IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV-2010-404-005457

	BETWEEN	THE OFFICIAL ASSIGNEE IN BANKRUPTCY IN THE PROPERTY OF KEITH JAMES BAINBRIDGE Plaintiff
	AND	ANNIE CATHERINE MENZIES AND SIMON MIDDLETON PALMER AS TRUSTEES Defendants

Hearing: 8 February 2011

Appearances: K W Fulton for Plaintiff
M J McCartney SC for Defendants

Judgment: 14 February 2011

CAVEAT JUDGMENT OF ASSOCIATE JUDGE BELL

This judgment was delivered by me on 14 February 2011 at 11:30 am pursuant to Rule 11.5 of the High Court Rules.

Registrar/Deputy Registrar

Date: ……..

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[1] The Official Assignee applies under s 145A of the Land Transfer Act 1952 for an order sustaining caveat 8546792.1 registered against the certificate of title to the property at 13A Summit Drive, Mt Albert, Auckland, Identifier 56327 (North Auckland Registry). Associate Judge Sargisson made an interim order sustaining the caveat on 24 August 2010.

[2] The interest claimed under the caveat is:

> Simon Middleton Palmer (Palmer) and Annie Catherine Menzies (Menzies) are the registered proprietors of the property as trustees of the Kahurangi Trust, such trust being established by deed dated 7 September 1999 (Trust); Keith James Bainbridge (Bainbridge) having been a trustee of the Trust on trust from 7 December 1999 to 31 March 2005; Palmer, Menzies and Bainbridge (Trustees) having incurred liabilities to Bainbridge pursuant to deeds of acknowledgement of debt dated 1 November 1999, 6 June 2000 and 2 May 2002; Bainbridge being entitled (notwithstanding his resignation as trustee) to an equitable lien over all the trust property for indemnification for any liabilities entered into by him as a trustee; and all property of Bainbridge including the equitable lien has vested in the Official Assignee absolutely, the Official Assignee being a trustee in the bankruptcy of Bainbridge, adjudicated bankrupt on 22 June 2005 and by virtue of s 42 of the Insolvency Act 1967.

[3] The caveat satisfies the requirements of s 137(2) of the Land Transfer Act 1952, especially the requirements to state the nature of the interest claimed and how the interest is derived from the registered proprietors.

[4] In an application to sustain a caveat, the onus is on the caveator to show that he has a caveatable interest. An application to sustain a caveat is a summary procedure which is quite unsuitable for determining disputed questions of fact. Accordingly, there will be a decision not to sustain a caveat only if it is patently clear that the caveat cannot be maintained either because there was no valid ground for lodging the caveat in the first place, or that a valid ground no longer exists, or that no useful purpose will be served by maintaining the caveat. The patent clarity will not exist where the caveator has a reasonably arguable case in support of the interest claimed. The interest claimed by the caveator must be a proprietary interest in land. It may be an equitable interest. The Court has a residual discretion whether to make an order removing the caveat or not, but that discretion is exercised cautiously. See *Sims v Lowe* [1988] 1 NZLR 656 (CA) at 660, *Pacific Homes Ltd (In Receivership) v Consolidated Joineries Ltd* [1996] 2 NZLR 652 (CA) at 656.

[5] The present proceeding arises out of the Official Assignee's administration of the bankruptcy of Keith Bainbridge. Mr Bainbridge filed a debtor's petition on 22 June 2005. Under s 444(2) of the Insolvency Act 2006, his bankruptcy is governed by the Insolvency Act 1967. Mr Bainbridge was discharged on 28 May 2010.

[6] Mr Bainbridge had been a property developer. The only creditor of his bankruptcy is a Mr Humphrey O'Leary, who is owed $941,400.85 under an arbitration award. Mr O'Leary bought a property from Mr Bainbridge and made a successful leaky home claim.

[7] A trust called the Kahurangi Trust was established by a deed dated 7 September 1999. The settlor is Simon Middleton Palmer, an Auckland solicitor. The trustees were Mr Bainbridge, Annie Catherine Menzies, his wife, and Mr Palmer. It is a discretionary family trust. It contains indemnity provisions:

> 14 Indemnity and limitation of trustees' liability
>
> 14.1 For the purposes of this clause a Trustee includes a former Trustee or any officer of any Trustee, former Trustee, additional or substituted Trustee.
>
> 14.2 Where the Trustees take or omit any action or incur any liabilities, they do so as Trustees and not in their personal capacities. No person has recourse to any property belonging to any Trustee which does not form part of the Trust Fund.
>
> 14.3 No Trustee is liable for any loss incurred by the Trust Fund or by any Beneficiary not attributable to that Trustee's own fraud, dishonesty or wilful commission or omission by that Trustee of any act known to be a breach of trust.
>
> 14.4 No Trustee shall be bound to take any legal proceedings against any co-trustee or former trustee for any breach or alleged breach of trust committed by such person.
>
> 14.5 A Trustee is hereby fully and completely indemnified from the Trust Fund for any personal liability which that Trustee may sustain in:
>
> a. Exercising or omitting to exercise any function, duty or power of the Trustee; or
>
> b. Purporting, in good faith, to exercise as Trustee any function, duty or power which is not authorised or which may be a breach of this Trust unless any such loss or liability is attributable to such

> Trustee's fraud, dishonesty or wilful commission or omission of any act known by that Trustee to be a breach of trust.
>
> 14.6 Simon Middleton Palmer has accepted office as trustee at the request of Keith James Bainbridge and Annie Catherine Menzies who hereby personally indemnify him for any loss or liability which he may sustain or incur in:
>
> a. Exercising or omitting to exercise any function, duty or power of the Trustees under this deed; or
>
> b. Purporting in good faith, to exercise as Trustee any function, duty or power which is not authorised under this deed or which may be a breach of trust;[1]
>
> Simon Middleton Palmer may call on Keith James Bainbridge and Annie Catherine Menzies to discharge their liability under this indemnity notwithstanding that the rights of indemnity in clause 14.5 have not been exhausted.

[8] Mr Bainbridge made loans to the trustees of the Kahurangi Trust:

(a)	1 November 1999:	$380,000
(b)	6 June 2000:	$1,382,989
(c)	2 May 2002	$366,621

[9] The first loan is recorded in a deed of forgiveness of debt. Deeds of acknowledgement of debt for the last two loans were put in evidence. Those last two deeds contain the following:

> The liability of the borrower under this deed shall at all times be limited to the assets for the time being of the Kahurangi Trust and shall not in any way be personal.

[10] Mr Bainbridge resigned as trustee on 31 March 2005.

[11] The defendants, the remaining trustees, own the property at 13A Summit Drive, Mt Albert.

[1] Some extraneous words have been omitted

[12] There is other litigation on foot between the Official Assignee and the defendants under CIV-2009-404-3391. The Official Assignee is claiming the sum of $1,394,072, plus associated relief. He says that this sum is due under the loans made, after setting aside various forgiveness of debt by Mr Bainbridge under ss 55 and 58 of the Insolvency Act and s 60 of the Property Law Act and making various other adjustments. The defendants strongly contest the Official Assignee's claim.

Caveatable Interest

[13] At first sight, it may seem odd that the Official Assignee is claiming a caveatable interest in the trustees' property. The deeds of acknowledgement of debt do not give Mr Bainbridge any security. There is therefore no security which could pass to the Official Assignee on his becoming bankrupt.

[14] However, the Official Assignee does not rely on Mr Bainbridge's rights as creditor of the Kahurangi Trust, but on his rights as one of the trustees. The Official Assignee says that, as a trustee of the Kahurangi Trust, Mr Bainbridge has certain rights over trust property – the trustee's equitable lien – and those rights have passed under s 42 of the Insolvency Act 1967.

[15] The starting point is that, as the deeds of acknowledgement of debt recognise, Mr Bainbridge and his co-trustees were debtors of Mr Bainbridge as sole creditor. It is his rights as a debtor trustee that are in issue here.

[16] Where trustees incur liabilities to external creditors, they have rights of indemnity (also called rights of exoneration and recoupment out of trust assets). The right of indemnity may be expressly provided under a trust deed, but it also arises in equity - *Worrall v Harford* (1802) 8 Ves. Jun. 4 at 8, 32 E.R. 250 at 252 per Lord Eldon:

> It is in the nature of the office of a trustee, whether expressed in the instrument or not, that the trust property shall reimburse him of all the charges and expenses incurred in the execution of the trust. That is implied in every deed.

[17] It is now provided under statute – s 38(2) of the Trustee Act 1952:

> A trustee may reimburse himself or pay or discharge out of the trust property all expenses reasonably incurred in or about the execution of the trusts or powers; but, except as provided in this Act or any other Act or as agreed by the persons beneficially interested under the trust, no trustee shall be allowed the costs of any professional services performed by him in the execution of the trusts or powers unless the contrary is expressly declared by the instrument creating the trust:
>
> Provided that the Court may on the application of the trustee allow such costs as in the circumstances seem just.

[18] The Official Assignee cited *Octavo Investments Pty Ltd v Knight* (1979) 27 ALR 129:

> It is common ground that a trustee who in discharge of his trust enters into business transactions is personally liable for any debts that are incurred in the course of those transactions: *Vacuum Oil Co Pty Ltd v Wiltshire* [1945] HCA 37; (1945) 72 CLR 319. However, he is entitled to be indemnified against those liabilities from the trust assets held by him and for the purpose of enforcing the indemnity the trustee possesses a charge or right of lien over those assets: *Vacuum Oil Co Pty Ltd v Wiltshire*. The charge is not capable of differential application to certain only of such assets. It applies to the whole range of the trust assets in the trustee's possession except those assets, if any, which under the terms of the trust deed, the trustee is not authorised to use for the purposes of carrying on the business: *Dowse v Gorton* [1891] AC 190. …

[19] Similarly, in *Re Suco Gold* (1983) 7 ACLR 873, the Supreme Court of South Australia said:

> The trustee's lien is an equitable lien which confers on him a charge over the trust property, whether in his possession or not, for the purpose of protecting and enforcing the right of indemnity. It also confers on the trustee a right to possession of the trust property for the purpose of protecting and enforcing the right of indemnity, *Jennings v Mather* [1902] 1 KB 2. The right of possession of the trustee, until his right of indemnity is exercised, is superior to those of a new trustee or the cestuis que trust.

[20] Under this argument, Mr Bainbridge had an equitable lien over trust assets of the Kahurangi Trust to support any right of indemnity for any liabilities he incurred as trustee.

[21] The Official Assignee says that Mr Bainbridge retained that right of indemnity and his equitable lien even after he resigned as trustee. He cited *Rothmore Farms Pty Ltd v Belgravia Pty Ltd* [1999] FCA 745 at [37]:

> Authority also indicates that the equitable interest of the trust assets, to the extent that the trustee's right of indemnity against the trust assets, is not lost by change of trustee or by the giving up of possession of the trust assets by that former trustee.

The passage from *Suco Gold* cited above also recognises that a trustee's lien is superior to those of a new trustee.

[22] The right of indemnity and the associated equitable lien passed to the Official Assignee. In *Re Suco Gold* the Court said:

> It is clear from the *Octavo* case that the trustee company's right of indemnity is a right which passes to the liquidator. It is important in the resolution of the problem under consideration to maintain a clear distinction between the beneficial interest of the trustee and the trust fund, which is no more and no less than the right of indemnity and supporting lien, and the trust fund itself which is and remains trust property subject only to the trustee's beneficial interest. The beneficial interest of the trustee company, that is to say the right of indemnity and supporting lien, passes to the liquidator and is properly divisible among the creditors; the residual beneficial interest remains property held in trust for another within the meaning of s 116(2) of the Bankruptcy Act and is excluded, by virtue of that section, from the property which vests in the liquidator and is divisible among the creditors.

[23] That was said in the context of a company liquidation. However, it also applies in New Zealand to a bankruptcy under the Insolvency Act 1967. Section 42(1)-(3) says:

> **42 Property passing to Assignee and commencement of bankruptcy**
>
> (1) All the property and powers of the bankrupt specified in subsection (2) of this section are hereby vested upon adjudication or as soon thereafter as this section becomes applicable thereto in the Assignee of the bankrupt's property:
>
> Provided that, upon any other Assignee becoming the Assignee of the property of the bankrupt the said property and powers are hereby vested, thereupon or as soon thereafter as this section becomes applicable thereto, in that other Assignee, but without prejudice to any disposition made by any former Assignee.
>
> (2) Subject to the provisions of subsection (3) of this section, and subject to the provisions of sections 47, 48, 49, 50, and 59 of this Act, the property and powers of the bankrupt to vest in the Assignee and be divisible amongst his creditors shall comprise the following:

(a) All property whatsoever and wheresoever situated belonging to or vested in the bankrupt at the commencement of the bankruptcy, or acquired by or devolving upon him before his discharge:

(b) The capacity to exercise and to take proceedings for exercising all such powers in or over or in respect of any property whatsoever and wheresoever situated as might have been exercised by the bankrupt for his own benefit at the commencement of the bankruptcy or before his discharge.

(3) … notwithstanding anything else in this Act, property held by the bankrupt in trust for any other person shall not pass to the Assignee.

…

[24] An equitable lien with its associated power to have the property the subject of the lien sold up comes within "all the property and powers of the bankrupt" in s 42(1). The power to enforce the lien is within the powers under s 42(2)(b). Subject to that lien, the assets held on trust do not otherwise pass to the assignee – s 42(3). Sections 101 and 104 of the Insolvency Act 2006 are broadly comparable provisions.

[25] Under the Official Assignee's argument, Mr Bainbridge's equitable lien over the trust assets, including the property at 13A Summit Drive, passed to him on the adjudication in bankruptcy, notwithstanding Mr Bainbridge's earlier resignation as trustee. The Official Assignee has the same powers that Mr Bainbridge had to enforce the lien.

[26] The Official Assignee also submitted that the equitable lien is a caveatable interest. For authority, the Official Assignee referred to *Zen Ridgway Pty Ltd v Adams* [2009] QSC 117. Citing *Custom Credit Corporation v Ravi Nominees Pty Ltd* (1992) 8 WAR 42 at 53, *Re Nymboida River Pty Ltd (In Liq) Caveats* (unreported, Queensland Supreme Court, Ambrose J, 30 September 1988), Wilson J said at [10]:

In principle, the trustee's lien is a caveatable interest.,

[27] In *Apa v Levin & Jordan* CIV-2009-404-4652, Associate Judge Robinson, 15 December 2009, upheld a caveat where the caveator claimed to be subrogated to the trustee's right of indemnity. That must have been on the basis that the trustee had a caveatable interest.

[28] Neither party submitted whether a caveatable interest under s 137 of the Land Transfer Act had to be capable of registration. The traditional view is that a caveatable interest must be capable of registration – *Staples & Co Ltd v Corby* NZLR (1900) 19 NZLR 517 (CA), *Miller v Minister of Mines* [1963] AC 484 (PC) at 497. However, in *re Haupiri Courts Ltd* [1969] NZLR 353 at 356, Richmond J recognised that an equitable lien might be the subject of a caveat. In *Superannuation Investments Ltd v Camelot Licensed Steak House (Manners St) Ltd* (High Court, Wellington M 695/87, Gallen J., 10 March 1988) held that an interest was caveatable even if it could not be registered. The Court of Appeal expressed a provisional opinion to the same effect in *Waitikiri Links Ltd v Windsor Golf Club Inc* (1998) 8 NZCPR 527. Following the more recent authorities, I find 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:

> 137 Caveat against dealings with land under Act
>
> (1) Any person may lodge with the Registrar a caveat in the prescribed form against dealings in any land or estate or interest under this Act if the person—
>
> (a) claims to be entitled to, or to be beneficially interested in, the land or estate or interest by virtue of any unregistered agreement or other instrument or transmission, or of any trust expressed or implied, or otherwise; or
>
> (b) is transferring the land or estate or interest to any other person to be held in trust.

[29] Against the Official Assignee's argument, the defendants submitted:

(a) The right of indemnity and the associated equitable lien applied only to an established liability of the trustees. Here liability was not

established, either by judgment or agreement, but was strongly contested.

(b) The trustees were not under any liability at all.

(c) The right of indemnity did not apply because the indemnity in the trust deed applied only to personal liabilities. In this case, the trustees had not incurred personal liabilities.

(d) The equitable lien could only arise in the case of a trading trust.

[30] On the submission that there is indemnity only for an established liability, the defendants' argument confuses what is required to enforce a trustee's equitable lien with what must be established on an application under s 145A of the Land Transfer Act. At the time of enforcement, a trustee needs an enforceable right of indemnity giving right to an equitable lien. Certainly, if the trustee needs the assistance of the Court to enforce the lien, for example, by seeking a Court order for sale of a trust asset, he will need to prove the liability giving rise to the right of indemnity and the lien. But at the caveat stage, the Court only needs to be satisfied that the caveator has an arguable case for the interest claimed under the caveat. It is not a condition for an order sustaining a caveat that the caveator must prove the claim to the extent of obtaining a judgment for indemnity.

[31] After the hearing, the defendants filed a memorandum adding a submission referring to *Hughes-Hallett v Indian Mammoth Goldmines Co* (1882) 22 Ch D 561. In that case, a trustee's claim for an indemnity against a beneficiary was held to be premature as the trustee's potential liability had not been established. That is distinguishable from the present case. The liability of the trustees under the loans is the subject of a proceeding already pending. Mr Bainbridge's bankruptcy means that he is not a party to those proceedings. Given that the liabilities under the loans are a live issue in the proceeding pending before the Court, it cannot be premature for the Official Assignee to lodge a caveat to protect the equitable lien. I have addressed the defendants' late memorandum so that they may be satisfied that I have turned my mind to the point raised. However, filing submissions after the close of the hearing

is irregular. This case does not fall within any of the exceptions. Filing late submissions is not encouraged. The defendants should not assume that any such future submissions will be considered.

[32] On the second point, the defendants contested the Official Assignee's claim on amount. In the substantive proceeding, there is considerable accounting evidence on the question. The Official Assignee had obtained judgment by default against the trustees for $2,102,610. The defendants applied to set aside the judgment. Eventually, the matter was resolved with the Official Assignee agreeing to judgment being set aside on terms. As part of the setting aside application, both parties filed accounting evidence. On the Official Assignee's side, there was evidence from Mr Clothier, the Official Assignee's investigating accountant, showing that the sum of $1,394,072 was due. Mr Colin McCloy, an experienced insolvency accountant, supported that evidence. On the defendants' side, Mr Dennis Lane, an experienced independent accountant, challenged the Official Assignee's calculations.

[33] A caveat application is not the appropriate setting to resolve conflicts between accounting experts. At this stage, it is sufficient to record that the Official Assignee has adduced evidence establishing an arguable claim for the sum of $1,394,072, plus interest and costs. Through the evidence of Mr Lane, the defendants have shown arguable defences to the claim. However, at this stage, I cannot say that the Official Assignee's case is so weak that it is not even arguable. For the caveat application, the Official Assignee has shown an arguable claim for a sum up to $1,394,072. It has a real, as opposed to a fanciful, prospect of success.

[34] The defendants' third point relies on the wording of the indemnity in paragraph 14 of the trust deed and the exclusion of personal liability under the deeds of acknowledgement of debt.

[35] Paragraph 14.5 of the trust deed says:

> 14.5 A Trustee is hereby fully and completely indemnified from the Trust Fund for any personal liability which that Trustee may sustain in:
>
> a. Exercising or omitting to exercise any function, duty or power of the Trustee; or

> b. Purporting, in good faith, to exercise as Trustee any function, duty or power which is not authorised or which may be a breach of this Trust unless any such loss or liability is attributable to such Trustee's fraud, dishonesty or wilful commission or omission of any act known by that Trustee to be a breach of trust.

[36] The defendants focus on "personal liability". They say that the purpose of paragraph 14 is to provide indemnity only for personal liabilities incurred by trustees. If the trustees do not incur personal liability, then they do not require indemnity and the paragraph does not extend further.

[37] They refer to the exclusion of personal liability under the deeds of acknowledgement of debt. Under them, the borrower's liability is limited to the assets of the Kahurangi Trust. The trustees do not have any personal liability. The defendants therefore argue that for the loans the Official Assignee relies on, there is no right of indemnity under paragraph 14.5, because the trustees have no personal liability under the deeds of loan.

[38] If this argument is correct, the combined effect of the deeds of acknowledgement of debt and paragraph 14.5 is that the loans are unenforceable. The lender cannot enforce the loans against the trustees personally because their personal liability is excluded. The lender cannot be subrogated to the trustees' rights of subrogation under paragraph 14.5 because the defendants say that there is no relevant personal liability under the deeds. There is no enforceable obligation to repay.

[39] As a preliminary point, it may be noted that the first loan is apparently recorded only in a deed of forgiveness of debt. That deed does not have any provision recording that the trustees are not personally liable. However, that is not necessarily a gap in the defendants' argument. Because there were later transactions between the trustees and Mr Bainbridge, it may be that the loan of 1 November 1999 has been repaid as a result of the rule in *Clayton's Case*. That may have to be determined at a substantive hearing.

[40] The defendants did not accept that their argument resulted in the loans becoming unenforceable. Their response was that the lender could sue on the deeds

and obtain judgment. Having obtained judgment, the lender could then enforce the judgment against trust assets.

[41] The Official Assignee pointed out that trustees could be changed so as to frustrate execution. But there is a more fundamental difficulty with the defendants' argument. A judgment creditor of a trustee cannot enforce his judgment against trust assets. For example, *Lewin on Trusts* (18th ed, 2008) at paragraphs 21-38 says:

> Although unsecured creditors and other claimants do not have a direct claim against the trust property in respect of unsecured liabilities incurred by trustees in the administration of the trust, and cannot levy execution upon trust property they may by subrogation have a right to stand in the place of the trustee and enforce their liabilities against the trust property to the extent that the trust will be so entitled.

[42] Similarly, in *General Credits Ltd v Tawella Pty Ltd* [1984] 1 QSR 388 at 389 McPherson J said:

> It is well settled that such a judgment cannot be enforced by execution levied upon trust assets even though the judgment against the trustee is founded on a debt incurred by him in the capacity of trustee: see *Jennings v Mather* [1902] 1 KB1, [1901] 2 QB 108, *Savage v Union Bank of Australia* (1906) 3 CLR 1170 at 1186, and *Octavo Investments Pty Ltd v Knight* (1979) 144 CLR at 360, 367.

[43] Accordingly, the defendants' argument of direct recourse against the trust assets is not available to a trust creditor. If a trust creditor does not have security and his recourse against a trustee personally is excluded by terms of contract, a creditor can enforce rights against the trust property only through subrogation to the trustee's right of indemnity. The point remains that the defendants' argument results in the lender not being able to enforce repayment. Plainly, the parties cannot have intended to enter into an unenforceable agreement. They were following a recognised form of estate planning by way of interest free loans, followed by annual gifts of $27,000, the maximum exemption before gift duty applies. They can hardly have intended that Mr Bainbridge was making over the funds absolutely, so as to expose him to liability for gift duty.

[44] It is accordingly appropriate to apply a construction which makes the deeds of acknowledgement of debt workable and enforceable. An approach which does this is to construe clause 14.5 as providing a partial indemnity, while leaving in place

the right of indemnity under s 38(2) of the Trustee Act 1952. Such an interpretation does not deprive paragraph 14.5 of its effect but still leaves in place a right of indemnity for other cases of liability incurred by trustees.

[45] There is a debate whether a trust deed can effectively exclude or limit a trustee's right of indemnity from trust assets. In New Zealand the issue turns on whether the right of indemnity comes within "power" in s 2(4) of the Trustee Act:

> The powers conferred by or under this Act on a trustee who is not a corporation are in addition to the powers given by any other Act and by the instrument, if any; creating the trust; but the powers conferred on the trustee by this Act, unless otherwise stated, apply if and so far only as a contrary intention is not expressed in the instrument, if any, creating the trust, and have effect subject to the terms of that instrument.

[46] If the right is a power, it might be modified or excluded by a contrary intention expressed in a trust deed. Cases following this approach are *R.W.G Management Ltd v Corporate Affairs Commissioner* [1985] VR 385 at 394-5 (where s 2(3) of the Victoria Trustee Act 1958 expressly refers to indemnities) and *Polly Peck International plc v Henry* [1999] 1 BCLC 407. On the other hand, in *Kemtron Industries Pty Ltd v Commissioner of Stamp Duties* [1984] 1 Qd R 576 at 585, McPherson J held that the right of indemnity is inseparable from a trusteeship and for that reason was probably incapable of being excluded. In its report *Some Problems in the Law of Trusts* R79 (2002), the Law Commission favoured the view that the right cannot be excluded or limited. I am not required to decide the point for this case. Even if the right of indemnity under s 38(2) can be modified under s 2(4), paragraph 14.5 can be read as not expressing a contrary intention. There are no words expressly excluding the right of indemnity. There is no reason to imply them with the result that the deeds of acknowledgement of debt would become unenforceable.

[47] On the fourth point, the defendants relied on the following passage from the judgment of Dixon J in *Vacuum Oil Co Pty Ltd v Wiltshire* (1945) 72 CLR 315 at 335-336:

> In cases of this description, the priorities are worked out upon principles involving some intricacy. The creditors of a deceased person are entitled to be paid out of the assets in a due course of administration, and a due course

of administration does not include the carrying on of the deceased's business, except in so far as may be reasonably necessary for the purpose of realisation of winding up.

An executor or administrator who carries on a business, except for that purpose, cannot therefore indemnify himself out of the assets in respect of liabilities he has incurred in so doing, at the expense of creditors of the deceased. He cannot do so even if he is empowered by the will to carry on the business, for that power can operate only as between himself and the beneficiaries, and that is true also of any order or decree extending or adding to the powers derived from a will or other trust instrument.

The liabilities the executor incurs in carrying on the business are his personal debts, and give the creditors to whom he has incurred them no direct right of recourse to the assets of the estate. But, if the executor has acted under some authority binding upon those who otherwise would be entitled to the assets, their claims are subject to his right to be indemnified out of the assets in respect of liabilities he has incurred in the proper performance of his duties or exercise of his powers. He has a lien over the assets which takes priority over the rights in or in reference to the assets of beneficiaries or others who stand in that situation. But the claims of creditors of the deceased, whose rights are, of course, independent of his will, cannot be postponed so as to rank behind this lien, except by their own act or conduct. Although the executor's creditors to whom he has become indebted in the course of carrying on the business have no direct claim upon the assets, because they deal with him on the footing of his personal liability, yet in equity they may be subrogated to his right of indemnity or lien. The principle is stated in a few words by Turner LJ in *Ex parte Edmonds* (1862) 4 De G F & J 488 at p 498, 45 ER 1273 at p 1277 – "The executor or trustee directed to carry on the business having the right to resort for his indemnity to the assets directed to be employed in carrying it on, the creditors of the trade are entitled to the benefit of that right, and thus become creditors of the fund to which the executor or trustee has a right to resort."

But the creditors of the trade carried on by the executor must, as in all other cases of subrogation, depend upon his rights, and in that sense their claims upon the assets of the estate are indirect. This is well shown by the example of an executor who, through his wrongful act, has lost his right of indemnity or has disentitled himself to an indemnity except on terms of making good a loss to the estate. In such a case the creditors of his trade can have no better right – *In re Johnson* (1880) 15 Ch D 548, 552, 555.

The application of these principles to the present case means that the claims of the trade creditors of the executor to rank before the creditors of the deceased debtor in the administration of his estate in bankruptcy must rest upon the existence in the executor, at the date when the order for administration in bankruptcy was made, of a right to be indemnified out of the assets in respect of those claims or to a lien over the assets. Further, the lien or right of indemnification must take priority over the rights of creditors of the deceased, and, as already explained, that can only be by reason of their own act or conduct.

[48] Naturally, I do not disagree with Dixon J's statement of the law. But it is necessary to bear in mind that that case concerned an argument as to priorities between the creditors of a deceased as at the date of death and trade creditors of the executors who had carried on business after death. In short, Dixon J recognised that the creditors of the deceased person could be postponed only if they had consented to the executors continuing the business of the deceased after death (beyond simply realising a winding-up of the business). The executors' right of indemnity and the accompanying lien arose only to the extent that the creditors of the deceased had authorised the business to be continued in the course of administration of the deceased estate. Trade creditors of the executor claiming rights of subrogation had rights which were no more extensive than that of the executors' right of indemnity.

[49] The defendants submitted that Dixon J was limiting a trustee's rights of indemnity only to cases of trading trusts and that this case did not involve a trading trust. That submission misunderstands a trustee's right of indemnity. A trustee has a general right of indemnity, whether the trust is a trading trust or not. The indemnity provisions of the Trustee Act, s 34-39B, make this clear. Claims made under trustees' rights of indemnity are more likely to arise in trading trusts, but that does not mean that the right of indemnity does not apply in other trusts.

[50] The defendants also placed some weight on Dixon J's statements that the executor must act under some authority binding on those who would otherwise be entitled to the assets. That has no relevance to the present case.

[51] The defendants also submitted that a trust creditor's right of subrogation is no more extensive than the trustee's right of indemnity. While that is correct, it is not relevant to the present case, which is concerned only with the trustee's right of indemnity.

[52] I accept the argument for the Official Assignee that Mr Bainbridge has a right of indemnity against the assets of the Kahurangi Trust, including the property at 13A Summit Drive, Mt Albert, Auckland, for liabilities up to $1,394,072. That right of indemnity carries with it an equitable lien over trust assets. Mr Bainbridge retained

that lien after he resigned as trustee and it has passed to the Official Assignee on Mr Bainbridge being adjudicated bankrupt. The lien gives a caveatable interest.

Exercise of discretion

[53] The defendants urged that I exercise the residual discretion to allow the caveat to lapse, even if the Official Assignee has a caveatable interest. The defendants say that there is more than enough equity to meet any claim in favour of the Official Assignee. They say that the Official Assignee will be adequately protected even if the caveat is not on the title. They need the ability to borrow against the property to finance the defence to the Official Assignee's substantive proceeding.

[54] The property has a rating valuation of $1,960,000 as at 1 July 2008. Mr Bainbridge asserts that the property has a current market of $2.15 million, but he has not qualified himself as having expertise in property valuation. No report by a valuer was put in evidence. I accept the rating valuation as indicating the likely value of the property, but at the same time bear in mind that that valuation is more than two years old and is unlikely to be the result of a site-specific inspection and report.

[55] The National Bank holds a first mortgage over the property. Mr Bainbridge says that it secures liabilities of about $550,000. He says that the amounts secured by the Bank's mortgage have fluctuated between $500,000 and $550,000 from the date of his bankruptcy.

[56] In *Pacific Homes Ltd (In Receivership) v Consolidated Joineries Ltd* [1996] 2 NZLR 652 at 656, the Court of Appeal said:

> In such circumstances the Court retains a discretion to make an order removing the caveat, though it will be exercised cautiously. An order will be made for removal only where the Court is completely satisfied that the legitimate interests of the caveator will not thereby be prejudiced. If, on the facts of a case, it can be seen that the caveator can have no reasonable expectation of obtaining benefit from continuance of the caveat in the form of the recovery of money secured over the land or specific performance of an agreement where the caveator's interests can be reasonably accommodated

> in some other way, such as by substituting a fund of money under the control of the Court, then it may be appropriate for the caveat to be removed notwithstanding that the right to the claimed interest is undoubted.

[57] This is not an appropriate case for the exercise of the discretion. The Official Assignee is entitled to lodge a caveat against the property. Leaving the caveat on the title provides greater protection for the Official Assignee than if the caveat is removed. If the caveat is removed, the Official Assignee is exposed to the risks of a loss of priority by registration of some other interest and of disposal of the property. There is no good reason to expose the Official Assignee to those risks.

[58] The Official Assignee has an arguable claim to $1,394,072. There is no good reason for the Court to cap the interest protected by the caveat at a lower sum. It is not clear that there is any residual equity available to the trustees. It is possible that if there is a forced sale of the property and the Official Assignee has proved his claim fully, he may not recover the entire amount of his claim from the net proceeds of sale.

[59] In *Pacific Homes Ltd (In Receivership) v Consolidated Joineries*, the Court of Appeal emphasised that the discretion should be exercised cautiously. The Court should not take risks with the Official Assignee's caveatable interest. The trustees have not offered any substitute arrangement which would give the Official Assignee protection comparable with the caveat remaining on the title.

[60] The defendants' claims of hardship relating to difficulties of funding the defence of their substantive claim are not relevant to the Court's exercise of the discretion in this case.

[61] Accordingly, I uphold the caveat.

[62] An order that a caveat will not lapse is provisional. It may be set aside following the substantive determination of the interest claimed by the caveator. At present, there are no proceedings on foot seeking a determination of the equitable lien and its value. A convenient way for the matter to be determined is for the Official Assignee' to add a further cause of action to his statement of claim in CIV-

2009-404-3391. The cause of action should seek a declaration as to the interest claimed in the caveat and associated relief. I give directions for the filing of pleadings below.

[63] I make these orders:

(a) Caveat 8546792.1 registered against Identifier 56327 shall not lapse pending further order of the Court;

(b) In proceeding CIV-2009-404-3391, the Official Assignee shall file and serve an amended statement of claim adding a cause of action seeking a declaration as to the equitable lien claimed by him in his caveat, plus any associated relief by **22 March 2011**;

(c) The defendants shall file and serve a statement of defence to the amended statement of claim by **12 April 2011**; and

(d) The defendants shall pay the Official Assignee costs on the caveat application on a 2B basis, together with disbursements as approved by the Registrar. Costs for the hearing are on the basis that the argument as to the caveat lasted for a third of the hearing time on 8 February 2011. If the parties are unable to agree on the amount of costs, they may file memoranda.

(e) Leave is reserved to the parties to apply for further directions on steps to be taken for the substantive determination of the equitable lien claimed by the Official Assignee.

R M Bell
Associate Judge