FEDERAL COURT OF AUSTRALIA

Commissioner of Taxation v Lane [2020] FCAFC 184

Appeal from:	*Lane (Trustee), in the matter of Lee (Bankrupt) v Deputy Commissioner of Taxation* [2017] FCA 953 *Lane (Trustee), in the matter of Lee (Bankrupt) v Commissioner of Taxation (No 3)* [2018] FCA 1572
File numbers:	QUD 514 of 2017 QUD 941 of 2018
Judgment of:	**ALLSOP CJ, PERRAM AND FARRELL JJ**
Date of judgment:	6 November 2020
Catchwords:	**BANKRUPTCY AND INSOLVENCY** – exercise of bankrupt trustee's right of exoneration from trust assets – discussion of the nature of the right of exoneration – whether right of exoneration "property divisible among the bankrupt's creditors" or trust property – whether the proceeds of the right of exoneration are to be distributed to all creditors or only to trust creditors – whether the priority regime in s 109 of the *Bankruptcy Act 1966* (Cth) applies to the proceeds of the right of exoneration **BANKRUPTCY AND INSOLVENCY** – where bankrupt held assets in his capacity as trustee of a trading trust – where proceeds from sale of trust assets distributed to trust creditors – where trust creditors claim on personal estate of bankrupt – whether in distribution of personal assets of bankrupt "hotchpot" principle applies **BANKRUPTCY AND INSOLVENCY** – recovery of preference payment – where trustee exercised right of exoneration to discharge taxation liability – where payment void under s 122 of the *Bankruptcy Act 1966* (Cth) – whether proceeds from preference recovery action are to be distributed to all creditors or only to trust creditors
Legislation:	*Bankruptcy Act 1966* (Cth) ss 58, 108, 109, 116, 122, sch 2 *Bankruptcy Regulations 1996* (Cth) r 6.02 *Corporations Act 2001* (Cth) ss 433, 555, 556, 560
Cases cited:	*Adsett v Berlouis* [1992] FCA 549; 37 FCR 201 *Akers as a joint foreign representative of Saad Investments Company Limited (in Official Liquidation) v Deputy*

Commissioner of Taxation [2014] FCAFC 57; 223 FCR 8

Albert Gregory Ltd v C Niccol Ltd (1916) 16 SR (NSW) 214

Attorney General for New South Wales v Perpetual Trustee Company (Limited) [1940] HCA 12; 63 CLR 209

Australian Securities and Investment Commission v Idylic Solutions Ltd [2009] NSWSC 1306; 76 ACSR 129

Australian Securities and Investment Commission v Letten (No 20) [2012] FCA 1283; 92 ACSR 630

Banco de Portugal v Waddell (1879–80) 5 App Cas 161

Bathurst City Council v PWC Properties Pty Limited [1998] HCA 59; 195 CLR 566

Boensch v Pascoe [2019] HCA 49; 375 ALR 15

Bradken Limited v Norcast S.ár.L [2013] FCAFC 123; 219 FCR 101

Brady v Stapleton [1952] HCA 62; 88 CLR 322

Bruton Holdings Pty Ltd (in liquidation) v Commissioner of Taxation of the Commonwealth of Australia [2009] HCA 32; 239 CLR 346

Burns Philp Trustee Co Ltd v Viney [1981] 2 NSWLR 216

Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth [2019] HCA 20; 368 ALR 390

Chief Commissioner of Stamp Duties for New South Wales v Buckle [1998] HCA 4; 192 CLR 226

Cleaver v Delta American Reinsurance Company (in liquidation) [2001] 2 AC 328

Commissioner of Taxation of the Commonwealth of Australia v Linter Textiles Australia Ltd (in liquidation) [2005] HCA 20; 220 CLR 592

CPT Custodian Pty Ltd v Commissioner of State Revenue of the State of Victoria [2005] HCA 53; 224 CLR 98

DKLR Holding Co (No 2) Pty Ltd v Commissioner of Stamp Duties [1980] 1 NSWLR 510

Edwards v Freeman (1727) 2 P Wms 435; 24 ER 803

Ex parte Cooper; In re Zucco (1875) 10 Ch App 510

Ex parte Wilson, In re Douglas (1871–72) 7 Ch App 490

Federal Commissioner of Taxation v Jaques [1956] HCA 40; 95 CLR 223

Fouche v Superannuation Fund Board [1952] HCA 1; 88 CLR 609

Hall v Robinson 8 Ired 56 (1847)

Harmer v Commissioner of Taxation of the Commonwealth of Australia [1991] HCA 51; 173 CLR 264

In re Ford, *Ex parte The Trustee* [1900] 2 QB 211

In re Gordon, Ex parte Navalchand [1897] 2 QB 516

In re Hobourn Aero Components Limited's Air Raid Distress Fund, *Ryan v Forrest* [1946] Ch 86

In re Lead Company's Workmen's Fund Society [1904] 2 Ch 196

In re Matheson Brothers Limited (1884) 27 Ch D 225

In re Oriental Inland Steam Co, Ex parte Scinde Railway Co (1874) LR 9 Ch App 577

In re Printers and Transferrers Amalgamated Trades Protection Society [1899] 2 Ch 184

In re Suco Gold Pty Ltd (in liquidation) (1983) 33 SASR 99

In re Yagerphone, Limited [1935] Ch 392

Jones (Liquidator) v Matrix Partners Pty Ltd, in the matter of Killarnee Civil & Concrete Contractors Pty Ltd (in liq) [2018] FCAFC 40; 260 FCR 310

JT International SA v Commonwealth [2012] HCA 43; 250 CLR 1

Kite v Mooney, in the matter of Mooney's Contractors Pty Ltd (in liq) (No 2) [2017] FCA 653

Livingstone v Commissioner of Stamp Duties (Qld) [1960] HCA 94; 107 CLR 411

Miller v Sawyer 30 Vt 412 (1858)

NA Kratzmann Pty Ltd (in liq) v Tucker (No 1) [1966] HCA 72; 123 CLR 257

NA Kratzmann Pty Ltd (in liq) v Tucker (No 2) [1968] HCA 44; 123 CLR 295

New Cap Reinsurance Corporation v Faraday Underwriting [2003] NSWSC 842; 177 FLR 52

NW Robbie & Co Ltd v Witney Warehouse Co Ltd [1963] 1 WLR 1324

Octavo Investments Proprietary Limited v Knight [1979] HCA 61; 144 CLR 360

Pearce v Piper (1809) 17 Ves 1; 34 ER 1

Re Alfred Shaw & Co Ltd, *Ex parte Mackenzie* (1897) 8 QLJ 93

Re Amerind Pty Ltd (receivers and managers appointed) (in liq) [2017] VSC 127; 320 FLR 118

Re Byrne Australia Pty Ltd [1981] 1 NSWLR 394

Re Byrne Australia Pty Ltd (No 2) [1981] 2 NSWLR 364

Re Enhill Pty Ltd [1983] 1 VR 561

Re Fiorino; Fiorino v Woodgate [1994] FCA 181

Re French Caledonia Travel Service Pty Ltd (in liq) [2003] NSWSC 1008; 59 NSWLR 361

Re Fresjac Pty Ltd (in liq); Campbell v Michael Mount PPB (1995) 65 SASR 334

Re HIH Casualty and General Insurance Ltd [2005] NSWSC 240; 190 FLR 398

Re Independent Contractor Services (Aust) Pty Ltd (in liq) (No 2) [2016] NSWSC 106; 305 FLR 222

Re Standard Insurance Company Limited [1968] Qld R 118

Re Ward; Thomas v L G Abbott & Co Ltd (1950) 16 ABC 214

Registrar of the Accident Compensation Tribunal v Commissioner of Taxation [1993] HCA 1; 178 CLR 145

Sedgwick Collins and Company v Rossia Insurance Company of Petrograd [1926] 1 KB 1

Selkrig v Davis 2 Rose 291

Steel v Dixon (1881) 17 Ch D 825

Superannuation Fund Investment Trust v Commissioner of Stamps (SA) [1979] HCA 34; 145 CLR 330

Truax v Corrigan 257 US 312 (1921)

Trustee of the Property of O'Halloran, in the matter of O'Halloran v O'Halloran [2002] FCA 1305

WA Sherratt Ltd v John Bromley (Church Stretton) Ltd [1985] QB 1038

Westpac Banking Corporation v Bell Group Ltd (in liq) (No 3) [2012] WASCA 157; 44 WAR 1

Wik Peoples v Queensland [1996] HCA 40; 187 CLR 1

Williams v Lloyd; *In re Williams* [1934] HCA 1; 50 CLR 341

Willmott v London Celluloid Co (1886) 31 Ch D 425; (1886) 34 Ch D 147

Woodgate, in the matter of Bell Hire Services Pty Ltd (in liq) [2016] FCA 1583

Young v Thomson [2017] FCAFC 140; 253 FCR 191

Division:	General Division
Registry:	Queensland

National Practice Area:	Commercial and Corporations
Sub-area:	General and Personal Insolvency
Number of paragraphs:	153
Date of hearing:	26 February 2020
Counsel for the Appellant:	Ms A Wheatley QC with Mr B McEniery
Solicitor for the Appellant:	Australian Government Solicitor
Counsel for the First and Second Respondents:	Mr P McQuade QC with Mr M Eade
Solicitor for the First and Second Respondents:	Cooper Grace Ward Lawyers
Counsel for the Third, Fifth and Sixth Respondents:	The Third, Fifth and Sixth Respondents did not appear
Counsel for the Fourth Respondent:	The Fourth Respondent filed a submitting notice save as to costs

ORDERS

QUD 514 of 2017
QUD 941 of 2018

BETWEEN:	**COMMISSIONER OF TAXATION** Appellant
AND:	**MORGAN GERARD JAMES LANE** First Respondent
	RAJENDRA KUMAR KHATRI Second Respondent
	JANET MAY LEE Third Respondent
	WESTPAC BANKING CORPORATION Fourth Respondent
	BEVMONT PTY LTD AS TRUSTEE FOR THE LEE FAMILY TRUST Fifth Respondent
	WARWICK GORDON LEE Sixth Respondent

ORDER MADE BY: **ALLSOP CJ, PERRAM AND FARRELL JJ**

DATE OF ORDER: **6 NOVEMBER 2020**

THE COURT ORDERS THAT:

1. Within 14 days, in each matter the parties file an agreed draft minute of order disposing of the matter and restating the terms of the advice in accordance with the judgment of the Court, granting any necessary extension of time in which to file an application for leave to appeal, granting leave to appeal, allowing the appeal on the first substantive question as to the application of ss 108 and 109 of the *Bankruptcy Act 1966* (Cth), and dismissing the appeal as to the questions of hotchpot and the use of the proceeds of the preference recovery action. If agreement is not possible, competing short minutes are to be filed, accompanied in that case by brief submissions as to the competing positions.

Note: Entry of orders is dealt with in Rule 39.32 of the *Federal Court Rules 2011*.

REASONS FOR JUDGMENT

ALLSOP CJ:

1 This is an application for leave to appeal, an extension of time for leave to appeal, and an appeal should leave be granted which concern directions and relief made pursuant to ss 90-15(1) and 90-20(1)(a) of Schedule 2 of the *Bankruptcy Act 1966* (Cth) in relation to the administration of the bankrupt estate of Mr Warwick Gordon Lee. The directions and form of relief sought by the trustees in bankruptcy and ultimately made by the primary judge were wide-ranging. This appeal focuses on three issues concerning the distribution of certain assets held by Mr Lee in his capacity as trustee of a discretionary trust known in these proceedings as the Warwick Lee Family Trust. The issues and my conclusions can be summarised as follows:

(1) Whether the priority regime in ss 108 and 109 of the *Bankruptcy Act* applies to the distribution of the proceeds of the sale of the assets of the Warwick Lee Family Trust: The primary judge erred in concluding that the priority provisions did not apply.

(2) Whether in the distribution of the personal estate of the bankrupt amongst all creditors, the trust creditors must bring into hotchpot the amount which they have received from the proceeds of the sale of the assets of the Warwick Lee Family Trust: The primary judge was correct to conclude that the trust creditors were so obliged.

(3) In dealing with the proceeds of recovery in a preference action referable to a preferred payment by the debtor trustee (now bankrupt) to a trust creditor (the Australian Taxation Office (**ATO**)) out of the proceeds of the exercise of the right of exoneration against trust assets, whether the trustees in bankruptcy were required to use that recovered money only for the purpose of discharging trust debts or whether the proceeds of recovery were general non-trust assets of the bankrupt estate: The primary judge was correct to conclude that the trustees in bankruptcy were so required.

2 The first and second of these issues were addressed by the primary judge in *Lane (Trustee), in the matter of Lee (Bankrupt) v Deputy Commissioner of Taxation* [2017] FCA 953; 253 FCR 46 (***Lane***), whilst the third issue was addressed in *Lane (Trustee), in the matter of Lee (Bankrupt) v Commissioner of Taxation (No 3)* [2018] FCA 1572 (***Lane (No 3)***). The substantive directions and orders arising from those published reasons were made on 19 September 2017 and 29 November 2018. The hearing of this application and appeal from those directions and orders was delayed by the parties' preference to await resolution of issues seen

as likely determinative or influential in other proceedings in the High Court, to which reference will be made in due course.

3 The appellant requires leave to appeal from the interlocutory judgments of the primary judge: *Federal Court of Australia Act 1976* (Cth) s 24(1A). The appellant also requires an extension of time to seek leave to appeal in respect of the orders made by the primary judge on 29 November 2018. The reasons for the appellant's delay in making the application for leave to appeal were set out in two affidavits sworn by the solicitor with carriage of the matter. For the reasons that follow, the extension of time and leave to appeal should be granted, and the appeal allowed in part.

4 After the handing down of the High Court decision in *Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth* [2019] HCA 20; 368 ALR 390 the appellant and first and second respondents agreed that the appeal must succeed on the first issue. Contrary to the conclusion of the primary judge, the priority regime provided for by ss 108 and 109 does apply to the proceeds of the exercise of the trustee's right of exoneration. It is appropriate to explain fully why that agreement was soundly based, not only because the Court does not allow appeals simply on the agreement of parties: *Bradken Limited v Norcast S.ár.L* [2013] FCAFC 123; 219 FCR 101, but also because the point is an important one affecting the practice of jurisdiction in bankruptcy, and it will arise again. Its future resolution should not be left for further agitation if this matter is seen to be resolved only by the agreement of the parties.

5 This first issue concerned the issue which this Court dealt with in *Jones (Liquidator) v Matrix Partners Pty Ltd, in the matter of Killarnee Civil & Concrete Contractors Pty Ltd (in liq)* [2018] FCAFC 40; 260 FCR 310 and with which the High Court dealt in *Carter Holt* in the context of corporate insolvency. In *Jones* at [2]–[3] I sought to encapsulate the issue that had dogged the law of insolvency, in particular corporate insolvency, for nearly 40 years:

> 2 The questions at the centre of the application are as follows: In circumstances of corporate insolvency how must the liquidator of a company, which was the trustee of a trading trust, treat the exercise and proceeds of the right of exoneration from assets of the trust? Does the right or do the proceeds form part of the general assets of the company that are available for the payment of all debts of the company, including costs and fees of the liquidator according to the regime of the *Corporations Act*? If not, must the right and the proceeds be used only for trust creditors? If so, and notwithstanding that conclusion, does the regime of the *Corporations Act* nevertheless apply to the distribution amongst trust creditors?
>
> 3 The issue has been the subject of discussion and of conflicting authorities for almost 40 years since the High Court's decision in *Octavo Investments Pty Ltd v Knight* (1979) 144 CLR 360. For purposes of introduction it is sufficient to say that there appear to

> have been three approaches taken in the authorities: the first exemplified by the decisions of Needham J in *Re Byrne Australia Pty Ltd* [1981] 1 NSWLR 394 and in *Re Byrne Australia Pty Ltd (No 2)* [1981] 2 NSWLR 364; the second exemplified by the decision of the Full Court of the Supreme Court of Victoria in *Re Enhill Pty Ltd* [1983] 1 VR 561; and the third exemplified by the decision of the Full Court of the Supreme Court of South Australia in *Re Suco Gold Pty Ltd (in liq)* (1983) 33 SASR 99. There is no decision of the Full Court of this Court on the subject. Because of the lack of agreement amongst courts of different jurisdictions on the question, it was thought appropriate to hear the matter in the original jurisdiction of the Court sitting as the Full Court.

6 Set in the context of personal bankruptcy, [2] can be re-expressed as follows:

> In circumstances of personal insolvency where the bankrupt was the trustee of a trading trust, how must the trustee in bankruptcy treat the exercise and proceeds of the right of exoneration from assets of the trust? Does the right or do the proceeds form part of the general assets of the bankrupt that are available for the payment of all debts of the bankrupt, including costs and fees of the trustees in bankruptcy according to the regime of the *Bankruptcy Act*? If not, must the right and the proceeds be used only for trust creditors? If so, and notwithstanding that conclusion, does the regime of the *Bankruptcy Act* nevertheless apply to the distribution amongst trust creditors?

7 In short, and oversimplifying matters, the answer given clearly by the High Court was that the correct approach was as set out in *In re Suco Gold Pty Ltd (in liquidation)* (1983) 33 SASR 99. In short, and again oversimplifying matters, the primary judge followed *Re Byrne Australia Pty Ltd* [1981] 1 NSWLR 394 and *Re Byrne Australia Pty Ltd (No 2)* [1981] 2 NSWLR 364.

8 In these reasons, I adopt the nomenclature used by the primary judge in *Lane* and the parties in their submissions. The creditors of Mr Lee whose debts arose in the proper performance by him of his obligations as trustee are referred to by the short-hand expression "trust creditors". The debts owing to "trust creditors" are referred to as "trust debts". Conversely, the creditors whose debts arose in the course of Mr Lee's personal dealings are referred to as "non-trust creditors" and their debts are referred to as "non-trust debts". These terms are merely used as short-hand. I do not wish to suggest that the trust has some independent existence apart from the trustee in whom the trust obligations are imposed. In this respect, I adopt what the primary judge said in *Lane* at 253 FCR 51 [2]:

> It is important to keep steadily in mind that each debt incurred by Mr Lee in his capacity as trustee was one for which he was personally liable. The "trust" is not a legal entity which has rights or to which duties and obligations are owed (*Agricultural Land Management Limited v Jackson (No 2)* (2014) 48 WAR 1 at [302]). It is merely the label given to that bundle of rights and obligations, both personal and proprietary, which constitute the relationship between a beneficiary and a trustee (*Kelly v Mina* [2014] NSWCA 9 at [103]). As a trust has no separate existence, so far as third parties are concerned the trustee's obligations to those parties are not limited in any way by reference to the assets of the trust, save in the case of an express agreement (*Elders Trustee and Executor Company Limited v EG Reeves Pty Ltd* (1987) 78 ALR 193 at

> 253). In the context of the *Bankruptcy Act*, any of the trustee's creditors were entitled to make the application for the sequestration order regardless of whether the debt to them was incurred in the course of the administration of the trust or otherwise.

See also *Jones* 260 FCR at 320 [31] and *Carter Holt* 368 ALR at 401 [24], 416 [82] and 428–429 [129].

Background

9 The Warwick Lee Family **Trust** was established by deed on 11 March 1998. The trustees of the discretionary Trust were Mr Lee and his wife, Mrs Lee, and the objects were Mr Lee, any spouse of Mr Lee, any child of Mr Lee and his or her spouse, and any companies in which a share is held by any of those persons. By December 2012, Mr Lee was the sole trustee of the Trust and has remained so at all relevant times since.

10 Mr Lee as trustee of the Trust operated a Subway franchise business in Queensland until he sold the business in December 2012, with settlement occurring in February 2013. The proceeds of the sale were paid to and held by Mr Lee's solicitors on his behalf as trustee of the Trust. In his capacity as trustee, Mr Lee employed a number of staff at the Subway franchise business. He did not employ anyone in his own individual capacity.

11 On 22 February 2013, Mr Lee presented his own debtor's petition and Mr Lane and Mr Khatri, the first and second respondents (the **Bankruptcy Trustees**), were appointed as the trustees in bankruptcy of his estate.

12 The Bankruptcy Trustees have kept and maintained two separate accounts when administering the bankrupt estate of Mr Lee. One account comprises of the assets of Mr Lee that were held by him in his capacity as trustee and the liabilities incurred by Mr Lee in his capacity as trustee of the Trust (**Trust Estate**). The second account comprises of the personal assets and liabilities of Mr Lee that were held and incurred in Mr Lee's own individual capacity (**Personal Bankrupt Estate**).

13 Following a request from the Bankruptcy Trustees pursuant to Mr Lee's right of indemnity (being his right of exoneration) as trustee, the proceeds from the sale of the Subway franchise business, being $448,659.49, were transferred to the Trust Estate.

14 Pursuant to s 122 of the *Bankruptcy Act*, the Bankruptcy Trustees recovered preference payments from the ATO amounting to $322,447.58. The preference payments had been paid to the ATO to discharge debts incurred by Mr Lee as trustee of the Trust, that is, to the ATO

as a trust creditor. Of this recovered sum, $171,659 was allocated to the Personal Bankrupt Estate because this amount had been previously paid to the ATO by Mr Lee from his personal funds and the Bankruptcy Trustees formed the view that Mr Lee had not lent or gifted this amount to the Trust, and thus the $171,659 was in the nature of the proceeds of the exercise of the right of recoupment for trust debts previously paid from the trustee's (Mr Lee's) personal assets. The remaining $150,788.58 was allocated to the Trust Estate, as that amount had been originally paid to the ATO from Trust funds by way of the exercise of the right of exoneration.

15 As at 31 March 2017, the asset position of the Trust Estate and the Personal Bankrupt Estate was determined by the Bankruptcy Trustees to be $599,782.02 and $183,750.22, respectively.

16 The amounts owed to the three creditors of the Trust Estate amounted to $1,317,165.35. Included in this amount was a claim by the ATO for $128,886.09 in respect of a superannuation guarantee charge (**SGC**) which had arisen in relation to Subway employees employed by Mr Lee as trustee of the Trust (the **SGC claim**).

17 The two other creditors of the Trust Estate, being Janet May Lee and Bevmont Pty Ltd as trustee for the Lee Family Trust, had purported by a deed dated 25 October 2012 to release and discharge Mr Lee personally from all claims in respect of the repayment of money loaned by the creditors to Mr Lee in his capacity as trustee of the Trust.

18 There were also three creditors of the Personal Bankrupt Estate, including the ATO, whose debts totalled $331,654.97. In addition to these creditors, Mr Lee in his personal capacity had purported to borrow money from himself as trustee of the Trust in the amount of $399,720, which amount remained unpaid and not restored to the Trust at the date of his bankruptcy.

19 Having finalised all recovery actions and ascertained all known unsecured creditors, the Bankruptcy Trustees applied to the Court in May 2017 seeking directions pursuant to ss 90-15(1) and 90-20(1)(a) of Schedule 2 of the *Bankruptcy Act*, which affords the Court power to make any order it thinks fit in relation to the administration of a bankrupt's estate. The wide-ranging directions were sought on the basis that, according to the Bankruptcy Trustees' written submissions, "a number of the issues the subject of the directions sought have no direct legal authority that has been located, and others are the subject of conflicting or inconsistent single judge and intermediate appellate decisions". Three of the issues covered by the directions made by the primary judge are the subject of the appeal to this Court.

Issue 1: Whether the priority regime in s 109 applies to the use of the right of exoneration

20 As stated at [16] above, the **Commissioner** of Taxation claims a priority pursuant to s 109(1)(e) of the *Bankruptcy Act* in respect of a SGC debt in the administration of Mr Lee's bankrupt estate. The liability was incurred by Mr Lee in the course of operating his Subway franchise business, in his capacity as trustee of the Trust. The parties agreed that, in accordance with reg 6.02 of the *Bankruptcy Regulations 1966* (Cth), any claimed priority amount under s 109(1)(e) of the *Bankruptcy Act* will be capped at $100,969.52. The balance of the SGC claim is $27,916.57.

21 Sections 108 and 109 of the *Bankruptcy Act* relevantly provide:

> **108 Debts proved to rank equally except as otherwise provided**
>
> Except as otherwise provided by this Act, all debts proved in a bankruptcy rank equally and, if the proceeds of the property of the bankrupt are insufficient to meet them in full, they shall be paid proportionately.
>
> **109 Priority payments**
>
> (1) Subject to this Act, the trustee must, before applying the proceeds of the property of the bankrupt in making any other payments, apply those proceeds in the following order:
>
> …
>
> (e) fifth, in payment of amounts (including amounts payable by way of allowance or reimbursement under a contract of employment or under an industrial instrument, but not including amounts in respect of long service leave, extended leave, annual leave, recreation leave or sick leave), not exceeding in the case of any one employee $1,500 or such greater amount as is prescribed by the regulations for the purposes of this paragraph, due to or in respect of any employee of the bankrupt, whether remunerated by salary, wages, commission or otherwise, in respect of services rendered to or for the bankrupt before the date of the bankruptcy;
>
> …
>
> (1B) The reference in paragraph (1)(e) to amounts due in respect of an employee of the bankrupt includes a reference to amounts due as contributions to a fund for the purposes of making provision for, or obtaining, superannuation benefits for the employee, or for dependants of the employee.
>
> (1C) The reference in paragraph (1)(e) to amounts due to or in respect of any employee of the bankrupt also includes a reference to amounts due as superannuation guarantee charge (within the meaning of the *Superannuation Guarantee (Administration) Act 1992*), or general interest charge in respect of non-payment of the superannuation guarantee charge.
>
> …
>
> (11) Except as provided in paragraph (1)(a), the debts in each of the classes

specified in subsection (1) rank equally between themselves and shall be paid in full unless the proceeds of the property of the bankrupt are insufficient to meet them, in which case they shall be paid proportionately.

(12) In subsection (11), ***debts*** includes liabilities, remuneration, commitments and expenses specified in subsection (1).

The approach of the primary judge

22 The primary judge's directions were relevantly as follows:

> 3. The Applicants are entitled to the following directions:
>
> (a) The proceeds of the sale of the assets of the Warwick Lee Family Trust ("the Funds") in the amount determined in accordance with Order 10, are subject to Mr Lee's right of exoneration out of the trust assets and, subject to the following orders herein, are available to be distributed to trust creditors to the exclusion of non-trust creditors.
>
> (b) The Applicants are entitled to distribute the Funds prior to the payment of any dividend from the bankrupt's estate.
>
> (c) The Commissioner of Taxation is not entitled to priority out of the Funds pursuant to s 109(1)(e) of the Bankruptcy Act 1966 (Cth).
>
> (d) The provisions of ss 108 and 109 of the Bankruptcy Act 1966 (Cth) do not apply in relation to the distribution of the Funds which are to be paid to the trust creditors pari passu. …

23 To understand the primary judge's approach to ss 108 and 109 it is necessary to look first at the part of his Honour's reasons at 253 FCR 57–83 [20]–[102] which dealt with whether the trust funds could be distributed to all creditors or only trust creditors. His Honour commenced that section with a discussion of the statutory regime pursuant to which the issue arises. At 253 FCR 57 [22], the primary judge considered the applicability of cases concerning the cognate insolvency provisions in the relevant companies' legislation:

> … Whilst, in some cases, differences in the various insolvency regimes may provide a legitimate ground for distinguishing certain decisions, the essential issue raised in cases of this ilk, concerns the manner in which a trustee's right of indemnity can be utilised by those responsible for administering the estate or property of the insolvent trustee. Neither the nature of that right nor the manner in which it is held by a trustee, will alter depending upon whether the trustee is an individual or a corporation. On the other hand, the method by which the property of the insolvent trustee might be disposed of under the alternative insolvency regimes may provide some legitimate ground of differentiation. That being so, it is necessary to consider the legislative context in which the assets and rights of the bankrupt are to be administered under the Act.

24 The primary judge then set out s 58 of the *Bankruptcy Act*, which provides for "the property of the bankrupt" to vest in the trustee in bankruptcy at the time the debtor becomes a bankrupt. His Honour set out the definitions of "property" and "the property of the bankrupt" in s 5 of the *Bankruptcy Act*, being:

> ***property*** means real or personal property of every description, whether situate in Australia or elsewhere, and includes any estate, interest or profit, whether present or future, vested or contingent, arising out of or incident to any such real or personal property.
>
> …
>
> ***the property of the bankrupt,*** in relation to a bankrupt means:
>
> (a) Except in subsections 58(3) and (4):
>
> (i) the property divisible among the bankrupt's creditors; and
>
> (ii) any rights and powers in relation to that property that would have been exercisable by the bankrupt if he or she had not become a bankrupt; …

25 The meaning of the phrase "property divisible among the bankrupt's creditors" is explained in s 116 of the *Bankruptcy Act* in the following terms:

> **116 Property divisible among creditors**
>
> (1) Subject to this Act:
>
> (a) all property that belonged to, or was vested in, a bankrupt at the commencement of the bankruptcy, or has been acquired or is acquired by him or her, or has devolved or devolves on him or her, after the commencement of the bankruptcy and before his or her discharge; and
>
> (b) the capacity to exercise, and to take proceedings for exercising all such powers in, over or in respect of property as might have been exercised by the bankrupt for his or her own benefit at the commencement of the bankruptcy or at any time after the commencement of the bankruptcy and before his or her discharge;
>
> …
>
> is property divisible amongst the creditors of the bankrupt.
>
> (2) Subsection (1) does not extend to the following property:
>
> (a) property held by the bankrupt in trust for another person.

26 After setting out ss 108 and 109, the primary judge dealt with the meaning of "proceeds" in ss 108 and 109. His Honour noted that the term should be given its ordinary meaning, being the "sum, amount, or value of land, investments, or goods, etc., sold, or converted into money", citing *Jowitt's Dictionary of English Law* (4th ed) at p 1920. His Honour observed at 253 FCR 59 [30] that the property of the bankrupt vested in the trustee in bankruptcy is not necessarily the property which is distributed to creditors; it is the "proceeds" of the realisation process from which payments are made to creditors under ss 108 and 109. His Honour thus concluded that the "proceeds" used to meet the creditors' claims in accordance with the priority regime are

not equivalent to the property of the bankrupt which vests in the trustee in bankruptcy on the making of a sequestration order. At 253 FCR 59–60 [32], the primary judge accepted (putting to one side some contrary recent authority in *Re Independent Contractor Services (Aust) Pty Ltd (in liq) (No 2)* [2016] NSWSC 106; 305 FLR 222 and *Re Amerind Pty Ltd (receivers and managers appointed) (in liq)* [2017] VSC 127; 320 FLR 118) that the trustee's right of indemnity (relevantly the right of exoneration) fell within the concept of "property divisible amongst the creditors of the bankrupt". His Honour reasoned at 253 FCR 59–60 [32]:

> … The right to be indemnified out of trust assets is personal property, being a right to exercise power with respect to "property" within the meaning of s 116(1)(b) as informed by the definition of s 5. Not insignificantly, there are also a number of authorities which have held that a trustee's right of indemnity is part of a trustee's personal estate which will pass to a bankruptcy trustee in the event of the trustee's insolvency. Some of the more significant are *Savage v Union Bank of Australia Ltd* (1906) 3 CLR 1170 at 1188 and 1196; *Octavo Investments Pty Ltd v Knight* (1979) 144 CLR 360 at 367-368 *(Octavo)* and *Re Suco Gold Pty Ltd (in liq)* (1983) 33 SASR 99 at 102 (*Re Suco Gold*). ...

27 Following a discussion of the nature of the trustee's right of indemnity and the relevant case law, the primary judge turned to the question of whether the right of exoneration could be used to meet non-trust creditors' claims. This involved the consideration of the application of "*the proceeds* of the property of the bankrupt" for the purposes of ss 108 and 109. His Honour stated at 253 FCR 81–82 [95]–[98]:

> 95 … In essence, the right of exoneration is a right of a limited nature and, even when it passes to the bankruptcy trustee, it cannot be exercised other than by causing trust funds to be applied to meet trust debts. In the course of any insolvency administration the external administrator is entitled to exercise the powers of the insolvent trustee to the extent to which they will benefit the estate. That will include the realisation of property where that is possible. The right of exoneration however is not capable of being realised, although it can be used in the administration to cause or require the payment of the debts of the trust creditors. In this respect, the distinction between the concepts in the bankruptcy legislation of "property of the bankrupt which is divisible among the creditors" and of the "proceeds" of the property has to be maintained. It is the "proceeds" of the realisation process which are applied proportionately as required by the operation of s 108 or in the priority dictated by s 109. …
>
> 96 The decision of the High Court in *Octavo* in relation to the provisions of the *Bankruptcy Act* (albeit in a corporate insolvency context) is binding on this Court. That decision concerned whether or not the trustee's right of indemnity was "property divisible amongst the creditors" within the meaning of s 116(1)(a) of the Act. It cannot be seriously doubted that the High Court concluded that the right of indemnity was not a trust asset and was, therefore, property "divisible amongst the creditors". However, the High Court did not suggest that the right of exoneration amounted to "proceeds of property of the bankrupt" which were to be applied as required by ss 108 and 109. In fact, the Court was clear that the right of exoneration was only to be used to meet the claims of the trust creditors who were entitled to be subrogated to the right. That conclusion is entirely consistent with the recognition of the right as a limited right or

> power of the trustee to apply trust funds only for the purpose of discharging trust liabilities. That is so whether it is exercised by the trustee prior to bankruptcy or by the bankruptcy trustees subsequent to a sequestration order being made. The bankrupt, as trustee, had no power, pursuant to that right, to appropriate funds in an amount equal to the liabilities which had been incurred as trustee so as then to be in a position to use them to meet the claims of all creditors. Further, there is nothing in the *Bankruptcy Act* which, upon the making of the sequestration order, transmogrified the right of exoneration into such a right.
>
> 97 It is instructive to consider what the position would be if, shortly prior to bankruptcy, the original trustee was replaced and the new trustee was in possession of the trust assets when the sequestration order was made. In those circumstances the bankruptcy trustees would be required to apply to the court for an order that the trust assets be applied in payment of the trust debts or an order that the new trustee indemnify the former trustee from liability for those debts. If necessary, an order for the judicial sale of some of the trust assets could be made along with an order appointing receivers to carry out the sale. The Bankruptcy Trustees would not be entitled to the payment of an amount of money (see *Lemery Holdings* at [18]). In *Re Pumfrey* it was held that the trustee who seeks to enforce the lien is required to apply to the court for an order to that effect (at 262) (see also *Hewett v Court* (1983) 149 CLR 639 at 663). The equitable lien which arises does not exist to enforce the payment of money to the erstwhile trustee, but to secure the right to have the trust funds applied in discharge of the trust debts. In addition, the trust creditors themselves might seek an order, relying upon their right of subrogation, for payment to them out of the trust assets. That is not something which the Bankruptcy Trustees could oppose.
>
> 98 It follows that even though the right of exoneration is the "property of the bankrupt" of which the bankruptcy trustees took possession, the only use to which it can be put in the course of the administration of the bankruptcy is to discharge liabilities owing to trust creditors. It is not capable of being used to meet the claims of non-trust creditors although they will benefit by having the claims on the remaining property of the bankrupt reduced.

28 At 253 FCR 90–92 [128]–[138], the primary judge considered further the question of whether the priority regime in s 109 applied to the use of the right of exoneration. Drawing on the reasoning set out above, the primary judge stated at 253 FCR 90 [130]:

> … [T]he right of exoneration which vested in the Bankruptcy Trustees **was merely the power to apply, or cause to have applied, trust property to the discharge of trust debts.** It is not property which might be sold so as to produce "proceeds" which can be applied as prescribed by s 109. Nor can it be logically said that the trust funds to be applied to the discharge of the trust debts are, themselves, "proceeds" of the right of indemnity. The trust funds are not derived from the sale or disposal of the right of indemnity. They are, until they are utilised by the exercise of the right of exoneration, trust assets which s 116(2) provides are not within the description of the "property of the bankrupt". It follows that s 109 cannot apply to the exercise of the power of exoneration in the hands of the Bankruptcy Trustees.
>
> (Emphasis added.)

29 The primary judge justified this position by reference to the proposition identified by Farrell J in *Woodgate, in the matter of Bell Hire Services Pty Ltd (in liq)* [2016] FCA 1583 at [37] to the effect that the right of exoneration is merely a limited right to pay trust debts from property

which is not owned by the trustee: namely, the trust funds. Once that point is realised, the primary judge reasoned at 253 FCR 91 [132]: "it follows that the payment to the trust creditors is not a payment from the property of the company as is contemplated by ss 555 and 556 of the *Corporations Act"*.

30 At 253 FCR 91 [133]–[134] of his reasons, the primary judge addressed the position under the *Corporations Act 2001* (Cth), commenting in particular on the decision of the Full Court of the Supreme Court of South Australia in *In re Suco Gold*:

> 133 The determination in *Re Suco Gold* that the priority provisions applied in respect of the discharging of trust creditor's claims by use of the right of exoneration, has not enjoyed widespread support. On occasion it has been suggested that such a principle would only apply where the trustee company acted solely as trustee and had no other liabilities of its own (see the analysis of Campbell J in *Re French Caledonia Travel Service Pty Ltd (in liq)* (2003) 59 NSWLR 361 at [194]-[217], although that approach was rightly questioned by Riordan J in *Freelance Global Ltd (in liq) v Bensted* [2016] VSC 181 at [82]).
>
> 134 In the Full Court of this Court in *Bruton Holdings Pty Ltd (in liq) v Federal Commissioner of Taxation* (2011) 193 FCR 442 at [27], it was observed, in the context of the liquidation of a corporate trustee, that the suggestion that the priority provisions would govern the distribution of trust assets where the assets were insufficient to meet the claims of all trust creditors was somewhat difficult. Indeed, it appears that there is good reason for accepting the view that the priority provisions (of either the *Corporations Act* or the *Bankruptcy Act*) only apply to the distribution of "proceeds" of the assets which are beneficially owned by the insolvent trustee (see *Jacobs' Law of Trusts in Australia* (8th ed, LexisNexis Butterworths, Australia, 2016) at [21.15]; McPherson J, "The Insolvent Trading Trust" in Finn PD (ed), *Essays in Equity*, 142 at 154; *Lerinda Pty Ltd v Laertes Investments Pty Ltd* [2010] 2 Qd R 312 at [14]; *Re Stansfield DIY Wealth Pty Ltd (in liq)* (2014) 291 FLR 17 at [29]). However, it must be acknowledged that the provisions of ss 555 and 556 of the *Corporations Act* do not expressly identify that what is distributed by the force of those sections are the "proceeds" of the property of the company. The provisions of ss 108 and 109 of the *Bankruptcy Act* are more explicit and easily allow for the conclusion that property which cannot be turned into proceeds is not within their scope. Nevertheless, it would appear that ss 555 and 556 do contemplate the payment of debts by use of the company's property. That can only occur if that property is realised by sale or otherwise and "proceeds", in the form of money, are produced. It would seem to follow that if the property in question was not capable of being realised, it would not be within the scope of ss 555 and 556. A trustee's right of exoneration is such property.

31 In the course of this discussion, the primary judge noted at 253 FCR 90 [131] and 91–92 [135] the approaches taken by Brereton J in *Re Independent Contractor Services* and by Robson J in *Re Amerind*, both of whom held that the right of exoneration was trust property and the priority provisions did not apply; the provisions were only applicable to the distribution of assets which were beneficially owned by the insolvent trustee and available for division between its general

creditors. Rejecting (correctly) the approach taken in these decisions, the primary judge stated at 253 FCR 92 [136]:

> A crucial, albeit implicit, foundation of the decisions in *Independent Contractor Services* and *Amerind*, is that the decision of the High Court in *Octavo* does not preclude the conclusion that a trustee's right of indemnity is "trust property", as opposed to property of the company. As the passages from *Octavo* which have been cited earlier in these reasons reveal, that is not terribly easy to sustain. When the majority of the High Court in *Octavo* identified (at the top of p 370) that the trustee's right of exoneration "will pass to the trustee in bankruptcy for the benefit of creditors of the trust trading operation", they could not have meant anything other than that the right was property divisible amongst the creditors of the bankrupt and, therefore, not trust property. If the right of exoneration were trust property, it would not pass to the trustee in bankruptcy. It is, with respect, sufficiently clear that the High Court accepted that as the right of exoneration is exercisable for the purposes of relieving the personal liability of the trustee, it is not held solely for the interests of the beneficiaries and, therefore, it is not properly characterised as "trust property". As that decision concerned the construction of the *Bankruptcy Act,* this court is bound by it in relation to the matters under consideration.

32 The primary judge concluded the portion of his reasons on this issue at 253 FCR 92 [137] with the following summary:

> The only conclusion which is open is that although the right of exoneration is not trust property and it passes to the bankruptcy trustee on the making of the sequestration, it can only be used in the administration of the bankrupt's estate by requiring the discharge of the debts owing to the trust creditors to be paid from the trust funds. Moreover, regardless of what the position might be in the corporate insolvency context pursuant to ss 555 and 556 of the *Corporations Act*, under the Act the priority provisions of ss 108 and 109 apply only to the "proceeds of the property of the bankrupt". The right of exoneration is incapable of producing "proceeds" within the meaning of those sections such that, whilst it may be property of the bankrupt, it is not property which is capable of being turned into "proceeds" for distribution pursuant to ss 108 and 109 of the Act.

33 Thus, the primary judge concluded that although the right of exoneration was property of the bankrupt, it was a mere power to use trust assets to direct the use and payment of trust property to trust creditors, and so there were no proceeds of its exercise that could amount to property of the bankrupt for the purposes of ss 108 and 109.

The appeal

34 The first ground in the amended notice of appeal stated:

> 3. His Honour erred in holding that ss108 and 109 of the *Bankruptcy Act* 1966 (Cth) (**the Act**) did not apply to the distribution of the proceeds of the sale of the assets ("the Funds" as defined in Order 3(a) of the Orders of 19 September 2017) of the Warwick Lee Family Trust ("the Trust") because the bankrupt's right of exoneration was not capable of being realised so as to create proceeds of the property of the bankrupt within the meaning of those provisions.

4. His Honour should have held that:

(a) because the trust liabilities exceeded the trust assets, the bankrupt as trustee of the Trust was beneficially entitled to the whole of the trust estate;

(b) the bankrupt's right of exoneration and his proprietary interest, alternatively, beneficial interest in the assets of the Trust, generated by his right of exoneration, vested in the trustees in bankruptcy pursuant to s 58 of the Act;

(c) the proceeds of the property of the bankrupt, comprising the Funds, should be applied in accordance with ss 108 & 109 of the Act for the benefit of the trust creditors of the bankrupt; and

(d) further or alternatively to paragraphs (a) to (c), if the bankrupt's interest, alternatively, beneficial interest in the assets of the Trust did not vest in the trustees in bankruptcy pursuant to s 58 of the Act, the bankrupt's right of exoneration did so vest, and the Funds were proceeds of the property of the bankrupt within the meaning of ss 108 and 109 of the Act, to be distributed in accordance with those provisions for the benefit of the trust creditors of the bankrupt.

35 Both the appellant and the first and second respondents to this appeal submitted that the primary judge's finding in respect of this issue cannot stand in the light of the recent decisions of the High Court in *Carter Holt* and *Boensch v Pascoe* [2019] HCA 49; 375 ALR 15. With the utmost respect to the primary judge, for the reasons that follow, the parties were correct in that submission.

The High Court decision of Carter Holt

36 The decision of the High Court in *Carter Holt* was an appeal from the decision of the Victorian Court of Appeal, on appeal from the decision of Robson J in the Supreme Court of Victoria in *Re Amerind*, which was discussed in some detail by the primary judge in *Lane*. The case concerned the affairs of a company, **Amerind** Pty Ltd, which carried on a business as the trustee of a trading trust and, to that effect, had granted a general security deed under which a bank provided credit. The security expressly (and validly) covered trust assets. In 2014, Amerind's sole director appointed administrators to the company and, on the same day, the bank terminated all facilities and appointed receivers. The receivers realised all of the assets of the trust and out of the proceeds satisfied Amerind's obligations to the bank. After provision for their own remuneration, the receivers had a surplus of distribution to creditors of $1,619,018, being the proceeds of realisation of inventory. The Commonwealth claimed that it was entitled to be paid out of the receivership surplus for advanced accrued wages and entitlements paid to Amerind's former employees, pursuant to ss 433(3), 556(1)(e) and 560 of

the *Corporations Act*, in priority to other creditors, including the appellant **Carter Holt** Harvey Woodproducts Australia Pty Ltd.

37 Section 433 provides that where a receiver is appointed on behalf of the holder of debentures of a company, the receiver must pay out of the property coming into his, her or its hands particular debts or amounts listed in s 433(3) in priority to any claim for principal or interest in respect of the debentures. Included in the priority debts or amounts listed in subs (3) is "any debt or amount that in a winding up is payable in priority to other unsecured debts pursuant to paragraph 556(1)(e), (g) or (h) or section 560". These sections give priority to certain claims, including claims by employees and by those who advance funds on behalf of the employer to meet them (here, the Commonwealth).

38 The primary judge in *Re Amerind* had held that the receivers were not in possession of "property of the company" within the meaning of s 433(3) because the right of indemnity (the right of exoneration) in respect of the trust liabilities, held by the trustee company, was not personal property of the trustee, but rather held on trust for the trust creditors. Alternatively, the primary judge reasoned, even if the right of indemnity were property of the company, it was not comprised in or subject to the circulating security interest, such that s 433 was not engaged.

39 The Court of Appeal upheld the Commonwealth's appeal, finding that Amerind's right to be indemnified out of the assets of the trust was "property of the company" and it necessarily followed that ss 433, 555 and 556 applied. The Court of Appeal further held that because the deed created a circulating security interest in the proceeds of realisation of the inventory, it was unnecessary to decide whether the deed created a circulating security interest in the company's right of indemnity. It was enough that s 433(3) operated according to its terms to require the receivers to pay out of the proceeds of realisation to the inventory the claims provided for in s 556(1)(e), (g) and (h), in priority to any claim for principal or interest. Importantly, though the Court of Appeal decided (correctly) that the right of exoneration was property of the company, it was not necessary to decide whether *Re Enhill Pty Ltd* [1983] 1 VR 561 or *In re Suco Gold* was correct. The debate between those two cases concerned whether the proceeds of the exercise of the right of exoneration were available to pay all creditors (trust and general) or only trust creditors. Both *Re Enhill* and *In re Suco Gold* held that the statutory order of priority applied, but for fundamentally different reasons.

40 Although the appeal to the High Court was dismissed unanimously, the Court provided three sets of reasons written by a (first) plurality consisting of Kiefel CJ, Keane and Edelman JJ, by a (second) plurality of Bell, Gageler and Nettle JJ, and by Gordon J, who agreed with the second plurality (at [106]), but who provided additional reasons. It is thus appropriate to deal with the reasons of the second plurality and of Gordon J, before dealing with the reasons of the first plurality.

The second plurality

41 The reasons of the second plurality, with which Gordon J agreed, commence at 368 ALR 411 [60]. After setting out the factual background and relevant statutory provisions, the second plurality at 368 ALR 415–417 [80]–[84] discussed the nature of the right of indemnity, emphasising that the right conferred on the trustee a beneficial interest in the trust assets:

> 80 A corporate trustee's right to be indemnified out of the assets of the trust confers "property" for the purposes of the Corporations Act. As was stated by the plurality in *Octavo Investments*, although a trustee who enters into business transactions as trustee is personally liable for debts incurred in the course of those transactions, the trustee is entitled to be indemnified (whether by recoupment or exoneration) out of the trust assets against such liabilities, and thus enjoys a beneficial interest in those assets. The corollary, as was stated unanimously in *Chief Commissioner of Stamp Duties (NSW) v Buckle*, is that the trustee does not hold the trust assets solely for the benefit of the beneficiaries to the extent of that right of indemnity.
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> 81 The idea of a trustee's right of indemnity conferring a beneficial interest in the trust assets has been criticised. Professor Ford, for example, argued that a trustee's right of exoneration, being limited to the discharge of trust liabilities, should properly be characterised as conferring a personal power, not property within the meaning of s 5(1) of the Bankruptcy Act 1966 (Cth). But criticism of that kind is misplaced. It is apt to distract attention from the practical relationship between the trustee's equitable right of indemnity and legal powers of ownership.
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> 82 As has been understood at least since Maitland's explication of the trust, a trustee as legal owner of the trust assets has all the powers incidental to ownership subject only to the power of the beneficiaries to compel the trustee to exercise the trustee's powers in accordance with the terms of trust. Inasmuch as a court of equity will aid the beneficiaries in the enforcement of the terms of trust, the beneficiaries are described, especially in revenue contexts, as having a beneficial interest in, or occasionally even beneficial ownership of, the trust assets. The beneficiaries' interest is not, however, to be conceived of as cut out of the trustee's legal estate but rather as engrafted onto it as a restriction on the manner in which the trustee may deal with trust assets.
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> 83 The trustee also has a right to be indemnified out of the trust assets in respect of liabilities properly incurred in the execution of the trust, which takes priority over the beneficiaries' claim on the trust assets. Until that right has been satisfied, the beneficiaries cannot compel the trustee to exercise the trustee's powers as legal owner of the trust assets for their benefit. A court of equity will assist the trustee to realise trust assets to satisfy the trustee's right of indemnity, in priority to the beneficiaries' interests, and thus it is said that the trustee has an equitable charge or lien over the trust assets. It is not, however, a charge or lien comparable to a synallagmatic security

> interest over property of another. It arises endogenously as an incident of the office of trustee in respect of the trust assets.
>
> 84 Possibly, the trustee's right of indemnity could be as well described as conferring a personal power (as Professor Ford argued it should be) as a proprietary interest. But the choice of description should conform to, rather than dictate, the application of fundamental principles to "solving a concrete legal problem". The trustee's right to apply trust assets in satisfaction of trust liabilities is proprietary in that it may be exercised in priority to the beneficial interests of the beneficiaries. To describe it as constituting a beneficial interest in the trust assets, and so as property, thus acknowledges the characteristic blending of personal rights and obligations with proprietary interests which is the "genius" of the trust institution. Such a beneficial interest falls naturally and ordinarily within the definition of "property" in s 9 of the Corporations Act.
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> (Footnotes omitted.)

42 The second plurality then at 368 ALR 417–418 [85]–[87] commented upon the meaning of "property of the company" under s 433, emphasising that it was a mistake to focus only upon the right of indemnity as property. The right of indemnity was not the property within the reach of s 433, but rather it conferred or generated a proprietary interest in the inventory (the so-called trust assets) which was covered by the circulating security interest. At 368 ALR 417–418 [85]–[86], the second plurality stated:

> 85 In several of the authorities, and thus in the proceedings below, the property of a trustee available for the payment of creditors in the event of insolvency is described as being the right of indemnity. That is so in the sense that the trustee's right of indemnity confers a beneficial interest in the trust assets. As this case demonstrates, however, it is necessary to keep in mind that the property constituted of the right of indemnity as such and the property constituted of the trust assets themselves are separate and distinct, albeit that the former confers a proprietary interest in the latter. Failure to bear that in mind is liable to result in the misconception at which the primary judge arrived, and which was perpetuated in the appellant's submissions before this Court, that, because Amerind's right of indemnity as such was not property that was subject to a circulating security interest, s 433 did not apply.
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> 86 In s 433(3) of the Corporations Act, the property of which the receiver takes possession or assumes control and out of which the receiver is required to pay the specified liabilities is the "property comprised in or subject to [the] circulating security interest", granted by a company, pursuant to which the receiver is appointed. Amerind's right of indemnity was not "property [of the company] comprised in or subject to a circulating security interest" granted by Amerind. In the absence of any suggestion that the Bank gave Amerind express or implied authority to transfer Amerind's right of indemnity in the ordinary course of business, it was not a "circulating asset" within the meaning of s 340 of the PPSA and thus any security over it was not a "circulating security interest" as defined in s 51C of the Corporations Act. The property "coming into [the receivers'] hands", and out of which they were to pay the priority "debts or amounts", did not include the right of indemnity itself. Nor was it the case, as the Court of Appeal reasoned might be possible, that the character of the trust assets automatically flowed through to the right of indemnity and so brought the right of indemnity within the reach of s 433. It was the inventory itself which was the circulating asset the subject of a circulating security interest (created by cl 2.1 of the

> Deed), pursuant to which the receivers were appointed, which attracted the operation of s 433.
>
> (Footnotes omitted.)

43 These passages are important. The right of indemnity (including the right of exoneration) confers a beneficial interest in the trust assets. So, when the right is exercised and the assets sold, the beneficial interest in the trust assets is converted into proceeds that are the property of the company (though with the character of use dictated by their legal source).

44 At 368 ALR 418–419 [88]–[90], the second plurality identified the amounts that would be payable by priority in a winding up under s 555 and s 556, concluding at 368 ALR 419 [90]:

> In the winding up of a corporate trustee, the "property of the company" that is available for the payment of creditors includes so much of the trust assets as the company is entitled, in exercise of the company's right of indemnity as trustee, to apply in satisfaction of the claims of trust creditors. Thus, in this case, where the liabilities identified in s 556(1)(e) were trust liabilities, the "property of the company" that would have been available for the payment of creditors in the event of a winding up would have been so much of the trust assets as would be sufficient to pay or satisfy the claims of trust creditors. Because the trust assets were inventory, rather than money or an equivalent, and there was a deficiency, the whole of the receivership surplus was to be applied to priority "debts" and "amounts".

45 In analysing how the proceeds from the exercise of the right of exoneration may be used, the second plurality approved the decision of *In re Suco Gold* which held that the proceeds from the exercise of the right of exoneration could only be used to pay trust debts. In doing so, the second plurality concluded that the decision of the Full Court of the Supreme Court of Victoria in *Re Enhill* was wrongly decided. In that decision Young CJ and Lush J (Gray J agreeing with both judgments) held that the proceeds from the sale of trust assets brought about by the exercise of the right of exoneration could be used to discharge all debts of the insolvent company and not merely those debts incurred in the course of performance of the trust duties. The following important passage in King CJ's judgment in *In re Suco Gold* 33 SASR at 107–108, explaining why *Re Enhill* was wrong, was set out and approved by the second plurality *in extenso* at 368 ALR 420 [92]:

> [T]he right of indemnity can only produce proceeds for division among the creditors generally if the trustee has discharged the liabilities incurred in the performance of the trust and is therefore entitled to recoup himself out of the trust property. If he has not discharged the liabilities, the right of indemnity entitles him to resort to the trust property only for the purpose of discharging those liabilities. He may apply the trust moneys directly to the payment of the trust creditors or he may take it into his own possession for that purpose. *If he takes trust property into his possession to satisfy his right to be indemnified in respect of unpaid trust liabilities, ... that property retains its character as trust property and may be used only for the purpose of discharging the liabilities incurred in the performance of the trust.* The exercise of the right of

> indemnity is for the benefit of the trustee in that it relieves him of liability for the trust debts. If the trustee is bankrupt, or being a company is in liquidation, the trustee in bankruptcy or liquidator can exercise the right of indemnity which vests in him as part of the property of the bankrupt or insolvent company. If the trust liabilities have been discharged, the trustee in bankruptcy or liquidator is entitled to recoup the bankrupt estate out of the trust property and the proceeds of the right of indemnity become part of the property divisible among the creditors. If the liabilities have not been discharged, *the trustee in bankruptcy or liquidator may, by reason of the right of indemnity which vests in him, apply the trust property to the payment of the trust liabilities*, thereby exonerating the bankrupt estate to the extent of the value of the available trust assets. In the latter circumstances there cannot be proceeds of the right of indemnity which are available for distribution among the general body of creditors.
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> (Emphasis added by the second plurality.)

46 The second plurality then addressed the question of priorities, by reference to the statute. Their Honours held at 368 ALR 420–421 [93] that it was wrong to presuppose that s 556 cannot apply in terms to the proceeds of realisation of the right of exoneration. At 368 ALR 421–422 [94]–[95], the second plurality stated:

> 94 From the outset, courts of equity construed the earliest bankruptcy statutes according to a presumption that assignees in bankruptcy, who were considered as volunteers, took subject to equities. To avoid circuity of action, courts of law went further, by holding that property the subject of a trust or assignment would not pass at all – unless the bankrupt had even "the most remote possibility of interest" in the property. Consistently with this history, the reference to property "held by the bankrupt in trust" in successors to s 15(1) of the Bankruptcy Act 1869 (32 & 33 Vict c 71), such as s 116(2) of the Bankruptcy Act 1966, is understood to mean held on trust *solely* for another person. Accordingly, where a trustee in bankruptcy or other administrator assumes control of the property of a bankrupt, the trustee in bankruptcy or assignee takes the bankrupt's property subject to equities, but otherwise as property divisible amongst creditors. That allows for the payment of creditors out of property held on trust to the extent that the bankrupt has a beneficial interest in the trust assets, and thus to the extent of the bankrupt's right of indemnity.
>
> 95 The position under the Corporations Act is comparable. The liquidator of a company assumes control of the company's assets subject to equities, and, accordingly, must deal with assets held by the company as trustee in accordance with the terms of trust. But to the extent that the company has a beneficial interest in the trust assets, as it has by reason of the company's right of indemnity in respect of properly incurred trust obligations, the trust assets are property of the company available for the payment of creditors. In *Re Suco Gold*, King CJ articulated the point thus:
>
> > The liquidator is bound by the provisions of s 292 [of the Companies Act, now s 556 of the Corporations Act] with respect to the payment of the company's debts. He must therefore endeavour to pay the debts in accordance with the order of priority set out in that section. To the extent that each priority debt has been incurred in the performance of a particular trust he should have recourse to the property of that trust for the purpose of paying it. If there is a residue of assets of a particular trust after payment of the priority debts incurred in the performance of that trust, that residue should be applied to the payment of the other debts applicable to that trust. If there is a deficiency in the assets of a particular trust, the non-priority debts applicable to that trust would have to rank *pari passu*. The unpaid balance would, of course, rank for dividend out

of the general assets of the company.

(Emphasis in original.)

47 The second plurality observed at 368 ALR 422 [96] that there is "therefore no reason in principle or by reference to text or context why the statutory order of priorities should not be followed in the distribution of the proceeds of the trustee's right of indemnity among trust creditors". The words of s 556 are ample and were a re-enactment of s 292 of the *Companies Act* after *In re Suco Gold* and its "general acceptance": 368 ALR 422 [96].

48 At 368 ALR 422 [97], the second plurality addressed the question (particularly relevant for the second issue in this appeal) of how one dealt with the circumstances of more than one trust or a trust and a general estate:

> Complications may arise in cases where a corporate trustee has carried on business as trustee of more than one trust or as trustee of a trust and on its own account. But the solution proposed by King CJ — of construing s 556 in such circumstances as if the liquidator of the corporate trustee held separate funds, each for a different group of creditors — coheres to the law of trusts and has common sense to commend it. It may not provide the whole of the answer where, for example, expenses, such as the wages and salaries of employees, have been incurred by a company partially on one account and partially on another. But as experience shows, situations of that kind are not insuperable. As Allsop CJ concluded in *Jones* [citing [108] of *Jones*], they fall to be resolved by the application of principle to the text of the legislation in the particular circumstances of each case.
>
> (Footnotes omitted.)

Justice Gordon

49 The concurring reasons of Gordon J also emphasised that it was wrong to view the right of exoneration as only giving a right to apply trust assets to pay trust debts. The right gives rise to a proprietary interest in the trust assets, one that is the company's interest but which is shaped by its purposes and origins in the trust relationship – to pay trust creditors. The lien or charge created by the right was not a security interest over the interests of the beneficiaries, but a prior interest in the fund: 368 ALR 430 [134] and 431–432 [139]. Gordon J noted at 368 ALR 430–431 [135]–[138] that this proprietary character of the lien or charge generated by the right of exoneration is consistent with the decisions of the High Court in *Octavo Investments Proprietary Limited v Knight* [1979] HCA 61; 144 CLR 360, *Chief Commissioner of Stamp Duties for New South Wales v Buckle* [1998] HCA 4; 192 CLR 226, *CPT Custodian Pty Ltd v Commissioner of State Revenue of the State of Victoria* [2005] HCA 53; 224 CLR 98 and *Bruton Holdings Pty Ltd (in liquidation) v Commissioner of Taxation of the Commonwealth of Australia* [2009] HCA 32; 239 CLR 346. At 368 ALR 432 [140], Gordon J highlighted the

imprecision in describing the right of exoneration as the proprietary interest. This, her Honour said, had contributed to the confusion. The proprietary interest is not the right of exoneration, but the proprietary interest by way of lien or charge in the property the subject of the trust that is generated by the right of exoneration. To call the right of exoneration a proprietary interest was to confuse the source of the proprietary interest with the interest itself: 368 ALR 432 [141]–[143]. One can see clearly in her Honour's reasons and in the reasons of the second plurality that the exercise of the right of exoneration and the sale of so-called trust property (in which the trustee had a proprietary interest of its own) produced proceeds of sale in which the trustee had a personal interest; but that personal interest in the assets and the proceeds of sale could only be used to pay trust creditors because of the limitation on the character of that proprietary interest and of the limitation on the trustee personally, not because it was just moving trust property from the company and the administration to trust creditors.

50 Finally, I note 368 ALR 438 [173]–[174] of her Honour's reasons which dealt with a submission of Carter Holt concerning consistency between the *Bankruptcy Act* and the *Corporations Act*:

> 173 At the hearing of the appeal, the appellant submitted that if s 433 of the Corporations Act were found to apply to proceeds of the trustee's right of exoneration, this would create a distinction between the treatment of a corporate trustee in insolvency and a trustee in bankruptcy. The appellant contended that, given trust property could not be applied to meet the debts of a bankrupt, then the same approach should apply in relation to a corporate trustee. That contention should not be accepted. The right of exoneration and the proprietary interest generated in the fund means that the "trust property" in which the trustee has an interest ceases to be aptly described as property "held on trust" but instead is property of the trustee subject to limitations as to use. So much was made clear in *Buckle*.
>
> 174 It follows that there is no apparent inconsistency between the corporate insolvency priority regime and s 116(2)(a) of the Bankruptcy Act 1966 (Cth), which provides that property held by a bankrupt in trust for another person is not property divisible amongst the creditors of the bankrupt. In *Lane v Federal Commissioner of Taxation*, Derrington J held that money to be paid from trust assets to trust creditors could not be characterised as "proceeds" within the scope of the phrase "proceeds of the property of the bankrupt" as that phrase is used in ss 108 and 109(1) of the Bankruptcy Act. That conclusion is wrong.
>
> (Footnotes omitted.)

51 With respect, this passage neatly encapsulates the error of the primary judge. The right of exoneration creates an interest in the property which is not aptly called property held on trust for the beneficiaries, but property held by the trustee in which it has a personal interest and otherwise in respect of which it has limitations as to use by reason of the equitable obligations upon the trustee owed to the beneficiaries. See also in this regard 368 ALR 416 [82] in the

reasons of the second plurality. The exercise of the right of exoneration brings about the sale of the property. The personal proprietary interest of the trustee is transformed by the sale into proceeds of the company, which is constrained in its use in like fashion. The nature of this is best seen in the way Gordon J put the matter at 368 ALR 430 [133]–[135], 434 [153]–[154] and 434 [156]:

> 133 Allsop CJ, in *Jones*, addressed the right of indemnity in the form of exoneration. Allsop CJ's description was rightly accepted by the appellant. His Honour confirmed that the right of exoneration generates a proprietary interest on the part of the trustee in the trust fund as follows:
>
> > [T]he right (in a sense personal in that it was distinct from and superior to the interests of cestuis que trust) of the trustee to use trust assets to exonerate itself arises to meet a trust liability, and can be exercised only for that purpose. *The property in the hands of the trustee remains trust property, but subject to the trustee's proprietary interest that exists for the purpose of paying the creditors. The property is not held on trust for the beneficiaries alone; the proprietary interest of the trustee is preferential to the interests of the beneficiaries, but that interest of the trustee is shaped by its purpose and origins in the trust relationship — to pay trust creditors in order to exonerate itself from those debts.* The character and limits of the interest are shaped by its purpose and origins. The obligation of the trustee to use the trust assets to pay trust creditors is reflected by, and provides the foundation for, the creditors' right of subrogation. (Emphasis added by Gordon J.)
>
> 134 The principle that the right of exoneration generates an equitable interest in the trust fund that is proprietary in nature was subsequently restated by Allsop CJ in the same decision as follows:
>
> > Thus, in one sense, *what exists can be seen to be an equitable proprietary interest or charge or lien in or over trust assets; but any enforcement by a Court of Equity is not of a security interest or a right created over the interests of the beneficiaries, but rather the enforcement by a Court of Equity of a prior proprietary interest in the trust fund to support the right of indemnity*. (Emphasis added by Gordon J.)
>
> 135 The approach of Allsop CJ to the right of exoneration, and, in particular, his explanation that the right of exoneration generates a proprietary interest in the trust fund, was consistent with a number of decisions of this Court.
>
> …
>
> 153 The Commonwealth's alternative contention was that s 433 operated on Amerind's interest in the receivership surplus, but did not alter the limitations of that interest. Thus, the assets were *only available to be applied by the receivers to meet trust debts,* but only in accordance with the priority rules mandated by s 433 (and in relation to liquidators, s 561). This approach was consistent with the decisions in *Re Suco Gold* and of Allsop CJ in *Jones*.
>
> 154 The Commonwealth's alternative contention should be accepted.
>
> …
>
> 156 In the case of a right of *exoneration*, the proprietary interest of the trustee in the

> trust fund is shaped by its purpose and origins in the trust relationship — to pay trust creditors in order for the trustee to exonerate itself from those debts. Circulating assets which are the subject of the right of exoneration can *only be applied to satisfy trust debts* and are not available for distribution to creditors generally. However, that limitation does not preclude the application of the relevant statutory priority rules — here, s 433.
>
> (Emphasis in original. Footnotes omitted.)

52 Relevant to the second question, I have already referred to 368 ALR 422 [97] of the second plurality's reasons that addressed multiple funds. Justice Gordon addressed the same topic at 368 ALR 435–436 [159]–[166]:

> 159 The appellant contended that difficulties that could arise in the case of an insolvent corporate trustee of multiple trusts constituted a "powerful indication" as to why the construction of s 433 which has been adopted was not consistent with the statutory scheme, given that s 555 mandates equal treatment of debts and claims unless otherwise provided. That contention is rejected.
>
> 160 In accordance with the earlier legal principles, a receiver or liquidator of an insolvent corporate trustee of multiple trusts should be viewed as holding multiple funds, each directed to different groups of creditors. If Amerind had been a trustee of multiple trusts, s 433 (or s 561) would then have applied, in its terms, to each fund separately, to the extent that the fund constituted circulating assets.
>
> 161 That approach follows from the fact that, as has been seen, there is an inherent limitation on the proprietary rights of the trustee in a trust fund. The funds can only be applied to satisfy debts incurred to creditors of the relevant trust. As just seen, there is nothing in the text of s 433 (read with s 9) that suggests that s 433 intends to sweep away the limitations and attributes of each proprietary interest of the trustee in each trust fund.
>
> 162 Put in different terms, where the trustee is a trustee of multiple trusts, the attributes of the trustee's proprietary interests require that s 433 be applied separately to each fund because s 433 does not alter the nature of the assets such that the funds can be mixed and applied to meet the claims of non-trust creditors.
>
> 163 Of course, it must be accepted that that approach may lead to practical difficulties and expense. In such a case, equity may need to fill the vacuum left by the failure of the statute to deal expressly with multiple trust funds. An available mechanism is for a receiver to apply under s 424 of the Corporations Act, or a liquidator to apply under s 90-15 of Sch 2 to the Corporations Act ("the Insolvency Practice Schedule"), for directions from the court to seek to resolve any issues in relation to allocation between multiple trusts. What will be appropriate will vary from case to case. Hotchpot (like marshalling) is one possibility; an illustration of the maxim that equity is equality.
>
> 164 Indeed, Allsop CJ referred to the possibility of a liquidator or receiver applying the principles of hotchpot to multiple funds in *Jones*, by reference to the approach of King CJ in *Re Suco Gold*, which is discussed shortly. In *Jones*, Allsop CJ stated that:
>
> > Complexities may arise in circumstances of multiple trusts or of trusts and activity on the corporation's own account. *Considerations of, or akin to, marshalling or hotchpot may be relevant as to the payment of debts dealt with in the statutory order.* But these complexities will be resolved by application of principle and the text of the legislation, in a manner reflected by the

approach of King CJ in *Re Suco Gold*. (Emphasis added by Gordon J.)

> 165 His Honour's suggestion should be adopted in the context of the application of s 433 to a trustee of multiple trusts — the trust funds should be kept separate and, where this causes practical difficulties or expense, the receiver or liquidator can apply to the court for directions. That is, equity can fill the vacuum.
>
> 166 Notably, the statutory framework for a liquidator to apply for directions has changed. Prior to its repeal and the enactment of the Insolvency Practice Schedule, s 479(3) of the Corporations Act allowed a liquidator to apply to the court for directions in relation to a matter arising under a winding up. Section 90-15(1) of the Insolvency Practice Schedule now provides a source of power for the court to provide directions to liquidators, and relevantly provides that the court may make "such orders as it thinks fit" in relation to the "external administration" of a company.
>
> (Footnotes omitted.)

53 It is central to the resolution of the first issue and highly relevant to the resolution of the second issue to appreciate an essential aspect of the reasons of the second plurality and Gordon J. The beneficial interest or ownership of the beneficiaries in the trust property (in which property the trustee has its own personal proprietary interest) is not to be seen as otherwise cut out of what is the trustee's ownership, but is engrafted on to it as a restriction (a fundamental one) as to use based on personal obligation. That this in some contexts permits the expression and conceptualisation of the matter in terms of beneficial interest of those for whom the property is held (the interest of the beneficiaries in trust assets) does not diminish the fundamental character of the ownership by the trustee: "as legal owner of the trust assets [having] all the powers incidental to ownership subject only to the power of the beneficiaries to compel the trustee to exercise the trustee's powers in accordance with the terms of the trust": the second plurality at 368 ALR 416 [82]. The cases cited by the second plurality at footnote 105 illuminate both the essential principle, and the duality of the personal and the proprietary within the institution of the trust. The first reference was to the illuminating and enduring reasons of Hope JA (with which Glass JA "fully concurred") in *DKLR Holding Co (No 2) Pty Ltd v Commissioner of Stamp Duties* [1980] 1 NSWLR 510 at 518–519. There Hope JA referred to the discussion in Jacobs KS, *Jacobs' Law of Trusts in New South Wales* (3rd ed, Butterworths, 1971) at p 109 as to the essential element of the trust being the personal obligation annexed to property:

> … 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. …

54 The consequence of this (as recognised by Brennan CJ, Toohey, Gaudron, McHugh and Gummow JJ in *Buckle* at 192 CLR 242 [37] and by Gleeson CJ, Gummow, Hayne, Callinan and Heydon JJ in *Commissioner of Taxation of the Commonwealth of Australia v Linter Textiles Australia Ltd (in liquidation)* [2005] HCA 20; 220 CLR 592 at 606 [30]) was then described by Hope JA at [1980] 1 NSWLR 519:

> … [A]n 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. … [A]lthough the equitable estate is an interest in property, its essential character still bears the stamp which its origin places on 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 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."

55 So, when exercising the right of exoneration by selling the property subject to the trust, the trustee is dealing with property it legally owns in which it has a personal proprietary interest and annexed to which property or in which property the beneficiaries have the benefit of the annexed obligation of the trustee to deal with the property in accordance thereafter with the terms of the trust. So, the trustee may take the proceeds of the sale representing its interest as its property. The character of the property, however, is stamped with its origins in the trust relationship, to be used to exonerate the trustee from trust debts, by payment to trust creditors, and the trustee is under a personal obligation to pay the proceeds to trust creditors. The so-called trust creditors, payment to whom is stamped on the character of the property, do not have any equitable or proprietary or secured right to such proceeds. They are not beneficiaries entitled to property in the trust funds to be paid to them; nor do they have a security interest in the property, though upon the bankruptcy of the trustee they will be subrogated to the beneficial interest enjoyed by the trustee: *Octavo Investments* at 144 CLR 367. They receive their share of the proceeds as unsecured creditors of the trustee. The fact that all creditors (whether general creditors or creditors of the trustee acting as trustee of another trust or other trusts) may not benefit from the proceeds does not flow from the trust creditors not being unsecured creditors

of the trustee (in his personal capacity), but arises from the character of the property and proceeds in the hands of the trustee and the enduring obligation upon the trustee and later the trustee in bankruptcy to use the property for the purposes that gave rise to the right of exoneration.

The first plurality

56 The judgment of the first plurality relevantly largely conformed with that of the second plurality, especially in the first plurality's analysis of the nature of the power or right of exoneration. See, in particular, 368 ALR 401–402 [25]–[28], 403–404 [30]–[32] and 404–405 [34]–[35] of the reasons. The first plurality also dealt with s 555, stating at 368 ALR 407 [44]:

> The conclusion that *Re Enhill* was wrongly decided on this point does not contradict the provision in s 555 of the Corporations Act that, except as otherwise provided in that Act, "all debts and claims proved in a winding up rank equally and, if the property of the company is insufficient to meet them in full, they must be paid proportionately". Recognising that the power of exoneration can only be used according to its terms is not to give priority to debts incurred by the trustee with authority over other proved debts and claims. It is, instead, to confine the use of trust funds by the power of exoneration to the discharge of those debts. Further, the proportionate payment requirement in s 555 is premised upon the extent to which the property of the company can "meet" those debts. The intrinsic limit of the power of exoneration precludes it from being used to meet debts other than those incurred with authority for the conduct of the trust business.

57 The first plurality differed from the second plurality in respect of its approach to what was the property of the company that was subject to the circulating security interest under s 433. For the second plurality, it was the inventory itself which yielded proceeds of realisation from which trust liabilities could be discharged. For the first plurality, it was the rights of the company to use the trust assets for its own benefit by paying trust creditors, saying at 368 ALR 408–409 [48]–[52]:

> 48 Applying this alleged implication in s 433 of the Corporations Act, senior counsel for Carter Holt effectively submitted that s 433 could have no operation in relation to the distribution of trust assets to trust creditors by use of Amerind's power of exoneration because Amerind's power of exoneration does not fall within the definition of a "circulating asset" …
>
> 49 Carter Holt's submissions should not be accepted for two reasons. First, there is no need for the suggested implication. …
>
> 50 Secondly, and fundamentally, the reason there is no such implied requirement in s 433 is that it is incorrect to treat rights held on trust by a company as if they existed separately and independently from its power of exoneration so that it could be said that (i) the rights held on trust, and subject to the circulating security interest, are not the property of the company, but (ii) the power of exoneration, which is the property of the company, is not subject to the circulating security interest. As explained above,

> Amerind's power of exoneration is the means by which its trust rights can be used for its personal benefit as trustee. It is meaningless to ask whether Amerind's power of exoneration is subject to the circulating security interest independently of the legal rights to the trust assets to which the power relates. The point is that Amerind's legal rights to the trust assets, to the extent that it has power to use them for its own benefit, are thus themselves circulating assets and are "property of the company" within s 433.
>
> 51 The same reasoning applies to s 561 of the Corporations Act, which is the provision cognate to s 433 but relevant to liquidators rather than receivers. …
>
> 52 Again, to the extent of the power of exoneration the rights held by the trustee on trust are the property of the company which is, again to the extent of that power, "available", in the sense of available to be used, for the payment of creditors. The trust rights held by Amerind and controlled by the Receivers are "subject to [the] circulating security interest".

58 Finally, the first plurality addressed Carter Holt's submission that, although the power of exoneration is property coming into the receivers' hands, a payment from the receivership surplus is a payment from trust assets, which are not property of the company held by the receivers (citing *Re Independent Contractor Services* 305 FLR 222 at 230–231 [23]–[25]). In rejecting this submission, the first plurality stated at 36 ALR 410 [55]:

> … To reiterate, the "trust assets" are the property of the company and are held by the Receivers, although only to the extent to which Amerind could use them for its own benefit, relevantly by Amerind's power of indemnity. Further, the statutory expression "out of the property" cannot mean that the payment must only be made immediately from the trust rights. That would preclude even the conversion of non-monetary trust rights to money and then payment of the cash. "Out of the property" must include payments made "by the use of the property". Hence, if the trustee can use its rights in relation to the trust assets, including its power of indemnity, to sell the assets for the purpose of exoneration, then a payment of a trust creditor directly from the trust assets by use of the power of exoneration is a payment made "out of" the trustee's rights in relation to the trust assets. A payment by the Receivers of trust creditors by use of Amerind's power of exoneration must be a payment "out of the property" in the Receivers' hands.

The High Court decision of Boensch v Pascoe

59 Six months after the High Court handed down its decision in *Carter Holt*, it had opportunity to consider the distribution of trust assets under the *Bankruptcy Act*. Applying *Carter Holt*, the Court in two separate judgments of Kiefel CJ, Gageler and Keane JJ, and Bell, Nettle, Gordon and Edelman JJ, confirmed in *Boensch v Pascoe* that a bankrupt trustee's entitlement in equity to be indemnified out of trust property is property that belongs to the bankrupt and, being divisible among creditors, vests in the trustee of the bankrupt's estate: 375 ALR 17 [4] and 34–37 [88]–[93]. Kiefel CJ, Gageler and Keane JJ confirmed at 375 ALR 17 [4] that "[w]here the legal estate in the property held on trust by the bankrupt passes to the trustee of the estate of the bankrupt, it passes with all of the equitable interests that were impressed on it when it

remained in the hands of the bankrupt: equitable interests of the bankrupt as well as equitable interests of the beneficiaries of the trust". See also 375 ALR 37 [92]–[93] of the judgment of Bell, Nettle, Gordon and Edelman JJ:

> 92 At the same time, it is also important to keep in mind that a bankrupt trustee's vested or contingent beneficial interest in trust property sufficient for the property to pass to the bankrupt's trustee in bankruptcy may arise either under the express terms of the trust or *aliunde*, including by reason of the bankrupt trustee's right to be indemnified out of the trust property for obligations incurred in the bankrupt's capacity as trustee. Farwell LJ in effect summarised the position in *Governors of St Thomas's Hospital v Richardson*, under provisions of the Bankruptcy Act 1883 which were relevantly no different from the applicable provisions of the Bankruptcy Act 1966, thus:
>
> > [T]he property of the bankrupt does not include property held by the bankrupt on trust for any other person. But it does include property held by the bankrupt on any trust for his own benefit, and when ... he holds property to secure his own right of indemnity in priority to all claims of any cestui que trust, and the retention of such property is necessary to give full effect to such right, it follows that the property, ie, the legal estate, and right to possession vest in the trustee in bankruptcy to the extent to which they were vested in the bankrupt. The law is stated by Jessel MR in *Morgan v Swansea Urban Sanitary Authority*, where he says, "Under the Bankruptcy Act, where a trustee has no beneficial interest, the legal estate does not pass; but where he has it does pass," ... The true test is, Can the trustee be compelled to convey the estate to the cestui que trust? If he can, then it does not pass to his trustee in bankruptcy, but if he cannot, then the property does pass.
>
> 93 Where, therefore, property is held by a bankrupt on trust for another, then, upon the making of a sequestration order, the property will pass to the bankrupt's trustee in bankruptcy (subject to the trust), unless the bankrupt has no valid beneficial interest in the property. And, ordinarily, the burden of proving the absence of such a beneficial interest is on the bankrupt.
>
> (Footnotes omitted.)

Resolution of the first issue

60 The primary judge's reasons must be looked at in the light of the High Court's subsequent decisions in *Carter Holt* and *Boensch v Pascoe*. It is clear that although *Carter Holt* concerned the interpretation of s 433 in relation to the distribution of trust assets in a receivership, the reasoning is equally applicable to the statutory priority provisions which apply to liquidation (ss 556, 560 and 561). It is also clear that much of the reasoning applies to the statutory priority regime under the *Bankruptcy Act*. As Gordon J stated in *Carter Holt* at 368 ALR 438 [173]–[174], there is no logical or countervailing reason why the principle would be any different under the bankruptcy regime. The principles of equity and trusts governing a trustee's right of indemnity apply equally to both personal and corporate trustees: *Jones* at 260 FCR 320 [32]. As observed by the primary judge in *Lane* at 253 FCR 71 [65], it is difficult to discern a reason

for a trustee's right of indemnity to be recast differently under the *Bankruptcy Act* compared to the *Corporations Act*.

61 Consistently with the High Court's reasons in *Carter Holt* and *Boensch v Pascoe*, the primary judge held that Mr Lee's right to be exonerated from trust assets vested in the Bankruptcy Trustees and fell within the meaning of "the property of the bankrupt" as that phrase is used in the *Bankruptcy Act*. The primary judge's approach, however, departed from that of the High Court when his Honour held that the right of exoneration could not produce "proceeds" for the purpose of ss 108 and 109.

62 The primary judge viewed the right of exoneration as operating not by producing proceeds in the hands of the trustee upon the exercise of the right, but rather by dealing with trust assets by directing them to trust creditors. This approach was also taken by Brereton J in *Re Independent Contractor Services* at 305 FLR 231–232 [24]–[25], Robson J in *Re Amerind* at 320 FLR 140 [84], 141–142 [92]–[94], Markovic J in *Kite v Mooney, in the matter of Mooney's Contractors Pty Ltd (in liq) (No 2)* [2017] FCA 653 at [140], and Siopis J in *Jones* at 260 FCR 348–349 [174]–[178]. This approach is also consistent with the position of Professor Ford, who was critical of the characterisation by the High Court in *Octavo Investments* of the right of exoneration as a proprietary right: Ford H, "Trading Trust and Creditors' Rights" (1981) 13 *Melbourne University Law Review* 1 at 5.

63 The view taken by the primary judge in this respect cannot stand in the light of the High Court's reasons in *Carter Holt*. Put simply, the first and second plurality and Gordon J held in *Carter Holt* that the right of exoneration is a right that generates a proprietary beneficial interest in the so-called trust assets. These assets are owned by the trustee, albeit in a constrained way. To exercise the right of exoneration is to take and use property which is property of the (trustee) company (or, here, of the (trustee) bankrupt) and so to deal with the proprietary beneficial interest of the company (or bankrupt) separate from and prevailing over the beneficial interests of the beneficiaries. When the assets and such beneficial interest are sold they are transformed into funds of the company or bankrupt: as proceeds of the property of the bankrupt. The proceeds of the exercise of the right, by the sale of the property with the beneficial interest, have a limitation on their use: only for payment of trust creditors. The proceeds are nevertheless property of the company or bankrupt (even if they have such limits on their use) in the hands of the liquidator or trustee in bankruptcy and are subject thus to the priority provisions of the statute.

64 The second plurality's judgment and that of Gordon J reveal two fundamental errors in the approach of the primary judge and the cases his Honour followed: First, the right of exoneration is not merely a power or right to transfer assets to creditors; the right of exoneration creates a beneficial proprietary interest in favour of the trustee in the assets of the trust; the exercise of the right creates proceeds which are also property of the company, because the exercise transforms the proprietary interest of the company in the (trust) assets into funds able to be used by the company for proper purposes – to pay trust creditors and exonerate itself. Secondly, there is no proper basis for the assumption that the notion of property of the company (or bankrupt) to which the *Corporations Act* and *Bankruptcy Act* speak must only be property of the company generally available to all creditors, and not property of the company being property owned by the company (properly constrained) that contains a proprietary interest of the company, albeit with restrictions on use by way of an equitable obligation to pay only some unsecured creditors of the company (trustee), or here of the bankrupt person.

65 The reasons of the first plurality do not lead to a different conclusion. Their Honours recognised the separate and beneficial character of the trustee's interest in the assets, and in dealing with the power of exoneration reasoned likewise.

66 As put in the submissions of the first and second respondents, the appropriate question is not whether the right of exoneration in and of itself is able to be realised so as to be capable of producing "proceeds", but whether the exercise of the right of exoneration was capable of generating "proceeds" from the relevant trust assets. The assets the subject of the trust can be realised to produce funds which are the trustee's own (and so under the control of the trustee in bankruptcy) but because of the nature and character of the funds and because of the personal obligation upon the trustee (passing to the liquidator or trustee in bankruptcy) such can only be used to meet trust debts. It is those funds which, through the exercise of the right of exoneration, are properly characterised as "proceeds of the property of the bankrupt" under ss 108 and 109, or as "property of the company" under ss 433, 555 and 556 of the *Corporations Act*.

67 Finally, the two considerations identified by the first plurality in *Carter Holt* at 368 ALR 411 [58] and second plurality at 368 ALR 422 [96] are equally applicable to the priority regime under the *Bankruptcy Act*. It would be perverse if the *Bankruptcy Act* operated to deny the statutory entitlements of priority creditors, which includes employees, solely because the bankrupt traded as a trustee. Further, the applicable provisions of the *Bankruptcy Act* have stood in substance unchanged following the decision of *In re Suco Gold* in 1983, which

recognised the applicability of the statutory priority provisions to trust assets subject to a right of exoneration.

68 It follows that when Mr Lee's right of exoneration vested in the Bankruptcy Trustees so too did the legal estate in all remaining trust assets. By virtue of the right of exoneration conferring a beneficial interest in the trust assets, the Bankruptcy Trustees were and are entitled to realise and distribute the trust assets and their proceeds to trust creditors in accordance with the statutory priority regime. The proceeds realised from the trust assets (being the profits from the sale of the Subway franchise) should be distributed in accordance with the priority regime provided for in ss 108 and 109, up to the statutory cap set in the *Bankruptcy Regulations*.

Issue 2: Whether the trust creditors must bring payment from trust assets to account by bringing them into hotchpot

The approach of the primary judge

69 The primary judge's directions were relevantly as follows:

> 3. The Applicants are entitled to the following directions:
>
> …
>
> (e) In the distribution of the personal estate of the bankrupt amongst all creditors, the trust creditors must bring into "hotchpot" the amount which they have received from the Funds as trust creditors.

70 The primary judge dealt with this issue at 253 FCR 94–96 [145]–[153] of *Lane*. His Honour concluded that the rights of the trust creditors to benefit from the personal estate of the bankrupt trustee were to be deferred until the non-trust creditors had received the same proportionate payment as the trust creditors had from the right of exoneration. In other words, the trust creditors, when participating in the distribution of the proceeds of the bankrupt's personal estate, should bring into "hotchpot" the amount which they have received by use of the trustee's right of exoneration.

71 The primary judge referred to the following authorities in support of this conclusion (at 253 FCR 94–95 [147]–[150]):

> 147 There is relatively little authority on this topic, but the weight of it supports the view that the "hotchpot" principle should apply where trust creditors have been able to benefit from the property of the bankrupt to the exclusion of non-trust creditors. In relation to its application in the winding up of an insolvent trading trust; McPherson J, writing extrajudicially in "The Insolvent Trading Trust" in Finn PD (ed), *Essays in Equity* (Law Book Co, 1985, 142 at 158), said:
>
> Hence, a person who is a creditor of the company in consequence of its

> activities as a trading trustee is entitled to prove in the winding-up together with the private creditors of the company; but he is not entitled to receive a dividend from the private assets of the company until the dividend paid to other creditors at least equals that paid to the trust creditors out of the trust funds. (*Re Oriental Inland Steam Co.* (1874) 30 LT 317; affd 9 Ch App 557; *Re Standard Insurance* Co [1968] Qd R 118, applying *Banco de Portugal v Waddell* (1880) 5 App Cas 161 at 168. Cf also the Rule in *Cherry v Boultbee* (1839) 4 My & Cr 442, discussed McPherson, op cit pp 366-367). That, in the end, is what is meant by saying that it is only by the "lucky accident" (*Re Johnson* (1880) 15 Ch D 548 at 552-553, per Jessell MR) of there being a trust that a trust creditor is put in a better position than any other creditor of the company. In practice it will confer on him no advantage unless in the end the assets of the trust produce a dividend that amounts to more than that payable out of the private assets to the general private creditors of the insolvent company.

148 Such an approach accords with the maxim that "equity is equality" (*Akers v Deputy Commissioner of Taxation* (2014) 223 FCR 8 at [135]) and the general insolvency principle that, to the extent possible, all creditors of a bankrupt are to be treated equally in the administration and distribution of the bankrupt's estate.

149 Both the application of "hotchpot" principle and its historical development were considered by the Privy Council in *Cleaver v Delta American Reinsurance Company (in liq)* [2001] 2 AC 328. That case concerned the liquidation in the United Kingdom of a foreign corporation which was also in the process of being liquidated elsewhere. It is fair to say that the transaction which was the subject of the litigation had a moderate degree of complexity to it. However, the "hotchpot" principles relating to cross-border insolvencies are relatively easy to identify. They provide that a creditor who has obtained a benefit from the distribution of the property of an insolvent company in a foreign jurisdiction, is not entitled to receive a dividend from the English liquidation of the same company unless it brought into hotchpot their foreign dividend. It was observed that the rule only applied where the foreign benefit had been derived from a "common fund" as was the situation in that case. If the benefit had been obtained from assets which were not otherwise available to the "common fund", the rule had no application. That principle is often reflected in the fact that secured creditors are not subject to the hotchpot principle in an insolvency context as property which is the subject of security has never been regarded as being part of a "common fund" which is distributable amongst all creditors. For that reason, a secured creditor might estimate the value of their security and prove, unimpeded, in the liquidation or insolvency for any balance owing (see *Cleaver* esp at [26]).

150 An adumbrated history of the hotchpot principle can be found in the decision of Barrett J in *Australian Securities and Investments Commission v Idylic Solutions Ltd* (2009) 76 ACSR 129 at 138-139. Relevantly, for present purposes, it is only necessary to refer to [60] of his Honour's reasons:

> The hotchpot concept is a reflection of the maxim "equality is equity" (with "equality", in an appropriate case, understood as proportionate equality), supplemented by the maxim "he who seeks equity must do equity". The equality (or proportionate equality) that equity in general will promote can only be struck after a person seeking the benefit of it has, as a preliminary, borne whatever burden equity demands be borne in order to ensure that the ultimate equality (or proportionate equality) is not distorted by the effects of unconscientious retention of separately received benefit.

72 In response to the submission by the Bankruptcy Trustees that the hotchpot principle did not apply because there was no common fund, the primary judge stated the following at 253 FCR 95–96 [151]–[153]:

> 151 The Bankruptcy Trustees submitted that the hotchpot principle did not apply in the present case because the right of exoneration was not property which formed part of the personal estate of the bankrupt such that the trust creditors were not benefiting from the "common fund" which is distributed under ss 108 and 109. However, for the reasons which have been stated above, that submission also cannot be accepted. The right of exoneration is part of the bankrupt's personal property which was divisible amongst the creditors and which vested in the Bankruptcy Trustees on the making of the sequestration order. The payments to the trust creditors via the right of exoneration are, therefore, payments out of a "common fund". That remains so, even though the debts to trust creditors are discharged in part by the use of trust funds.
>
> 152 Although the Bankruptcy Trustees submitted that the trust creditors were "secured creditors" for the purposes of the *Bankruptcy Act*, the authorities are to the contrary (see *Buckle* at 247; *Lerinda Pty Ltd v Laertes Investments Pty Ltd*). Indeed, it can be remarked that if they were secured creditors, the fifty or so authorities cited by the Bankruptcy Trustees for the purposes of the application would have been otiose as there could have been no argument as to which creditors were entitled to priority.
>
> 153 The same result is reached by an application of s 108 of the Act. That section has two aspects to it. First, that all debts proved in a bankruptcy must rank equally. The second is the legislative direction to discharge the debts of the bankrupt proportionately if the proceeds of the property of the bankrupt are insufficient to meet them in full. It follows that when the Bankruptcy Trustees attend to the distribution of the "proceeds" of the property of the bankrupt they are required, to the best of their ability, to ensure that the debts proved in the bankruptcy are paid proportionately and, unless otherwise provided for, equally. Where, in the course of the administration the trust creditors have received partial payment of their debts by use of the right of exoneration, the legislative direction necessarily requires that the "proceeds" are to be applied in favour of the non-trust creditors until that point is reached where their debts have been paid in the same proportion as the trust creditors' debts. Thereafter, the remainder of the proceeds, if any, are to be applied proportionately across all debts. This application of s 108 of the Act to the circumstances of an insolvent trustee reflects both the hotchpot principle and the overriding scheme of the *Bankruptcy Act* that the bankrupt's creditors are to be treated equally.

The grounds of appeal

73 This issue was dealt with in grounds 4A and 4B of the amended notice of appeal as follows:

> 4A. His Honour erred in holding that in the distribution of the personal estate of the bankrupt amongst all creditors, the trust creditors must bring into hotchpot the amount which they have received from the Funds as trust creditors.
>
> 4B. His Honour should have held:
>
> (a) there was no common fund on which both trust creditors and non-trust creditors could claim;
>
> (b) therefore, the hotchpot principle is inapplicable;
>
> (c) if –

(i) each priority claim that is limited by an applicable statutory cap (a capped claim) and all other priority claims are satisfied in full from trust assets in accordance with s 109 of the Act, and

(ii) after payment of all priority creditors' claims, there are still trust assets available for distribution under s 108 of the Act,

such trust assets shall be distributed to trust creditors, including any trust creditor having a capped claim, to the extent it exceeds the statutory cap (the "cap excess"), *pari passu*;

(d) to the extent that any priority trust creditor's capped claim is not satisfied in full from trust assets, the shortfall is a priority claim against the bankrupt's personal estate;

(a) section 109 of the Act applies to the distribution of the bankrupt's personal estate to both trust creditors and non-trust creditors; and

(b) after all priority creditors have been paid in accordance with s 109 of the Act (up to any applicable statutory cap) from the bankrupt's personal estate, any remaining personal estate is to be distributed in accordance with s 108 of the Act in payment or satisfaction of all amounts outstanding to all creditors, including any creditor having a capped claim, to the extent it exceeds the cap excess, *pari passu*.

The submissions of the parties

74 The appellant's essential submission was an attack on the primary judge's conclusion that the payments to trust creditors were from a "common fund". In the first paragraph of his written submissions on this issue, the appellant stated the perceived error of the primary judge: "even though the debts to trust creditors are discharged in part by the *use of trust funds*". (Emphasis added.)

75 Particular reliance was placed by the appellant upon *Cleaver v Delta American Reinsurance Company (in liquidation)* [2001] 2 AC 328 at 338–341 [18]–[29] where the Privy Council in a Cayman Islands Appeal, in a judgment delivered by Lord Scott of Foscote, discussed the principles of hotchpot; upon the decision of Barrett J in *Australian Securities and Investment Commission v Idylic Solutions Ltd* [2009] NSWSC 1306; 76 ACSR 129; and upon the decision of Gordon J in *Australian Securities and Investment Commission v Letten (No 20)* [2012] FCA 1283; 92 ACSR 630.

76 The submission was that a "common fund" was a precondition to the operation of the principle of hotchpot. *Carter Holt* makes clear, it was submitted, that proceeds from the exercise of the right of exoneration can only be used to discharge debts of "trust creditors". If the bankrupt has incurred debts both in a personal capacity and as a trustee there are effectively two (or more) "pools" of funds to be administered. Non-trust creditors have no right to share in the pool

represented by the proceeds of the exercise of the right of exoneration in respect of any trust; that pool is not part of a common fund, because there must (as a matter of logic) be more than one "pool" of funds. In such circumstances, there is no relevant common fund and no basis to call upon trust creditors to bring into hotchpot anything they have received by way of distribution of the trust estate before seeking to participate in the personal estate.

77 Reliance was placed upon King CJ in *In re Suco Gold* at 33 SASR 109–110, *Jones* at 260 FCR 338–339 [108], and upon both the second plurality and Gordon J in *Carter Holt* at 368 ALR 421–422 [95]–[97] and 435–436 [163]–[166], respectively.

78 The only circumstances where hotchpot might affect the matter, it was submitted, relying on *Idylic* at 76 ACSR 141–144 [73]–[87] and *Letten (No 20)* at 92 ACSR 650 [71], were where there had been an intermingling of funds that should have remained separate or where there had been an inequitable distribution of funds.

79 The first and second respondents commenced their submission with the proposition that trust creditors and non-trust creditors are equal creditors within the same class – unsecured creditors, to be treated equally. To deny hotchpot, it was submitted, would be to posit distinct proofs of debt and distinct liquidations, and would be inconsistent with the equality of the creditors to the one subject bankruptcy, and inconsistent with the statutory reality. The proper characterisation of the funds was, as the primary judge viewed it, as one fund: the property of the bankrupt divisible amongst the bankrupt's unsecured and equal ranking creditors. The appellant's characterisation of the common fund was submitted to be too narrow, and to be inconsistent with the necessary equality of unsecured creditors in one insolvency administration. Particular reliance was placed by the first and second respondents on *Akers as a joint foreign representative of Saad Investments Company Limited (in Official Liquidation) v Deputy Commissioner of Taxation* [2014] FCAFC 57; 223 FCR 8, *New Cap Reinsurance Corporation v Faraday Underwriting* [2003] NSWSC 842; 177 FLR 52, and *Re HIH Casualty and General Insurance Ltd* [2005] NSWSC 240; 190 FLR 398.

80 The appellant rejected the proposition that the trust and non-trust creditors are equal, even though both are unsecured. The effect of *Carter Holt* and *In re Suco Gold*, it was submitted, was the administration of separate estates. To require hotchpot would be to intermingle the trust estate and the personal estate of the bankrupt in a manner rejected by the conclusion that *Re Enhill* was wrong.

81 It will be necessary to deal with the above submissions and authorities, but, in essence, it is the proper characterisation of the common fund, or not, that divided the parties in their submissions.

82 Before turning to the authorities and the nature of the principle of hotchpot, it is necessary to return to *Carter Holt* and *Jones,* to isolate and be precise about the nature of the proceeds in the hands of the trustee and the place of the various creditors in the bankruptcy.

***Distillation of relevant considerations from* Carter Holt**

83 The emphasised last phrase in the appellant's submissions set out in [74] above contains the seed of the flaw of the submission. To explain why that is so, one needs first to return to the three judgments in *Carter Holt* and to some features of *Jones.* It is important not to become tangled in words, but to identify the principles involved. The use of the phrases "trust property" or "trust funds" by King CJ in *In re Suco Gold*, in the three judgments in *Carter Holt* and in *Jones* should not disguise or mask the essential features of the operation or exercise of the right of exoneration to which I have referred above at [53]–[55] and [63]–[65]. It is essential to appreciate that all the judgments in *Carter Holt* recognised that the right or power of exoneration produced funds or property in which the company had its own personal interest to which the statutory order applied. The contextual and institutional source of that interest was the trust and the obligation of the trustee to use the property for the purposes of the trust, being relevantly, the payment of trust creditors. These considerations stamped the property with an incident of its character, and created an obligation that bound the liquidator.

84 The second plurality at 368 ALR 422 [97] referred with approval to King CJ's solution to the insolvent trustee having acted as trustee for more than one trust or on its own account as well as a trustee: "*as if* the liquidator had separate funds, each for different groups of creditors": see *Carter Holt* at 368 ALR 422 [97] (Emphasis added). Further, it is to be noted that in the same paragraph the second plurality referred without disapproval (at 368 ALR 422 [97]) to the following passage in *Jones* at 260 FCR 339 [108]:

> … Complexities may arise in circumstances of multiple trusts or of trusts and activity on the corporation's own account. **Considerations of, or akin to, marshalling or hotchpot may be relevant as to the payment of debts dealt with in the statutory order**. But these complexities will be resolved by application of principle and the text of the legislation, in a manner reflected by the approach of King CJ in *Re Suco Gold*.
>
> (Emphasis added.)

See also Gordon J at 368 ALR 436 [164].

85 The following considerations present here are relevant to the application of the principle of hotchpot: All creditors, trust and non-trust, are unsecured, equally ranking creditors of the one person: the (now bankrupt) trustee. The trust creditors do not have any superior position of security over, or as beneficiaries of a trust in respect of, the proceeds of the exercise of the right of exoneration. The position of the trust creditors stems from their entitlement to be paid from those proceeds, from their rights of subrogation on the bankruptcy of the trustee to the trustee's beneficial interest in the trust assets: *Octavo Investments* at 144 CLR 367, from the nature or character of the proceeds of the exercise of the right of exoneration, and from the enduring personal obligation upon the liquidator or trustee in bankruptcy derived from the position of, and personal obligation upon, the insolvent trustee. Thus, there arises a feature or incident of some property of the company or bankrupt (as trustee) and the personal obligation upon the company or bankrupt to which the liquidator or trustee in bankruptcy succeeds, which makes the proceeds payable to only some creditors. Otherwise, the creditors are equally ranking creditors of the one debtor, in the one insolvency, even if, for the working out of entitlements, there can be seen, in the one insolvency, to be separate funds: See in particular the way the first plurality in *Carter Holt* put it at 368 ALR 407–408 [44], set out at [56] above, and also see *Jones* at 260 FCR 336–337 [101]–[103].

86 With these considerations in mind, I turn to a consideration of the nature of hotchpot.

The principle of hotchpot

87 Hotchpot is an expression of equity's concern for equality. "Equality is equity" as a maxim of equity lay at the foundation of doctrine concerning rights of all who are connected by any common bond of interest or of obligation. This reflected the notions of equality and impartiality lying at the foundation of the jurisprudence of Chancery, in contradistinction to the common law's protection of the rights of the person as a distinct and separate individual: Pomeroy J N, *A Treatise on Equity Jurisprudence* (5th ed, S W Symons (ed), The Law Book Exchange Ltd, 1941) Vol 2 p 144 at §405. The maxim is the source of a number of doctrines: pro rata distribution, contribution, ownership in common in preference to joint tenancy and survivorship, settlement of insolvent estates, and marshalling: Pomeroy (1941) pp 145–159 at §406–§412.

88 The principle of hotchpot reflected in the *Statute of Distribution 1670* (22 & 23 Car 1 c 10) requiring settlements and advances to children in the lifetime of the intestate to be taken into account in their share of intestacy was, as Lord Chief Justice Raymond said in *Edwards v*

Freeman (1727) 2 P Wms 435; 24 ER 803 at 806, cited by Barrett J in *Idylic* at 76 ACSR 138 [54], grounded on the "most just rule of equity, *equality*." (Emphasis in the original report.)

89 The examples of the expression of the maxim take their form according to the nature of the common bond of interest or obligation concerned and what is necessary to vindicate equality and avoid unconscionability in respect of the common bond: Pomeroy (1941) p 144 at §405; *Idylic* at 76 ACSR 139 [60]; and *Letten (No 20)* at 92 ACSR 651 [73].

90 The sharing equally of burden by co-sureties requiring one co-surety to share pro-tanto the benefit of any security from the principal debtor is an example stemming from the common bond of obligation: see *Steel v Dixon* (1881) 17 Ch D 825 approving the Vermont and North Carolina cases of *Miller v Sawyer* 30 Vt 412 (1858) and *Hall v Robinson* 8 Ired 56 (1847), respectively, referred to by Barrett J in *Idylic* at 76 ACSR 138 [56]–[57]. The expression of the matter in both these cases explains the requirement to bring into hotchpot because of the commonality of burden and the common ground of interest and right: *Miller v Sawyer* (cited by Barrett J in *Idylic* at 76 ACSR 138 [56]):

> [P]ersons subject to a common burden stand in their relation to each other upon a common ground of interest and of right, and whatever relief, by way of indemnity, is furnished to either by him for whom the burden is assumed, enures equally to the relief of all the common associates.

See also *Hall v Robinson* (cited by Barrett J in *Idylic* at 76 ACSR 138 [57]):

> The relief between co-sureties in equity proceeds upon the maxim that equality is equity, and that maxim is but a principle of the simplest natural justice. It is a plain corollary from it that, when two or more embark in the common risk of being sureties for another, and one of them subsequently obtains from the principal an indemnity or counter-security to any extent, it enures to the benefit of all. The risk and the relief ought to be co-extensive.

91 In a circumstance of co-sureties, the requirement to share the benefit of security from the debtor that is not held by all, arises from the common burden all have undertaken.

92 *Idylic* concerned the application or not of hotchpot to a mixed fund brought about by the management of two unregistered managed investment schemes where investors, who had been promised lucrative returns, had contributed to a pool of funds. From time to time some investors received "returns" from the fund. The questions for decision included the characterisation of the mixed fund and whether or not investors who had received returns should bring such into hotchpot in the sharing of what remained. The authorities to which Barrett J referred in *Idylic* and to which Campbell J had referred in *Re French Caledonia Travel Service Pty Ltd (in liq)*

[2003] NSWSC 1008; 59 NSWLR 361 in dealing with mixed funds, and whether or not payments out should be required to be brought to account, recognised that the proper approach depended on the circumstances, the practical difficulties involved and what will be an equitable distribution as the best answer that the circumstances of the case allow: See the discussion by Barrett J in *Idylic* at 76 ACSR 140 [64]–[67] of *In re Printers and Transferrers Amalgamated Trades Protection Society* [1899] 2 Ch 184, *In re Hobourn Aero Components Limited's Air Raid Distress Fund*, *Ryan v Forrest* [1946] Ch 86, *In re Lead Company's Workmen's Fund Society* [1904] 2 Ch 196, *Pearce v Piper* (1809) 17 Ves 1; 34 ER 1 and *Re French Caledonia Travel* 59 NSWLR 361.

93 As Cohen J said in *In re Hobourn Aero* [1946] Ch at 97–98, quoted by Barrett J in *Idylic* at 76 ACSR 140 [66]:

> … the general principle [is] that a person seeking to participate in the distribution of a fund must bring into hotchpot anything he has already received **therefrom**.
>
> (Emphasis added.)

94 What is, however, "the fund" that gave content to the word used by Cohen J: "therefrom"? In the cases of mixed funds, it can be seen as the one pool of money augmented and depleted over time to which all have contributed, and some participated by withdrawal. This was how Barrett J conceived of the one fund in *Idylic*. His Honour rejected the argument put by the contradictor that the fund should not be seen as one fund, but as a series of funds, reconstituted from time to time as money was returned, such that once funds were returned, later contributors had no interest in the (previously) returned funds. This characterisation of multiple and successively reconstituted funds was rejected (at 76 ACSR 142 [74]) as failing "to afford necessary weight to the nature of a common or collective investment pool". The contributions were mixed and lacked any identity to the respective contributors, whose rights became "proportionate rights in relation to the fund as it exist[ed] from time to time".

95 The answer in *Idylic* was reached by the appropriate *characterisation* of the nature of the fund: not as a succession of separate estates, but as a common single pool. The personal equities among the contributors were described by Barrett J at 76 ACSR 142 [77]:

> Applying the rationale in the *Re French Caledonia* case, personal equities can be seen to exist between the recipients of "returns" and other contributors to a particular scheme causing those recipients to merit a lower priority as to participation in the fund, which relegation will, however, be eliminated if the "returns" are brought into hotchpot. In order to "carry out the strict rights to the fullest extent", to quote the words of Byrne J in *Re Printers* (above), there must be an account of the "returns" in order to ascertain the whole of each remaining fund to which the principle of division in

> proportion to contributions is to be applied. The recipients of the "returns" must, as against the other persons interested in the pooled fund as a whole, do equity by giving up the advantage of the "returns" before participating rateably in what remains of the fund.

96 This process of characterisation (discussed by Dixon and Evatt JJ in *Attorney General for New South Wales v Perpetual Trustee Company (Limited)* [1940] HCA 12; 63 CLR 209 at 226–227) has regard to all relevant attendant circumstances, to the relevant informing considerations of equity, and to the proper attention to the reason one is asking the question that calls forth the need for the characterisation. In that process, danger lies in the "delusive search" for definitional certainty by reference to fixed, universal and exhaustive criteria: Heydon JD, Leeming MJ and Turner PG, *Meagher, Gummow and Lehane's Equity: Doctrines and Remedies* (5th ed, LexisNexis Butterworths, 2015) Ch 4, esp pp 106–107 at [4-005] and [4-010]; and *Livingstone v Commissioner of Stamp Duties (Qld)* [1960] HCA 94; 107 CLR 411 at 448–449 (Kitto J). As Holmes J said in *Truax v Corrigan* 257 US 312 (1921) at 342, cited by Gummow J in *JT International SA v Commonwealth* [2012] HCA 43; 250 CLR 1 at 35 [47]:

> Delusive exactness is a source of fallacy throughout the law. By calling a business "property" you make it seem like land, and lead up to the conclusion that a statute cannot substantially cut down the advantages of ownership existing before the statute was passed. An established business no doubt may have pecuniary value and commonly is protected by law against various unjustified injuries. But you cannot give it definiteness of contour by calling it a thing.

The approach and technique of equity in its administration was described by Kearney J in *Burns Philp Trustee Co Ltd v Viney* [1981] 2 NSWLR 216 at 223–224:

> … The administration of equity has always paid regard to the infinite variety of interests and has refrained from formulating or adhering to fixed universal and exhaustive criteria with which to deal with such varying situations. The approach traditionally adopted by equity has been to retain flexibility so as to accommodate the multitudinous instances in which fundamental equitable rules fall to be applied.

97 In *Idylic*, the bringing of the "returns" into hotchpot saw those funds returned to the fund by an account of them as taken from the fund, as would make the distribution of the remaining fund equal according to proportion. Once the movement of funds: the flow and ebb, the in and out of accounts was characterised as the movement in and out of one fund, the commonality of the fund could be seen as present.

98 The principle has been applied to the working out of entitlements in insolvency. The circumstances of transnational or multi-jurisdictional insolvencies is not new. How one deals with the assets of the insolvent entity fairly amongst equal creditors with different local rights for some reason is not a new problem. Three English authorities concerned with the problem

were reviewed in *Cleaver*: *Selkrig v Davis* 2 Rose 291; *Ex parte Wilson, In re Douglas* (1871–72) 7 Ch App 490; and *Banco de Portugal v Waddell* (1879–80) 5 App Cas 161.

99 The consideration in *Cleaver* of the matter in these cases was directed to the question of timing as to when the creditor or creditors had acquired the insolvent's property in the other jurisdiction. If the assets had been acquired before the commencement of the insolvency, they would not form part of the common fund of the insolvent estate in which all creditors were entitled to share equally, that is, proportionately. It is unnecessary for present purposes to examine this question of precise timing as a satisfactory basis for a rule or criterion of the application of the principle.

100 The circumstances of the three cases were similar: In *Selkrig*, there was a sequestration of Scottish property by Scottish creditors and the requirement to bring such to account by those creditors who sought to prove in the English bankruptcy against the English assets. *Ex parte Wilson* concerned Brazilian assets administered under Brazilian law giving Brazilian creditors priority; such creditors were not entitled to a dividend from the English liquidation until all creditors had received a dividend equal to that received by them. *Banco de Portugal* concerned Portuguese assets which had been made available to Portuguese creditors by order of a Portuguese Court. In *Cleaver* [2001] 2 AC at 340 [26], Lord Scott said:

> The three cases to which reference has been made demonstrate that the hotchpot requirement applies only to assets that, under English law, are regarded as forming part of the estate in liquidation.

All creditors were entitled to share in all the insolvent property; only some had taken some property; they must bring in or account for the benefit thus received if they wished to participate in the balance.

101 The appellant placed significant reliance upon *Cleaver*, which concerned the participation of a reinsurer creditor (**Delta** American Reinsurance Co) in the liquidation of its retrocessionaire (**Transnational** Insurance Co Ltd). Delta was incorporated in Kentucky and licensed to carry on reinsurance business in New York and Kentucky. Transnational was an insurance company incorporated and licensed under the laws of the Cayman Islands. It carried on business as a retrocessionaire: that is, as a reinsurer of reinsurers. Pursuant to agreement Transnational was Delta's retrocessionaire. Delta went into liquidation. It began proceedings against Transnational and other retrocessionaires in the United States District Court in New York. As a foreign company, Transnational was required by New York law, as a condition of defending the proceeding, to deposit in court, or provide security for, the full sum of the claim against it.

The security was provided by a bank letter of credit, which was secured by the bank by a charge against deposits belonging to Transnational kept with the bank. As Delta's paid losses increased, the security required to be provided by the letter of credit increased, as did the required deposits for the charge to secure the bank. Eventually, Transnational was unable to increase further the deposits securing the letter of credit and it went into creditors' voluntary liquidation, under the supervision of the Grand Court of the Cayman Islands. Delta then sought and obtained default judgment; Delta claimed on the letter of credit; the bank paid; and the bank exercised its charge and deducted the relevant sum from Transnational's deposit account.

102 Delta submitted a proof of the balance of the debt owed to it by Transnational in the Cayman Islands liquidation of Transnational. The question was: Did Delta have to bring into hotchpot or account for the sums it received from the bank letter of credit, before participating in the Cayman Islands liquidation for the balance of the debt? The insolvency judge said, yes; the Court of Appeal of the Cayman Islands said, no; and the Privy Council agreed with the Court of Appeal. Lord Scott described hotchpot as a "rule": [2001] 2 AC at 341 [32]. Whether or not such elevates the principle as an expression of the maxim into possibly overly rigid categorisation need not detain us. It is sufficient to say that for the Privy Council the rule required the taking by one creditor of funds from a common fund after the commencement of insolvency. Delta had not taken from a common fund available to all creditors. It had called upon a letter of credit from a third party that was secured for that third party over deposits of the debtor. The letter of credit and the secured funds were not part of the common funds available to all creditors. Further, that arrangement pre-dated the commencement of the winding up of Transnational: see [2001] 2 AC at 341–342 [30]–[35]. The rule did not extend to "cater for all cases of 'unfair advantage'": at 342 [35]. There was, in any event, no unfairness. The arrangement, effectively a payment into court, transformed Delta into a species of secured creditor: *WA Sherratt Ltd v John Bromley (Church Stretton) Ltd* [1985] QB 1038; *In re Gordon, Ex parte Navalchand* [1897] 2 QB 516; and *In re Ford*, *Ex parte The Trustee* [1900] 2 QB 211.

103 The principle of hotchpot can, however, apply where one can see two funds: one of which is reserved to one group of creditors. Insurance or companies legislation protecting local creditors are familiar examples.

104 In *Re Standard Insurance Company Limited* [1968] Qld R 118, a New Zealand incorporated company was ordered to be wound up in New Zealand. Similar, but ancillary, orders were made in all Australian States and Territories where the company had carried on business. A provision

of the *Companies Acts* 1931 to 1960 (Qld) required that all land in Queensland of a foreign company in liquidation should be applied, in the first instance, to paying debts contracted in Queensland. Upon application for directions, Lucas J held that whilst the statute provided for the payment of proceeds of land, the benefited Queensland creditors were not entitled to rank for or receive any further dividend from the other assets of the company in Queensland until the other creditors reached dividends at a level of equality with Queensland creditors. Justice Lucas (applying what today would be described as "modified universalism") said at [1968] Qd R 125 that where a winding up was proceeding in different jurisdictions the principle to be applied was that subject to priorities by reference to local law, all creditors of the company were as far as possible to be treated equally, wherever they were and wherever their debts were contracted, relying upon *Re Alfred Shaw & Co Ltd*, *Ex parte Mackenzie* (1897) 8 QLJ 93 at 96 (Griffith CJ), *In re Matheson Brothers Limited* (1884) 27 Ch D 225 at 231 (Kay J), and *Sedgwick Collins and Company v Rossia Insurance Company of Petrograd* [1926] 1 KB 1 at 13 (Scrutton LJ). As to distribution, Lucas J relied on *Banco de Portugal,* referring to the approach at [1968] Qd R 127 as "another example of the application of the doctrine of marshalling." Reliance was also placed by Lucas J on *In re Oriental Inland Steam Co, Ex parte Scinde Railway Co* (1874) LR 9 Ch App 577 (not referred to by, or cited to, the Privy Council in *Cleaver*) in which case a creditor, who had obtained execution against the assets of the company in a foreign country, was required to bring them to the liquidation for the benefit of all creditors equally.

105 The reference by Lucas J to the doctrine of marshalling should not deflect one from the substance of his Honour's approach. It was the necessity to vindicate equality among creditors of a liquidation when some had preferential access to an identified portion or fund of the company's assets, and so access to two funds over other equally ranking creditors having access to only one fund, that was seen as the essence of the applicable doctrine. The cognate or analogous doctrine of marshalling of funds or securities between creditors without a common bond between them and based on subrogation to avoid injustice to one by the legitimate choice of another (*Meagher, Gummow and Lehane's Equity: Doctrines and Remedies* (5th ed) Ch 11, esp 11-020) is not directly relevant, though one can see its analogical relevance: See Pomeroy (1941) pp 154–156 at §410 for the informing place of equality in this regard.

106 In *New Cap Reinsurance* 177 FLR 52, the insurer in liquidation had written international reinsurance in Australia. Section 116(3) of the *Insurance Act 1973* (Cth) reserved assets in Australia of bodies licensed to carry on insurance business for the discharge of Australian

liabilities. The Australian creditors had a form of priority in respect of Australian assets, but the rights of other creditors were not displaced, and s 116(3) did not transform Australian creditors into secured or priority creditors, that is, creditors of a different ranking: 177 FLR at 73. Following *Re Standard Insurance*, Windeyer J applied the hotchpot principle in circumstances where one group of creditors (by s 116(3)) had access to assets of the company denied to others (at least in point of timing) in circumstances where under the statute (s 556) the creditors were of equal ranking. The principle applied even though one could see from the effect of the statute that there were two funds available. But that was the point: One group of creditors (of equal standing to others) had access to more than one fund of assets of the insolvent company, whereas other (equally ranking) creditors had more limited access to the assets of the insolvent company. The difference in rights of access arose from a statute that gave some creditors an advantage, but one that did not transform them into secured or truly priority creditors.

107 In *Re HIH Casualty and General Insurance* 190 FLR 398, Barrett J dealt with a complex proposed scheme of arrangement concerning related insurance companies in the failed HIH Group. The proposal, otherwise commercially unobjectionable, saw the substitution of rights conferred by statute, by an arrangement modelled on English "run-off" schemes, which rearranged the assets of the companies into three funds applying assets to different groups of creditors. In refusing to approve the scheme, Barrett J said the following at 190 FLR 429 [108]:

> Because the claims of a particular kind that may be met out of particular funds at successive stages are claims of equal degree (for example, several s 562A claims no longer enjoying priority because the relevant reinsurance proceeds have been exhausted, or several claims for wages enjoying the priority given by s 556(1)(e) or several non-preferred debts) and stand in a pari passu relationship with one another, the appropriate method of treatment is by way of hotchpot in accordance with the second method discussed under the immediately preceding heading. **Participation by claims of equal degree in separate funds administered in a single winding up is logically to be treated in the same way as participation by claims of equal degree in several concurrent windings up.**
>
> (Emphasis added.)

108 This passage recognises that one liquidation may, by statute (such as s 116(3) of the *Insurance Act* or local companies legislation), have within it separate funds to be administered. Where that is so, and where the claims (even if to be met out of particular funds at successive stages) are claims of equal degree the appropriate approach is by way of hotchpot, involving treatment of claims of equal degree as if in several concurrent windings up of the same entity in different jurisdictions.

109 In each of the above circumstances, the creditors were of equal ranking, but a local statute gave some an advantage.

110 In *Akers* 223 FCR 8, an equally ranking creditor was subject to a disadvantage in a foreign jurisdiction in connection with access to the assets of the company. The question under the *Cross-Border Insolvency Act 2008* (Cth) and the Model Law on Cross-Border Insolvency was whether assets in Australia of the insolvent company being wound up in the Cayman Islands should be transferred to that jurisdiction for the administration of the company in the foreign main proceedings. The assets remaining were the residue of what were said to be capital profits made by the company in Australia. The Deputy Commissioner of Taxation asserted rights of a creditor in respect of Australian taxation said to be owed by the company. The funds in Australia were property of the company otherwise available in the liquidation for the payment of creditors. The difficulty faced by the Deputy Commissioner was, consistently with the not unusual rule of private international law, that as a foreign (Australian) revenue authority, the Deputy Commissioner was not entitled to prove in the Cayman Islands winding up: 223 FCR at 40 [134]. If there were an ancillary winding up in Australia (hypothesised as if the *Cross-Border Insolvency Act* had not been enacted) along with the Deputy Commissioner all the foreign creditors would be entitled to prove against the Australian assets, but they would also be entitled to prove in the main Cayman Islands winding up. In that context, the Deputy Commissioner had only one fund of the company's property and all other creditors had two funds of the company's property, against which to prove: all creditors ranking equally, all property (subject to the rule in the Cayman Islands) was available to all creditors. At 223 FCR 40–42 [134]–[135] and [138]–[139], I explained (with the concurrence of Robertson J and Griffiths J at 50 [168] and [169] respectively) why hotchpot applied:

> 134 The DCT is not entitled to prove in the Cayman Islands winding up. All other creditors are entitled to prove in the posited local (ancillary) winding up, but are also entitled to prove in the Cayman Islands winding up (assuming they not to be other foreign revenue creditors). The DCT has, therefore, one fund of the company (the hypothesised local administration) in which to prove; all other creditors have two funds of the company (the hypothesised local administration and the Cayman Islands administration) in which to prove. A creditor who seeks to share in the assets of a debtor in an administration must bring to account the benefits of recovery from other assets of the debtor, whether by execution, self-help or through participating in a second administration: *Selkrig v Davies* (1814) 2 Dow 230; 3 ER 848 (Lord Eldon); *Banco de Portugal v Waddell* (1880) 5 App Cas 161 at 167-168, 170 and 175-176 (Earl Cairns LC, Lord Selborne and Lord Blackburn, respectively); *Ex parte Wilson; Re Douglas* (1872) 7 Ch App 490 at 492-493 and 493-494 (James LJ and Mellish LJ); *Re Harris, Goodwin & Co* (1887) 7 QLJ (NC) 94; *Re Standard Insurance* at 127-128 (Lucas J); *Re National Employers' Mutual General Insurance Association Ltd* (1995) 15 ACSR 624 at 626 (McLelland CJ in Eq); *Cleaver v Delta American Reinsurance*

Company (in liq) [2001] 2 AC 328 at [16]-[29]; and *Re HIH Casualty and General Insurance Co* (2005) 190 FLR 398 at [96]. In these circumstances, the local liquidator would be entitled to require the foreign creditors to bring to account in the nature of hotchpot the value of their participation in the Cayman Islands winding up (or indeed any other foreign winding up) in the equal distribution of the assets of the company, and in the overall equal distribution of the local assets. An illustration of the approach is *Re Oriental Inland Steam Company*. There, the execution creditor in India was required to bring to account in England the value of the execution in India based on the fairness of bringing to account in the English winding up the access to the company's property that the creditor had achieved in India.

135 The analogue to the above cases here is close. If one hypothesises a local winding up the foreign creditors have access to more than one administration; the DCT to one only. Both administrations concern the assets of the company, although the nature of the task of the liquidator in the local (ancillary) winding up is limited in the way I have discussed. Even if the local ancillary winding up is limited to local assets or assets outside the place of incorporation, both administrations are dealing with the assets of the company that are to be available to unsecured creditors. Hotchpot (like marshalling) is an illustration of the maxim that equity is equality. The nature of the ancillary winding up, as a winding up of the company for the benefit of all its creditors, under local (here, Australian) law would permit (*quaere* require) an Australian liquidator to require foreign creditors to bring to account the value of their participation (or expected participation) in the other assets of the company (including through participation in another administration of the company's assets) before they obtained any benefit from the Australian assets. This would vindicate the equality of the local creditor and also vindicate the ancillary winding up as being one for all creditors. This would also reflect the operation of Art 32 of the Model Law.

...

138 Any hypothesised liquidation is just that: an hypothesis – a posited framework to assist in the organisation of informing principle. The most potent informing principle is the notion of fair and equal treatment of all creditors, and the *pari passu* distribution of the assets of the debtor company. The principle of *pari passu* distribution adopted by the primary judge is informed by fairness and equality*: Re Harris, Goodwin & Company*; *The case of the Bankrupts* (1592) 2 Co Rep 25, 76 ER 441; *British Eagle International Airlines Ltd v Compagnie Nationale Air France* [1975] 1 WLR 758; *Hardy v Fothergill* (1888) 13 App Cas 351 at 363; and see generally Symons SW, *Pomeroy's Equity Jurisprudence* (5th Ed) Vol 2 at pp 144-148 [405]-[407]. Though there is no local winding up, the DCT has access only to one fund of the company's assets and other creditors have access to more than one fund.

139 The fairness and equality in the approach of the primary judge is reinforced when one recognises the available principle of hotchpot that is based on the same notions of fairness and equality. The balancing of the protection of the local creditor under Art 21.2 and the protection of all creditors under Art 22.1 is thus achieved by recognising the equality of all creditors, when considering the dealing with, and access to, the funds of the company. The approach is consistent with the views of the reporters in the report to the American Law Institute (ALI) on *Transnational Insolvency: Global Principles for Co-operation in International Insolvency Cases* presented to the 2012 Annual Meeting of the ALI, at pp 127-128 on Global Principles 34 and 35.

Resolution of the second issue

111 To the extent that the requirement of the trust creditors to bring into hotchpot their dividends from the exercise of the right of exoneration against property of the trust depends upon the characterisation of there being one fund that characterisation is satisfied. It derives from proper weight being given to the equitable consideration of equality among equally ranking creditors: all being unsecured and entitled to the proportionate payment called for by s 108 in one bankruptcy administration. That the nature of particular property, and the equitable obligation inherited by the trustee in bankruptcy in respect of that property, require that property to be distributed among only some creditors (just as insurance, companies, or other legislation protecting local creditors may do) does not deny the operation of the doctrine, but rather calls it forth.

112 The search for one fund is but a recognition of the need for a common bond of interest or obligation to enliven the doctrine and its concerns with equality, fairness and avoidance of unconscionability. Where parties have a common bond of interest as equally ranking creditors of an insolvency administration of one person there may be various circumstances that give rise to differential access to particular property: statute or rule that creates an advantage to a creditor (such as insurance or companies legislation); statute or rule that creates a disadvantage to a creditor (such as the rule against proof of a foreign revenue creditor); or features of the property, otherwise owned beneficially by the company, which make it available only to some creditors. Such differential access might, from one perspective, be seen to create two or more "funds". Indeed that was the language of King CJ in *In re Suco Gold*, approved in *Jones* and *Carter Holt*. But the common bond of interest that calls forth the doctrine of hotchpot derives from that very circumstance, because of all the considerations that attend the analysis: the equally ranking character of the creditors by s 108, the lack of security over, or proprietary interest in, the funds held by the creditors, the funds being the property of the bankrupt as proceeds available for distribution to unsecured creditors (albeit of a certain limited class), and in such circumstances the affront to equality and fairness by some equally ranking creditors being given unequal priority by what might be the mere chance of the creditor's rights arising by reference to the trust.

113 The application of equitable doctrine here does not rest on finding a rule of universal definition of criterion. It applies because the circumstances call forth the underlying equitable principle of equality drawn from the common bond of interest and obligation of equally ranking creditors of one insolvent administration where some creditors, for some reason, have greater (and

unequal) access to the property of the insolvent administration than others, without that advantage being seen to be the creation of a true position of priority by reference to a secured or proprietary interest in the property or of a position of seniority of position (as in circumstances of subordination of creditors). Those considerations set the correct focal length of attention for the characterisation of any concept of one common fund (if that be a necessary criterion for the operation of the doctrine): The common fund is comprised of all the assets of the insolvent company or bankrupt available for payment to ranking unsecured creditors, irrespective of any features of the property or of circumstance of legislation and the like which may direct some assets to some equally ranking creditors and not others.

114 Contrary to the submission of the appellant, the application of hotchpot is not to deny the application of *In re Suco Gold* after recognising its application to the proceeds of the exercise of the right of exoneration; nor is it to apply *Re Enhill*. *Re Enhill* was founded upon the erroneous proposition that the proceeds of the exercise of the right of exoneration were available to all creditors in a mixed fund of all other assets of the insolvent trustee. *In re Suco Gold*, *Jones* and *Carter Holt* deny that. That account should be given by the trust creditors for what they have received from the distribution of the proceeds of the exercise of the right of exoneration in the distribution of general assets is not a mixing of funds, but an operation of equitable doctrine dealing with the appropriate and fair consequences of that priority by reference to the fundamentally equal status of the creditors. No doubt some circumstances of operation of hotchpot may produce a similar outcome to an application of *Re Enhill*; but many others will not. By way of example: $100 of trust debts owed to trust creditors; $50 trust assets; $100 of non-trust debts owed to non-trust creditors; and $50 non-trust assets, would produce 50c in the dollar for trust and non-trust creditors, as it would if *Re Enhill* applied. But $100 of trust debts owed to trust creditors; $75 trust assets; $100 of non-trust debts owed to non-trust creditors; and $30 non-trust assets, would produce 75c in the dollar for the trust creditors and 30c in the dollar for the non-trust creditors, whereas if *Re Enhill* applied, the $105 of assets would be divided rateably between the $200 of creditors giving each 52.5c in the dollar.

115 As these examples show, the operation of equitable doctrine sees the position of trust creditors as advantaged to a degree for the reasons discussed in *Carter Holt*; but that advantage is not built on a circumstance which takes them out of a position of equally ranking unsecured creditors with access to all the property of the insolvent administration. Their common bonds of interest with creditors of equal ranking call forth the requirement to stand back and bring to

account their advantage of access to some assets of the administration to which other equally ranking creditors are denied.

116 For these reasons the proper approach was as submitted by the first and second respondents:

(a) first, priority trust creditors will receive a distribution from the Trust estate (this includes the ATO's SGC claim, limited by the statutory cap);

(b) secondly, all trust creditors will receive a distribution from the Trust estate (funds permitting);

(c) thirdly, all priority creditors, with creditors in each s 109 cascading priority to be treated separately, will receive a distribution from the personal bankrupt estate, and those creditors from step one who had not had their debts fully discharged would be required to bring into hotchpot should there be any other creditors of equal priority to them (here the ATO has no other creditor of equal priority); and

(d) fourthly, all creditors will receive a distribution from the personal bankrupt estate (funds permitting), with those creditors in step two being required to bring into hotchpot the distribution received from the trust estate.

Issue 3: the proper treatment of the proceeds of the preference claim against the ATO

117 The issue arises from the operation of s 122 of the *Bankruptcy Act* that avoids preferences. Its terms are relevantly as follows:

> **122 Avoidance of preferences**
>
> (1) A transfer of property by a person who is insolvent (the ***debtor)*** in favour of a creditor is void against the trustee in the debtor's bankruptcy if the transfer:
>
> (a) had the effect of giving the creditor a preference, priority or advantage over other creditors; and
>
> (b) was made in the period that relates to the debtor, as indicated in the following table.
>
> [Table not reproduced.]
>
> (1A) Subsection (1) applies in relation to a transfer of property by the debtor in favour of a creditor:
>
> (a) whether or not the liability of the debtor to the creditor is his or her separate liability or is a liability with another person or other persons jointly; and
>
> (b) whether or not the property transferred is the debtor's own property or is the property of the debtor and one or more other persons.
>
> …

(5) If a transfer of property is set aside by the trustee in a bankruptcy as a result of this section, the creditor to whom the property was transferred may prove in the bankruptcy as if the transfer had not been made.

…

(8) For the purposes of this section:

(a) transfer of property includes a payment of money; and

(b) a person who does something that results in another person becoming the owner of property that did not previously exist is taken to have transferred the property to the other person; and

(c) the market value of property transferred is its market value at the time of the transfer.

118 From the background facts recited earlier, it can be seen that the relevant preference was the payment of $322,447.58 to the ATO as the payment of a trust debt. Of this sum $171,659 was paid out of Mr Lee's personal funds and the equivalent sum on return was treated as equivalent to the product of the right of recoupment. It is the balance of the returned funds, $150,788.58, that is the subject of the question: whether these funds should be treated as if still subject to use only for the benefit of the creditors of the trust in respect of which the debtor trustee had the right of exoneration, or whether the recovery proceeds of the preference claim were now available to all creditors as general non-trust assets.

The approach of the primary judge

119 The primary judge did not make an explicit direction concerning the characterisation of the proceeds received by the Bankruptcy Trustees from the ATO as an unfair preference. Instead, the primary judge made an order on 29 November 2018 determining that the proceeds of the sale of the assets of the Trust which were subject to Mr Lee's right of exoneration and available to be distributed to trust creditors to the exclusion of non-trust creditors, amounted to $599,782.02. That amount included the $150,788.58 received by the Bankruptcy Trustees from the ATO as an unfair preference. The primary judge thus concluded that those funds should be treated as if still subject to use only for the benefit of the trust creditors.

120 The argument before the primary judge and his reasons in *Lane (No 3*) were framed on the basis of his Honour's approach in *Lane*: That the exercise of the right of exoneration did not produce proceeds that were property of the bankrupt, rather the exercise resulted in the payment of trust funds to trust creditors. Hence, the Bankruptcy Trustees submitted (see *Lane (No 3)* [2018] 1572 at [7]) that the "funds received by them [from the ATO upon repayment of the

preference] were impressed with the terms of the trust such that they (in the shoes of Mr Lee) would only be entitled to use them to discharge liabilities owing to 'trust creditors'".

121 In his analysis of the operation of s 122, the primary judge accepted as correct the statement of the operation of s 122 (and ss 120 and 121) of Drummond AJA in *Westpac Banking Corporation v Bell Group Ltd (in liq) (No 3)* [2012] WASCA 157; 44 WAR 1 at 480 [2526] and 482 [2535]. There the position of ss 120, 121 and 122 were distinguished from the position under the Statute of Elizabeth. In the operation of the latter, an act of the creditor avoiding the transaction is required; under ss 120, 121 and 122 the *Bankruptcy Act* itself avoids the transaction from the date of the commencement of the bankruptcy.

122 The primary judge recognised that s 122 does not confer a cause of action to recover money paid. If successful in showing the engagement of the section and the avoidance, the title to property is to be regarded as never having passed: *Westpac v Bell (No 3)* at 44 WAR 487–488 [2560]. Relief flowing therefrom was referable, his Honour said, to the general law: *Lane (No 3)* at [15], the applicable relief and causes of action being declaration as to title, tracing, moneys had and received, conversion, detinue or an order under the *Bankruptcy Act*. His Honour referred to *Westpac v Bell (No 3)* at 44 WAR 625–626 [3228], *Re Ward; Thomas v L G Abbott & Co Ltd* (1950) 16 ABC 214 at 222, *NA Kratzmann Pty Ltd (in liq) v Tucker (No 1)* [1966] HCA 72; 123 CLR 257 at 285 and *NA Kratzmann Pty Ltd (in liq) v Tucker (No 2)* [1968] HCA 44; 123 CLR 295 at 298–299.

123 At [24]–[28] and [31]–[32], the primary judge reasoned as follows:

> 24 It should be mentioned that, on one view, there appears to be some tension in the reasons of the Court in *NA Kratzmann (No 2)* between the concept that the Bankruptcy Trustee may recover the avoided payments on a simple common law cause of action on the one hand, and, on the other, the suggestion that the trustee's title "does not depend, upon his succession to any title which the bankrupt had". If the Bankruptcy Trustee cannot assert the bankrupt's title to the money paid, one might wonder what form of cause of action might be asserted given it is well accepted the Act does not confer a cause of action to recover the preference payment. The entitlement of the Bankruptcy Trustee to recover the payment must stem from s 58 of the *Bankruptcy Act* which vests the property of the bankrupt in the Official Trustee or registered trustee as the case may be. That would appear to be the source of the title to the property which a Bankruptcy Trustee might assert against the creditor who has received the preferential payment and, on the strength of which, might pursue a claim for money had and received, or an order for payment. It may be that the reference in *NA Kratzmann (No 2)* to "succession to any title" was a reference to a continuing beneficial or legal interest in the property transferred. On that basis it can be accepted that in this case title to the property did not remain with Mr Lee as trustee. The funds were received by the Commissioner who became fully entitled to them. However, when the transaction was vitiated on the making of the sequestration order, the right to be paid

an equivalent amount could only arise in the entity who was entitled to funds which had been paid to the Commissioner. In this case that was Mr Lee. But importantly, Mr Lee's right was one which he held in his capacity as trustee of the family trust and not in his personal capacity; namely his entitlement to use trust funds to exonerate him from debts incurred in the proper administration of the trust. It would appear to be axiomatic that the right to receive repayment from the Commissioner consequent upon the avoidance of the preference payment was a right which vested in Mr Lee *qua* trustee such that the right is property of the trust, albeit one in which Mr Lee also had a beneficial interest. Support for this can be found in *Octavo Investments Pty Ltd v Knight* (1979) 144 CLR 360 at 374 where the High Court ordered that the preference payment be returned to the insolvent company and not to the liquidator. That was logical because, although the liquidator had the right to cause the preference payment to be avoided, once that occurred the right to recover an equivalent amount arose in the company which had paid the money and not the liquidator. Although the regime under the *Bankruptcy Act* vests the bankrupt's assets in the Bankruptcy Trustee, it is still the case that the Bankruptcy Trustee's title to assets is only as good as the bankrupt's.

25 It is also not insignificant that in *Octavo* at 371, the High Court expressly left open whether, where the bankrupt was a trustee, the repayment of money paid out of a trust which was a preference should be refunded to the Bankruptcy Trustee or the trustee. To date there is no sufficiently authoritative statement on this topic although the learned authors of *Jacobs' Law of Trusts in Australia* (Heydon JD and Leeming MJ, *Jacobs' Law of Trusts in Australia* (8th ed, LexisNexis, 2016) at 524, [21-16] advance the view that the money received is to be used to discharge trust debts only. The Bankruptcy Trustees have no independent right to assert an entitlement to the funds.

26 The Commissioner further argued that the right of the Bankruptcy Trustees to "recover the unfair preference is not a right held by the bankrupt in his capacity as trustee of the Family Trust for the benefit of the beneficiaries". But, as the authorities identified above disclose, the Bankruptcy Trustee is not afforded a right to recover the amount paid, but merely to recover, at general law, a payment which has been avoided by reason of the making of the sequestration order. The right to recover is dependent on whatever general rights exist. In this case that right is to recover an amount paid out of the trust funds in discharge of a trust debt. Both the beneficiaries and trustee have a beneficial interest in the right and an interest in seeing that it is applied in discharge of trust debts.

27 The Commissioner further submitted that in order for the proceeds, when received, to have the character of trust assets, the beneficial interest in them must never have been transferred, or that the trust obligations would have to re-enliven, and there is no sound basis for that to occur. Whilst the first can be accepted where the property transferred is not traceable, the second cannot. The second amounts to an assertion that if a trustee, in the course of the administration of a trust, enters into an agreement pursuant to which it pays out trust money but the agreement is vitiated, any funds recovered by the trustee would not be subject of the trust obligations. That, of course, cannot be correct. If a trustee acquires a *chose in action* as a consequence of the operation of a trust, that *chose in action* is held pursuant to the trustee's rights and obligations, no less than other trust property. In this case, the taxation liability which was discharged by the payment of trust funds to the Commissioner arose as a result of the operation of the trust and Mr Lee paid the amount of $150,788.58 out of the trust funds to discharge that liability and, *pro tanto*, it reduced the trustee's equitable lien over the trust assets. He was only entitled to use that money by reason of his position as trustee and the rights and entitlements he acquired as a result. When the transaction was avoided by reason of the making of the sequestration order, the right to recover the payment only existed because of Mr Lee's position as trustee. His right to recover

the amount paid is subject to the trust obligation to use the trust funds for the purposes of the trust. It is not possible to hive off from the other rights and obligations of a trustee, the right to recover payments made for the purposes of the trust which have been avoided. The right is necessarily a constituent element of the bundle of rights and obligations of the trustee and no principle was referred to which suggests that a trustee might exercise such rights independently of the other trust obligations. If, as the authorities referred to above seem to indicate, the avoidance of the preferential payment merely negates the existence of the original transfer for all purposes and leaves the right to recover to the general law, the foundation of the general law right cannot be ignored.

28 At the very least, the right to receive the funds would be subject to the fiduciary duty that Mr Lee is not to profit from his position as trustee. The Bankruptcy Trustees must also be subject to that obligation to the extent to which they seek to exercise Mr Lee's rights as the trustee. On the Commissioner's arguments, Mr Lee's personal estate will obtain a benefit from the making of preference payments out of the trust assets because, on their repayment to the Bankruptcy Trustees, they can be used to discharge personal debts. The Commissioner's submissions did not explain how the use of trust power could legitimately circumvent the undoubted trust and fiduciary duties.

…

31 There is little doubt that much uncertainty presently exists as to the use to which proceeds recovered as preference payments can be put where the original payment arose from the exercise of a trustee's right of exoneration. As the above identifies, a principled approach to the analysis suggests that the right of a trustee to use trust funds to discharge trust debts does not transform on insolvency into a right to use funds for the benefit of the trustee. If the use of trust funds to discharge a trust debt is vitiated and avoided, the entitlement to recover from the payee exists only because the trustee was entitled to use the funds *qua* trustee. Neither the trustee, nor anyone claiming through him, has an entitlement to recover the funds for their personal use. Neither principle, nor authority, suggest to the contrary.

32 It follows that funds recovered consequent upon a transaction where trust funds were used to discharge a trust debt, are subject to the obligation to use them in the manner required of the original funds, being for the purposes of discharging trust debts. The parties should bring in short minutes of orders reflecting the above conclusions.

The grounds of appeal

124 This issue was dealt with in grounds 5 and 6 of the amended notice of appeal as follows:

> 5. His Honour erred in holding that the Bankruptcy Trustees were subject to trust and fiduciary obligations in respect of the money recovered from the Commissioner of Taxation (**recovered money**), requiring them to use that recovered money only for the purpose of discharging trust debts.
>
> 6. His Honour should have held that the recovered money was the property of the bankrupt (as defined in the *Bankruptcy Act 1966* (**the Act**)) and subject to the order of payments in ss108 and 109 of the Act, in the administration of the bankrupt estate.

The submissions of the parties

125 The primary submission of the appellant was that the primary judge's reasons were inconsistent with the reasoning of the High Court in *Kratzmann (No 2)*. There the Court held that the

amounts recovered in accordance with a preference section (s 95 of the *Bankruptcy Act 1924* (Cth)) were not subject to a charge that had existed at the time of payment because the money was not the same money as was paid. In *Kratzmann (No 2)* McTiernan, Taylor and Menzies JJ said at 123 CLR 300–301:

> … The position of the secured creditor who has a charge on specific property is, of course, not in question; such property in the hands of the trustee will still remain subject to the charge. But where security has been given by a bankrupt over all of his assets and a payment to a creditor is made by him out of moneys subject to the charge and the payment is, as against the trustee, subsequently declared void as a preference the moneys paid, when recovered, will not be subject to the charge. In such a case it may be said that although the moneys paid as a preference were at the time of payment subject to the charge, the moneys recovered by the trustee are not the same moneys and that they do not, by virtue of payment to the trustee, become moneys of the bankrupt or in any way subject to the charge; when recovered they become the moneys of the trustee and his title to them does not depend, upon his succession to any title which the bankrupt had. It was, we think, in this sense that Bennett J meant in the passage that we have first cited that, applying the bankruptcy rules in a winding up,
>
> > … the sum of money when recovered by the liquidators by virtue of s. 265 of the *Companies Act*, 1929, and s. 44 of the *Bankruptcy Act*, 1914, did not become part of the general assets of Yagerphone, Ltd., but was a sum of money received by the liquidators **impressed in their hands with a trust for those creditors** amongst whom they had to distribute the assets of the company.
>
> (Emphasis added.)

126 The appellant correctly focused on the different character of the funds paid to and recovered from the preferred creditor. The issue is not a question of title to the funds paid to the preferred creditor. But, as will be seen below, the above passage from the reasons of Bennett J in *In re Yagerphone, Limited* [1935] Ch 392 quoted and approved by the High Court is critical to the resolution of this case.

127 The appellant submitted (correctly) that the funds come to the trustee in bankruptcy as property to be distributed in accordance with the intention of the statute. This meant, it was submitted (incorrectly), that the trustee in bankruptcy was entitled and bound to make the payment received available to all creditors of the bankruptcy.

128 The appellant criticised the primary judge's reasoning in *Lane (No 3)* at [24]–[28] as founded on a misunderstanding that the trustee in bankruptcy was asserting a right transmitted from the bankrupt. The right was submitted to be that of the trustee in bankruptcy who was asserting a right to repayment based on the receipt by the preferred creditor of funds that were part of the bankrupt estate (to which the trustee in bankruptcy had title) at the time of payment. The payment of the sum representing the preference came back to the trustee in bankruptcy for the

benefit of the (whole) estate. The appellant also relied on what Doyle CJ said in *Re Fresjac Pty Ltd (in liq); Campbell v Michael Mount PPB* (1995) 65 SASR 334 at 339:

> Once the money of the company was paid to the defendant, the money of the company had lost its identity. At the time of the payment and immediately thereafter the company had no rights in relation to the money paid to the defendant. Upon the making of the winding-up order the payment by the company to the defendant was avoided, having been made after the commencement of the winding up, and the result of that avoidance is that a new right to compel repayment of an equivalent amount of money arose ... it is not possible, as it seems to me, to analyse the matter as if the payment had never taken place.

129 The first and second respondents submitted that the primary judge was correct to view the action as one that vested in the bankrupt and through him the trustee in bankruptcy under s 58 and s 116(1) of the *Bankruptcy Act*. The first and second respondents emphasised that the payment was made from trust assets by the trustee (Mr Lee). Thus it was submitted that upon avoidance by s 122 the right to recover was held by the (now bankrupt) trustee subject to the equities as when made, drawn from their character as trust funds. The Bankruptcy Trustees succeeded to that claim subject to the equities of the trust property.

The resolution of the question

130 The resolution of the question requires close attendance to the operation of the *Bankruptcy Act*, and to the underlying purposes of the powers, obligations and rights of the trustee in bankruptcy.

131 The phrase "void against the trustee in … bankruptcy" appears in ss 120 (undervalued transactions, previously settlements) and 121 (transfers to defeat creditors) and s 122. As to the meaning of the phrase, see *Brady v Stapleton* [1952] HCA 62; 88 CLR 322 at 332–358, esp 334, *Williams v Lloyd*; *In re Williams* [1934] HCA 1; 50 CLR 341 at 374 and the other authorities cited in *Trustee of the Property of O'Halloran, in the matter of O'Halloran v O'Halloran* [2002] FCA 1305 at [76].

132 The operation of s 95 of the *Bankruptcy Act 1924* (the predecessor to s 122) was discussed by Dixon CJ, Fullagar, Kitto and Taylor JJ in *Federal Commissioner of Taxation v Jaques* [1956] HCA 40; 95 CLR 223. The question in issue was whether s 95 was a provision contemplated by s 5(3) of the *Bankruptcy Act 1924* (Cth) which provided for certain provisions of the Act to bind the Crown, as follows:

> Except as otherwise expressly provided in this Act, the provisions of this Act relating to the remedies against the property of a debtor, the priorities of debts, … shall bind the Crown as representing the Commonwealth or any State.

133 The answer of the Court was that s 95 was not such a provision, their Honours saying at 95 CLR 229–230:

> It may be thought to be a question whether s. 95 (1) is not one of the provisions of the Act "relating to the priorities of debts". It is true that it is not included in the group of sections by which the Act prescribes the order of priorities to be observed by the trustee in the application of the estate of a bankrupt, namely ss. 84, 85, 86, 87, 88A and 89 in Div. 2 of Pt. VI. It is, however, in the nature of a corollary to those sections, in the sense that **it is directed to ensuring that the administration of a bankrupt's estate in accordance with them shall not be prevented by any conveyance, transfer, charge, payment, obligation or judicial proceeding, occurring within six months before the presentation of the petition and not possessing certain saving characteristics, which, if it were allowed to be effective, would put a debt ahead of the place appropriate to it in the prescribed order.** Its operation, so far as payments are concerned, is to "prevent a payment to anybody who, but for such payment, would share in the administration of the bankrupt's estate", that is to say "any person who, at the date of the payment to him, would have had to come in and prove and rank with the other creditors in the bankruptcy": *In re Paine; Ex parte Read*. **The section is therefore analogous in its purpose to the old rule which invalidated a fraudulent preference on the ground that if it were permitted to stand "the policy of the bankruptcy laws would be defeated"**: *Wheelwright v. Jackson*, and to the provision now in force in England under s. 44 of the *Bankruptcy Act* 1914 which has been described as invalidating such a preference as "a fraud upon the administration in bankruptcy": *Butcher v. Stead*.
>
> (Emphasis added. Footnotes omitted.)

134 The following is to be noted about the text of s 122 and about these passages from *Jaques*: First, the avoidance is *as against the trustee*. Secondly, its operation in respect of a payment is to make the payment void as a payment so that, in favour of the trustee, the creditor is to be considered as having received money which is part of the bankrupt's estate, and the creditor's debt is considered not paid. Thirdly, the trustee in bankruptcy's remedies as to monetary recovery include: a suit at common law, for moneys had and received (now in restitution) or an order for payment under the *Bankruptcy Act* (s 25 under the 1924 Act, s 30 under the 1966 Act). Fourthly, that the avoidance is as against the trustee in bankruptcy (not generally or as against the debtor, now bankrupt) means that the sequestration order marks the event to which the section speaks and the date of commencement of the bankruptcy marks the earliest time from which the avoidance operates: *Williams v Lloyd* at 374; and *Re Fiorino; Fiorino v Woodgate* [1994] FCA 181 at [42]. Fifthly, the provision does not provide for avoidance entitling the debtor to sue to recover the payment to which the trustee in bankruptcy succeeds by force of s 58. Rather, it is the trustee's common law action because, by force of the statute and the making of the payment void as against the trustee in bankruptcy, the creditor is to be treated as having received money which belonged and belongs to the estate of the bankrupt. The trustee in bankruptcy would be the plaintiff in the action, not because he or she succeeded

a right of action of the debtor (now bankrupt), but because the operation of the section treats the creditor as having received property of the bankrupt estate administered by the trustee in bankruptcy. In any event, an order could also be made under the *Bankruptcy Act* to pay to the trustee in bankruptcy moneys representing money belonging to the bankrupt's estate. Sixthly, the creditor is remitted to the remedy that it had: to prove in the bankruptcy. Seventhly, the purpose of the section is to ensure that the administration of the estate takes place in the order prescribed by the *Bankruptcy Act* and that the payment not dislocate the working of the statute: in the language referable to the notion of the fraudulent preference – to avoid a fraud on the administration of the bankruptcy.

135 Reading and understanding the *Bankruptcy Act* against the background of equitable principle and the operation of the law of trusts, as one should: s 122, *Jaques* and the above observations lead to the following further conclusions concerning the present circumstances. First, the moneys belonging to the bankrupt estate that the creditor is taken to have received were the proceeds of the exercise of the right of exoneration and thus property of the bankrupt estate representing the bankrupt's proprietary interest in the trust property. Secondly, the creditor is remitted or restored to its position as a trust creditor enjoying its right of subrogation to the bankrupt's (trustee's) beneficial interest in the trust funds. Thirdly, the preference that is the subject of the operation of s 122, by treating the payment as void as against the trustee, is one concerned with, *and only with*, the relative mutual standing or positions among trust creditors. The payment of the money (being money belonging to the bankrupt estate) to one trust creditor could not have preferred or advantaged that creditor over non-trust creditors because the non-trust creditors could never participate in the proceeds of the exercise of the right of exoneration. There could be no preference if there were only one trust creditor. If there were more than one trust creditor, it is it or they who has or have suffered the disadvantage by the preference or priority of the payment; it or they will receive proportionately less from the trust assets than the payee of the preference. The general creditors are not disadvantaged, because whatever be the division of the proceeds of the right of exoneration amongst the trust creditors (pari passu and equally, or unequally resulting from the preference) if the trust creditors are not paid in full there will be the same overall amount which they, as a group, will claim from the general or non-trust assets (whether or not the trust creditors have to bring funds already received into hotchpot). Thus the section is engaged only by reference to the effect of the payment upon the position of trust creditors. Fourthly, the purpose of the operation of s 122 in these circumstances is to prevent the dislocation of the proper distribution to the trust creditors that would have

taken place had the preference payment not taken place and had the money been retained by the bankrupt and vested in the trustee in bankruptcy.

136 This is the proper context to answer the question whether the proceeds of the preference recovery action referable to a payment by the (trustee) debtor to a trust creditor of moneys being part of the proceeds of the exercise of the right of exoneration in respect of that trust should be available only to the trust creditors of that trust or available to all creditors as non-trust assets of the bankrupt estate.

137 The operation of the avoidance as against the trustee from the accrual of the title of the trustee in bankruptcy (from the date of the commencement of the bankruptcy, here being the earliest act of bankruptcy relating back within six months from the date of the presentation of the petition: s 115 of the *Bankruptcy Act*) means that, as stated in *Jaques*, the preferred creditor has received funds of the bankruptcy estate to which the trustee in bankruptcy is and was by the operation of the Act entitled.

138 The moneys paid to the preferred creditor were not trust funds in the sense of funds to which the beneficiaries of the relevant trust were entitled. They were proceeds of the sale of assets in which Mr Lee had a personal beneficial interest by the exercise of his right of exoneration: *Carter Holt*.

139 The nature and character of the proceeds of the preference recovery action, being funds received by the trustee in bankruptcy or liquidator, was discussed in *Kratzmann (No 1)* and *Kratzmann (No 2)*, and *In re Yagerphone*.

140 It is convenient to deal with *In re Yagerphone* first, recognising that in *Kratzmann (No 2)* the Court approved the reasons of Bennett J in *In re Yagerphone*. It also needs to be recognised that none of these cases concerned the present immediate problem of the insolvency of a trustee that had carried on trust and non-trust affairs.

141 *In re Yagerphone* concerned the recovery by liquidators of a fraudulent preference paid to a creditor. A debenture holder (that is, a secured creditor) took out a summons in the liquidation for an order that the recovered moneys were property of the company in liquidation and were property secured by the debenture. Justice Bennett rejected the claim, finding that the sum could be retained by the liquidators and distributed among the creditors who had proved in the liquidation. Justice Bennett commenced his reasons by pointing out that a secured creditor has no right to enforce, for his or her benefit, the remedy which is given to a trustee in bankruptcy

or a liquidator of avoiding a payment or setting aside a transaction made or entered into with a view to preferring a creditor. Importantly for present purposes, Bennett J stated that the right to recover a sum from the creditor preferred was "conferred for the purpose of benefiting the general body of creditors": [1935] Ch 396. His Lordship agreed with the submission of senior counsel for the liquidators saying at [1935] Ch 396 that which is set out at [125] above.

142 In coming to his conclusion, Bennett J found that the security had crystallised at a time when the sum was not part of the property of the company, but was instead in the hands of the creditor to whom the preference payment had been made. This finding was commented upon by Russell LJ in *NW Robbie & Co Ltd v Witney Warehouse Co Ltd* [1963] 1 WLR 1324, where his Lordship stated that he did not think that the decision in any such case could depend upon whether or not the charge had crystallised at the time when the payment to the creditor was made, his Lordship saying at 1338:

> ... a claim by the liquidator for repayment to him of a fraudulent preference was not subject to the debentureholder's charge; a statutory right in and only in the liquidator to make such a claim could never have been property of the company subject to the charge.

143 Justices McTiernan, Taylor and Menzies in *Kratzmann (No 2)* referred with approval to the statements by Bennett J and Russell LJ set out above*:* see 123 CLR 300–302. *Kratzmann (No 2)* concerned preference payments made by the respondent, **Reid Murray** Developments (Qld) Pty Ltd to **NA Kratzmann** Pty Limited. Shortly after the payments were made, both companies were the subject of winding up orders. The Supreme Court of Queensland then declared the payments void and ordered that NA Kratzmann repay the full sum to Reid Murray. The Supreme Court held that NA Kratzmann was not entitled to prove in the winding up of Reid Murray in respect of the amount without first having paid it in full to the liquidator of Reid Murray. The appeal to the High Court concerned whether the liquidator of Reid Murray was entitled to be paid the recovered preference in full, and whether NA Kratzmann was permitted to participate in the liquidation of Reid Murray before the preference amount had been paid back in full. After citing the passages of *In re Yagerphone* discussed above, McTiernan, Taylor and Menzies JJ stated that where security has been given by a bankrupt over all of his assets and a payment to a creditor is made by him out of money subject to the charge and the payment is, as against the trustee, subsequently declared void as a preference the moneys paid, when recovered, will not be subject to the charge. Their Honours reasoned that, although the moneys paid out as a preference were at the time of payment subject to the charge, the moneys recovered by the trustee are not the same moneys and they do not, by virtue of the payment to

the trustee, become moneys of the bankrupt or in any way subject to the charge: see [125] above where their Honours' reasons are set out in part. Their Honours noted that the position would be different where a preference consists of the disposition of specific and identifiable property subject to a charge, citing *Albert Gregory Ltd v C Niccol Ltd* (1916) 16 SR (NSW) 214, *Ex parte Cooper; In re Zucco* (1875) 10 Ch App 510 and *Willmott v London Celluloid Co* (1886) 31 Ch D 425; (1886) 34 Ch D 147. Referring to what the New South Wales Supreme Court said in *Albert Gregory*, the Court noted that the cases of *Ex parte Cooper* and *Willmott* decided that a secured creditor could not himself assert a claim to set aside a dealing as a preference and that a trustee ought not to assert such a claim where the resultant benefit would accrue only to a secured creditor; no doubt, the Court noted, it was thought that the creditor should be left to rest upon his security: 123 CLR at 301–302.

144 The Court went on to say, at 123 CLR 302, that the question was *not* who may take the benefit of the situation created by the avoidance of the payments in question, but rather the extent to which consequential relief may properly be afforded against a company already in liquidation. The Court held that the appropriate relief was for Reid Murray to prove in the winding up of NA Kratzmann as a creditor for the amount equivalent to the preference payment. The Court noted that to order otherwise (that is, declare that Reid Murray was entitled to payment of the amount in question in full) would "be in conflict with the statutory duties of [NA Kratzmann's] liquidator (see particularly ss 291 and 292 [of the *Companies Act 1961* (Qld)])": 123 CLR at 302. Their Honours held, however, that NA Kratzmann could not prove in the winding up of Reid Murray unless and until it had repaid the preference payment in full: 123 CLR at 303.

145 In *Re Fresjac* 65 SASR at 341–342, Doyle CJ commented on *Kratzmann (No 2)* as follows:

> This decision of the High Court seems to me to establish that the avoidance of a transaction and the consequences of that avoidance require separate consideration, and in particular will require separate consideration when the relevant transaction is a payment of money. In such a case the final result will not be disclosed simply by an analysis which proceeds on the basis that title to the property has not left the company which disposed of the property.
>
> … As I understand the decision of the High Court, the point being made was that in the case of a money payment, moneys recovered by a trustee in bankruptcy or by a liquidator were not received as the charged property, or as its substitute, but simply as moneys due on a common law cause of action by virtue of the avoidance of the payment. That left the destination of the proceeds of the recovery to be decided. And in the case of a preference the court held that the recovery was for the benefit of the unsecured creditors.
>
> That same question has to be decided here, and it seems to me that *Kratzmann's* case demonstrates that the destination of the proceeds of the recovery of money are not to

> be determined by reference to title to property (the payment of money being involved) nor by reference simply to the notion of a void transaction or the notion of a transaction which, as a matter of law, is taken never to have happened. As I have endeavoured to explain, even the law has difficulty denying facts and the fact is that the money had changed hands, the property of the company had passed, and the effect of the avoidance of the transaction is to create a right to the recovery of an equal amount of money.

146 The reasons of the High Court in *Kratzmann (No 2)* do not detract from or alter the statement made by Bennett J in *In re Yagerphone* that proceeds of a preference recovery action received by a trustee in bankruptcy or liquidator were "impressed in their hands with a trust for those creditors amongst whom they had to distribute the assets of the company".

147 Such a notion of a trust for creditors must be correctly understood. The office of the trustee in bankruptcy is a creature of statute, created and regulated by the *Bankruptcy Act* and *Bankruptcy Rules*. The trust executed by the trustee in bankruptcy constitutes a statutory trust in the sense discussed by the High Court in *Fouche v Superannuation Fund Board* [1952] HCA 1; 88 CLR 609 at 640, *Superannuation Fund Investment Trust v Commissioner of Stamps* (SA) [1979] HCA 34; 145 CLR 330 at 353–354 and 362–364, *Harmer v Commissioner of Taxation of the Commonwealth of Australia* [1991] HCA 51; 173 CLR 264 at 274, *Registrar of the Accident Compensation Tribunal v Commissioner of Taxation* [1993] HCA 1; 178 CLR 145 at 161–168 and 180–184, *Wik Peoples v Queensland* [1996] HCA 40; 187 CLR 1 at 97, and *Bathurst City Council v PWC Properties Pty Limited* [1998] HCA 59; 195 CLR 566 at 592 [67]. See also *Re Fiorino* at [47] and Gummow W, *Change and Continuity: Statutes, Equity and Federalism* (Oxford University Press, 1999) at 55–56. That is, it is not a trust for persons, but a trust for statutory purposes. The trustee is bound to administer the estate in accordance with the *Bankruptcy Act* and *Bankruptcy Rules* and holds the funds subject to the obligation to dispose of them in accordance with the statutory regime: *Adsett v Berlouis* [1992] FCA 549; 37 FCR 201 at 208 and *Young v Thomson* [2017] FCAFC 140; 253 FCR 191 at 217 [112] and 218–219 [117]. The creditors and the bankrupt are not beneficiaries in the conventional sense of a private, non-charitable trust, although each of them has standing to apply to the Court under Schedule 2 of the *Bankruptcy Act* in respect of acts, omissions or decisions of the trustee in his or her administration of the estate. A trustee in bankruptcy is governed by the general law relating to trustees, with all the fiduciary duties of a trustee, save where the position of the trustee is modified by the *Bankruptcy Act* or *Bankruptcy Rules*: *Adsett* at 37 FCR 209 and *Young* at 253 FCR 217 [110].

148 Though this conceptual underpinning was not discussed by Bennett J in *In re Yagerphone*, such a form of statutory trust for purposes can be seen as referable here to the proceeds of the

preference action by the interaction of s 122 with the general law, in particular the context of the operation of equitable principles in which s 122 was presently engaged. The clear purpose of s 122, the nature of the preference as against only trust creditors, and the consequences of the remittal of the preferred creditor to its rights assist in shaping the clear obligation on the trustees in bankruptcy to hold and use the proceeds for the evident statutory purpose of removing the dislocation of the proper order of priorities that occurred by the payment of the preference. In the present circumstances, the trust is one for the purposes of the statute that would see the trust creditors share rateably. The preference and dislocation was only in relation to their interests; the provision thus exists for their benefit (not the benefit of general non-trust creditors) as the only persons (in the present circumstances) disadvantaged by the preference and as the persons whose rights give rise to the existence of a preference. For the liquidator to use the funds for the benefit of non-trust creditors (at least before trust creditors were fully paid) would be to disadvantage the trust creditors who had been originally disadvantaged by the preference, by not allowing them to take full advantage of the recovery in circumstances where the erstwhile preferred creditor had been remitted to its position as a trust creditor in the full amount. These circumstances would undermine the intended operation of s 122 to eliminate as far as possible the dislocation of order of payment provided for by the *Bankruptcy Act* in its operation in the context of equitable principles arising from the trustee's activities. See also the remarks of Doyle CJ in *Re Fresjac* at 65 SASR 341–342.

149 The Bankruptcy Trustees are bound to apply the funds in accordance with the trust for purposes to which I have referred and which binds them. For the reasons explained above, those purposes involved the use of the funds to remedy the dislocation of distribution caused by the preference by payment rateably among the trust creditors.

150 It is unnecessary to decide how the Bankruptcy Trustees would be obliged or entitled to use any excess of such funds if all trust creditors were paid in full before the recovered funds were exhausted. Given the separate nature of the funds received from the preferred creditor, it may be that such balance would go to general creditors of the bankrupt, rather than to the beneficiaries of the original trust. This question does not fall for decision.

Orders

151 Thus the appeal should be allowed upon the first issue, but dismissed on the second and third issues. The parties should bring in short minutes to reflect the directions that should be given consequent upon, and in accordance with, these reasons.

I certify that the preceding one hundred and fifty-one (151) numbered paragraphs are a true copy of the Reasons for Judgment of the Honourable Chief Justice Allsop.

Associate: 

Dated: 6 November 2020

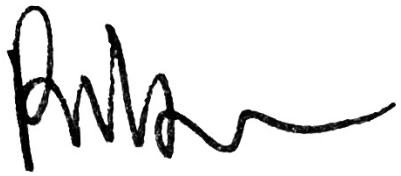
REASONS FOR JUDGMENT

PERRAM J:

152 I have read the reasons of the Chief Justice and respectfully agree with them and the orders he proposes.

I certify that the preceding one (1) numbered paragraph is a true copy of the Reasons for Judgment of the Honourable Justice Perram.

Associate:



Dated: 6 November 2020

REASONS FOR JUDGMENT

FARRELL J:

153 I have read Chief Justice Allsop's reasons and the orders proposed and respectfully agree with them.

I certify that the preceding one (1) numbered paragraph is a true copy of the Reasons for Judgment of the Honourable Justice Farrell.

Associate: 

Dated: 6 November 2020