

## **Subrogation of retired trustee's right of indemnity, equitable lien & caveat on trust property - *Re Estate Bainbridge (in bankruptcy); The Official Assignee v Menzies* (HC Auckland, 14 February 2011)**

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The 14 February 2011 High Court judgment in *Re Estate Bainbridge (in bankruptcy); The Official Assignee v Menzies* (HC Auckland CIV 2010-404-005457, Bell AJ) concerned an application by the Official Assignee in bankruptcy to sustain a caveat against trust property on the basis of subrogation of the bankrupt's right of indemnity and to an equitable lien over trust property. The case has a number of unusual features.

### **Case Background**

Mr Bainbridge established a discretionary family trust in September 1999, the trustees of which were himself, his wife (Mrs Menzies) and their solicitor. The trust deed contained an indemnity for any personal liability a trustee may sustain and a limitation of trustees' liability provision in favour of the trustees. Assets (including a house property) were transferred by Mr Bainbridge to the trust with the trustees incurring liability to Mr Bainbridge under acknowledgments of debt in 1999, 2000 and 2002. Under the deeds of acknowledgement of debt the trustees' liability was limited to the assets of the trust.

Mr Bainbridge resigned as a trustee on 31 March 2005. He had been a property developer and a successful leaky home arbitration award of \$941,400.00 had been made against him. In June 2005 Mr Bainbridge filed a debtor's petition in bankruptcy. The defendants, the remaining trustees, owned the house property in Auckland against which the Official Assignee lodged a caveat. In August 2010 an interim order sustaining the caveat was made. In this application the Official Assignee sought to sustain the caveat.

### ***Caveat interest claimed***

The interest claimed under the caveat was that Mr Bainbridge was entitled (notwithstanding his resignation as a trustee) to an equitable lien over all the trust property for indemnification for any liabilities entered into by him as a trustee.

### ***Applicant's submissions***

The Official Assignee argued that Mr Bainbridge had an equitable lien over the trust's assets, including the house property, to support any right of indemnity for any liabilities he incurred as trustee (including the acknowledgments of debt). It was argued that Mr Bainbridge retained that right of indemnity and his equitable lien even after he resigned as a trustee and that this passed to the Official Assignee on Mr Bainbridge's bankruptcy. It was also submitted that the equitable lien was a caveatable interest.

### ***Result***

The High Court granted the application sustaining the caveat. The trustees have filed notice of intention to appeal the decision.

## Comment

The case combines a number of unusual features. These include:

- **A retired trustee's right of indemnity.** Where trustees incur liabilities to external creditors they have rights over the trust property – the trustee's equitable lien - and rights of indemnity (also called rights of exoneration and recoupment). The right of indemnity may be provided under the trust deed but also arises in equity, *Worrall v Harford* (1802) 8 Ves.Jun.4, 32 ER 250. This right of indemnity is also provided by statute under s 38(2) of the Trustee Act 1956. This right of indemnity extends to a retired trustee, [paragraphs [13] – [17] of the judgment].
- **The right of indemnity passes to the liquidator/Official Assignee.** The right of indemnity and the associated equitable lien passed to the liquidator (where the trustee is a company and in liquidation), *Re Suco Gold* (1983) 7 ACLR 873. However this also applies in New Zealand to a bankruptcy under the Insolvency Act 1967, s 42(1)-(3), the right of indemnity and equitable lien passing to the Official Assignee [19] – [23].
- **A caveatable interest.** The Court held that an equitable lien could be the subject of a caveat. It was considered that an equitable lien falls within the words *or otherwise* under s 137 (1) (a) of the Land Transfer Act so as to allow a caveat. At this stage, the Court needed only to be satisfied that the caveator had an arguable case for the interest claimed under the caveat [28b] – [30].
- **Court's residual discretion.** The Court had a residual discretion to allow the caveat to lapse, but it was considered that it was not an appropriate to exercise the discretion in the circumstances. The caveat provided greater protection for the Official Assignee than if it were removed. The Official Assignee was exposed to the risks of a loss of priority by registration of some other interest and of disposal of the property. There was no good reason for the him to be exposed to those risks [57] –[61].

With the abolition in New Zealand of gift duty from 1 October 2011, one issue has been whether trust settlors should forgive all debts owing by trustees for assets transferred to trusts. While it has been argued by some that settlors would want to retain such debts should a need for capital in the form of repayment of debt or so as to provide some leverage over the trustees should the need arise. However, where the settlor is also a trustee and the trust has been established for creditor protection, the *Bainbridge* decision indicates that having outstanding debt in the settlor/trustee's favour may not be appropriate.

Full head notes reported by John Brown and the judgment are available on line from CCH NZ Ltd. The judgment is set out below.