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Trustee Succession and Indemnification

Jessica Hudson*

Abstract

Trustee succession and indemnification are important mechanisms in trust administration, but their interaction generates uncertainties as to the relationship between successive trustees, key of which are whether the former trustee: can retain and withhold transferring trust assets against the successor trustee; has priority to indemnification over the successor trustee; and is owed a fiduciary duty by the successor trustee. Also, there is the question of whether the trustees' respective unsecured trust creditors have any claim to the trust fund. This article answers these questions by starting with a different conception of the incumbent trustee's indemnity to show that succession fundamentally alters the process of indemnification, generating a new entitlement in favour of the former trustee who assumes the position of a (preferential) beneficiary. As with any other trust relationship, the successor trustee, as the incumbent trustee, should be indemnified in priority to any other beneficiary, including former trustees; the successor trustee owes the former trustee fiduciary duties, the scope of which will be determined by the trust terms; and the distinction between the exoneration and reimbursement limbs of the indemnity, while often overlooked, are essential to resolving questions about retention and creditors' access to trust property.

I. Introduction

Trustee succession is an important mechanism in trust administration and court supervision, ensuring the trustee continues in her role only if she is willing to, and does, administer the trust according to its terms. A trustee must sometimes cease being a trustee prior to the termination of the trust relationship. This might be because the trustee wishes to retire, or the terms require it, for example when a trustee is insolvent. Alternatively, a trustee might be removed when the court, a trust beneficiary, or another party exercises a power of removal, for example when the trustee is unfit or unable to act or is in breach of her duties. A trust cannot exist without a trustee and there are equitable and statutory principles allowing for the outgoing trustee to be succeeded by another, and the vesting of the rights or other legal entitlements held on trust (also referred to as the trust property or trust fund) in the successor trustee.

Succession occurs via the termination of the outgoing trustee's role and obligations as trustee and her divestiture of trust property to the successor trustee. This occurs automatically under statute, except for registered assets, where further steps need to be taken. But what of the former trustee's indemnity for properly incurred liabilities, such as expenses and debts incurred in trust administration? Once the trust property vests in the successor trustee, the former trustee no longer has the means to indemnify herself, for example by paying trust funds to the third-party creditor directly or reimbursing a previously paid expense. Having relinquished the trust property, the former trustee must instead look to her successor

for indemnification, who may incur expenses in her administration of the trust and have her own indemnity.

Ideally, the rules pertaining to trustee succession and indemnification should operate as clear and accessible rules that the parties can adopt, if necessary, modify, and adhere to without the need for court intervention. However, the interaction of these two sets of rules has generated uncertainties as to the relationship between the former trustee and her successor, key among which are whether the former trustee: can retain and withhold transferring the trust property as against the successor trustee; has priority to indemnification over the successor trustee where the trust property is inadequate to satisfy both fully; and is owed a fiduciary duty (or any other duty) by the successor trustee. Also, there is the question of whether the former and successor trustees' respective unsecured trust creditors have any claim to the trust fund, including via subrogation. Courts have been divided on the answers to these questions, with differences of opinion being expressed within and between cases, including in the decisions of the Judicial Committee of the Privy Council in *Equity Trust (Jersey) Ltd v Halabi*¹ and the NSW Court of Appeal in *Jaken Properties Australia Pty Ltd v Naamaan*.²

This article presents a new way of analysing the interaction between trustee succession and indemnification that is informed by a different conception of the incumbent trustee's indemnity. It argues that trustee succession fundamentally alters the process for indemnification, changing it from a permission or authority to use the trust property granted to the incumbent trustee, to a new and different entitlement to be indemnified out of the trust property recognised in favour of the former trustee. The former trustee's new entitlement is that of a (preferential) beneficiary, enforceable against the successor trustee, whose duty to the former trustee is similar to that of her duty owed to (other) beneficiaries, as it controls how she uses the legal entitlements held on trust, i.e. the trust property.

The article then uses its analysis to resolve the uncertainties relating to priority, retention, fiduciary loyalty and creditors. It will be argued that as with any other trust relationship, the successor trustee, as the incumbent trustee, should be indemnified in priority to any other beneficiary, including former trustees; the successor trustee owes the former trustee fiduciary duties, the scope of which will be determined by the trust terms; and the distinction between the exoneration and reimbursement limbs of the indemnity, while often overlooked, are essential to understanding when an outgoing trustee may retain trust property, and when trust property may be available to creditors.

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¹ [2022] UKPC 36.

² [2023] NSWCA 214, special leave to appeal granted in *Naaman v Jaken Properties Australia Pty Limited* [2024] HCASL 21.

While the article analyses the law³ as it is, some of the solutions advocated for herein are different to those preferred, or are not considered at all, in the cases. This is because the article starts with a different conception of the incumbent trustee's indemnity and understanding of the impact of succession upon it. Most cases start from the premise that the trustee's indemnity is some sort of sui generis or unique right, equitable proprietary right or equitable lien or charge that survives or continues through trustee succession, from which different conclusions are then drawn as to the issues of priority to indemnification, retention, fiduciary loyalty and creditors. The problem is that these labels are only ever used in specific, idiosyncratic senses. They all fail to capture how the process of indemnification actually occurs. Rather than relying on one or more of a range of inaccurate labels, this article looks to how the rules operate in the cases to understand and conceptualise indemnification, the impact of trustee succession upon it, and the consequent relationship between successive trustees.

The article proceeds as follows: Part II gives an outline of the interaction between trustee indemnification and succession, and the problems that can arise; Part III examines the nature of the trustee's indemnity, the impact of succession, and the relationship between the former trustee and her successor; Part IV considers the priority between them; Part V outlines the scope of an outgoing trustee's authority to retain trust property; Part VI examines the role of fiduciary loyalty; Part VII considers the implications for creditors; and Part VIII concludes.

II. Trustee Indemnification & Succession

Trustee indemnification is achieved by legal rules that authorise the trustee to use the trust fund to indemnify herself in two different ways. The *exoneration limb* authorises the trustee to use trust funds to discharge her liability to a third party. It applies when the trustee incurs a liability in the proper administration of the trust, such as a debt owed to a third party for their supply of goods or services, or an obligation to pay tax, or to pay a judgement debt or other sum. The *recoupment limb* authorises the trustee to use the trust fund for her own benefit by releasing so much of the fund from the obligations of trusteeship as necessary to reimburse the trustee. Reimbursement is not possible until the trustee has used her own funds to discharge a liability, such as a debt or other liability. The trustee has no authority

³ The article is mostly concerned with Australian cases (a small sample includes *Kemtron Industries Pty Ltd v Commissioner of Stamp Duties* [1984] 1 Qd R 576; *Lemery Holdings Pty Ltd v Reliance Financial Services Pty Ltd* [2008] NSWSC 1344; *Agusta Pty Ltd v Provident Capital Ltd* [2012] NSWCA 26; *Apostolou v VA Corporation Aust Pty Ltd* [2010] FCA 64, (2010) 7 ACSR 84; *Re Suco Gold Pty Ltd* (1983) 33 SASR 99; *Jones (Liquidator) v Matrix Partners Pty Ltd, in the matter of Killarnee Civil & Concrete Contractors Pty Ltd (in liq)* [2018] FCA 40; *Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth of Australia* (2019) 268 CLR 524 in addition to others cited below) and considers English cases owing to their Australian relevance. The arguments herein have relevance beyond Australia owing to the reliance placed by England as well as other trust law jurisdictions on appellate as well as some first instance Australian decisions including those mentioned above in this note, as in *Re Z Trusts II* [2019] JCA 106; *Meritus Trust Co Ltd v Butterfield Trust (Bermuda) Ltd* [2017] SC (Bda) 82 Civ; *Investec Trust (Guernsey) Ltd v Glenalla Properties Ltd* [2019] AC 271; *Equity Trust* (n 1).

to use trust funds in her favour to recoup herself unless she has paid some trust expense herself out of her personal funds first.

A trustee can be authorised to indemnify herself out of trust funds by the trust terms, and otherwise there are statutory provisions⁴ and equitable principle that do this. No matter the juridical source, indemnification is possible only for liabilities (including debts, expenses and other obligations) incurred in trust administration, sometimes referred to as ‘authorised’⁵ or ‘properly incurred’⁶ expenses. There is much to be said about the scope of the trustee’s indemnity, including the equitable and statutory rules and the parties’ role in defining when an expense is properly incurred. Likewise in relation to the rules reducing the trustee’s indemnity to the extent the trustee must account for a prior breach of trust.⁷

This article examines a different issue, which is the impact of changes in trusteeship on the process of indemnification, and the ensuing relationship between a former trustee and her successor. The interaction of indemnification and succession raise complex legal problems which are important to resolve given the fundamental role each phenomenon plays in supporting trust administration, and the impact on creditors of either or both trustees in insolvency.

Trustee indemnification supports trust administration in multiple ways. It provides for the ‘protection of the trustee’⁸ and ‘plays a valuable societal role in encouraging the assumption of high obligations of trusteeship’,⁹ maintaining ‘the integrity, credibility and utility of relationship perceived to be of importance in a society’.¹⁰ Encouragement is needed because the express trust is a legal relationship between the trustee and beneficiary¹¹ that requires the trustee to incur personal liability in transacting with third parties. While ‘the trust’ is often objectified or referred to as if it has an existence separate from the parties to it, it does not have a legal personality separate from the trustee. The trustee does not act for ‘the trust’, or as agent of the beneficiaries. Her actions generate legal relations between herself as principal and other legal persons. When the trustee incurs an obligation to pay, for example, she incurs this obligation personally and judgments may be executed against the trustee’s personal assets,

⁴ See, eg, Trustee Act 1925 (UK), s 30(2); Trustee Act 1925 (NSW) 59(4) and equivalents in other States’ and Territories’ trusts legislation.

⁵ *Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth of Australia* (2019) 268 CLR 524 [40].

⁶ *Investec* (n 3) [59](v), (vii); *Equity Trust* (n 1) [56], [59]. As to the meaning of ‘properly incurred’ see, eg, *Gatsios Holdings Pty Ltd v Nick Kritharas Holdings Pty Ltd* [2002] NSWCA 29; *Nolan v Collie* (2003) 7 VR 287; *RWG Management Ltd v Commissioner for Corporate Affairs* [1985] VR 385, 397.

⁷ *Equity Trust* (n 1) [65], [191], [257], [262]; *RWG* (n 6). For academic criticism, see N D’Angelo, *Transacting with Trusts and Trustees* (LexisNexis Butterworths, 2020) [2.251] to [2.259]; R White ‘Insolvent Trusts: Implications of *Buckle* and *CPT Custodian*’ (2017) 44 ABR 1, 18-23; D Coshott, ‘Understanding and Reforming the Trustee’s Right of Indemnity’ (2019) 33 Tru LI 45

⁸ *Equity Trust* (n 1) [69], [182] (Lord Richards JSC and Sir Nicholas Patten).

⁹ *Jaken* (n 2) [21] (Bell CJ).

¹⁰ Paul Finn, *Fiduciary Obligations* (Federation Press, 2016) 26, quoted in *Jaken* (n 2) [21] (Bell CJ).

¹¹ As to the rationale for the indemnity, see further, *Equity Trust* (n 1) [58]-[59] (Lord Richards JSC and Sir Nicholas Patten); [257] (Lord Briggs); [288] (Lady Arden).

irrespective of whether the obligation being enforced has been incurred by the trustee in the performance of her duties as trustee or not (assuming there is no limitation of liability or recourse contractually agreed between the parties).

Trusteeship thus exposes the trustee's personal assets to the liabilities incurred by the trustee in trust administration. To prevent people from being dissuaded from assuming the position of trustee, trustees may use trust property to discharge a liability or recoup any she has already paid. The indemnity, to the extent of the trust fund, provides some assurance that 'the trustee is not required to bear liabilities which are not incurred for the trustee's personal benefit'¹² and that 'trustees are in their performance of their fiduciary duties of single-minded loyalty to them, relieved of personal expense and liability'.¹³

A second, but no less important rationale is to support ongoing trust administration, specifically, the trustee's ability to transact with third parties. Such parties may be less likely to transact with a trustee if their personal liability is limited to her personal assets, i.e. those assets held by the trustee free of any trust relationship. Instead, creditors are recognised as having a right of recourse via subrogation to the trustee's indemnity. This is explained by Lord Briggs in *Equity Trust*¹⁴ as being 'to ensure that services can be obtained (including loans) for the better operation of the trust, with a normative basis (though not necessarily a secure basis) for the creditors getting paid, or for the trustees getting reimbursed if the supplier insists on being paid up front.'

Also important are the rules providing for trustee succession, which in one way or another, ensure that a person continues as trustee only for so long as she is willing and able to so do. The trust terms, and in default, statutory provisions and equitable principle, allow a trustee to retire from the role if she is no longer willing to fulfill it.¹⁵ Outside the situations where the trustee chooses to retire, a trustee may be removed, for example by a beneficiary or other party with a power given to them by the trust terms,¹⁶ or by order of the court in response to a trustee's maladministration or other breach of trust,¹⁷ or

¹² *Equity Trust* (n 1) [69] (Lord Richards JSC and Sir Nicholas Patten) [245] (Lord Briggs), [286] (Lady Arden), see also *In re The Exhall Coal Co Ltd* (1866) 35 Beav 449, 453; 55 ER 970, 971-972 (Lord Romilly MR); *Jennings v Mather* [1901] 1 KB 1, 6-7 (Stirling LJ); *Jones (Liquidator) v Matrix* (n 3) [48] (Allsop CJ).

¹³ *Equity Trust* (n 1) [245] (Lord Briggs).

¹⁴ *Equity Trust* (n 1) [245].

¹⁵ A person 'cannot have an estate put into him in spite of his teeth'; *Thompson v Leach* 86 ER 391; (1690) 2 Vent 198 206 (Ventris J) 396 and there are statutory provisions providing for a trustee to retire from a co-trusteeship, in default of trust terms providing for the same, see, eg, Trustee Act 1925 (UK) s 39(1); Trustee Act 1925 (NSW) s 8 and equivalents in other States' and Territories' trusts legislation. There are some formalities, such as consent by the remaining trustees and appropriate arrangements having been made: *Commonwealth v Colonial Combing, Spinning and Weaving Co Ltd* (1922) 31 CLR 421, 470; *Courtenay v Courtenay* (1846) 3 Jo & Lat 519; 72 RR 111, 121; *General Investment Pty Ltd v Tyson* [1967] Tas SR 96, 102.

¹⁶ See, eg, *IRC v Schroder* [1983] STC 480, 500.

¹⁷ See, eg, Trustee Act 1925 (UK) s 41; Trustee Act 1925 (NSW) s 70(1). Trustee removal is inherent to the courts' equitable jurisdiction to supervise trust administration, see, eg, *Letterstedt v Broers* (1884) 9 App Cas 371; *Guazzini v Pateson* (1918) 18 SR (NSW) 275; *Hunter v Hunter* [1938] NZLR 520.

unfitness,¹⁸ death,¹⁹ or loss of capacity.²⁰ Another reason for trustee succession is that the trust terms, may include terms, sometimes referred to as ‘trustee ejection’ clauses, that automatically remove the trustee if she becomes bankrupt or, being a corporation, it enters into any form of insolvent administration.²¹

Trustee succession occurs via two legal mechanisms, which may occur simultaneously or at different points in time. One is the transfer or other vesting of trust property from the outgoing trustee to the successor trustee, who must also accept her position as such.²² This might occur for example, by the outgoing trustee’s transfer or assignment of trust property to the successor trustee, the precise actions for which will depend on the rules applicable to the assignment of subject property; operation of statutory provision;²³ by a court by a vesting order;²⁴ or by a transfer into court.²⁵ The other mechanism is the variation to the terms of the trust permitting the succession and transfer or other vesting of trust property. This might occur by way of execution of a deed of removal or retirement and appointment (sometimes referred to as a ‘DORA’), or by court orders, for example.

Typically, the outgoing trustee and the incoming trustee, and where necessary other parties, such as beneficiaries, protectors or enforcers, determine for themselves via a DORA and/or an additional contractual agreement how any outstanding indemnity of the outgoing trustee will be satisfied. The parties, might for example, agree that the outgoing trustee may retain some part of trust property for that purpose, or instead may have a right of indemnification against the successor trustee (which may be limited in recourse to the trust fund). In some situations, the relationship between the former trustee and her successor may be defined by the terms of the DORA and, potentially any further contract between them. However, the parties do not always have these arrangements in place, and even when they do the insolvency of one or both trustees may render any contractual indemnity useless. The background equitable and statutory indemnification rules still matter and determine the relationship between successive trustees and their recourse to the trust fund for indemnification.

These rules are, however, a source of controversy, as is highlighted by the decisions of the Judicial Committee of the Privy Council in *Equity Trust (Jersey) Ltd v Halabi* and the New South Wales Court of Appeal in *Jaken Properties Australia Pty Ltd v Naaman*, which considered the questions of priority

¹⁸ *Re Turner* [1923] VLR 189.

¹⁹ Trustee Act 1925 (UK) s 18; *Mallott v Wilson* [1903] 2 Ch 494.

²⁰ *Re East* (1873) 8 Ch App 735.

²¹ See *D’Angelo* (n 7) [9.31] et seq.

²² In the absence of there being someone prepared to fulfill this role, a court will appoint someone to succeed the outgoing trustee, since equity will not allow a trust to fail for want of a trustee.

²³ See, eg, Trusts of Land and Appointment of Trustee Act 1996 (UK) 19(4); Trustee Act 1925 (UK) s 37(1)(d); Trustee Act 1925 (NSW) s 9 and equivalents in other States’ and Territories’ trusts legislation.

²⁴ See, eg, Trustee Act 1925 (NSW) s 71(2); *Chang v Registrar of Titles (Vic)* (1976) 137 CLR 177, 186 (Mason J).

²⁵ See, eg, Trustee Act 1850 (UK) s 48; Trustee Act 1925 (NSW) s 95.

between successive trustees and fiduciary loyalty respectively. In the absence of authority binding either Court, the judgments in both cases looked to fundamental rules of trust and fiduciary law and their underlying policy rationales. Both cases reveal deep divisions between the majority and minority opinions as to the nature of the relationship between the former trustee and her successor, despite all being grounded in the same rules, and attaching the same importance to adherence to precedent and rationale.

In *Equity Trust* this resulted in differing views as to which trustee (if any) would have priority to indemnification out of the trust fund when the trust funds are insufficient to meet the claims of both. The majority found that the former and successor trustee ranked equally according to a *pari passu* distribution.²⁶ Equality of treatment was preferred on the basis the trustee's indemnity was a sui generis 'lien' that survived or continued through succession to which the usual rules for priority did not apply.²⁷ The minority found a former trustee had priority over the successor trustees, according to the trustee's date of appointment on the basis the trustee's indemnity is an equitable proprietary interest that survives succession and takes priority according to the rules of equitable priorities that favour the earlier acquired interest.²⁸

In *Jaken* the trustee's indemnity determined the fiduciary status of the relationship between the successor trustee and the former trustee. In this case, the trust funds were insufficient to indemnify the former trustee and its creditors, due to the successor trustee's unauthorised transfers of trust property. Claiming by way of subrogation, the judgment creditor of the former trustee sought equitable relief against the third-party recipients on the basis of knowing receipt or assistance. At first instance, and on appeal, both sides accepted that this claim depended on whether the successor trustee's unauthorised transfers were made in breach of fiduciary duty, agitating the question of the successor trustee's fiduciary status (if any) vis a vis the former trustee.

At first instance, Kunc J²⁹ found that the successor trustee owed a fiduciary obligation to the former trustee in respect of the latter's right to be indemnified or exonerated out of trust property. This finding was, however, overturned by the Court of Appeal. Leeming JA and Kirk JA, in separate concurring judgements, held the successor trustee did not owe a fiduciary duty, and in consequence the claims based on knowing receipt or assistance failed. Both Leeming JA and Kirk JA had minimalistic views of the former trustee's indemnity, confining it to an equitable proprietary right to be indemnified out of the

²⁶ *Equity Trust* (n 1) [238]-[240], [254]-[268], [270] and [272]-[278] (Lord Briggs, with whom Lord Reed and Lady Rose agreed, see also Lady Arden [279]ff).

²⁷ *Equity Trust* (n 1) [246] (Lord Briggs).

²⁸ *Equity Trust* (n 1) [164]-[166], [167], [210] (Lord Richards and Sir Nicholas Patten, with whom Lord Stephens agreed), applying the rule that 'if the merits are equal, priority in time of creation is considered to give the better equity'; *Heid v Reliance Finance Corp Pty Ltd* (1983) 154 CLR 326, 333; *Macmillan Inc v Bishopsgate Investment Trust plc (No 3)* [1995] 1 WLR 978, 999-1000 (ChD).

²⁹ *Jaken Properties Australia Pty Ltd v Naaman* [2022] NSWSC 517.

trust property.³⁰ This right survived the trustee's succession, making any fiduciary duty unnecessary³¹ and difficult to accommodate.³² In dissent, Bell CJ found that the successor trustee's duty to a former trustee is fiduciary because, among other things, of the former trustee's 'special and superior'³³ right to indemnification over the beneficiaries.

The Court of Appeal stopped short of determining the priority between the former and successor trustee, although Leeming JA relied upon the majority decision in *Equity Trust* favouring equal allocation³⁴ as one reason why the successor trustee did not owe a fiduciary duty.

As with *Equity Trust*, the basal nature and purpose of the trustee's indemnity was critical in *Jaken*. Both cases started from the same assumption that the incumbent trustee's indemnity is a 'right', 'equitable proprietary right' or 'interest' or 'lien' or 'charge' that 'survives' or 'continues' despite succession.³⁵ But for reasons to be discussed in Part III, this starting point misapprehends the basal nature of the incumbent trustee's indemnity and overlooks the fundamental change caused by trustee succession.

III. The Relationship Between the Former Trustee and Her Successor

A. The Former Trustee's Indemnity Does Not Survive the Loss of Trusteeship

The trustee's indemnity cannot survive or continue through her succession and divestiture of trust property. This is because the trustee's indemnity does 'not exist independently of the rights that the trustee holds on trust'.³⁶ There is a 'practical relationship'³⁷ between the trustee's indemnity and the legal entitlements she holds on trust, because, no matter the labels used, the process of indemnification always operates in the same way. The trustee is authorised to do things with the trust property that would otherwise be unauthorised and a breach of trust: such as to use trust funds to discharge a debt the trustee owes personally to a third party (under the exoneration limb); or to treat trust property as her own to reimburse the trustee for an expense she has paid (under the reimbursement limb).

³⁰ *Jaken* (n 2) [126]-[128], adopting the reasoning of Bell, Gageler and Nettle JJ in *Carter Holt* (n 5) [83].

³¹ *Jaken* (n 2) [128], [136].

³² *Jaken* (n 2) [137]-[139] (Leeming JA), [234]-[237] (Kirk JA).

³³ *Jaken* (n 2) [6], [21], [33].

³⁴ *Jaken* (n 2) [137].

³⁵ The same assumption as to the survival of the trustee's indemnity is made in: *Dimos v Dikeakos Nominees Ltd* (1996) 68 FCR 39; *Lemery* (n 3) [45]-[50]; *Oakhurst Property Developments Ltd v Blackstar (Isle of Man) Ltd* [2012] EWHC 1131 (Ch), [2012] WTLR 1255 [36]-[37]; *Meritus Trust* (n 3) [13]-[14]; *Investec* (n 3) [59](v), relying on *Re Johnson* (1880) 15 Ch D 548 (Ch); *Ridge Estate Pty Ltd v Fairfield Pastoral Holdings Pty Ltd* [2024] FCAFC 17 [60] (Banks-Smith J, with whom O'Sullivan and Feutrill JJ agreed); L Tucker, N Le Poidevin and J Brightwell, *Lewin on Trusts*, (20th edn, Sweet & Maxwell, 2020) paras [17.57]-[17.58]; M Leeming and J Heydon, *Jacob's Law of Trusts in Australia* (8th edn, LexisNexis, 2016) 514 para [21.04]. Statutory force is also given to the 'continuing lien' rule by the Trusts (Guernsey) Law 2007 Article 44(1) and (2).

³⁵ *Chief Commissioner of Stamp Duties (NSW) v Buckle* (1998) 192 CLR 226 [50] (the Court).

³⁶ *Carter* (n 5) [30]-[31], [32].

³⁷ *Cater* (n 5) [81].

The indemnity is the trustee's authority to use trust property to indemnify herself.³⁸ This idea finds some expression in the cases, such as *Equity Trust*, where Lord Briggs explains the indemnity as 'a means of payment, not a security for payment',³⁹ that 'authorises'⁴⁰ the trustee to use the trust property in her favour. In *Carter Holt*, Kiefel CJ, Keane and Edelman JJ refer to the indemnity as 'a means by which trust rights can be used'.⁴¹ Other cases also use permissive language, stating that the trustee 'may apply'⁴² or 'has a right to apply'⁴³ trust property in satisfaction of trust liabilities.⁴⁴

As an authority or permission to use the trust property, the trustee's indemnity cannot be separated from that property. When the trustee is divested of trust property, she loses the authority to use that title, including to indemnify herself. Trustee succession thus profoundly changes the trustee's indemnity, which must be 'enforced in a different way ... [as the] ... former trustee may no longer simply appropriate trust assets to reimburse or exonerate it.'⁴⁵

B. Confusion about the Nature of the Trustee's Indemnity

The impact of succession on the trustee's indemnity has been misunderstood because the nature of indemnification is not properly understood. This is reflected by the courts' use of different labels to describe the indemnity followed by explanations why the label is used in a unique sense to describe some aspect of the indemnity that otherwise is considered *sui generis*.

The indemnity, for example, has been referred to as a 'right',⁴⁶ yet cases also acknowledge that it is unlike any other legal right because the indemnity 'does not impose any personal liability on any

³⁸ See further, S Agnew and K Purkis, 'Trustees' Indemnities – Is Timing Everything?' (2018) 24 T&T 989; J Hudson and C Mitchell, 'Trustee Recoupment: A Power Analysis' (2021) 35 Tru LI 3; B McFarlane, 'Trusts Property and Rights' in S Degeling et al (eds) *The Philosophical Foundations of the Law of Express Trusts* (OUP 2023) ch 2, 29; D'Angelo (n 7) [5.124] *et seq*.

³⁹ *Equity Trust* (n 1) [249].

⁴⁰ *Equity Trust* (n 1) [247]-[248].

⁴¹ *Carter Holt* (n 5) [30] (Kiefel CJ, Keane and Edelman JJ), see also [85]-[87] (Bell, Gageler and Nettle JJ). See, also, *Jaken* (n 2) [141] (Leeming JA) '[the incumbent trustee] was entitled to be indemnified for liabilities properly incurred as trustee. While in office, it had legal title to trust assets, which it could use to indemnify itself.' As to the idea of the trustee's indemnity as an authority to use trust property see further: S Agnew and K Purkis, 'Trustees' Indemnities – Is Timing Everything?' (2018) 24 T&T 989; J Hudson and C Mitchell, 'Trustee Recoupment: A Power Analysis' (2021) 35 Tru LI 3; B McFarlane, 'Trusts Property and Rights' in S Degeling et al (eds) *The Philosophical Foundations of the Law of Express Trusts* (OUP 2023) ch 2, 29; D'Angelo (n 7) [5.124] *et seq*.

⁴² *Jones (Liquidator)* (n 3) [100]; 'may be applied' in *Carter Holt* (n 5) [91]-[92].

⁴³ *Equity Trust* (n 1) [140].

⁴⁴ *Carter Holt* (n 5) [84]; *Jaken* (n 2) [141].

⁴⁵ *Peter Sleiman Investments Pty Ltd v Deputy Commissioner of Taxation* [2017] NSWCA 81 [58].

⁴⁶ See, eg, *Investec* (n 3) [59](v); *Equity Trust* (n 1) [56]-[65], [279]; *Carter Holt* (n 5) [17]-[18]; *Jaken* (n 2) [125], [128].

person'.⁴⁷ The trustee does not have a right to indemnification in the Hohfeldian sense⁴⁸ of a claim-right that correlates to a duty that she can enforce against any other person. The label of 'right' has been used in a loose sense to refer to the trustee's authority or permission to use or apply trust funds to indemnify herself.

Cases also refer to the indemnity as a 'proprietary right'⁴⁹ or 'proprietary interest' while also acknowledging that it is *sui generis*.⁵⁰ Courts apply the proprietary label because the trustee has an entitlement to specific equitable relief; the mechanism for indemnification is the trustee's power to use the trust property in her favour;⁵¹ and to identify the priority afforded to the trustee's indemnity over the beneficiary.⁵² Nonetheless, it is difficult to make sense of the trustee having an equitable proprietary right in *her own legal entitlements* that she holds on trust.

The indemnity has also been understood as an 'equitable lien' because the trustee can withhold trust property from the beneficiaries (including by resisting a *Saunders v Vautier* claim) and seek equitable relief in the form of orders for sale or appointment of a receiver. It is hard to make sense of the indemnity as an equitable lien, and this difficulty has been recognised in some cases.⁵³ The indemnity is unlike any other security interest as there is no one who owes the trustee a duty the performance of which the lien could secure.⁵⁴ The indemnity 'is a means of payment, not a security for payment.'⁵⁵ For these reasons, the indemnity has been described as a 'truly *sui generis*'⁵⁶ interest arising 'endogenously'⁵⁷ as an incident of trusteeship that is incomparable to any other legal or equitable security interest.⁵⁸ The High Court of Australia in *Buckle*⁵⁹ explain the indemnity is a lien only '*in [the] sense*' that a trustee may apply for the court's assistance in indemnification.

⁴⁷ *Equity Trust* (n 1) [63] (Lord Richards JSC and Sir Nicholas Patten), see also [109]-[110]. The problems with 'right' are discussed in: A Silink, 'Trustee Exoneration from Trust Assets – Out on a Limb?' (2018) 12 J Eq 58, 69-70; D'Angelo, n 7, at [2.14] to [2.22]; Hudson and Mitchell, 'Trustee Recoupment' (n 38); M Conaglen, 'Trustees Competing Over Indemnity Rights' (2024) 48(1) MULR (forthcoming).

⁴⁸ W Hohfeld, 'Fundamental Legal Conceptions as Applied in Judicial Reasoning' (1913) 23 Yale LJ 16, 30-33.

⁴⁹ See, eg, *Octavo Investments Pty Ltd v Knight* (1979) 144 CLR 360, 370; *Carter Holt* (n 5) [32]; *Equity Trust* (n 1) [109]-[112].

⁵⁰ *Equity Trust* (n 1) [250].

⁵¹ *Carter Holt* (n 5) [32]-[33], [82]-[84].

⁵² *Carter Holt* (n 5) [83], *Jaken* (n 2) [126]; *Vacuum Oil Co Pty Ltd v Wiltshire* (1945) 72 CLR 319, 335; *Buckle* (n 35) [47]-[48].

⁵³ *Agusta* (n 3) [41] (Barrett JA) it is 'anomalous to refer to a person having a charge or lien over property of which the person is the owner'.

⁵⁴ *Equity Trust* (n 1) [249] (Lord Briggs).

⁵⁵ *ibid.*

⁵⁶ *Equity Trust* (n 1) [249].

⁵⁷ *Carter Holt* (n 5) [83].

⁵⁸ *Carter Holt* (n 5) [83]; see also *Jaken* (n 2) [126]; *Equity Trust* (n 1) [249] (Lord Briggs)

⁵⁹ *Buckle* (n 35) [50] (the Court) [emphasis added].

Each label of ‘right’, ‘equitable proprietary interest’ and ‘equitable lien’ has been used in an idiosyncratic and imprecise sense to describe one or more aspects of the trustee’s indemnity. None of these labels capture the essential nature of trustee indemnification, which itself fails to exhibit the essential features of any of these other juridical phenomena. These problems are not avoided by adding the additional label of ‘equitable’ ‘sui generis’ or ‘unique’, or using two or more at once to capture different aspects.⁶⁰ If the trustee’s indemnity really is so unique or distinct then other labels should not be used, let alone relied upon, to draw conclusions about the process of trustee indemnification and its interaction with other rules, such as those providing for changes in trusteeship.

Another source of confusion is the elision of the trustee’s so called ‘equitable right of indemnity’ and her ‘legal powers of ownership.’ The indemnity is not literally the trustee’s ownership and constitutive legal entitlements including the power to transfer ownership. The trustee’s power to transfer or assign the legal entitlements held on trust, for example, is not the indemnity. The indemnity is the trustee’s authority or permission to use the legal entitlements held on trust to indemnify herself. As discussed above,⁶¹ there is an inseparable connection between the indemnity, i.e. the trustee’s authority to use the legal entitlements held on trust, and those legal entitlements, but they are distinct.

Even the label of ‘indemnity’ is imprecise. The trustee’s indemnity operates differently from other indemnities, such as a contractual indemnity that indemnifies one party by generating a right in her favour to another party’s performance of a duty, such as to pay money. A trustee is not indemnified this way and she does not acquire a right to payment against anyone, and no one owes a duty to indemnify the trustee that the trustee can enforce against anyone.

Despite the warnings by courts that labels are inconclusive and apt to mislead, they are still relied upon when one or another legal question is resolved by reference to the fact that the indemnity is an ‘equitable proprietary right’ or ‘interest’ or an ‘equitable lien’, for example. Reliance on these labels has caused confusion as to the impact of trustee succession on indemnification as well as the ensuing relationship between the trustee and her successor, as will be discussed further below.

C. A New and Different Entitlement is Generated in Favour of the Former Trustee on Succession

A trustee’s succession means she is divested of the legal entitlements held on trust and thus her authority to use those entitlements to indemnify herself. What does continue or survive, however, is the rationale or policy for indemnifying the former trustee for liabilities properly incurred while she was trustee. To this end courts have given effect to this rationale by recognising a new entitlement or right to be

⁶⁰ For example, when it is said the indemnity is a right and lien, or other equitable proprietary right, see, eg, A Silink, ‘Priority between competing successive trustee liens: the limits of judicial innovation and the opportunity for law reform’ (2024) *King Law Journal* (forthcoming).

⁶¹ In Part III.A.

indemnified out of the trust property that correlates to the successor trustee's duty not to prejudice the former trustee's entitlement.⁶² The successor trustee's duty extends to all of the legal entitlements that from time to time may be held as part of the trust fund, not just those originally held by the former trustee.⁶³

The former trustee can enforce her entitlement by applying to the Court for orders for equitable execution,⁶⁴ such as the appointment of a receiver or for sale of the property and payment out of the proceeds of an amount sufficient to discharge the indemnity,⁶⁵ or if the trust property is constituted by a fund an order for the payment out of that fund.⁶⁶ The former trustee has 'a right to have the trust property applied'⁶⁷ in her favour for indemnification. This right is a 'beneficial interest'⁶⁸ in the trust property, which is 'proprietary'⁶⁹ on account of the availability of specific equitable relief, and this interest ranks in priority to the beneficiary's, including the beneficiary's right to call in the trust property in accordance with the rule in *Saunders v Vautier*.⁷⁰

D. A Relationship of Beneficiary – Express Trustee

The relationship between the former trustee and her successor is best analysed as a trust relationship. It bears the essential feature of any other trust relationship: the successor trustee's authority to use the legal entitlements held on trust is conditioned on her adherence to terms.⁷¹ In *Jaken*,⁷² Leeming JA disavowed the trust characterisation on the basis that 'merely having custody and administration of property' is not sufficient, pointing to other situations meeting these criteria that are not trust relationships such as 'a cloakroom attendant holding a patron's coat' and bailment. Regardless of whether a successor trustee has physical custody of tangible property, what sets her apart from a bailee is that the former trustee is vested with title to the trust property, which may or may not include a right

⁶² *Jaken* (n 2) [2] (Bell CJ), Leeming JA [37]-[38].

⁶³ *Peter Sleiman Investments* (n 45) [60].

⁶⁴ *Equity Trust* (n 1) [102], [282]; *Jaken* (n 2) [116], [128], [141].

⁶⁵ *Swiss Bank Corporation v Lloyds Bank Ltd* [1982] AC 584, 604. A liquidator of a corporate trustee (including a former trustee) may seek appointment as a receiver of the trust property to exercise an indemnity, see, eg, *Re Aberdeen All Farm Pty Ltd (in Liq)* [2020] NSW 770 (Black J).

⁶⁶ *Hewett v Court* (1983) 149 CLR 639, 663.

⁶⁷ *Ridge Estate* (n 35) [104].

⁶⁸ See, eg, *Jaken* (n 2) [4], [22]-[24] (Bell CJ); [130] (Leeming JA); *Agusta* (n 3) [84].

⁶⁹ *Commissioner of Taxation v Bruton Holdings Pty Limited (in liq)* [2008] FCAFC 184, (2008) 173 FCR 472 [43]; *Equity Trust* (n 1) [139], quoting *Carter Holt* (n 5) [80], see also, *Armill Pty Ltd v Tippers & Co Pty Ltd* (2006) 58 ACSR 616.

⁷⁰ *Buckle* (n 36) [47]-[51]; *Carter Holt* (n 5) [29]-[33]; [80]-[84]; *Agusta* (n 3) [84]; *Jaken* (n 2) [24] (Leeming JA), [93] (Bell CJ).

⁷¹ See, eg, *Countess of Bective v Federal Commissioner of Taxation* (1932) 47 CLR 417, [1932] HCA 22, where Dixon J emphasised the trustee's obligation to obey the trust terms as the feature distinguishing a trust from a conditional gift; *DKLR Holding Co (No 2) Pty Ltd v Commissioner of Stamp Duties* [1980] 1 NSWLR 510, 520 (Hope JA) [emphasis added], see also 518-519; *Carter Holt* (n 5) [25]-[27] (Kiefel CJ, Keane and Edelman JJ), [82] (Bell, Gageler and Nettle JJ).

⁷² *Jaken* (n 2) [129].

to possess a tangible thing, and her authority to use them is conditioned on terms requiring indemnification of the former trustee. The former trustee, like other beneficiaries, has an entitlement to control how the successor trustee uses the trust property. This entitlement is enforceable by equitable relief, such as an injunction to prevent an unauthorised dealing with trust property. The availability of such equitable relief has meant each of the former trustee and other beneficiaries have an ‘equitable proprietary interest or right’ or ‘beneficial interest in the trust assets’.⁷³

The content of their entitlements differ. The former trustee’s entitlement is for payment of out the trust fund, or other transfer of trust property to reimburse a previously discharged liability (the reimbursement limb), or for the successor trustee to discharge the former trustee’s liability to a third party (the exoneration limb). The beneficiary’s entitlement to be paid trust funds or receive the trust property will be defined by the terms, which may give her a presently existing and absolute entitlement, or condition such an entitlement and/or its content on the occurrence of future events, such as the exercise of a power of appointment, for example. But no matter the variation in content, each have an entitlement to control how the successor trustee uses the trust property.

The former trustee, while not called this in the cases, is a *preferential* beneficiary⁷⁴ because the successor trustee must indemnify the former trustee before satisfying the other beneficiaries’ entitlements.⁷⁵ There are thus ‘two classes of persons having a beneficial interest in the trust assets, first the beneficiaries, ... secondly the trustee in his right to be indemnified ... The latter interest will be preferred to the former.’⁷⁶ The former trustee’s preferential status over other beneficiaries should not detract from the similarities in the relationships a successor trustee has with them. The preference afforded to the former trustee is no different to other situations where the trust terms provide for payment or satisfaction of one beneficiary, or class of beneficiaries, over another.

It is sometimes said that the successor trustee owes no personal duty to indemnify the former trustee.⁷⁷ This does not mean the successor trustee owes no duty at all. The successor trustee does owe a duty to the former trustee to administer the fund to preserve its availability to indemnify the former trustee. This duty is not personal in the sense that it only controls what the successor trustee does with the trust fund. The successor trustee is not liable to pay the former trustee out of her personal assets if the trust fund is insufficient for some reason other than a breach by the successor trustee, such as losses on

⁷³ Descriptions of the former trustee’s entitlement in, *Equity Trust* (n 1) [154], referring to *Lemery* (n 3) [21]; *Jaken* (n 2) [141]; see also *Ridge Estate* (n 35) [104]; are functionally equivalent to those of a beneficiary in, *DKLR Holding Co (No 2) Pty Ltd v Commissioner of Stamp Duties (NSW)* [1980] 1 NSWLR 510, 518-520.

⁷⁴ See also, D Loxton, ‘In with the Old, Out with the New? The Rights of a Replaced Trustee against Its Successor, and the Characterisation of Trustees’ Proprietary Rights of Indemnity’ (2017) 45(4) Australian Business Law Review 285.

⁷⁵ See n 70 above.

⁷⁶ *Arkmill* (n 69).

⁷⁷ *Equity Trust* (n 1) [163].

authorised investments. The former trustee does not have a claim for relief that can be executed against the successor trustee's personal assets.⁷⁸

Likewise, the relationship between a trustee and beneficiary is limited to the trust fund. The trustee's duty to administer the trust according to its terms, while often described as personal, is still limited to the trust fund. The trustee is not a surety for the trust fund, and the beneficiary does not have a claim for any relief that can be executed against the trustee's personal assets in the event the trust fund is insufficient to meet their entitlements for some reason other than a breach by the successor trustee, such as losses on authorised investments. For example, if a beneficiary is entitled to be paid \$10 per month, and the trust funds are insufficient for this to occur the trustee is not personally liable to make up the difference.

Of course, the trustee is personally liable for her failure to administer the fund according to its terms,⁷⁹ or breach of other duty. In these circumstances the trustee is accountable to each of the beneficiary and the former trustee. Both have an entitlement to information, such as to an accounting by the successor trustee of her administration of the fund.⁸⁰ Both also have available to them the equitable proprietary claim for recovery of misappropriated trust property against third party recipients of the original or traceable substitute.⁸¹

A former trustee's entitlement meets the same criteria for certainty as the trust beneficiary's:⁸² the subject matter is the legal entitlements held on trust from time to time; the former trustee's entitlement is to be indemnified out of the trust fund for liabilities properly incurred in trust administration; and correlatively this is the content of the successor trustee's duty assumed when she manifests her intention to be trustee. As will be discussed further below, there may sometimes be some evidential uncertainty or administrative workability challenges, particularly when a former trustee has unknown liabilities. However, the existence and extent of the relationship between the former trustee and her successor is conceptually certain.⁸³

Analysing the relationship between the former trustee and successor trustee as that of beneficiary–trustee has implications for the issues of priority, retention, fiduciary loyalty and creditors, each of which are discussed in turn.

⁷⁸ *Jaken* (n 2) [128], [141]; *Equity Trust* (n 1) [63], [80], [109], [113] explaining the indemnity 'does not impose any personal liability on the replacement trustee, beyond its obligation as trustee to apply the trust property in accordance with the rights of, among others, a former trustee with a right of indemnity', see also [170]; *Arkmill* (n 66); *Re Handberg, in the matter of Greight Pty Ltd (in liq)* [2006] FCA 17, (2006) 56 ACSR 334 [9].

⁷⁹ *Re Handberg* (n 78) [10]; *Agusta* (n 3) [84].

⁸⁰ *Lewin on Trusts*, para [17-069].

⁸¹ *Jaken* (n 2) [38], [136]; *Re Handberg* (n 76) [10]

⁸² *Knight v Knight* (1840) 3 Beav 148; *Byrnes v Kendle* (2011) 243 CLR 253.

⁸³ As to the difference between evidential uncertainty and administrative workability, which do not undermine a finding of a trust, and conceptual uncertainty, which does, see *McPhail v Doulton* [1971] AC 424.

IV. Priority between the Former Trustee and Her Successor

A. Priority to the Successor Trustee

When it comes to deciding who has priority to indemnification, this article's submission is that it should be decided the same way as any other trust relationship. The incumbent trustee, be they the original or a successor, should have priority to indemnify herself out of the trust fund, including over any former trustee. The incumbent trustee bears the 'onerous and sometimes dangerous'⁸⁴ duties of trusteeship and is exposed to unlimited personal liability to third parties, such as taxation liabilities or other liabilities incurred as the titleholder or in connection with trust administration. For so long as the incumbent trustee is in the hotseat of trusteeship the trust funds should be available to indemnify her first.

Any successor trustee should have priority to indemnification for the same reasons as any other incumbent trustee: to support trust administration and ensure people are not dissuaded from taking on trusteeship from another. Added to this, a successor trustee should have priority to avoid rewarding a trustee for ceasing as trustee which is the effect of rules prioritising indemnification of the former trustee, or equality of treatment. These reasons are discussed further below but it is first necessary to acknowledge that this article's solution differs from that developed and applied in *Equity Trust*. In that case a majority of the Judicial Committee of the Privy Council treated the former trustee and successor trustee equally according to *pari passu* distribution as an exceptional disapplication of the first in time rule. This article's solution of prioritising indemnification of the successor trustee was not considered, let alone mentioned. This is not surprising given the starting premise adopted by the parties and the judgments in *Equity Trust* was that the former trustee had priority according to the first in time rule unless there was some reason why equal distribution should apply. The problems with this starting premise are discussed further below in Part IV.B.

Having admitted an exception to the first in time rule to allow for equality of treatment, we can speculate whether English courts may expand the breadth and depth of this exception to other situations, and even apply a different form of priority. Either way, this article's solution of prioritising indemnification of the incumbent (including a successor) trustee is one the Australian courts should adopt as it best implements the rationale for the trustee's indemnity, and has some case support already, for reasons discussed further in this Part IV.A. The problems with the other options of prioritising the former trustee and equality of treatment are set out in Part IV.B below.

i. Priority to Successor Trustee Best Supports Trust Administration and Succession

Prioritising indemnification of the incumbent trustee, including any successor, supports ongoing trust administration, including the trustee's ability to transact with third parties, who may be less likely to

⁸⁴ *Re Grimthorpe* [1958] Ch 615, 623.

deal with the successor trustee if her indemnity does not have priority over other claims on the trust fund. The incumbent trustee may find it harder to administer the trust and perform her duties as trustee, including in favour of any former trustee. Third parties may be less willing to deal with the successor trustee, or only deal on less favourable terms, owing to the limited recourse they would have to trust assets in the event of the trustee's insolvency.

Prioritising the successor trustee's indemnity is also important for trustee succession. As discussed in Part II above, trustee succession provides for changes in trusteeship when a trustee is unwilling or unable to administer the trust. Trustee succession is critical for ongoing trust administration but depends on there being someone to take the place of the outgoing trustee. A prospective trustee may be less likely to do this if the protection afforded by the indemnity is subordinated to the former trustee's. Prioritising the successor trustee's indemnity helps to prevent people from being dissuaded from assuming trusteeship by succeeding another as trustee.

From the perspective of the former trustee, the rationale for prioritising her indemnification out of the trust fund no longer applies once she relinquishes the trust property. Once she ceases as trustee, the former trustee avoids the ongoing personal liability and exposure of her personal assets. If a liability on a former trustee 'emerges from the shadows and is due for payment'⁸⁵ the incumbent trustee is responsible for preserving the adequacy of the trust fund and indemnifying the former trustee. The adequacy of the trust fund to meet the former trustee's indemnity depends upon the successor trustee's due administration, *whatever cost* that may be to the successor trustee. Just as the beneficiary cannot have the benefit of the administration of the fund without accepting the priority of indemnification for the trustee's expenses incurred in administration, neither should the former trustee be able to deny the priority of the successor trustee's indemnity for expenses incurred in administering the fund, first and foremost for the former trustee over the beneficiaries.

This rationale has been recognised in cases such as *Re Z Trust II*⁸⁶ where the Royal Court explained 'the new trustees should be paid for the work done in winding up the trust, because without that work, there would be no funds to pay the former trustee, or indeed anyone else.' This draws on the principle identified with *Re Universal Distributing Co Ltd*⁸⁷ that, where a person's efforts have produced a fund in the administration of which various parties are interested, that person's expenses should be a first claim on the fund.⁸⁸

⁸⁵ *Equity Trust* (n 1) [292] (Lady Arden).

⁸⁶ *Re Z Trust II* (n 3) [53].

⁸⁷ *Re Universal Distributing Co Ltd (in liq)* (1933) 48 CLR 171, 174-175.

⁸⁸ *Shirlaw v Taylor* (1991) 31 FCR 222; *Re Primespace Property Investment Ltd (in liq)* [2016] NSWSC 1821 at [68]-[71].

There is a connection between this rationale and salvage, which is made in *Equity Trust*⁸⁹ where Lady Arden stated that the trust expenses doctrine is a ‘sort of salvage principle’, explaining the trustee as ‘salvor’ should be paid if he enables ‘a ship to be saved or the trust to operate’. Lady Arden makes this analogy in connection with explaining the trustee’s priority *over beneficiaries*, but later goes on to acknowledge that if the former trustee is to be indemnified at all, it will be as a result of the successor trustee.⁹⁰

This idea extends beyond the situations where a successor trustee steps in just for the purpose of winding up and realising trust funds for distribution. Even in the situation where a successor trustee replaces a former trustee to administer the trust on an ongoing basis for the beneficiaries, the successor administers the trust for and on behalf of the former trustee in priority to the beneficiaries. The successor trustee’s expenses in so doing should be paid first. If and when the former trustee is indemnified it will be because of the successor trustee’s administration of the fund and exercise of her power in favour of the former trustee.

Against this, it might be said that the *former* trustee’s administration is why there is a trust fund for the successor to succeed to at all so that the former and successor trustee have equal claims to indemnification. What tips the scales in favour of the successor trustee is the context of succession and reasons for it. The former trustee has either chosen to retire, has been removed because she is unable or unwilling to administer the trust according to its terms, or has been removed according to the trust terms which she accepted as trustee initially. Allowing a former trustee to have equal access or priority to indemnification while avoiding unlimited personal liability rewards a trustee for ceasing as trustee, for the reasons discussed further in Part IV.B below.

The successor trustee should have priority to the trust fund for indemnification for so long as she serves in the hotseat as trustee with exposure to unlimited personal liability in connection with her administration of the trust *for the former trustee*, as well as beneficiaries. The former trustee should not be able to avoid unlimited personal liability by discontinuing as trustee while also having priority to the trust fund for indemnification, the expense of which is borne by the successor trustee.

ii. Some support for priority in favour of the successor trustee

There are some Australian cases that support this article’s solution of prioritising indemnification of the successor trustee.⁹¹ In *Global Funds Management (NSW) Ltd v Burns Philp Trustee Co Ltd*⁹² priority was given to a successor trustee’s indemnity when a former trustee was ordered to transfer trust property to the successor. While the successor trustee was required to give an undertaking to preserve the

⁸⁹ *Equity Trust* (n 1) [286].

⁹⁰ *Equity Trust* (n 1) [292].

⁹¹ And outweigh the Australian case favouring the former trustee, *Fotios v Helios* [2023] FCA 251 (Colvin J).

⁹² *Global Funds Management (NSW) Ltd v Burns Philp Trustee Co Ltd (In Prov Liq)* (1990) 3 ACSR 183.

adequacy of the trust fund to meet the former trustee's indemnity, this was only in so far as the trust funds were not required 'in carrying on the ordinary business of the trust...'.⁹³ In other words, the successor trustee's indemnity took priority. Her duty to preserve the trust property in favour of the former trustee was limited from the outset as the successor trustee was authorised to use trust property in 'carrying out the ordinary business of the trust'.⁹⁴

Added to this the successor trustee had priority for indemnification of her expenses incurred in getting in and realising the fund, as well as remuneration in *Richardson v Aileen Pty Ltd*.⁹⁵ This had been agreed between the parties. Mandie J indicated that even without agreement, the successor trustee's indemnity would still take priority, drawing on the principle identified with *Re Universal Distributing Co Ltd*⁹⁶ discussed above.

B. Other Options – Equality of Treatment and Priority to the Former Trustee

As mentioned already, this article's solution is different to the two options usually canvassed in the cases, which are treating the trustees equally by distributing trust funds *pari passu*, or prioritising indemnification of the former trustee. For the reasons discussed next, both of these options reward a trustee for ceasing as trustee, undermining the rationale for the trustee's indemnity, as well as that for trustee succession.

i. Both Options Reward Succession

Both options of prioritising the former trustee's indemnity and equality of treatment reward a trustee for discontinuing. These options give the former trustee absolute or equal priority to indemnification while also avoiding ongoing personal liability for expenses incurred in trust administration. This places the former trustee in a better position than if she remains as trustee, as she would have the same priority to indemnification, but no longer have continuing and unlimited personal liability.

This argument can be demonstrated by the example of a change in trusteeship of a fund that is insufficient to meet the indemnities of the former and successor trustees. The fund is worth \$100; the former trustee has an outstanding indemnity of \$45 and the successor trustee incurs a tax liability of \$75. If the former trustee's indemnity is given absolute priority, she will be completely indemnified for her liability of \$45 in priority to the successor trustee. If the option of equality of treatment is applied

⁹³ *Global Funds Management* (n 92) 186 [emphasis added].

⁹⁴ *Primary Securities Ltd v Willmott Forests Ltd* [2016] VSCA 309, [53] cites *Global Funds Management* (n 92) as providing obiter support for the contrary argument that a replacement trustee takes subject to its predecessor's 'lien'. This however overlooks the terms of the undertaking required by the successor trustee that excepted or reserved the successor trustee's indemnity in the form of her authority to use trust funds in trust administration. The successor trustee was only required 'to ensure that the trust assets are not diminished, *other than in carrying on the ordinary business of the trust...*'.

⁹⁵ *Richardson v Aileen Pty Ltd* [2007] VSC 104 [54]-[57].

⁹⁶ *Re Universal Distributing Co Ltd (in liq)* (1933) 48 CLR 171, 174-175.

the former trustee will be indemnified \$37.50 out of trust funds, leaving her to bear the \$7.50 shortfall out of her own personal funds. Whereas if the trustee remains as trustee, she would be \$20 worse off. The trustee continues and incurs the later tax liability of \$75, leaving her with an overall personal liability of \$120, and \$100 of trust funds to use for indemnification.

This concern was not raised in *Equity Trust* where the parties' framed the question for determination as a binary choice between giving priority to the former trustee or equality of treatment. A problem endemic to both options was not likely to be raised. The fact that both options reward the outgoing trustee is nonetheless significant bearing in mind the context in which succession occurs. Succession is a choice made by the outgoing trustee when she is no longer willing or able to administer the trust, or a choice made by a third-party or the court, potentially for the same reasons. Rewarding an outgoing trustee in any of these circumstances undermines the rationales for trustee succession and indemnification. These options discourage the assumption of trusteeship and remove an essential support for trust administration which is to prioritise the trust fund to pay for the trustee's liabilities incurred in trust administration.

This articles' preferred option of prioritising indemnification of the successor trustee, while not considered in *Equity Trust*, avoids the problem of rewarding for creating as such. In the example outlined above, the trustee is in the same position whether she remains as trustee or not. If the trustee continues, she incurs will be out of pocket by \$20 after using \$100 of trust funds to pay her combined liabilities of \$120. If she discontinues, she will still be out of pocket by the same amount of \$20 as her successor will have priority to use \$75 of trust funds to discharge the taxation liability of \$75, leaving \$25 to indemnify the former trustee for her \$45 expense.

ii. Equitable Priorities are Irrelevant

A further problem for prioritization of the former trustee is that it starts from the assumption that the incumbent trustee has an equitable proprietary right or lien that continues or survives her succession and thus takes priority according to the rules of equitable priorities. This is the wrong starting point. An incumbent, including any successor, trustee does not have an equitable proprietary interest or lien capable of engaging the rules of equitable priorities, as explained in Part III.A above.⁹⁷

A further problem with application of equitable priorities is that these are rules that apply when there are two or more *competing* equitable proprietary rights. Competition is more specific than the general sense of competition inherent in any legal dispute. The rules of equitable priorities apply when equitable rules compete by giving inconsistent answers as to what the same legal entitlement holder should do regarding the same legal entitlement in favour of two or more parties, each of whom have an entitlement

⁹⁷ This assumption has been questioned extra-judicially by Justice Leeming in 'Trusts and Trustees: Their Successes and Successors' (2023) 53 Aust Bar Rev 97, 110, see also, Conaglen (n 47).

to specific equitable relief. Examples include when a legal entitlement is held by the same person on trust for a beneficiary, as well as subject to an equitable mortgage for an equitable mortgagee.

The incumbent trustee's indemnity, whatever it is, does not compete with that of a former trustee in the same sense just described. The former trustee and successor trustee are granted indemnities for the same purpose of supporting the due administration of *the same trust relationship*. The rules of equitable priorities do not apply, just as they do not apply to resolve other disputes between parties to the same trust relationship such as those arising between income and capital beneficiaries; or objects of appointment and beneficiaries entitled in default of appointment.

iii. Equality of Treatment is Practically Difficult

Equality of treatment was preferred by a majority in *Equity Trust*. This rule permits the successor trustee to give equal weight to her own indemnity only when the trust funds are *insufficient*. While it does avoid relying on equitable priority rules, it has some further difficulties which were not considered in *Equity Trust*.

First there are complications with conditioning equality of treatment on the sufficiency or solvency of 'the trust'. There are conceptual difficulties with the idea of the solvency of 'the trust'. Legal persons, such as trustees go bankrupt or insolvent, not 'trusts'.

Added to this, are the practical difficulties that will be faced by parties and courts in ascertaining the exact point in time when there are insufficient trust funds such that the equality of treatment applies. It will not always be clear when the trust funds are insufficient to meet the claims upon it. While the successor trustee is required to have an understanding of the state of the trust fund she will not always be in a position to know the extent of her claim for indemnification let alone that of a former trustee. This makes it hard for a successor trustee, and any court when approached for advice, to know precisely when trust funds are insufficient to meet the claim upon it so that she is permitted to give equal weight to her indemnification, and to do so in good faith.

C. Unknown Liabilities

The spectre of unknown liabilities 'emerg[ing] from the shadows'⁹⁸ looms large in debate about the priority between the former trustee and her successor. A trustee is well-advised to know or have the best estimate possible of her liabilities incurred as trustee before ceasing as trustee. This will mean she is best placed to indemnify herself while she is trustee and can secure the necessary and reasonable terms in any DORA or other contractual arrangements between herself and the incoming trustee, as well as to

⁹⁸ *Equity Trust* (n 1) [292].

negotiate novation with creditors. Equally, the well-advised incoming trustee will conduct detailed pre-appointment due diligence on any extant liabilities and insist that they be allowed for or paid out.⁹⁹

However, it will not always be possible for the outgoing trustee to know of the existence or extent of some liabilities incurred while trustee. Cases provide examples of former trustees learning of liabilities, such as taxation or tortious liabilities incurred during trusteeship but revealed only *after* they cease as trustee. In these situations, it will be too late for the former trustee to pursue the options above, and she must rely on her entitlement to be indemnified out of the trust fund as against the successor trustee.

This article's preferred option does expose the former trustee to unknown liabilities, but this is no more than that assumed by the successor trustee, who will face the same uncertainty during her trusteeship and when she ceases as trustee. For example, the successor trustee may find out about a liability she has to a third party only after she has made substantial payments out of the trust fund to the beneficiaries and by which time it is too late for her to retain or use trust property to indemnify herself. It would be 'unworkable' and 'impossible' to expect a successor trustee to administer a trust if she is also required to give priority to the claim of a former trustee to an unknown amount and at some later and unknown point in time.¹⁰⁰

The spectre of uncertain liabilities arising against either or both of the former trustee and her successor should not militate in favour of either trustee.¹⁰¹ It is a problem faced by both.

V. Retention

This article's analysis assists with resolving the controversial issue of whether an outgoing trustee can retain trust property by addressing some common misperceptions about retention.

One is that a trustee has a 'right to retain possession' to indemnify herself. A trustee who has ownership of tangible property may have an entitlement to possess that property. However, she will have no entitlement to possession of any tangible thing, let alone the authority to exercise it, when the trust is of intangible property or a chose in action such as a debt. When we ask whether a trustee may retain we are not necessarily asking about a trustee's entitlement to possession. We are asking whether she can retain some or all of the legal entitlements held on trust and withhold transferring them to her successor.

A second misconception is that retainer is not possible because the trustee's indemnity is a non-possessory lien that does not confer a right to possession.¹⁰² For reasons just discussed, retainer is not about possession. Also, the indemnity is not an equitable lien and the non-possessory nature of equitable

⁹⁹ See, further, D'Angelo (n 7) [9.14] – [9.21].

¹⁰⁰ The uncertainty created by the later discovered liability of a former trustee that is a reason cited by Leeming JA in *Jaken* (n 2) [140]-[141] *against* the former trustee having priority over the successor.

¹⁰¹ *Equity Trust* (n 1) [290].

¹⁰² See, eg, *Lemery* (n 3) [45]-[50]; *Pitard Consortium Pty Ltd v Les Denny Pty Ltd* [2019] VSC 614.

liens are irrelevant. Leeming JA in *Jaken*¹⁰³ warned against the ‘danger in syllogistic reasoning which turns on the conclusionary language of “charge or lien”’, explaining that while such labels might be ‘convenient’ for some purposes, they ‘may be an unsafe component in the legal analysis’ of the former trustee’s indemnity. An outgoing trustee’s authority to retain should not be determined by reference to the non-possessory nature of (other) equitable liens.

A third misconception is that there is a meaningful difference between retainer against a beneficiary, which is possible, and retainer against the successor trustee.¹⁰⁴ The premise for the distinction is that the former trustee’s indemnity operates as a form of set-off against a beneficiary that permits retention.¹⁰⁵ But as has been pointed out before,¹⁰⁶ the trustee’s indemnity is not a form of set-off such that the principles applicable to that body of rules can apply to determine the former trustee’s entitlements against beneficiaries or her successor.

On this article’s analysis, there is no meaningful distinction between an outgoing trustee’s authority to retain against a beneficiary or incoming trustee: both have the same fundamental entitlement against the outgoing trustee, which is to require the trust property to be duly administered in accordance with its terms.

If those terms permit the outgoing trustee to reimburse an expense, then trust property, to this extent may be retained against either the beneficiary or successor trustee.¹⁰⁷ The outgoing trustee is not required to vest the subject property in the new trustee because the effect of reimbursement is that the property is not ‘trust property’ to which various equitable and statutory obligations apply.¹⁰⁸ The outgoing trustee has the same unrestricted authority of any other legal entitlement-holder who is allowed to do what she wants with her legal entitlements including to keep them against the demands or wishes of another, such as a successor trustee or beneficiary. Also, the automatic vesting provisions will not apply as their scope is limited to the legal entitlements held on trust.¹⁰⁹

Precisely how the outgoing trustee retains will depend on the trust property, for example if it is a fund of liquid or divisible assets, and the trust terms. If the trust property is not liquid or divisible then the trustee will have to realise some or all of it to indemnify herself. To do this, she may have a power of sale, or otherwise apply to the court for orders for the sale of trust property and/or the appointment of a

¹⁰³ *Jaken* [125]. A similar warning is given in *Carter Holt* (n 5) [84].

¹⁰⁴ A misconception pointed out in *Apostolou* (n 3), [50]–[51].

¹⁰⁵ *Lemery* (n 3) [35]–[36], [47].

¹⁰⁶ Hudson and Mitchell (n 38) ‘Trustee Recoupment: A Power Analysis’.

¹⁰⁷ Retention against the successor trustee is recognised in *Equity Trust* (n 1) [105]; *Carter Holt* (n 5) [132]; *Apostolou* (n 3), [50]–[51]; *QNI Resources Pty Ltd & Ors v Queensland Nickel Pty Ltd (in liq)* [2017] QCA 167 [59] (Gotterson JA with whom Douglas and Applegarth JJ agreed).

¹⁰⁸ See, eg, Trusts of Land and Appointment of Trustees Act 1996 (UK) s 19(4).

¹⁰⁹ See, eg, Trustee Act 1925 (UK) s 37(d); Trustee Act 1925 (NSW) ss 9(1) and (2) and equivalent elsewhere.

receiver as necessary to make funds available to pay her creditors. If the trust property is liquid, or made liquid after sale, the trustee may pay a liability herself and retain trust property to reimburse herself.

Exoneration, on the other hand, does not permit the outgoing trustee to retain or withhold transferring the trust property to her successor. Exoneration only authorises *the trustee* to use trust funds to pay third parties for so long as she is trustee. It does not release funds (or other property) from the trust, which keep their character as trust funds that will vest in the successor trustee by operation of the trust terms, statute or a court order.

If there is a lag between a trustee discontinuing as trustee and being divested of trust property, she will hold that property on bare trust subject to the obligation to protect and transfer trust property to her successor.¹¹⁰ Either way, the outgoing trustee is not permitted to retain trust property for the purpose of using it to discharge a future liability, she may only use trust property to indemnify herself for so long as she is trustee.

There is thus a critical difference between the reimbursement and exoneration limbs when it comes to the trustee's authority to retain, which has been overlooked in the cases. Practically this means that an outgoing trustee wishing to retain for the purposes of exoneration after ceasing as trustee needs to seek permission of the court, whether that take the form of orders: permitting retention for this purpose;¹¹¹ for vesting or transfer that carve out or except some portion of trust property to be retained or transferred into court;¹¹² or undertakings to be given by the successor trustee in lieu of the former trustee retaining title.¹¹³

VI. Fiduciary Duties

A. Does the Successor Trustee Owe a *Fiduciary* Duty?

Orthodox fiduciary principle tells us that trustees are usually fiduciaries.¹¹⁴ This principle supports the view that the successor trustee owes fiduciary duties to the former trustee having regard to the trust relationship between them. Regardless of the trust status of this relationship, it bears the critical feature of other status based fiduciary relationships:¹¹⁵ the successor trustee holds the trust property, such as rights and powers, for and on behalf of the former trustee. As with any other person holding a power for and on behalf of another, the successor trustee should be subject to fiduciary loyalty, which at

¹¹⁰ *Bruton* (n 69) [42]; *Jones (Liquidator) v Matrix* (n 3) [142]; *Re Glenvine Pty Ltd (in liq)* [2020] NSWSC 866 [40]-[41] (Black J); *Park, in the matter of Queensland Nickel Pty Ltd (in liq) (No 3)* [2022] FCA 1301 [176]-[178] (Downes J).

¹¹¹ See, eg, *Park (No 3)* (n 110) [192].

¹¹² See, eg, *Hillig v Darkinjung Local Aboriginal Land Council* (2006) 205 FLR 450, [38]; *Apostolou* (n 3) [50]-[51].

¹¹³ *Global Funds Management* (n 92).

¹¹⁴ See, eg, *Bristol & West Building Society v Mothew* [1998] Ch 1; *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41, [1984] HCA 64.

¹¹⁵ As outlined in *Hospital Products* (n 114) 96-97 (Mason J).

minimum are the proscriptive duties to avoid conflicts between self-interest and duty, conflicts between duties to multiple parties and to avoid profits.¹¹⁶

From the perspective of the former trustee, she is in the same position as that of a beneficiary or subsequent mortgagee like those owed fiduciary duties in *Bofinger v Kingsway Group Ltd*.¹¹⁷ all may have their interest eviscerated by the authorised and unauthorised actions of another. Albeit, ‘vulnerability is not the touchstone of fiduciary obligation’.¹¹⁸ In *Jaken*, Leeming JA¹¹⁹ and Kirk JA¹²⁰ point to other relationships of vulnerability, yet fiduciary duties do not apply. We can add to these a mortgagor, who for example, is vulnerable to the mortgagee’s exercise of a power to raise interest rates, or to foreclose and sell the property, yet the mortgagee is not subject to fiduciary duties in the exercise of these powers.

The critical point of difference between vulnerability attracting fiduciary duties and that which does not is the mandate or terms according to which the corresponding power is held. When those terms require power to be exercised for and on behalf of another, then the power is held in a fiduciary capacity and fiduciary duties apply.¹²¹ Conversely when the terms permit the self-interested, or otherwise conflicted, exercise of power, then fiduciary duties do not apply. Terms requiring power to be held for and on behalf of another is the critical feature attracting fiduciary loyalty and is where the line can be drawn to restrict any ‘significant expansion’¹²² in the cases in which fiduciary duties apply.

The mortgagee, for example, is given her power to raise rates or sell the mortgaged property for her own benefit, and thus can exercise it self-interestedly and free from fiduciary duties. The mortgagee’s power over residual proceeds of sale, on the other hand, is held for the benefit of subsequent mortgagees or the mortgagor, and thus subjected to fiduciary duties.¹²³ Turning to the trust, the trustee holds trust property for and on behalf of the beneficiaries as well as the former trustee to the extent of her

¹¹⁶ *Breen v Williams* (1996) 186 CLR 71, 137-138 (Gummow J); M Conaglen, *Fiduciary Loyalty* (Hart Publishing, 2010) 59-61, compare thicker accounts of fiduciary loyalty in *Bristol* (n 114) 18; *Lehtimäki v Cooper* [2020] UKSC 33, [2020] 3 WLR 461 [44]; L Smith, ‘Fiduciary Relationships’ (2014) 130 LQR 608; L Smith, ‘Prescriptive Fiduciary Duties’ (2018) 37 QULJ 261.

¹¹⁷ *Bofinger v Kingsway Group Ltd* [2009] HCA 44; 239 CLR 269 [49] (the Court).

¹¹⁸ *C-Shirt Pty Ltd v Barnett Marketing and Management Pty Ltd & Anor* [1996] FCA 1079; *John Alexander's Clubs Pty Ltd v White City Tennis Club Ltd* (2010) 241 CLR 1; [2010] HCA 19 [83], cited in *Jaken* (n 2) [17] Bell CJ.

¹¹⁹ *Jaken* (n 2) [38], [130]-[134].

¹²⁰ *Jaken* (n 2) [230]-[233].

¹²¹ This feature and supporting cases are discussed further in J Hudson, ‘Justifying Equity’s Control of Power: Status and Beyond’ in P Miller and J Oberdiek (eds) *Oxford Studies in Private Law, Vol II* (OUP, 2023), 122-124. See also, L Smith, *The Law of Loyalty* (OUP, 2023) 100-105.

¹²² *Jaken* (n 2) [232] (Kirk JA).

¹²³ *Residential Housing Corporation v Esber* (2011) 80 NSWLR 69, [2011] NSWCA 25 [14] (Campbell JA); *Jaken* [19] (Bell CJ).

unsatisfied indemnity. As pointed out by Bell CJ in *Jaken*,¹²⁴ it would be anomalous for the successor trustee to owe fiduciary duties to the beneficiaries, but not in respect of the former trustee who the successor trustee is required to afford priority and preference.

This article's argument is different to the majority decisions of Leeming JA and Kirk JA in *Jaken* rejecting the argument that a successor trustee owes a *fiduciary* duty not to prejudice the adequacy of the fund to indemnify the former trustee. Framed in this way, the label of 'fiduciary' identified a duty owed by someone who owes further duties to avoid conflicts and profits, which themselves are also labelled 'fiduciary duties'.¹²⁵ This argument was rejected as it would be 'decidedly odd'¹²⁶ and 'onerous'¹²⁷ for any fiduciary duty to arise on the basis of the successor's knowledge or notice of the existence and size of the former trustee's liability.¹²⁸

A court must decide the case argued before it. The reasoning in *Jaken* reflects the parties' acceptance that a fiduciary relationship could only arise once the successor trustee had knowledge or notice of a realistic claim by the former trustee. Framed this way, the spectre of unknown liabilities arises again, agitating the concern that a successor trustee might be subject to onerous fiduciary duties upon acquiring knowledge or notice of a former trustee's liability. This, however, misses the point that when the successor trustee accepts her trusteeship, she assumes a duty to preserve the adequacy of the fund to indemnify the former trustee irrespective of either or both parties' knowledge or notice of the content of this duty.

This timing is captured by the idea that the former trustee's indemnity survives her termination as trustee so that the successor is immediately bound.¹²⁹ For the reasons discussed above in Part III.A, the idea of survival is inaccurate as the former trustee loses her indemnity in the form of an authority to use the trust property. No matter how it is described, the former trustee acquires a new right and the successor trustee is subject to a duty to the former trustee, when there is a change in trusteeship and the former trustee is divested of trust property, irrespective of their knowledge of the former trustee's indemnity.

Knowledge may be practically important to the successor trustee's performance. A successor trustee who is unaware of a former trustee's liability may distribute funds to beneficiaries in good faith yet be in breach of her duty to preserve the adequacy of the fund to indemnify the former trustee. In *Agusta* Barrett JA indicated that a successor trustee's distribution to beneficiaries before satisfying the former trustee's indemnity would be an 'impermissible disregard' of the former trustee's 'beneficial interest'

¹²⁴ *Jaken* (n 2) [6], [21], [33].

¹²⁵ The varied usages of 'fiduciary' are examined further in Hudson 'Justifying Equity's Control of Power' (n 121); C Mitchell, 'Knowing Receipt After Byers' (forthcoming).

¹²⁶ *Jaken* (n 2) [140].

¹²⁷ *Jaken* (n 2) [234].

¹²⁸ *Jaken* (n 2) [108]-[111], [138]-[140] (Leeming JA), [234] (Kirk JA).

¹²⁹ See (n 35) above.

that '[e]quity would have given full effect to...'.¹³⁰ Barrett JA does not elaborate on precisely what equitable relief is available. However, in *Jaken*, Leeming JA indicates a breach entitles the former trustee to recovery from the recipient(s) via the equitable proprietary claim.¹³¹

It may seem harsh if the successor trustee is liable for breach of trust when she has acted in good faith and without knowing about the former trustee's indemnity at the time of distribution. But this is no different from the liability faced by a trustee when she is held liable for a breach of trust caused by her misunderstanding of the trust terms, including when she may have acted on incorrect legal advice.¹³² These problems further indicate the onerous and dangerous nature of trusteeship, and the importance of a trustee's ability to approach a court for judicial advice;¹³³ and/or seek excusal from personal liability,¹³⁴ the costs for which are indemnifiable out of the trust fund.¹³⁵

Returning to the fiduciary question, the point is that whether we label the successor trustee's duty as a *fiduciary* duty has no bearing on whether the successor trustee can be under a duty before she has knowledge. Knowledge is not determinative of the existence and extent of the successor trustee's duty, just as it should not determine whether this duty is *fiduciary* in the sense of attracting additional fiduciary duties to avoid conflicts and profits. This is even more so given a breach of any fiduciary duty does not depend on the fiduciary's knowledge or subjective perception of a potential or actual conflict.¹³⁶

B. Why do Fiduciary Duties Matter?

If the successor trustee owes additional fiduciary duties to avoid conflicts and profits, they would be limited in scope as they accommodate themselves to the terms of the relationship. The terms are analogous to other trust relationships with classes of beneficiaries with differentiated priorities, such as income and capital beneficiaries, objects of appointment and default or residuary beneficiaries. Just like these other situations, the successor trustee's fiduciary duties accommodate the terms requiring differentiated priority to be given to the former trustee over other beneficiaries. For example, the successor trustee must prioritise indemnification of the former trustee over satisfaction of the

¹³⁰ *Agusta* (n 3) [84].

¹³¹ *Jaken* (n 2) [38], [140].

¹³² See, eg, *Brooksbank v Smith 2 Y & C Ex 58* (Alderson B); *Blue Sky Private Equity Limited v Crawford Giles Pty Ltd* [2012] SASC 28 [99] ff – [103]; *Re Robertson* [1953] VLR 685, [1954] ALR 53 (Martin J).

¹³³ See, eg, Trustee Act 1925 (NSW) s 63, and equivalents in other States' and Territories' trusts legislation; *Macedonian Orthodox Community Church St Petka Inc v His Eminence Petar the Diocesan Bishop of Macedonian Orthodox Diocese of Australia and New Zealand* [2008] HCA 42; 237 CLR 66 [54]-[76] (Gummow ACJ, Kirby, Hayne and Heydon JJ).

¹³⁴ Trustee Act 1925 (NSW) s 85, and equivalents in other States' and Territories' trusts legislation.

¹³⁵ *Macedonian Orthodox* (n 133) [70]-[72].

¹³⁶ *Australian Careers Institute Pty Ltd v Australian Institute of Fitness Pty Ltd* [2016] NSWCA 347 [132] (Sackville AJA).

beneficiaries' interests, and to this extent the conflict between the successor trustee's duties to these parties is permitted.

Also, fiduciary duties accommodate the successor trustee's priority over the former trustee, just as any other trustee's fiduciary duties accommodate the priority of the trustee's indemnity over other beneficiaries. Conflicts in this regard will be permitted, or breach is non-existent as the duty is limited in scope.

Breach of fiduciary duty may thus be unlikely given the terms necessitate and thus authorise from the outset these conflicts (actual and potential) between the trustee's duties owed to different beneficiaries, as well as her own self-interest in indemnification. That is not to say that fiduciary loyalty has no work to do. It would for example, prohibit the successor trustee from being in a position where her interest and other duties conflict with those owed to the former trustee. Breach can still occur, as shown by the facts of *Jaken* where the successor trustee misappropriates trust funds by making unauthorised transfers to associated third parties.

Jaken demonstrates the purposes for which fiduciary loyalty is sometimes said to apply, one of which is third party liability under knowing receipt and/or assistance. This is particularly the case in Australia where the availability of knowing receipt has been confined to recipients of property previously held subject to a *fiduciary* relationship. This contrasts with England, where the UK Supreme Court in *Byers v Saudi National Bank*¹³⁷ held that knowing receipt is confined to receipt of property in which a claimant has an equitable proprietary interest.¹³⁸ The situations where a claimant can show breach of fiduciary duty overlap, but are not coextensive with, when she has an equitable proprietary interest in the form of an equitable proprietary claim for recovery of misdirected property against third party recipients. It is beyond the scope of this article to resolve the ambit of knowing receipt, save to say that on either view knowing receipt should be available if the former trustee has the benefit of both fiduciary duties as well as having an equitable proprietary interest in so far as she has the equitable proprietary claim, as recognised in *Jaken*.

VII. Implications for Creditors

A. Juridical Source of Creditors' Rights to Trust Property

Conceptualising the incumbent trustee's indemnity as an authority or permission, rather than a right, removes the premise assumed by a body of cases that the incumbent trustee's indemnity gives her a *right* to indemnification to which creditors may be subrogated.¹³⁹ The analysis above shows that the incumbent trustee's indemnity does not give the trustee a right. What the trustee has is the legal

¹³⁷ *Byers v Saudi National Bank* [2023] UKSC 51.

¹³⁸ *Byers* (n 137) [56]-[61] (Lord Briggs) and [182]-[188] (Lord Burrows).

¹³⁹ A small sample includes *Vacuum Oil Co Pty Ltd v Wiltshire* (1945) 72 CLR 319, 335; *Octavo* (n 49) 367, 370; *Carter* (n 3) [34].

entitlements held on trust, which she is authorised to use to indemnify herself, either by way of exoneration or reimbursement. Whether a creditor can be subrogated to these entitlements is a question that must be left for another day, save to observe that the legal entitlements held on trust may sometimes differ from those more easily understood¹⁴⁰ as being something a creditor can enforce by way of subrogation, such as a debt. A creditor may be less easily understood as being subrogated to the trustee's ownership of tangible property, for example.

Leaving aside the question whether subrogation is always possible, there may be other options available and the trustee's creditors are not left high and dry. This article's analysis shows that creditors may have access to the trust property without recourse to subrogation owing to the interaction between statutory insolvency regimes and trustee indemnities.

The general rule of bankruptcy and insolvency is that only property owned by the bankrupt person or insolvent company beneficially, i.e. free of a trust, is available for distribution to creditors. This rule excludes trust property from that distribution. However, the reimbursement limb of the indemnity changes what property is held on trust, and thus what is available for distribution to creditors. If an *incumbent* trustee goes bankrupt or insolvent with an outstanding indemnity by way of *recoupment*, then some portion of trust property is available for distribution to creditors. This is because the reimbursement limb indemnifies the trustee by releasing property from the trust in favour of the trustee, to the extent necessary to indemnify the trustee.¹⁴¹ Like other property held by the trustee beneficially will be available for distribution in accordance with the applicable insolvency or bankruptcy regime.

Whereas the *exoneration* limb indemnifies the trustee by authorising the payment of trust funds to third parties. Unlike reimbursement, exoneration does not release property from the trust in favour of the trustee absolutely. The property is still subject to the condition that it be used only to discharge liabilities properly incurred by the trustee during administration. The trustee's trustee in bankruptcy or liquidator, and creditors, cannot be in a better position and are subject to this 'intrinsic limit of the power of exoneration' that 'precludes it from being used to meet debts other than those incurred with authority for the conduct of the trust business.'¹⁴² The exoneration limb permits trust property to be distributed to creditors without the need for subrogation, albeit it remains subject to the 'intrinsic limit' that it be paid only to those creditors whose debts were properly incurred by the trustee.

If the *former trustee* is insolvent or bankrupt, her trustee in bankruptcy or liquidator may enforce an entitlement to indemnification against the successor trustee. This entitlement forms part of the corporate

¹⁴⁰ *Banque Financiere de la Cite v Parc (Battersea) Limited* [1999] 1 AC 221, 236 (Lord Hoffman), see also S Agnew and C Mitchell, 'Trust Law Committee Discussion Document: Trustee Indemnities and the Priority Ranking of Claims against Trust Property' a paper given at the Trust Law Committee: *Trustee Indemnities and the Priority Ranking of Claims against Trust Property*, UCL, 18 January 2024.

¹⁴¹ *Carter Holt* (n 5) [28] (Kiefel CJ, Keane and Edelman JJ).

¹⁴² *Carter Holt* (n 5) [40]-[44]. See also *Equity Trust* (n 1) [182]; *Re Glenvine* (n 110) [40]-[41] (Black J).

trustee's or individual trustee's estate divisible to creditors without any need to rely on subrogation. The former trustee's liquidator or trustee in bankruptcy can enforce this entitlement as they would any other legal or equitable entitlement as part of getting in and realising the estate for distribution.

As with the incumbent trustee, the former trustee's entitlement to indemnification *by way of exoneration* is subject to the same 'intrinsic limit' that trust funds may only be paid to creditors whose debts were properly incurred by the trustee and fall within the scope of the indemnity. Any trustee in bankruptcy or liquidator will be subject to this limit. Reimbursement on the other hand entitles the former trustee and any trustee in bankruptcy or liquidator to apply funds received from the successor trustee to the benefit of the creditors in general (including those who remain unsatisfied after distribution of all trust assets), or otherwise in accordance with the applicable statutory regime.

This article's argument that the successor trustee should have priority to indemnification over the former trustee applies *mutatis mutandis* to their creditors as their claims, whether by way of subrogation or not, are subject to the same limits and priorities.

B. Can Trust Property be Available to all Creditors Under Exoneration?

In *Carter Holt*¹⁴³ Kiefel CJ, Keane and Edelman JJ observed there was an 'intrinsic limit' on trust funds held subject to the exoneration limb, which precluded trust funds being used to meet liabilities other than those that were authorised and properly incurred in trust administration. In this case, all of the creditors of the insolvent trustee fell within the scope of the indemnity because the corporate trustee incurred all its debts and other liabilities as trustee. The statutory order of priority thus operated *within* and did not conflict with the 'intrinsic limit' of the exoneration limb.¹⁴⁴

In the future, a question might arise as to how the statutory order of priority might apply if there are general creditors who are not owed debts properly incurred in trust administration. This article's analysis shows that the exoneration limb authorises the incumbent trustee to pay trust funds for the purpose of discharging a properly incurred trust liability, whether that be one owed by a former trustee or the incumbent trustee herself. The trust funds remain subject to the 'intrinsic limit' in the bankruptcy/insolvency of either of the former trustee or her successor. Exceeding this limit requires express statutory authority.

VIII. Conclusion

The rules of trustee succession and indemnification are essential to trust administration, although problems can arise at the intersection of these rules, which are exacerbated by the imprecise labels and concepts used to articulate and understand them. This article has turned to the fundamental nature of

¹⁴³ *Carter Holt* (n 5) [44], preferring *Suco Gold* (n 3) over *Re Enhill Pty Ltd* [1983] 1 VR 561.

¹⁴⁴ See also *McLean v Hill, TMC Plumbing & Drainage Pty Ltd (in liq)* [2019] FCA 1439 (Moshinsky J)

the trustee's indemnity to understand the impact of trustee succession and resolve uncertainties about the relationship between successive trustees relating to priority, retention, fiduciary loyalty and their creditors.

A better idea of trustee succession and indemnification assists with the prevention and resolution of disputes, as well as to maintain trust law as a facilitative body of legal rules that can be taken up and utilised by the parties outside of court. The rules for indemnification need to provide the trustee with a means of using trust funds to pay for expenses incurred in the due administration of the trust without court assistance. Likewise, the rules for trustee succession need to facilitate changes in trusteeship without court assistance. To do this, these rules need to be clear, reliable and accessible to the practitioners and parties who engage with and are subject to them, as well as the courts applying and enforcing them. These rules will not achieve their ends when they are expressed and understood using imprecise labels and metaphors that result in divisions within legal systems as to their scope, operation and effect. It is hoped this article provides a stronger analytical basis on which to understand indemnification, the impact of trustee succession and ensuing relationship between the former trustee and her successor.