOW SETTLED AS TO HOW A LIQUIDATOR MAY DEAL WITH TRUST ASSETS

Bonnie Scovell of Edwards Mac Scovell & Lee Christensen of Christensen Partners

Highlights:

- If a liquidator is appointed over a company that vacated its office as trustee, then the liquidator does not have a power to sell trust assets.
- In the circumstances described above, a liquidator cannot acquire power to sell trust assets the subject of the trustee's indemnity and lien by applying for orders under s477 of the Corporations Act.
- However, the Court has confirmed that if a trust asset need not be sold in order to be realised, then the liquidator does not need the court's intervention to call in that asset.
- Once trust assets are realised, a liquidator may distribute the proceeds of the liquidation pursuant to the priority regime in the Corporations Act.
- In a case where a company has traded both as trustee and in its own right, or as trustee of multiple trusts, the liquidator must deal with creditors of each body separately, including by only applying the assets of each body to its respective creditors.
- In such cases as that described above, thought needs to be given by the liquidator as to how to divide their remuneration claims as between those pools of funds created by the sale of trust assets, and that pool of assets owned by the company in its own right.

In July 2017 the writers published an article foreshadowing certain impending decisions of both the Victorian Court of Appeal and the Full Federal Court relating to the manner in which a liquidator is entitled to apply the proceeds of sale of trust assets to the payment of creditors of an insolvent trustee. In March and April 2018 respectively, those Courts have decided those issues in a harmonised way, with the consequence that liquidators may now get on with the job of dealing with such liquidations with comfort as to the state of the law.

The article previously published by the writers can be found here: "How is a Liquidator to Deal With Trust Assets in a Liquidation? Finally an Answer is on its Way", which sets out the relevant background to the issues discussed in this article. Citations to the two decisions prefaced above are: *Commonwealth v Byrnes and Hewitt in their capacity as joint and several receivers and managers of Amerind Pty Ltd (Receivers and Managers appointed) (in liquidation)* [2018] VSCA 41 (Amerind) and *Jones (Liquidator) v Matrix Partners Pty Ltd, in the matter of Killarnee Civil & Concrete Contractors Pty Ltd (in liq)* [2018] FCAFC 40 (**Killarnee**). This article will address the reasoning in Killarnee, because the Full Federal Court's decision in that case follows that of Amerind.

A recap on what the issues were

The cases to which these issues are relevant are where a corporate trustee becomes insolvent. There has never been a question as to whether or not the insolvent corporate trustee has a right of indemnity over trust assets supported by equitable lien – the answer to this has always been yes. The question was whether the liquidator of the corporate trustee (including a former trustee corporation) was entitled to call in the proceeds of sale of trust property (pursuant to his or her right of indemnity, specifically the right of exoneration) to pay the general body of creditors such proceeds being 'property of the company' within the meaning of section 9 of the Corporations Act; and secondly, whether such proceeds ought be distributed to the 'trust creditors' in accordance with the priority regime established by ss 555, 556, 560 and 561 of the Corporations Act, or pari passu in accordance with the rule of equity that stems from the maxim that 'equity is equality'. For nearly fifty years, the courts of various Australian jurisdictions have given conflicting views on these questions, leaving the industry in a state of relative flux as to how liquidators were obliged to distribute the proceeds of such liquidations. The situation became critical when, in March 2016, his Honour Justice Brereton of the NSW Supreme Court handed down his decision in *Independent Contractor Services (Aust) Pty Limited ACN 119 186 971 (in liquidation)* (No 2) [2016] NSWSC 106 holding that the statutory priority set down by section 556 of the Corporations Act did not apply in respect to trust assets and that creditors must share pari passu in the proceeds of sale of trust assets (after deducting the liquidator's remuneration and expenses).

What the Courts have now said

The Full Federal Court has held that the decision in *Re Enhill Pty Ltd* [1983] 1 VR 561 was wrong insofar as it decided on the availability of trust assets to pay creditors of the insolvent trustee who are not trust creditors, and that *In re Suco Gold Pty Ltd (in liq)* (1983) 33 SASR 99 **(In re Suco Gold)** is correct.[1] Those decisions represented the divergent lines of authority on the overarching issues prefaced above. These decisions may be applied to cases where a corporate trustee has only ever traded and otherwise acted in a trustee capacity, where the corporate trustee has traded or otherwise acted in both a trustee capacity and in its own right, and where the corporate trustee has traded or otherwise acted as trustee of multiple trusts.

It is now settled that the trust assets over which the trustee's right of indemnity may be or has been exercised are not themselves 'property of the company' – those assets remain impressed with the trust.[2] The Court has found, however, that the trustee's right of indemnity supported by its equitable lien to enforce that right is 'property of the company' within the meaning of section 9 of the Corporations Act.[3] The Court has explained though, that such 'property' (being the right of indemnity) is inhered with the proviso that it may only be used to satisfy those debts the trustee has incurred in administering the trust (that is, to pay 'trust creditors').[4] In other words, while the trustee may apply trust assets to payment of its creditors, the right by which the trustee has to do so may only be exercised in such a way as to extinguish the debts of creditors of the trust.

The question then becomes the manner in which those trust creditors are to share in the fruits of the sale of the trust assets. The plurality in Killarnee has held (Siopis J dissenting) that such proceeds are to be distributed to trust creditors in accordance with the priority regime set out in the Corporations Act.[5]

---

[1] Killarnee per Allsop CJ at [30]

[2] Per Allsop CJ at [69]

[3] The Court unanimously found for that result, and the Court has specifically followed the reasoning of King CJ in *In re Suco Gold* at [108] on this point: see Farrell J at [210]-[211]

[4] Ibid at 2 and see also per Farrell J at [211]

[5] Per Allsop CJ at [91] and Farrell J at [223]

As an aside, her Honour Justice Farrell has also made a point of lamenting that the legislature has not addressed these issues by clarifying the nature and scope of the intended application of the priority regime to trading trusts, resulting in many cases where the costs to creditors have increased because liquidators have needed to seek directions from the courts as to how to deal with these types of liquidations.[6]

What does it all mean?

The relevant takeaways are as follows:

1. If a liquidator is appointed over a company that vacated its office as trustee (whether upon appointment of the liquidator or for some other reason), then the liquidator does not have a power to sell trust as sets. He or she must seek orders for appointment of a receiver to do so, and there is no reason why (in ordinary circumstances) the liquidator ought not be appointed as such.[7]

2. In the circumstances described above, a liquidator cannot acquire power to sell trust assets the subject of the trustee's indemnity and lien within the ambit of ss477(2)(c) and (m) of the Corporations Act.[8] This is a further reason why it will be necessary for a liquidator to approach the Court seeking to appoint himself (or where appropriate, another) as a receiver of those assets or alternatively, seek to rely upon the power of sale to found in each jurisdiction's legislation dealing with trustees and trusts (in Western Australia see section 89 of the Trustee's Act).

3. However, the Court has confirmed that if a trust asset need not be sold in order to be realised (for example cash at bank), then the liquidator does not need the court's intervention to call in that asset.[9]

4. Once trust assets are realised, the liquidator may distribute the proceeds of the liquidation in the manner s/he ordinarily would have (that is, pursuant to the priority regime).

5. In a case where a company has acted both as trustee and in its own right, or as trustee of multiple trusts, the liquidator must deal with creditors of each body separately, including by only applying the assets of each body to its respective creditors. Siopis J has expressed the view in obiter (which view the writers respectfully agree follows naturally from the balance of the Court's findings) that trust creditors who do not receive 100c in the dollar from the proceeds of sale of the trust assets are then entitled to prove again among the general body of creditors of the company for their shortfall.[10]

6. In such cases as those described in point 5 above, thought needs to be given by the liquidator as to how to divide their remuneration claims as between those pools of funds created by the sale of trust assets (and if more than one trust, then between each), and that pool of assets owned by the company in its own right.

---

[6] See [207]-[209] of her Honour's reasons

[7] Per Allsop CJ at [89]-[91]

[8] Per Allsop CJ at [91], Siopis J at [139] and Farrell J at [198]

[9] Per Allsop CJ at [44]

[10] Per Siopis J at [190] (in obiter)

Please contact Bonnie Scovell of Edwards Mac Scovell on (08) 6245 0222 or Lee Christensen of Christensen Partners on (08) 6381 0432 if you wish to discuss the manner in which the proceeds of trustee companies ought to be dealt with, or generally.

Lee Christensen, Director
T 0419 921 824
E lee@christensenpartners.com.au

Bonnie Scovell, Partner
T 08 6245 0222
E bonnie.scovell@emslegal.com.au