Subrogation to the Trustee's Personal Right of Indemnity

Ahmed Terzic*

It is settled that an unsecured creditor to whom a trustee has properly incurred a liability in the administration of a trust may be subrogated to the trustee's right of indemnity out of the trust estate in circumstances where the trustee is insolvent or where obtaining judgment against the trustee would be futile. This is the only method available for the creditor to recover value from the trust estate. An alternative for the creditor to recoup its debt might be to seek subrogation to the trustee's personal right of indemnity against the beneficiaries of that trust; however, Australian case law has proven this to be a murkier proposition. This article traces the judicial development of the unsecured creditor's remedy of subrogation to the trustee's personal indemnity in Australia. It contends that such a creditor may be subrogated to the personal indemnity without the need for it to exhaust all of its remedies against the trustee.

INTRODUCTION

An unsecured creditor that engages in business with a trading trust often runs the risk that the trustee with which it contracted cannot repay its debts. If this occurs, the creditor will ordinarily seek repayment from the trustee. The trustee, of course, is personally liable for any debt properly incurred in furthering the trust business. If the trustee cannot discharge this liability, the creditor has neither a direct claim, nor the ability to levy execution, against the trust assets;[1] the creditor may instead be subrogated to the trustee's right of indemnity against the trust assets by standing in the trustee's shoes and enforcing its liabilities against those assets.[2] This particular right of indemnity, which may be described as the proprietary indemnity, arises as a necessary incident of the trustee's office,[3] save for any limitation on its availability as a result of a contractual agreement between the trustee and any given creditor.[4]

The trustee's right of indemnity may not always be limited to the trust assets. The court has recognised that, in some circumstances, a trustee has a personal right of indemnity against trust beneficiaries.[5] Whether, and, if so, the extent to which, an unsecured creditor may be subrogated to this personal indemnity, where it exists, is by no means certain. The question is nonetheless an important one for all parties concerned: the unsecured creditor has an interest in recovering value from beneficiaries in addition to, or in lieu of, the trust assets; the trustee will heed the consequences of contracting with third parties and the effect of the trustee's subsequent default or insolvency on a beneficiary; and the beneficiary is made aware of its potential liability for trust debts, which may alter its individual risk profile and cause the beneficiary to either reconsider its willingness to invest or insist that the trust instrument expressly negate any personal indemnity that the trustee may have.

* BCom, LLB (Hons) (Monash); Senior Associate to the Hon Justice JG Santamaria, Court of Appeal, Supreme Court of Victoria.

[1] A possible exception is where the judgment creditor seeking satisfaction through a writ of execution is the trustee's only creditor: *Agusta Pty Ltd v Provident Capital Ltd* [2012] NSWCA 26, [75].

[2] *Vacuum Oil Co Pty Ltd v Wiltshire* (1945) 72 CLR 319, 335; *Octavo Investments Pty Ltd v Knight* (1979) 144 CLR 360, 370.

[3] *JA Pty Ltd v Jonco Holdings* (2000) 33 ACSR 691.

[4] *Re German Mining Co* (1854) 4 De G M & G 19; *RWG Management Ltd v Commissioner for Corporate Affairs (Vic)* [1985] VR 385; cf *JA Pty Ltd v Jonco Holdings* (2000) 33 ACSR 691; *Kemtron Industries Pty Ltd v Commissioner of Stamp Duties* (1984) 15 ATR 627.

[5] See, eg *Hardoon v Belilios* [1901] AC 118; *Balkin v Peck* (1998) 43 NSWLR 706.

This article first explains the trustee's personal indemnity against beneficiaries. It also describes the historical basis of the creditor's remedy of subrogation and outlines the operation of this remedy in respect of the proprietary indemnity. This article then traces a line of Australian authority which indicates that unsecured creditors can be subrogated to the trustee's personal indemnity. The circumstances in which this may occur – including whether a creditor must first exhaust its remedies against the trustee before being subrogated to the personal indemnity – are unclear. It is observed that the relevant decisions fail to expound the reasoning behind the very principles for which they stand. This plight is compounded by the lack of a distinct procedure for subrogation to the personal indemnity – a problem that does not arise in respect of subrogation to the proprietary indemnity.[6]

This article highlights the flexibility of subrogation as an equitable remedy and concludes that there should be no hindrance to allowing an unsecured creditor to be subrogated to the personal indemnity. The discretionary nature of subrogation – informed by equity's concern with preventing unconscionability – may ultimately determine whether subrogation is permitted in any given instance. In view of the commercial interests of the unsecured creditor, the beneficiary and the trustee, it is asserted that an unsecured creditor need not first resort to the proprietary indemnity or exhaust the remedies available against the trustee in order to be subrogated to the personal indemnity. Finally, in order to protect the interests of a beneficiary who potentially faces unlimited liability for properly incurred debts, it is suggested that the personal indemnity may be explicitly excluded in the trust instrument or, alternatively, the trustee may, on behalf of the beneficiaries, contractually exclude their personal liability as part of transacting with an unsecured creditor.

TRUSTEE'S RIGHT OF PERSONAL INDEMNITY AGAINST BENEFICIARIES

It is worth noting at the outset that subrogation is entirely derivative; that is, if the trustee has no right of indemnity then there is nothing to which the creditor may be subrogated.[7] Accordingly, a brief discussion of the trustee's right of personal indemnity against beneficiaries is warranted, for it sheds light on the rights of creditors who seek to be subrogated to this indemnity. A seminal statement on the personal indemnity is found in *Hardoon v Belilios*, where Lord Lindley, delivering the advice of the Judicial Committee of the Privy Council, said:

> The plainest principles of justice require that the cestui que trust who gets all the benefit of the property should bear its burden unless he can shew some good reason why his trustee should bear them himself.[8]

The rationale is that it is inequitable for a beneficiary who benefits from the trust property or a transaction involving the trust not to bear all or a proportionate part of the burden associated with that property or transaction.[9] Davies, Virgo and Burn observe that the principle is consistent with the rule in *Saunders v Vautier*,[10] which provides that beneficiaries who are *sui juris* and together absolutely entitled to trust property may exercise their proprietary rights to wind up the trust; the authors go as far as to say that beneficiaries will not be liable to indemnify a trustee if the conditions for this rule are not satisfied.[11]

Rather than restricting the application of the benefit/burden principle to the facts in *Hardoon*, Lord Lindley framed it as a general right in equity that was subject to exceptions.[12] The question before the Privy Council was whether the registered holder of some shares in an insolvent company could be indemnified by the beneficial owner of those shares against calls made on them during

[6] The conditions for subrogation to the proprietary indemnity are discussed below.

[7] *General Credits Ltd v Tawilla Pty Ltd* [1984] 1 Qd R 388.

[8] *Hardoon v Belilios* [1901] AC 118, 123. This principle was approved by McGarvie J in *JW Broomhead (Vic) Pty Ltd (In liq) v JW Broomhead Pty Ltd* [1985] VR 891, 936.

[9] GE Dal Pont, *Equity and Trusts in Australia* (Lawbook, 6th ed, 2015), 869 [27.75].

[10] *Saunders v Vautier* (1841) Cr & Ph 240.

[11] PS Davies, G Virgo and E Burn, *Equity & Trusts: Text, Cases, and Materials* (OUP, 2013), 539.

[12] *Hardoon v Belilios* [1901] AC 118, 124-125.

liquidation.[13] The beneficiary was absolutely entitled to the shares and *sui juris*. Importantly, the shares – the trust property in this instance – were worthless. Thus, there was no value in the proprietary indemnity; however, this fact by itself did not appear to trigger the trustee's claim to a personal indemnity. In supporting its articulation of the benefit/burden principle as a general right in equity, the Privy Council cited *Balsh v Hyam*,[14] where a trustee was entitled to claim a personal indemnity against a beneficiary who had requested that the trustee borrow money for the beneficiary's benefit; in *Hardoon*, however, the beneficiary made no such request or demand. Had it done so, the Privy Council's advice could have been substantiated on the basis that the control exercised by the beneficiary over the trustee would have exhibited elements of an implied relationship of principal and agent.[15] It is arguable that there may even be an implied contract of indemnity arising between the trustee and the requesting beneficiary.[16]

In view of the Privy Council extracting such a general principle from a confined factual matrix, one may conclude that, unlike the proprietary indemnity, the personal indemnity does not arise as a necessary incident of the trustee's office. Rather, as suggested by the cases discussed below, the question whether the personal indemnity exists is a factual inquiry that depends on the circumstances of the case, including the nature of the relationship between the trustee and beneficiary.[17] Any concerns about *Hardoon*'s precedential value appear to have been overcome in subsequent Australian decisions.[18]

Assuming that the personal indemnity exists in a particular case, of relevance to the present discussion is whether a trustee may claim a personal indemnity against beneficiaries directly without resorting to the proprietary indemnity first. In other words, is the personal indemnity available only where the trust assets are insufficient to satisfy the proprietary indemnity? The Privy Council in *Hardoon* did not deem conclusive the fact that the shares in the insolvent company were worthless, thereby precluding recourse to the proprietary indemnity. It is, however, difficult to conceive that the question whether the personal indemnity was available would have arisen at all if the shares had been of some value and the proprietary indemnity could have been exercised. Ford contends that a trustee need not exhaust its proprietary indemnity in this instance; there may be practical considerations, such as the liquidity of the trust assets and the potential detriment to a beneficiary of converting those assets into cash, which may guide the trustee's decision to proceed against the beneficiary personally.[19] Nor does a creditor have to pursue the trustee to judgment prior to being subrogated.[20] It stands to reason that the exhaustion of trust assets is a factor that influences, rather than triggers, a court's decision to allow a trustee to claim the personal indemnity.

[13] *Hardoon v Belilios* [1901] AC 118, 120-121.

[14] *Balsh v Hyam* (1728) 2 P Wms 453.

[15] See N D'Angelo, *Commercial Trusts* (LexisNexis, 2014) 136 [3.62].

[16] HAJ Ford and IJ Hardingham, "Trading Trusts: Rights and Liabilities of Beneficiaries" in PD Finn, *Equity and Commercial Relationships* (Lawbook, 1987) 80.

[17] D'Angelo, n 15, 136 [3.62].

[18] See, eg *JW Broomhead (Vic) Pty Ltd (In liq) v JW Broomhead Pty Ltd* [1985] VR 891; *Fitzwood Pty Ltd v Unique Goal Pty Ltd (In liq)* [2002] FCAFC 285, [135]. See also RA Hughes, "The Right of a Trustee to a Personal Indemnity from Beneficiaries" (1990) 64 ALJ 567, 570-571; Y Grbich, "Liability for Trust Debts" in Y Grbich *et al*, *Winding Up Trusts* (CCH, 1984), 194. Hughes contends that the Privy Council's comments are *obiter dicta* and do not stand for a wider principle that a beneficiary is liable personally to indemnify a trustee based on the nature of equitable ownership generally. Nonetheless, subsequent cases that have applied the benefit/burden principle appear to have employed the general formulation in *Hardoon*, vindicating the prescient observation of Grbich *et al* that it is a potential "hook on which to hang a much wider burden on the beneficiary".

[19] HAJ Ford, "Trading Trusts and Creditors' Rights" (1981) 13 MULR 1, 8. See also *Balkin v Peck* (1998) 43 NSWLR 706, where the NSW Court of Appeal suggested that the trustee might avail itself of both the proprietary and personal indemnity simultaneously; cf *Fitzwood Pty Ltd v Unique Goal Pty Ltd (In liq)* [2002] FCAFC 285, [135].

[20] *Re Wilson* [1942] VLR 177. See Ford and Lee, *The Law of Trusts* (Thomson Reuters, subscription service) [14.6310].

DOCTRINE OF SUBROGATION: ORIGIN AND APPLICATION

Subrogation Generally

Put succinctly, subrogation involves the transfer of rights from one person to another, at the court's discretion and without the need for consent or assignment, thereby enabling the latter to step into the shoes of the former.[21] The term "subrogation" has been described as one which "embraces more than a single concept in English law".[22] As the authors of *Meagher, Gummow and Lehane's Equity: Doctrines and Remedies* note, subrogation has been ordered in respect of: the vendor's lien; payment out of prior securities; indemnity insurance; guarantees; executors and receivers carrying on ultra vires business; unauthorised or unenforceable borrowings by married women, infants, partners and companies; and marshalling.[23] As a general proposition, "subrogation may arise either from the express or implied agreement of the parties or by operation of law in a number of different situations".[24] While the doctrine of subrogation is thought to derive from Roman law,[25] the history of its reception into English law is largely uncharted.[26] The origins of subrogation lie in equity, in particular as concerns the law of sureties and the principal-surety relationship; however, it has also been recognised by the common law.[27]

Subrogation in a Trusts Context

In a trusts context, it is uncontroversial that a trust creditor may be subrogated to the trustee's proprietary indemnity by operation of law.[28] Ford explains that subrogation to the proprietary indemnity derives from the Court of Chancery practice of distributing funds from trusts that were under the administration of the Court:

> When the Court of Chancery took into its own hands the administration of an estate, it restrained creditors from pursuing their legal remedy at common law. When the Court made the decree for administration it operated as a judgment for all the creditors and the creditors then had to prove their debts under the administration decree.[29]

This point was demonstrated in *Re Wilson*, which concerned an application by a trust creditor seeking an order for the administration of a deceased estate. O'Bryan J said:[30]

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[21] *Orakpo v Manson Investments Ltd* [1978] AC 95, 104. See, eg *Boscawen v Bajwa* [1996] 1 WLR 328; *Cochrane v Cochrane* (1985) 3 NSWLR 403; *Cook v Italiano* (2010) 190 FCR 474; *Gordon v Leon Plant Hire Pty Ltd* [2015] NSWSC 397.

[22] *Cheltenham & Gloucester plc v Appleyard* [2004] EWCA Civ 291, [32] (Neuberger LJ).

[23] JD Heydon, MJ Leeming and PG Turner, *Meagher, Gummow and Lehane's Equity: Doctrines and Remedies* (LexisNexis, 5th ed, 2014) 367 [9.040].

[24] *Banque Financière de la Cité v Parc (Battersea) Ltd* [1999] 1 AC 221, 231 (Lord Hoffmann); Lord Hoffmann went on to say that the doctrine of subrogation falls within one of two "radically different institutions": one is part of the law of contract and the other part of the law of restitution. As explained below, the High Court of Australia in *Bofinger v Kingsway Group Ltd* (2009) 239 CLR 269 rejected the restitutionary basis of subrogation in England in favour of orthodox equitable principles and unconscionability; cf *Balkin v Peck* (1998) 43 NSWLR 706, 712. See generally G Tilley, "Restitution and the law of subrogation in England and Australia" (2005) 79 ALJ 518.

[25] See *John Edwards & Co v Motor Union Insurance Co Ltd* [1922] 2 KB 249, 252 (McCardie J); McCardie J said that the concept was not known as "subrogation" in Roman law. But see R Thomas (ed), *The Modern Law of Marine Insurance: Volume Four* (Routledge, 2015), 196 [9.10] fn 25, arguing that, as insurance contracts developed in Europe in the 14th and 15th centuries, "the likelihood is that there was no directly analogous Roman law doctrine". However, that author acknowledges that there were "subrogation-like rights under Roman law available to a surety as against co-sureties and with respect to the rights and security available to the creditor".

[26] See J O'Donovan and J Phillips, *The Modern Contract of Guarantee* (Thomson Reuters, subscription service) [12.2450]. In *Commissioners, State Savings Bank of Victoria v Patrick Intermarine Acceptances Ltd (In liq)* [1981] 1 NSWLR 175, 170, Meares J suggested that subrogation "is perhaps an example of the maxim that equality is equity".

[27] See, eg *Ex parte Crisp* (1744) 1 Atk 133.

[28] See, eg *Napier v Hunter* [1993] AC 713, 736.

[29] Ford, n 19, 18-19 (citation omitted).

[30] *Re Wilson* [1942] VLR 177, 183. See also *Re Frith; Newton v Rolfe* [1902] 1 Ch 342; *Re Bracey; Hull v Johns* [1936] Ch 690.

> There appears to be no reason in principle why a creditor must pursue his common law rights to judgment before he will be allowed to be subrogated to the trustees' indemnity against the estate. It is one thing to refuse him an order for administration as a matter of discretion if no more appears than the fact of the debt, but if he has demanded payment from his debtor and has failed to receive payment and the circumstances are such as to lead to the reasonable conclusion that a judgment, if obtained, would be fruitless, it would be a harsh and unnecessary rule that required him first to proceed to judgment.

It warrants mention that the Court of Chancery practice was supplemented by the Court formulating a remedy in an attempt to avoid the enrichment of an individual to whom the trust estate had been wrongly distributed, such as a beneficiary or next of kin who derived title from the deceased testator.[31] The Court thus ordered that the money which had been distributed be refunded to the creditor where the assets of the estate were deficient.[32] By the same token, where a legatee was paid by a creditor and the assets of the estate were deficient, the legatee was ordered to refund the money in favour of any unpaid creditors.[33] With no such remedy existing at common law,[34] it was urged that the rationale for these orders was "to do justice and to avoid the evil of allowing one man to retain what is really and legally applicable to the payment of another man".[35]

The foregoing brief historical discussion explains why a creditor may be subrogated to the proprietary indemnity. Based on the cited authorities, there is indeed little to suggest that a creditor may be subrogated to the personal indemnity. However, enabling a creditor to be subrogated to the personal indemnity may be defensible on the basis that it prevents the injustice of a trust creditor remaining unpaid in circumstances where the trustee is insolvent or cannot be made a defendant to proceedings and the trust fund is exhausted, a fortiori where a beneficiary or others have profited from the wrongful or unjust distribution of trust property. This is a gloss on the rationale invoked by the Court of Chancery in its administration of deceased estates centuries ago, and it can be reconciled with the unconscionability basis of subrogation that has been espoused in Australia.[36]

Operation of Subrogation in a Trusts Context

Evidently, there is no existing procedure whereby a trust creditor may be subrogated to the personal indemnity. It is doubtful whether this point alone explains why some authorities oppose direct subrogation to the personal indemnity.[37] As a starting point, an unpaid trust creditor may be subrogated to the trustee's proprietary indemnity so as to recover amounts personally owed to it by the trustee.[38] The sequence of events leading up to this outcome can be summarised as follows. A trustee incurs a debt in the course of performing a trust. The trustee is personally liable for the full amount of

[31] See *Noel v Robinson* (1682) 1 Vern 90, 94 (Lord Chancellor Nottingham), where it appears that the ecclesiastical Spiritual Court engaged in the same practice; see also *Harrison v Kirk* [1904] AC 1, 7 (Lord Davey).

[32] *Hodges v Waddington* (1683) 2 Vent 360.

[33] *Anonymous* (1683) 1 Vern 162.

[34] See *Ministry of Health v Simpson* [1951] AC 251, 266 (Lord Simonds).

[35] *Harrison v Kirk* [1904] AC 1, 7 (Lord Davey).

[36] See Tilley, n 24, 520-523. As discussed below, English courts have preferred to base the remedy of subrogation on the principles of unjust enrichment. However, the basis of subrogation on orthodox equitable principles and unconscionability, which has found support in the High Court of Australia (see *Bofinger v Kingsway Group Ltd* (2009) 239 CLR 269), appears to have surfaced in older English cases dealing with subrogation in other contexts. In *Duncan Fox & Co* (1880) 6 App Cas 2, 19, a case where an indorser of a bill of exchange claimed that he was subrogated to securities provided by the acceptor to the bill's holder, Lord Blackburn said: "I think it is established … that where a creditor has a right to come upon more than one person or fund for the payment of a debt, there is an equity between the persons interested in the different funds that each shall bear no more than its due proportion. This is quite independent of any contract between the parties thus liable … If several persons are indebted, and one makes the payment, *the creditor is bound in conscience* (if not by contract) to give to the party paying the debt all his remedies against the other debtors" (emphasis added).

[37] See, eg D'Angelo, n 15, 141 [3.76], observing that some Canadian commentators are adamant that subrogation to the personal indemnity is not available in Canada. Accepting that the personal indemnity exists in the first place, this article is concerned with whether a creditor may be subrogated to the personal indemnity without first resorting to the trust estate – a question which, as discussed below, has apparently divided judicial opinion in Australia.

[38] *Octavo Investments Pty Ltd v Knight* (1979) 144 CLR 360, 367, 370.

this debt regardless of the value of the trust fund,[39] unless the trustee and third party to whom the debt is incurred have contracted to limit the trustee's personal liability.[40] Provided that this debt was properly incurred,[41] the trustee has, by virtue of the nature of its office, a proprietary indemnity.[42]

The right of indemnity is secured by an equitable charge or lien over the trust assets. The charge or lien takes priority over the beneficiaries' equitable interests[43] and is said to arise from the trust relationship by the operation of equity.[44] The trustee is entitled to retain the trust assets, or part thereof, as against the beneficiaries until the right of indemnity has been satisfied.[45] If the trustee is bankrupt or insolvent or has few or no assets of its own to discharge its personal liability – the latter being the case for trading trusts whose corporate trustee is nominally capitalised[46] – or it is reasonable to conclude that obtaining judgment against the trustee would be futile, the creditor may be subrogated to the trustee's proprietary indemnity so as to obtain a beneficial interest in, and access the value of, the trust assets.[47] In this context, subrogation provides unsecured trust creditors with an indirect method of extracting value from trust assets in circumstances where they otherwise have no proprietary interest in such assets.[48] Subrogation is also a collective process; it may not be invoked "to engineer an unequal outcome between otherwise unsecured creditors of an insolvent trustee and where to advance one creditor's position would disadvantage that of the others".[49]

As noted above, subrogation is entirely derivative in the sense that it is only available if the trustee has a right of indemnity.[50] Circumstances in which an unsecured trust creditor may not be subrogated to the trustee's right of indemnity include where the right of indemnity is excluded in the trust instrument; where the debt is not one that was properly incurred on behalf of the trust; or where

[39] If the trustee's personal liability is not satisfied, the creditor may seek to bankrupt or wind up the trustee; however, this may hinder the creditor's ability to eventually recover against the trust assets. See P Agardy, "Aspects of Trading Trusts" (2006) 14 Insolv LJ 7.

[40] *Muir v City of Glasgow Bank* (1879) 4 App Cas 337, 355; *Helvetic Investment Corp Pty Ltd v Knight* (1984) 9 ACLR 773, 774. See generally D Loxton and N D'Angelo, "Trustees' limitation of liability: Myths, mysteries and a model clause" (2013) 41 ABLR 142.

[41] See *Nolan v Collie* (2003) 7 VR 287, 302-308.

[42] *Octavo Investments Pty Ltd v Knight* (1979) 144 CLR 360, 367, 371; *Worrall v Harford* (1802) 32 ER 250, 252; *Trustee Act 1958* (Vic) s 36(2) and equivalent legislation in other jurisdictions. The right of indemnity has two limbs: a right of recoupment, which is a right to be paid out of the trust estate for properly incurred trust liabilities that the trustee has discharged out of its own personal property; and a right of exoneration, which entitles the trustee to draw upon trust assets directly to meet properly incurred trust liabilities. See also *Belar Pty Ltd (In liq) v Mahaffey* [2000] 1 Qd R 477, 488: upon the corporate trustee's liquidation, the right of indemnity vests in the liquidator.

[43] *Octavo Investments Pty Ltd v Knight* (1979) 144 CLR 360, 367; *Chief Commissioner of Stamp Duties v Buckle* (1998) 192 CLR 226, 247.

[44] *Re Pumfrey* (1882) 22 Ch D 255, 261-262; *Vacuum Oil Co Pty Ltd v Wiltshire* (1945) 72 CLR 319, 324, 335.

[45] *Stott v Milne* (1884) 25 Ch D 710, 715; *Octavo Investments Pty Ltd v Knight* (1979) 144 CLR 360, 367. In *Re Beddoe; Downes v Cottam* [1893] 1 Ch 547, 558, Lindley LJ described the proprietary indemnity, which gives rise to the trustee's lien, as "the price paid by *cestuis que trust* for the gratuitous and onerous services of trustees".

[46] Victorian Law Reform Commission, *Trading Trusts – Oppression Remedies* (Report, January 2015) 90 [6.14].

[47] *Re Pumfrey* (1882) 22 Ch D 255, 263; *Octavo Investments Pty Ltd v Knight* (1979) 144 CLR 360, 367. See generally *Agusta Pty Ltd v Provident Capital* [2012] NSWCA 26, [70]-[74].

[48] On a discussion of this indirect method, being the only method available for unsecured creditors to extract value from the trust assets, see *RWG Management Ltd v Commissioner for Corporate Affairs* [1985] VR 385, 401; *Vacuum Oil Co Pty Ltd v Wiltshire* (1945) 72 CLR 319, 327-328. A direct method, on the other hand, is only available to secured creditors, who may exercise a proprietary remedy by enforcing their security interest in the trust assets. As D'Angelo, n 15, 232 [5.22] notes, subrogation is only relevant to secured creditors "if and to the extent they might become unsecured creditors because of failure of their security or a shortfall in recovery against their secured asset". On the implications of a trust deed excluding the trustee's right of indemnity, see Chief Justice Allsop, "The Nature of the Trustee's Right of Indemnity and Its Implications for Equitable Principle" (Paper presented at the Federal Court of Australia) 28-30.

[49] *Lerinda Pty Ltd v Laertes Investments Pty Ltd* [2010] 2 Qd R 312, [14].

[50] *General Credits Ltd v Tawilla Pty Ltd* [1984] 1 Qd R 388. See generally HF Stone, "A Theory of Liability of Trust Estates for the Contracts and Torts of the Trustee" (1922) 22 Colum L Rev 527.

a beneficiary's claim for compensation in respect of a trustee's breach of trust exceeds the value of any right of indemnity by the operation of a set-off.[51] If the right of indemnity is available and a creditor may be subrogated to it, the creditor cannot claim in excess of the trustee's entitlement.[52]

Having explained the historical basis of subrogation and its operation in the context of the trustee's proprietary indemnity, it is convenient to set out the development of Australian case law on a road less travelled: subrogation to the trustee's personal indemnity.

DEVELOPMENT OF SUBROGATION TO THE PERSONAL INDEMNITY IN AUSTRALIA

Marginson

In *Marginson v Potter*,[53] the High Court of Australia only peripherally dealt with the trustee's right of indemnity. The case concerned the application of the Statute of Frauds in Queensland in the context of a promise to sell shares, the proceeds of which would be applied in part satisfaction of a debt. Jacobs J relied solely on a passage from *Halsbury's Laws of England* to assume that creditors could be subrogated to the trustee's right of personal indemnity against beneficiaries:

> Where a trustee has properly paid or incurred expenses or liabilities in performing a trust, or in respect of the trust property, he is entitled to reimbursement or indemnity in respect thereof out of the trust property, or from a person sui juris who is beneficially entitled thereto. His right extends to calls on shares which he has been obliged to pay … Persons to whom a trustee has incurred liability in respect of which he has a right of indemnity may be entitled to be subrogated to the trustee's right.[54]

The quoted passage signifies that the trustee's personal right of indemnity against beneficiaries exists and that a creditor may be subrogated to this indemnity. Notably, Jacobs J did not appear to distinguish between subrogation to the trustee's right of indemnity against trust assets and against beneficiaries personally. There appears to be no conceptual basis or line of authority for such a jurisprudential leap,[55] yet, as some of the following cases make clear, this statement by Jacobs J is the genesis of the proposition that there is no difference between the two indemnities as regards creditor subrogation.

Countryside

Countryside v Bayside Brunswick concerned a creditor's claim for damages for breach of a contract of sale against an insolvent corporate trustee of a unit trust. The creditor argued that it was entitled to be subrogated to the trustee's personal indemnity, based on the Privy Council's advice in *Hardoon*, so as to be indemnified from the unit holders. The creditor apparently made no reference in its submissions to Jacobs J's observation in *Marginson*. Brownie J held that the creditor was entitled to be subrogated to the trustee's personal indemnity and claim the value of the damages from the unit holders personally. His Honour first addressed the unit holders' submission that *Hardoon* was wrongly decided:[56]

> I accept that the decision in *Hardoon* is only as binding as its reasoning is persuasive, but I regard the reasoning as quite persuasive; and in any event the decision is so well embedded in the law of Australia (and England) that it would be inappropriate for a judge at first instance to do other than follow it.

[51] See *RWG Management Ltd v Commissioner for Corporate Affairs (Vic)* [1985] VR 385.

[52] *Re Johnson* (1880) 15 Ch D 548; *General Credits Ltd v Tawilla Pty Ltd* [1984] 1 Qd R 388, 389-390; cf JD Merralls, "Unsecured Borrowings by Trustees of Commercial Trusts" (1993) 10 Aust Bar Rev 248, 256-257.

[53] *Marginson v Potter* (1976) 136 CLR 161.

[54] *Marginson v Potter* (1976) 136 CLR 161, 175-176 (quoting *Halsbury's Laws of England* (3rd ed) Vol 38, 943-944), Gibbs and Mason JJ did not find it necessary to decide this point.

[55] Indeed, in *Ron Kingham Real Estate Pty Ltd v Edgar* [1999] 2 Qd R 439, 443, McPherson JA undermined the passage in *Halsbury's Laws of England* on which Jacobs J had relied in *Marginson* by observing: "the authorities cited in support of [the proposition] are, when examined, once again cases in which a right of subrogation was sought in order to enforce the indemnity against the trust assets and not against beneficiaries personally."

[56] *Countryside (No 3) Pty Ltd v Bayside Brunswick Pty Ltd* (unreported, Supreme Court, NSW, Brownie J, No 1677 of 1990, 20 April 1994), 17

In their submissions, the unit holders relied upon an indemnity clause in the trust instrument which did no more than recognise the trustee's proprietary indemnity. Brownie J held that such a clause could not impliedly exclude the personal indemnity. Moreover, no term in the trust instrument excluded the unit holders' liability, and the contract of sale did not purport to exclude the creditor's ability to be subrogated to the personal indemnity.[57] According to Brownie J, the creditor's ability to be subrogated in this instance was tenable on policy grounds and the Court of Chancery practice discussed above.[58]

The decision in *Countryside* was upheld on appeal.[59] In *Metcalfe v NZI Securities*, the Full Court of the Federal Court saw no issue with allowing a creditor to be subrogated directly to a corporate trustee's personal indemnity against unit holders. The Court cited the decision in *Countryside* as authority for this very proposition,[60] the implication being that a trust creditor need not obtain judgment against a trustee prior to being subrogated to the trustee's personal indemnity.

Edgar

In *Ron Kingham Real Estate v Edgar*, a creditor obtained judgment against a corporate trustee. While the judgment remained unsatisfied, the trust assets were transferred to the beneficiaries of the trust. The creditor, by way of subrogation, sought to enforce the trustee's personal indemnity against the beneficiaries. The Queensland Court of Appeal noted that, in the reported cases that have discussed subrogation, "the precise question at issue [seemed] always to have been whether the creditor was entitled to be subrogated to the trustee's claim to indemnity *out of the trust assets*".[61] Absent any specific decision holding that a creditor can be subrogated to the personal indemnity, the Court said:[62]

> In the end, however, I cannot see that it makes any difference in principle whether the creditor claims to be subrogated to the trustee's right of indemnity against the trust property or against the beneficiary in person … [I]n this field of law the authority of Jacobs J [in *Marginson*] is such that it would be bold, without good reason, to question the accuracy of his Honour's statement on the subject.

Despite confirming that the creditor may be subrogated to the personal indemnity and approving the statement of Jacobs J in *Marginson*, the Court held that the creditor was entitled to sue the beneficiaries directly without needing to resort to subrogation. What were the circumstances of the case that triggered this finding? The Court reasoned:[63]

> The defendants had notice of the plaintiff's claim at the time they arranged for the trust assets to be paid to themselves, and they enriched themselves at the expense of satisfying the plaintiff's claim against the trustee. It would plainly be against conscience for them to retain the proceeds of their conduct so as to defeat that claim. In equity they would be considered as constructive trustees of the assets received at least to the extent necessary to satisfy the trustee's liability.

It is unclear whether the Court eschewed granting the remedy of subrogation altogether or simply conflated the concepts of subrogation to the personal indemnity and suing the beneficiaries directly. Nonetheless, grounding the creditor's right in this instance on the principles of unjust enrichment is not inconsistent with earlier authorities that have dealt with the personal indemnity. The NSW Court of Appeal in *Balkin v Peck* observed that Lord Lindley's benefit/burden concept in *Hardoon* may be

[57] *Countryside (No 3) Pty Ltd v Bayside Brunswick Pty Ltd* (unreported, Supreme Court, NSW, Brownie J, No 1677 of 1990, 20 April 1994), 22.

[58] *Countryside (No 3) Pty Ltd v Bayside Brunswick Pty Ltd* (unreported, Supreme Court, NSW, Brownie J, No 1677 of 1990, 20 April 1994), 27, citing HA Ford and WA Lee, *Principles of the Law of Trusts* (Lawbook, 2nd ed, 1990) [1410]. These policy grounds were later elaborated in Ford, n 19, 8.

[59] See *Causley v Countryside (No 3) Pty Ltd* (unreported, Court of Appeal, NSW, Clarke, Cole and Beazley JJA, 2 September 1996).

[60] *Metcalfe v NZI Securities Australia Ltd* (unreported, Federal Court, Sheppard, Burchett and Lindgren JJ, 5 March 1996), [27].

[61] *Ron Kingham Real Estate Pty Ltd v Edgar* [1999] 2 Qd R 439, 443 (emphasis added).

[62] *Ron Kingham Real Estate Pty Ltd v Edgar* [1999] 2 Qd R 439, 443.

[63] *Ron Kingham Real Estate Pty Ltd v Edgar* [1999] 2 Qd R 439, 444.

described in terms of unjust enrichment.[64] D'Angelo contends that the same direct liability result could be attained on the basis of implied agency,[65] where a court would view the relationship between beneficiary and trustee as including elements of implied principal and agent.[66] Another circumstance that may have enabled the creditor to sue the beneficiaries directly is the lack of remedies available against the trustee by virtue of the trustee having no assets in its possession. The Court did not, however, cite this as a factor in finding that the creditor could proceed against the beneficiaries directly; instead, it relied upon the unjust enrichment principle expounded above.[67]

The decision in *Edgar* confirms that the subrogation of a trust creditor on the trustee's insolvency is at least limited to the proprietary indemnity. It is convenient at this point to distinguish between the right of exoneration, which is a right to use trust assets to discharge a trust liability;[68] and the right of recoupment, which is a right to be reimbursed out of the trust assets for trust liabilities that have already been discharged using the trustee's own property.[69] The right of recoupment arises only once a trustee has paid an unsecured creditor with the trustee's own property, thereby discharging its trust-liabilities. An unpaid trust creditor will be concerned only with the right of exoneration, being the only right to which the creditor may be subrogated.[70]

Belar

The question whether a creditor must exhaust its claim for indemnity out of the trust assets before proceeding against beneficiaries personally was explored in detail in *Belar v Mahaffey*. There, a company in liquidation sought to demonstrate, among other matters, that a former trustee of a family trust could be indemnified in respect of certain liabilities incurred by it as trustee.[71] The Queensland Court of Appeal distinguished *Edgar* on the basis that:[72]

> [t]he trustee [in *Edgar*] was left with no assets at all, and the creditor of the trustee was in these circumstances able to say that it had exhausted all remedies against the trustee and was entitled to assert the trustee's rights of indemnity against the beneficiaries

The Court reasoned that exhausting all remedies against the trustee was a prerequisite to allowing the creditor to be subrogated to the personal indemnity. The Court said:[73]

> The creditor's right of subrogation of course depends on the rights of the trustee. This may be affected by the trust instrument and in the present case where there had been a change of trustee the focus must be upon the position of the new trustee. A former trustee may assert its claims for indemnity against the continuing trustee, and in that respect may assert the right of the new trustee to indemnity by bringing an action against him. *But in our view it must be shown that there is a fund or asset to which the lien may attach.*

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[64] *Balkin v Peck* (1998) 43 NSWLR 706, 712. But see *Bofinger v Kingsway Group Ltd* (2009) 239 CLR 269; N D'Angelo, "The unsecured creditor's perilous path to a trust's assets: Is a safer, more direct US-style route available?" (2010) 84 ALJ 833, 854-855, noting, "[t]he High Court is wary of using equity to cut through the clear terms of a contract, or to fill in transactional gaps, solely on the basis of a nebulous notion of 'fairness'".

[65] D'Angelo, n 15, 122-134 [3.30]-[3.56].

[66] Ford and Lee, n 20, [1.1590].

[67] See *Ron Kingham Real Estate Pty Ltd v Edgar* [1999] 2 Qd R 439, 475, McPherson JA (Davies JA and Fryberg J substantially agreeing) acknowledged that, because the trustee was left with no assets, the creditor had exhausted all remedies available against the trustee. However, this was discussed in the context of *Trusts Act 1973* (Qld) s 109, which requires that a plaintiff first proceed against a trustee either *in rem* or *in personam* before resorting to remedies *in personam* against a recipient of trust property that has been wrongly appropriated. See also Ford and Lee, n 20, [14.6310].

[68] *Chief Commissioner of Stamp Duties v Buckle* (1998) 192 CLR 226, 245-247.

[69] See generally *Lane (Trustee), Re Lee (Bankrupt) v Deputy Commissioner of Taxation* [2017] FCA 953, [36]-[47].

[70] Ford and Lee, n 20, [14.110].

[71] See *Belar Pty Ltd (In liq) v Mahaffey* [2000] 1 Qd R 477, 484, 487: the Court noted that this case involved "a claim by a former trustee to be indemnified by the beneficiaries personally for liabilities properly incurred in the execution of a trust", and thought it curious that no claim was ever brought against the new trustee in his capacity as trustee.

[72] *Belar Pty Ltd (In liq) v Mahaffey* [2000] 1 Qd R 477, 487.

[73] *Belar Pty Ltd (In liq) v Mahaffey* [2000] 1 Qd R 477, 488 (emphasis added).

The Court observed, as it did in *Edgar*, that the issue of subrogation in earlier cases arose only in the proprietary indemnity context. It followed that "the general principle underlying a trustee's claim to indemnity is a right to be indemnified out of trust assets"; that is, subrogation to the personal indemnity is limited to the extent to which trust assets are available to satisfy the claim.[74] Support for this point was found in *Re Suco Gold*, where King CJ of the South Australian Full Court, discussing the proprietary indemnity, said:[75]

> If the [trust] liabilities have not been discharged, the … 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* …
>
> The rights conferred by the lien passed to the liquidator. They would enable him to obtain and retain possession of the trust property until the right of indemnity has been exercised.

As to whether a creditor may be subrogated to the personal indemnity directly without first exhausting all of its remedies against the trustee, the quoted passage only begs the question. In *Suco Gold*, there was no discussion of the personal indemnity. The Court held that, while the right of indemnity is a proprietary right of the trustee that, on insolvency, is controlled by the liquidator, the liquidator may only rely upon trust property for the purpose of discharging trust, as opposed to non-trust, liabilities.[76] The upshot is that the trustee's preferred proprietary interest in the trust assets, being its right of exoneration, takes effect for the benefit of the unpaid creditors.[77] In *Fitzwood v Unique Goal*,[78] a case that followed *Belar*, the Full Court of the Federal Court assumed that a trustee may claim the personal indemnity only where the trust assets are inadequate to satisfy the proprietary indemnity, although the Court made no mention of *Belar*.

Arguably *Belar*, *Suco Gold* and *Fitzwood* stand for no more than the proposition that the proprietary indemnity is what affects a beneficiary's claim to trust assets, since this indemnity is "exercisable *as against* the beneficiary, albeit with a limitation on recourse to the trust estate and no right of personal recourse for any shortfall".[79] In the words of Brereton J in *Lemery Holdings v Reliance Financial Services*, the lien conferred on the trustee by the proprietary indemnity:[80]

> is a manifestation of set-off, in that once a trustee has an accrued right of indemnity, the trustee is entitled to set it off against the beneficiary's claim to the trust assets, and to refrain from distributing until the trustee's claim is satisfied.

Accordingly, where there are sufficient trust assets to satisfy a creditor's claim, it may be argued that the personal indemnity need not arise, or even exist, given that the beneficiary would be economically in the same position upon a creditor's subrogation to the proprietary indemnity. The cases above demonstrate that, where the trust assets are inadequate to meet the creditor's claim and the personal indemnity is available, a court is likely to enable subrogation to the personal indemnity. This article asserts that subrogation to the personal indemnity is likely to, and should, also be available in circumstances where the trust assets are adequate and the personal indemnity exists and is available. As illustrated below, this conclusion gives effect to subrogation as an equitable remedy, conforms with the historical basis and rationale of subrogation, and, as a matter of policy, accommodates the commercial interests of the trustee, beneficiary and trust creditor.

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[74] *Belar Pty Ltd (In liq) v Mahaffey* [2000] 1 Qd R 477, 488, citing *Re Earl of Winchelsea's Policy Trusts* (1888) 39 Ch D 168; cf Ford and Lee, n 20, [14.6310].

[75] *Re Suco Gold Pty Ltd (In liq)* (1983) 33 SASR 99, 108-109 (emphasis added).

[76] *Re Suco Gold Pty Ltd (In liq)* (1983) 33 SASR 99, 108-110; cf *Re Enhill Pty Ltd* [1981] 1 VR 561.

[77] *Octavo Investments Pty Ltd v Knight* (1979) 144 CLR 360, 370; *Re Byrne Australia Pty Ltd [No 2]* [1981] 2 NSWLR 364; *Re Richardson* [1911] 2 KB 705; cf Ford and Lee, n 20, [14.110].

[78] *Fitzwood Pty Ltd v Unique Goal Pty Ltd (In liq)* [2002] FCAFC 285, [135].

[79] D'Angelo, n 15, 138 [3.68].

[80] *Lemery Holdings Pty Ltd v Reliance Financial Services Pty Ltd* [2008] NSWSC 1344, [47].

CREDITOR SUBROGATION: A PROPOSED LEAP TO THE PERSONAL INDEMNITY

Flexibility of Subrogation as an Equitable Remedy

The nature of equitable subrogation is such that it is a remedy, rather than a cause of action or right.[81] It is framed by the demands of reason and justice, and in a trusts context its purpose is to avoid any prejudice caused by a beneficiary receiving assets as a result of credit provided to the trustee that has not been repaid.[82] Accordingly, the remedy is subject to the court's discretion, and the court reserves the "right to refuse to make equitable orders if the party seeking them has acted unconscientiously or is otherwise disqualified by reason of any other rule of equity".[83] English courts have held that subrogation is based on the principles of unjust enrichment.[84] In *Re Johnson*, Jessel MR said that the unsecured creditor's right to access trust assets:[85]

> is a mere corollary to those numerous cases in Equity in which persons are allowed to follow trust assets. The trust assets having been devoted to carrying on the trade, it would not be right that the cestui que trust should get the benefit of the trade without paying the liabilities.

At first glance, this reasoning suggests that a creditor who has not conferred a benefit on the trust would be precluded from subrogation. Yet, as Ford observes, the proprietary indemnity has been found to apply in England more broadly than *Johnson* intimates, such as where a creditor obtains judgment against the trustee personally for damages and costs arising from a tort committed by the trustee in furthering the trust business.[86] In any case, the High Court of Australia has expressed its disinclination to base subrogation on the principles of unjust enrichment, settling instead on orthodox equitable principles and unconscionability;[87] that is, it must be unconscionable for one to deny the proprietary interest claimed by the creditor.

Quelling the Apparent Conceptual and Procedural Barriers

There appears to be no explanation, unique to the personal indemnity, as to why subrogation should be available only in respect of the proprietary indemnity. So much is implicit in the decisions that have allowed creditors to be subrogated to the personal indemnity. In the decisions that have held to the contrary, such as *Belar* and *Fitzwood*, the Courts have sternly followed a seemingly unfounded doctrine that the proprietary indemnity must first be exhausted – a view that appears to be informed by the fact that the issue of creditor subrogation in earlier authorities arose only in respect of the proprietary indemnity. As argued above, enabling subrogation to the personal indemnity conforms to the policy that underpinned the Court of Chancery practice of distributing funds from trusts that were under its administration. That a creditor may be subrogated to the proprietary indemnity affords no basis, in Ford's view, for concluding that a creditor should be subrogated to the personal indemnity. While no analogous procedure for subrogation to the personal indemnity exists, that author nonetheless submits that there are no policy barriers to allowing for a right of subrogation to the personal indemnity without the need to exhaust the proprietary indemnity.[88]

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[81] *Boscawen v Bajwa* [1996] 1 WLR 328, 335; *Bofinger v Kingsway Group Ltd* (2009) 239 CLR 269; see also *Re Trivan Pty Ltd* (1996) 134 FLR 368, 372-373.

[82] *Orakpo v Manson Investments Ltd* [1978] AC 95, 110; *Levin v Ikiua* [2010] 1 NZLR 400, [119].

[83] *Nolan v Collie* (2003) 7 VR 287; Heydon, Leeming and Turner, n 23, 366 [9.020].

[84] See, eg *Re Johnson* (1880) 15 Ch D 548, 552; *Boscawen v Bajwa* [1996] 1 WLR 328; *Banque Financière de la Cité v Parc (Battersea) Ltd* [1999] 1 AC 221.

[85] *Re Johnson* (1880) 15 Ch D 548, 552.

[86] Ford, n 19, 16, citing *Re Raybould* [1900] 1 Ch 199. In Ford's view, while the trustee is technically a principal of the trust, the court focuses on the trustee's representative role in acting on the trust's behalf. Ford highlights that trust assets are accessible only where there is loss related to the trustee's conduct in furthering the trust. Where the trustee acts *ultra vires*, any subsequent loss cannot be recovered from the trust assets.

[87] *Bofinger v Kingsway Group Ltd* (2009) 239 CLR 269, 299-302; see also *Australasian Conference Association Ltd v Mainline Constructions Pty Ltd (In liq)* (1978) 141 CLR 335, 348; cf *Balkin v Peck* (1998) 43 NSWLR 706, 712.

[88] Ford, n 19, 18-19.

As explained above, the trustee's right of exoneration entitles the trustee to call on the trust assets directly to meet liabilities incurred on behalf of the trust. That this right of exoneration is necessarily limited to the extent of the value of the available trust assets should not be a basis for discounting direct subrogation by the creditor to the personal indemnity; both the proprietary indemnity and personal indemnity are merely two aspects of the same trustee right.[89] Nor should the personal nature of the beneficiary's obligation to indemnify the trustee deter a court from ordering subrogation to the personal indemnity.[90] As the authors of *Ford and Lee* assert, limiting the remedy of subrogation to the extent to which trust assets are available to satisfy a creditor's claim would clash with *Re Richardson*,[91] which held that money recovered from a beneficiary by a trustee in bankruptcy was payable to the particular creditor to whom the bankrupt trustee was liable.[92] Applying the principle espoused by the Queensland Court of Appeal in *Belar*, the proceedings in *Re Richardson*, according to the authors, "would have been dismissed, since there were no trust assets, the lease the subject matter of the trust having expired".[93]

Given that the doctrine of subrogation is concerned with preventing injustice and the categories of its operation are not closed,[94] it is asserted that a court's order for subrogation would fall within its inherent power to control all trusts and administer practical equity.[95] From a procedural perspective, a creditor seeking to enforce the remedy of subrogation may commence a proceeding seeking a declaration to that effect, with consequential relief directed to enforcing its rights *in personam* to recover the debt owed by the trustee.[96]

Policy Reasons in Favour of Subrogation to the Personal Indemnity

As a matter of policy, there are advantages to allowing a creditor to be subrogated directly to the personal indemnity without first exhausting the proprietary indemnity. Where the trust property is illiquid, converting it to cash in order to satisfy a creditor's claim may be impractical. As a solution, the beneficiaries may agree to provide funds personally.[97] Some unsecured creditors, such as trade suppliers or sub-contractors, may have a vested interest in seeing that the trust business is financially viable and continues to trade. In such cases, it is prudent to keep the trust solvent and alive rather than depleting its value.

From the viewpoint of other unsecured creditors that contract with the trustee for the supply of goods or services, it could be commercially advantageous to have the option of pursuing beneficiaries personally rather than risk diminishing the value of the trust assets and business. Where the trust assets are insufficient to discharge the trustee's debt, or proceedings against the trustee are likely to be

[89] Hughes, n 18.

[90] Compare O'Donovan and Phillips, n 26, [12.2880], which states that in a sureties context the *Mercantile Law Amendment Act 1856* (UK) may prevent a guarantor's claim to securities via subrogation where the security is a personal right of the creditor. A broader conception was adopted in *Re Wrexham Mold & Connah's Quay Railway Co* [1899] 1 Ch 440; *Banque Financiere de la Cite SA v Parc (Battersea) Ltd* [1999] 1 AC 221, where the respective courts did not limit subrogation claims to proprietary rights.

[91] *Re Richardson* [1911] 2 KB 705.

[92] Ford and Lee, n 20, [14.6310]. On a discussion of the application of *Re Richardson* [1911] 2 KB 705 in subsequent cases, see *Re Amerind Pty Ltd (In liq)* [2017] VSC 127, [125]-[164].

[93] Ford and Lee, n 20, [14.6310].

[94] J Glover and A Robertson, "Subrogation" in P Parkinson (ed), *The Principles of Equity* (Lawbook, 2nd ed, 2002) 555, 558; *Metro Motor Inns Hotels & Motels Pty Ltd v Strathaven Holdings Pty Ltd* [2000] NSWSC 1004 [10].

[95] See *Metro Motor Inns Hotels & Motels Pty Ltd v Strathaven Holdings Pty Ltd* [2000] NSWSC 1004 [10], [14].

[96] *Ex parte Edmonds* (1862) 4 DeG F & J 488, 498.

[97] See Ford, n 19, 8.

impractical or protracted, being subrogated to the personal indemnity will in most cases be preferable to the unsecured creditor joining the queue for the distribution of the trustee's assets in insolvency or bankruptcy.[98]

The creditor to which the trustee has properly incurred a liability on behalf of the trust is said to benefit from the "lucky accident" of ranking higher than the trustee's other unsecured creditors because only the former is able to access the value of the trust assets.[99] While not spelled out in the authorities, it is envisaged that enabling a trust creditor to be subrogated directly to the personal indemnity would confer on that creditor the same advantage by virtue of its ability to pursue beneficiaries personally. Moreover, this direct subrogation would not bestow on the creditor higher rights than the trustee itself, since there is no requirement that the trustee first exhausts its proprietary indemnity before proceeding to claim personally against beneficiaries.[100]

Protecting the Beneficiary's Interests

Generally speaking, enabling creditors to be subrogated directly to the personal indemnity exposes beneficiaries to unlimited liability for debts properly incurred in furthering the trust business. One way to diminish this liability would be to waive or exclude it in express terms, ideally in the trust instrument itself.[101] This is another key difference between the proprietary indemnity and the personal indemnity: while it is debatable whether the former can be excluded in the trust instrument, there is universal acceptance that the latter can be. The personal indemnity may also be excluded by implication;[102] however, as the decision in *Countryside* demonstrates, a clause in a trust instrument that merely confirms the trustee's proprietary indemnity, without reference to the personal indemnity, does not exclude the personal indemnity.[103]

Absent any legislation conferring on beneficiaries limited liability in respect of some trusts,[104] it is suggested that excluding the personal indemnity is the most effective way of protecting beneficiaries' interests. However, a creditor may be unwilling to conduct business with a trust if the creditor's routes of recovering its debt are limited. The same is true with respect to excluding the proprietary indemnity, although there are conflicting viewpoints on whether this indemnity can actually be excluded.[105]

Where the trust instrument does not expressly exclude the personal indemnity, how does the trustee protect a beneficiary's interests prior to transacting with an unsecured creditor? In theory, the trustee could contract with the creditor such that the latter will be paid only out of the trust assets[106] or a specific fund,[107] despite the absence of an express power in the trust instrument to do this.[108] This would bear a two-pronged result: first, it would necessarily limit the creditor's ability to pursue the beneficiary, since subrogation to the personal indemnity would be excluded by implication; and

[98] D Whitehead, "Pride or prejudice: A better understanding of the English law risks of corporate trustees can benefit a large number of investors" (2011) 30 IFLR 32.

[99] *Re Johnson* (1880) 15 Ch D 548, 552.

[100] Ford, n 19, 8; Hughes, n 18, 567; *Re Richardson* [1911] 2 KB 705.

[101] This was envisaged in *Hardoon v Belilios* [1901] 1 AC 118, 127, where Lord Lindley alluded to "special trusts limiting the right to indemnity". See also *Wise v Perpetual Trustee Co* [1903] AC 139.

[102] JD Heydon and MJ Leeming, *Jacobs' Law of Trusts in Australia* (LexisNexis, 8th ed, 2016) 515-516 [2106].

[103] *Countryside (No 3) Pty Ltd v Bayside Brunswick Pty Ltd* (unreported, Supreme Court, NSW, Brownie J, No 1677 of 1990, 20 April 1994) 22.

[104] On a summary of the US position, where there are statutory mechanisms in place to guarantee limited liability for some trusts, see D'Angelo, n 15, 147 [3.92]-[3.94].

[105] See generally Heydon and Leeming, n 102, 515-516 [2106]. See also *Re German Mining Co* (1854) 4 De G M & G 19; *RWG Management Ltd v Commissioner for Corporate Affairs (Vic)* [1985] VR 385; cf *JA Pty Ltd v Jonco Holdings* (2000) 33 ACSR 691; *Kemtron Industries Pty Ltd v Commissioner of Stamp Duties* (1984) 15 ATR 627.

[106] Merralls, n 52, 251.

[107] *Head v Kelk* (1961) 63 SR (NSW) 340, cited in *Action A1 Pty Ltd v Chin* [1997] NSWSC 421 (Young J).

[108] Merralls, n 52, 252; *Parsons v Spooner* (1846) 67 ER 845, 848.

secondly, it would exclude the trustee's personal liability, thereby insulating it against insolvency arising from trust debts.[109] A trustee's ability to limit, by means of contract, its personal liability in the context of a private express trust has found support in both Australia and England.[110] The same is true in respect of trusts in a commercial context.[111] The relevant clause must be expressed clearly and unambiguously,[112] lest it be read against the trustee.[113]

CONCLUSION

The reported authorities provide no conclusive answer to the question whether, assuming that the personal indemnity exists, an unsecured creditor may be subrogated to the personal indemnity either at all or without first resorting to the trust assets or exhausting all of its remedies against the trustee. In the midst of this obscurity, this article contends that, as a matter of policy and conceptual clarity, the court should permit an unsecured creditor to be subrogated directly to the personal indemnity, irrespective of whether the creditor has obtained judgment against the trustee. This accords with the historical basis of subrogation in a trusts context and would fall within the court's inherent power to administer trusts and prevent unconscionable conduct at the expense of trust creditors. To refuse such an order may be inconsistent with the commercial interests of the trustee and beneficiaries, including unit holders or other investors, who may have no desire in eroding the value of the trust assets merely in order for a creditor to recoup its debt. This avenue of pursuing beneficiaries directly is especially valuable for creditors who have no claim against a nominally capitalised corporate trustee.

In cases where the trust estate is valueless, the court has demonstrated that it will justify the subrogation of a creditor to the personal indemnity based on the benefit/burden principle or, more controversially, unjust enrichment. Where the trust estate has value, it is conceived that preserving the option of a creditor to be subrogated directly to the personal indemnity would ensure that the contracting parties are not bound by any hard-and-fast rules that may subvert the parties' commercial interests. This would also yield an outcome that coincides with the discretionary nature of subrogation, being an equitable remedy that arises on the basis of established principles that seek to prevent unconscionability.[114] In order to counter the unlimited liability to which a beneficiary may be exposed if an unsecured creditor can be subrogated to the personal indemnity directly, the trust instrument should contain a provision excluding the personal indemnity; however, the same end may not necessarily be attained *vis-à-vis* excluding the proprietary indemnity. Alternatively, the trustee and unsecured creditor may contract in clear and unambiguous terms that the creditor's only recourse will be out of the trust assets or a specific fund, thereby excluding the trustee's personal liability and protecting the beneficiaries from any later claims that the creditor may wish to make.

[109] D'Angelo, n 15, 189 [4.91].

[110] *Re Anderson* (1927) 27 SR (NSW) 296; *Parsons v Spooner* (1846) 67 ER 845.

[111] See, eg *Helvetic Investment Corp Pty Ltd v Knight* (1984) 9 ACLR 773, 774; *Elders Trustee & Executor Co Ltd v EG Reeves Pty Ltd* [1987] FCA 332. See also DG Gardiner, "Trading Trusts and Straw Trustees" (1987) 3 QITLJ 17, 18-20.

[112] *Parsons v Spooner* (1846) 67 ER 845; *Re Anderson* (1927) 27 SR (NSW) 296.

[113] See *Producers and General Finance Corp Ltd v Dickson* (1938) 40 WALR 34.

[114] Heydon, Leeming and Turner, n 23, 366 [9.020], citing *Re Dalma No 1 Pty Ltd (In liq)* (2013) 279 FLR 80.