Supplementary Submission

This submission is intended to be read with my submission dated 2 April 2018. There are some respects in which it elaborates on or qualifies some parts of the earlier submission. This submission deals with four matters relevant to the first of the topics in the Commission's reference.

- Whether Lord Lindley's statement of the rule in *Hardoon* was justified by the previous case law

- Is there any real doubt about whether it is possible for a provision in the trust deed to remove any personal right of indemnity that the trustee would otherwise have, and

- What are the circumstances in which a member of a superannuation fund could have an obligation to indemnify the trustee, if Lord Lindley's statement of the rule were correct

- What is the effect of the trustee's right of indemnity from the assets on Lord Lindley's formulation of the rule

Part 1 - Did Lord Lindley overclaim?

1.1 What is Lord Lindley's rule?

If the Commission is considering whether to abolish or alter Lord Lindley's rule in *Hardoon* it is important, for the drafting of any proposed legislation, to be precise about exactly what the rule is. The headnote in the Authorised Reports identified the ratio of *Hardoon* as being:

> "A party who is sui juris and beneficially entitled to shares which he cannot disclaim is personally bound, in the absence of contract to the contrary, to indemnify the registered holder thereof against calls upon them. It is immaterial whether the beneficial owner originally created the trust by which the registered holder was plainly affected, or accepted a transfer of the beneficial ownership with knowledge of the trust."

I suggest that the headnote could mislead. Lord Lindley's judgment mentioned disclaimer three times. The first was when he said that any attempt to make someone a beneficial owner against his will could be defeated by disclaimer[1]. The second when he listed all the positive acts that the defendant had done concerning the shares that were involved in that case and said:

> It is idle after this to rely on the fact that the defendant did not create the trust in the first instance, and idle to talk of renunciation or disclaimer of these shares by the defendant. [2]

The third was when he said:

> In this case their Lordships have only to deal with a person sui juris beneficially entitled to shares which he cannot disclaim.[3]

The judgment mentioned a contract negativing the obligation to indemnify only once:

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[1] At 123
[2] At 127
[3] At 127

> In this case their Lordships have only to deal with a person sui juris beneficially entitled to shares which he cannot disclaim. The obligation of such a person to indemnify his trustee against calls upon them appears to their Lordships indisputable in a court of equity unless, of course, there is some contract or other circumstance which excludes such obligation. Here there is none.[4]

However the principle that Lord Lindley applied was:

> The plainest principles of justice require that the cestui que trust who gets all the benefit of the property should bear its burden unless he can shew some good reason why his trustee should bear them himself.[5]
>
> … where the only cestui que trust is a person sui juris, the right of the trustee to indemnity by him against liabilities incurred by the trustee by his retention of the trust property has never been limited to the trust property; it extends further, and imposes upon the cestui que trust a personal obligation enforceable in equity to indemnify his trustee.[6]

Disclaimer of the beneficial interest, or a contract excluding an obligation to indemnify, are merely examples of what could be "good reason why his trustee should bear [the burden of the trust property] himself." They are matters for a beneficiary who is sui juris and absolutely entitled to prove if he or she wants to avoid liability to indemnify a trustee. The rule that Lord Lindley discovered and applied in *Hardoon* was that a beneficiary of a trust who is *sui juris*, and absolutely entitled to the trust property has a personal obligation to indemnify the trustee for liabilities incurred in proper administration of that property burden unless he can shew some good reason why his trustee should bear them himself.

That rule is now embedded in Australian law to such an extent that only the High Court, or legislation, could alter it. In *Trautwein v Richardson* two of the members of a three-judge bench of the High Court regarded the mere fact that a person was the beneficiary of trust property as a sufficient reason for that person having an obligation to indemnify the trustee [7]. That is decisive, as a matter of precedent, of the applicability of the rule so far as any court in the hierarchy below the High Court is concerned. The fact that the decision in *Trautwein* was given in 1946, at a time when the High Court regarded itself as bound to follow decisions of the Privy Council, might make a High Court sitting after the abolition of appeals from Australia to the Privy Council somewhat more willing to question the applicability of the rule. However it can have no effect on the strength of the precedent so far as courts below the High Court are concerned. As well, the rule has been accepted in a judgement of Jacobs J in the High Court[8], in numerous decisions of intermediate courts of appeal[9], and in a large number of first instance decisions.

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[4] At 127

[5] At 123

[6] At 124

[7] [1946] Argus Law Reports 129 at 131 per Latham CJ, 134-5 per Dixon J. it was clear, from the facts, that the beneficiary was sui juris and absolutely entitled.

[8] *Marginson v Ian Potter & Co* (1976) 136 CLR 161 esp at 175 – 6. No other judge in *Marginson* considered the question.

[9] Some are *Causley v Countryside (No 3) Pty Ltd* (NSW Court of Appeal, 2 September 1996, unreported) *Balkin v Peck* (1998) 43 NSWLR 706 at 712 per Mason P (Priestley JA and Sheppard AJA agreeing); *Rosanove v O'Rourke* **[**1988] 1 Qd R 171; *Chief Commissioner of State Revenue v CCM Holdings Trust Pty Ltd* [2014] NSWCA 42 at [72] per Gleeson JA and *Wieland v Texxcon Pty Ltd* |[2014] VSCA 199, **(**2014) 313 ALR 724 at [95]

When the Commission is deciding whether to alter Lord Lindley's rule it is relevant for it to consider whether, prior to 1900, the judge made law recognised any such rule. I suggest that it did not, and that Lord Lindley not only stated the rule in terms that were wider than were necessary for the decision of the case before him, but also stated it in wider terms than had been recognised by previous authority. If that is so, changing the rule is a less radical step that it might otherwise be.

1.2 Deed of Settlement Companies

In seeking to understand some of the cases that Lord Lindley relied on, it is important to bear in mind what was involved in being a shareholder in a deed of settlement company. Such a company was a "company" only in the sense that it was a group of individuals who joined together for a common purpose – it was a company in the sense that a company of travellers, or a company of actors, are a company. It was usual for there to be a deed of settlement, which stated the basis on which the individuals would contribute their money and have it managed. It was usual for there to be a provision where the money that was contributed would be vested in trustees, who would be given powers to manage the property that was administered pursuant to the deed. Those trustees were sometimes given powers to make calls on the shareholders, requiring the shareholders to contribute more money. The shareholders sometimes agreed amongst themselves that there was a limit to the amount that a shareholder could be required to contribute for the activities of the company. However any such agreement did not bind anyone who was not a shareholder – so far as a person dealing with the managers of the company were concerned, the shareholders were all partners, and liable as such for any debts or other liabilities that the managers contracted within the scope of their actual or ostensible authority concerning the company business. True limited liability of shareholders in companies became available in England only with the passage of legislation in 1855[10].

Sometimes the deed of settlement made provision for the share of a shareholder to be transferred to someone else. If the deed contained such a provision, it would usually stipulate the sort of instrument of transfer that was required, and the procedure that had to be gone through to effect the transfer. That procedure often involved making the transfer instrument available to an officer of the company, the directors agreeing that the transfer could be made, the removal of the name of the transferring shareholder from the list of shareholders and the inclusion of the transferee in that list.

1.3 The Cases Considered by Lord Lindley

The cases that were considered by Lord Lindley do not justify the rule that he drew from them. Decades ago Ashburner recognised that Lord Lindley's rule was a novelty:

> "It was laid down clearly for the first time in *Hardoon v Belilios* that the right of a trustee to be personally indemnified by his cestui que trust, where the cestui que trust was an absolute beneficial owner, rested on a general principle of equity as much as his right to indemnity out of the trust funds. In most of the earlier cases in which the personal right to indemnity had been enforced the cestui que trust was also creator of the trust, and the right to

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[10] T F Bathurst, *The historical development of corporations law* (2013) 37 Australian Bar Review 217 especially at 220-224

indemnity could therefore be and often was based on a contract implied from the request to undertake the duties of trustee.[11]"

1.3.1 *Balsh v Hyham*

Balsh v Hyham[12] was part of the working through of the consequences of the South Sea Bubble. The plaintiff was trustee for the defendant of £1000 face value of stock in the South Sea Company. The defendant had requested the plaintiff to borrow £4000 from the Company, secured by this stock. The plaintiff borrowed the money, and paid it to the defendant. After the crash of the Company an Act of Parliament enabled anyone who owed money to the Company to be discharged of their obligation if, before a particular day, they paid the Company 10% of the amount owed.

The defendant directed the plaintiff not to pay the 10%, claiming that there was a real doubt about whether the £4000 was a valid debt. The plaintiff paid regardless. The plaintiff then sought to recover from the defendant the amount he had paid. He succeeded. Lord Chancellor King referred to several factors:-

- the failure of the defendant, when forbidding repayment of the 10%, to offer the plaintiff a secured indemnity [presumably, for the entire £4000 borrowed and any interest that had accrued, and perhaps the cost of contesting the validity of the debt]
- the plaintiff had good reason to think he was liable to repay the whole money borrowed, because money that has been borrowed ought to be repaid
- even if there was only a risk that the plaintiff might continue to be liable for the whole amount borrowed, he ought not remain under such a risk[13]
- "it is a rule that the *cestui que trust* ought to save the trustee harmless, as to all damages relating to the trust, so within the reason of that rule, where the plaintiff the trustee has honestly and fairly, without any possibility of being a gainer, laid down money by which the cestui que trust is discharged from being liable for a greater sum lent, or from a plain and great hazard of being so, the trustee ought to be paid "[14]

Lord Lindley read the early 18th-century language of Lord King anachronistically. He read Lord King's judgement as though a "rule" was a statement of the consequences that followed (or perhaps followed subject to identifiable exceptions) in a particular set of circumstances. It was more in keeping with the early 18th-century usage to regard a rule as a general statement of a principle that could (but might not) decide a case. The "rule" was not a set of words that were to be applied like the words of a statute to the facts of any individual case[15]. As well one needed to check whether the

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[11] Dennis Browne, *Ashburner's Principles of Equity*, 2nd ed Butterworth's London 1933, p 161. He went on to give as examples *Balsh v Hyham*, *German Mining Co*, and *Jervis v Wolferstan* and *Wynne v Tempest*, all mentioned later in this submission.

[12] (1728) 2 P Wms 453; 24 ER 810

[13] This reason begs the question

[14] 2 P Wms at 455, 24 ER at 810. The "short report of *Balsh v Hyham*" that Lord Lindley referred to in *Hardoon* at 124, contained in 2 Eq Ca Ab 741 para 8; 22 ER 629, consists only of the sentence I have just quoted.

[15] The former Lord Chancellor Francis Bacon explained: "It is a sound precept not to take the law from the rules, but to make the rule from the existing law. For the proof is not to be sought in the words of the rule, as if it were the text of law. The rule, like the magnetic needle, points at the law but does not settle it." (*De Augmentis Scientiarum* (1623) Bk viii Ch. 3 Aph 85, as translated by Spedding, and quoted in Sir W Holdsworth *A History of English Law Volume V*, 3rd edn, London: Methuen 1945 at 240.) Lord Nottingham illustrated the

"reason of the rule" was such that it should apply in the circumstances of the case that was being considered. That is exactly what King LC did in his reasoning in *Balsh v Hyham*. It was a mistake to regard the ratio of *Balsh v Hyham* as consisting of the "rule" stated by the Chancellor without also paying attention to the facts of the case and the reasons why the "reason of the rule" was satisfied in the particular factual situation.

There is ample justification for the outcome of the *Balsh v Hyham* because the plaintiff had become trustee of the shares for the defendant at his request, the plaintiff had incurred the liability for £4000 at the defendant's request, the defendant had received the whole benefit of that £4,000 and, when the defendant had refused to indemnify him, the plaintiff had acted reasonably to minimise both his own, and potentially the defendant's, liability. Indeed the plaintiff being a trustee of the shares was not the main justification for the outcome. That the plaintiff was the trustee of the shares was only a precondition for the arising of the loan liability that was the real subject of the dispute: if the plaintiff had not been the trustee of the shares he would not have had them available to offer as security for the loan, but it was liability for the loan that was the real subject of the case. It was not even as though borrowing on the security of the shares was within the scope of the powers that the plaintiff could exercise on his own initiative as trustee – he had power to borrow on the security of the shares only because of the specific request of the defendant to do so.

Balsh v Hyham appears to have been referred to by a judge in very few cases before *Hardoon*[16] *,* and then in a way which did not take literally and in isolation the "rule" articulated by King LC. Yet in *Hardoon*[17] Lord Lindley treated the "rule" stated by King LC as being a self-contained proposition of law, in need of qualification only in that it should apply only to *cestuis que trust* who were *sui juris* and sole beneficial owners.

1.3.2 *Phené v Gillan*

In *Phené v Gillan*[18] the plaintiff lent the defendant money, upon the security of a mortgage of shares in a deed of settlement company. The plaintiff became the registered proprietor of those shares, on the basis of an express promise that he would re-transfer the shares when the debt was repaid. The debt was repaid, and the defendant required a transfer. The plaintiff provided a transfer but the directors of the company declined to register it. A judgement was then obtained against the public officer of the company, for a significant sum of money.

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malleable nature of rules in *Strode v Blanchard* [15] (1677) Lord Nottingham's Chancery Cases case 659, in D E C Yale (ed) *Lord Nottingham's Chancery Cases Vol 2* (London: Bernard Quaritch 1961 (Publications of the Selden Society, vol. 79). p 496: " … the case gave the Court a fair opportunity to set some bounds and distinctions to that rule of buying in precedent incumbrances, which was now grown a common practice and very mischievous." Another illustration of the imprecise and malleable nature of rules is when Lord Nottingham wrote: "And yet all cases that are without remedy at common law, are not relievable in equity; nor is the rule *nullus recedat a cancellaria sine remedio* [no-one should depart from the Chancery without a remedy] so to be understood: for some cases are only to be considered between a man and his confessor." Nottingham, *Prolegomena of Chancery and Equity* Ch III [27], in DEC Yale (ed) *Lord Nottingham's 'Manual of Chancery Practice' and 'Prolegomena of Chancery and Equity* (Cambridge University Press 1965) p 193-194

[16] it appears that the only cases are *ex parte Chippendale, re German Mining Co* (1854) 4 De G M & G 19 at 54, 43 ER 415 at 428 and *Fraser v Murdoch* (1881) 6 App Cas 855 at 872. Both cases drew from *Balsh v Hyham* a proposition that a *cestui que trust* was obliged to indemnify a trustee when the *cestui que trust* had requested the trustee to undertake the trust – a proposition narrower than the bald statement of the "rule" that Lord King LC gave, and narrower than Lord Lindley's rule. See the extract from *German Mining Co* at 10 below and from *Fraser* at 16 below

[17] At 124

[18] (1845) 5 Hare 1; 67 ER 803

The plaintiff, as a shareholder, was liable to pay a proportionate part of that judgement. The plaintiff sought indemnity from the defendant for that liability. Sir James Wigram VC held that the plaintiff had no contractual entitlement to indemnity. However he held that the Defendant had an equitable obligation to indemnify the plaintiff, upon terms that the defendant have leave to take proceedings in the name of the plaintiff to compel the directors to register the retransfer, and to challenge the validity of the judgement that the creditor of the company had obtained.

Sir James held that the plaintiff had become a trustee for the defendant of the shares. The decision that the defendant had an obligation to indemnify was closely tied to the facts of the case, not to any general proposition about beneficiaries having a personal obligation to indemnify trustees. It was immediately following an account of the circumstances in which the shares had been transferred as security, the debt had been repaid and the retransfer attempted that Sir James said: "I cannot doubt but that a trustee, *circumstanced as the Plaintiff was*, has a right to be indemnified by his *cestui que trust* against all liabilities which he may properly have incurred in that character."[19] That is far short of saying that all *cestuis que trust* who are *sui juris* and absolutely entitled are personally liable to indemnify their trustee for properly incurred liabilities.

Sir James also gave an example of:

> "a trustee of leasehold property under covenants for the benefit of a *cestui que trust.* It is quite clear, I apprehend, that if such a trustee were obliged to pay money for the benefit of his *cestui que trust*, he would have a right of indemnity over."[20]

This appears to be a reference to *Marsh v Wells*[21], one of the cases to which counsel for the plaintiff had referred Sir James[22]. In *Marsh* leasehold land had been settled upon W Pemble as tenant for life, with a reversion that came to be held by Marsh. With the consent of the life tenant Marsh took a renewed lease, which contained a covenant to repair. At W Pemble's death the premises were in poor repair, and Marsh was obliged to pay for remedying the breach. Marsh was held to be entitled to indemnity from W Pemble's executor for the amount paid. Mr Sugden[23], counsel for the plaintiff, said as part of his argument[24]: "The covenants were entered into by the plaintiff as a trustee; and *as it was done with the privity and consent of the tenant for life*, they were in equity his covenants, and might have been enforced against him." The brief judgement of Sir John Leach VC evidently accepted this argument[25]:

> The Plaintiff, during the life of W Pemble, was in effect the trustee of these premises for W Pemble, and was so constituted by his consent. The covenant of the Defendant to keep the premises in repair is, during the life of W Pemble , to be considered as entered into by the Plaintiff on the behalf and at the request of W Pemble; and the plaintiff is plainly therefore entitled to be indemnified out of the assets of W Pemble for W Pemble's breach of that covenant."

If that is the situation to which Sir James was referring, his example of the trustee of leasehold property depends on the covenant having been entered at the request of the *cestui que trust,* and so provides no support for Lord Lindley's broad proposition.

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[19] 5 Hare at 9,67 ER at 806 (emphasis added)
[20] 5 Hare at 9, 67 ER at 806
[21] (1824) 2 Sim & St 87; 57 ER 278
[22] See 5 Hare at 5, 67 ER at 805
[23] Later Lord St Leonards
[24] At 90 of 2 Sim & St at 90, 67 ER at 279 (emphasis added)
[25] At 90 o2f Sim & St at 90, 67 ER at 279

Sir James considered what the situation would have been if the defendant had come to be under a liability, by virtue of being the holder of the shares, before the plaintiff's debt had been repaid. He held that in that situation the plaintiff would have no obligation to indemnify the defendant – the plaintiff could simply waive his right to redeem the shares. It was critical to the outcome of the case (namely that the defendant was obliged to indemnify) that the defendant had *already elected* to take a transfer of the shares. Having elected to take that transfer, he was bound to pay all the expenses that were involved in the management of the shares. The defendant's election, in that situation, was an election to take back legal title to the shares – and it was this election to take back legal title that was critical to his obligation to indemnify. The obligation arose for reasons similar to those applied, concerning transfers of shares that were unregistered but otherwise complete, in *Castellan v Hobson* and *Loring v Davis*, considered below.

I suggest that the statement of Lord Lindley that it "is impossible to read the judgement of Vice-Chancellor Wigram in *Phené v Gillan* without coming to the conclusion that he also regarded the general rule as well-established"[26] is mistaken.

1.3.3 *German Mining Co; ex parte Chippendale* (1853) 4 De G M & G 19; 43 ER 415

In *German Mining Co; ex parte Chippendale*[27] a deed of settlement company was formed for the purpose of working certain German mines. The company was formed with 100 shareholders. There seems to have been no provision in the deed for the transfer of the shares. The deed of settlement contained a provision that the directors had the sole and entire control of the business of the company. The directors were also shareholders[28]. The deed gave the directors power to make calls on the shareholders to the extent of £500 per share, each call not exceeding £50 per share, and gave the directors power to forfeit shares on which calls were not paid. At the time of the litigation, 11 of the shares had been forfeited, and the remainder had been paid in full[29]. The mines were unprofitable, all the capital that had been contributed had been expended, and a meeting of shareholders had authorised the directors to sell all or any part of the property of the company. After that, liabilities were incurred to keep the mines operating with a view to sale. The report contains two separate decisions, concerning two different types of liability.

The first decision, in May 1853, related to the liability of the shareholders[30] for monies that some of the directors and shareholders had advanced for the purpose of payment of miners' wages and other debts incurred in the course of ordinary operation of the mines. The question arose in the course of taking the accounts of the company, in the form of whether those shareholders who had made the advances were entitled to prove in the winding up for the amount of their advances, and thus to set the amounts of their respective advances against their liability to pay calls. The monies had been spent bona fide and for the purpose of saving the enterprise from complete ruin, and if the debts had not been paid it would have been open to the creditors to sue the shareholders personally for them. It was held that the company was a partnership[31], and that on that basis the loan should

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[26] *Hardoon* at 124

[27] (1853) 4 De G M & G 19; 43 ER 415

[28] Knight Bruce LJ at 4 De G M & G 32, 43 ER 420 referred to the respondents as being "some of the directors and other shareholders", and at 4 De G M & G 32-35, 43 ER 420 referred to the directors as "managing partners"

[29] 4 D M & G at 25, 43 ER at 417

[30] The question arose in the course of taking the accounts of the company, in the form of whether those shareholders who had made the advances were entitled to set the amounts of their respective advances against their liability to pay calls.

[31] Knight Bruce LJ at 4 De G M & G 32, 43 ER 420, Turner LJ at 4 De G M & G 41-42, 43 ER 423

be treated as company liabilities. That is a completely orthodox application of the law of partnership: subject to any contrary provision in the partnership agreement, a partner who incurs a liability in the course of the partnership business is entitled to have that liability borne by all the partners.

The second decision, in June 1854, arose from guarantees that directors of the company (plus one shareholder who was not a director) had given to a bank concerning money that the bank had lent. The question at issue was whether, in taking the accounts of the company in its winding up, the directors and the shareholder who had given a guarantee to the bank were entitled to prove as creditors for the amount that they had paid to the bank pursuant to the guarantees. It was accepted that "the moneys thus borrowed of the bankers were expended in carrying on the business of the company in its ordinary course."[32] The court held that the guarantors were entitled to prove, and thus to set off the amounts that they had paid against their respective liabilities in the winding up of the company.

There had been some earlier litigation in the Court of Exchequer, which had decided "that the company were not liable to the bankers[33]" – ie, that the bank could not prove as a creditor in the winding up of the company. It was only after that decision that the guarantors had paid the bank. The shareholders who opposed the guarantors being entitled to prove argued that the powers of the directors of the company to borrow were derived from the deed, and the directors could not act beyond those powers. They put an argument, which sounds rather like an argument of issue estoppel, that:

> "it having been established at law that this company was not liable to the bankers for the moneys advanced by them, it followed, as a necessary consequence, that the Respondents could not be entitled to be repaid by the company the monies which they had paid in discharge of the amount due to the bankers"

It was to rebut this argument that Turner LJ said[34] that the directors were both agents and trustees,

> "and all trustees are entitled to be indemnified against expenses bona fide incurred by them in the due execution of the trust. There is no inconsistency in this double view of the position of directors. They are agents, and cannot bind the companies beyond their powers. They are trustees, and are entitled to be indemnified for expenses incurred by them within the limits of their trust."

Turner LJ drew a distinction between the rights that an outsider to the company might have against the shareholders as a result of a director dealing with the outsider, and the rights that the director had against other shareholders as a result of that same dealing. He said[35]:

> "If therefore it appears that monies advanced by the directors of companies have been duly applied for the purposes of the trust reposed in them … it may well be, that they may be entitled to be repaid by their companies the monies which they have so advanced, although the persons from whom they have borrowed for the purpose of making the advance may not be entitled to recover against the companies. The question, in the one case, depends upon the powers of the directors; in the other, upon the rights incident to the character which they fill".

[32] At 4 De G M & G 50, 43 ER 426
[33] 4 De G M & G at 51, 43 ER at 427
[34] 4 De G M & G at 52, 43 ER at 427
[35] 4 De G M & G at 52, 43 ER at 427

The Court of Exchequer had decided that the borrowing was not a transaction that was within the powers of the directors under the partnership deed, that the bank was not entitled to prove as a creditor in the winding up of the company on the basis of the directors having had power to borrow, but that there should be a new trial because the borrowing might have been within power if the shareholders had consented to it[36]. It may be that the decision of the Court of Appeal in Chancery in *German Mining Co* is a sliding around this decision of the Exchequer. It is hard to see how a transaction could be outside the powers of the director considered as agent, but a bona fide exercise of the powers of a director considered as trustee. The tenor of the decision of the Court of Appeal in Chancery suggests that those judges would have held that the authority of the directors to carry on the business brought with it the power to incur whatever expenses were appropriate to be incurred in carrying on that business, and that they would thus have disagreed with the judges of the Exchequer about whether the transaction was within power[37].

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[36] *Burmester v Norris* (1851) 6 Exch 796; 155 ER 767.

[37] One of the cases referred to in argument was *In the matter of the Worcester Corn Exchange Company* (1853) 3 De G M & G; 43 ER 71. In that case a deed of settlement company that had been formed to construct a corn exchange gave power to the directors to borrow under certain conditions, and power to make calls up to the amount unpaid on their respective shares. When the capital of the company had been all called up and expended the directors advanced out of their private funds and borrowed from other quarters (but not in conformity with the provisions of the deed) an amount sufficient to pay the extra expenditure which had been incurred. The company was wound up.

Lord Cranworth LC held that the shareholders were not liable to reimburse the directors. In his view, the provision in the deed that limited the liability of the shareholders to 5 pounds per share was decisive, as between the shareholders and the directors. In *German Mining Co* counsel referred the judges to the decision in *re Worcester Corn Exchange Company*. Knight Bruce LJ dealt with it (at 36 of 4 De G M & G, 421 of 43 ER) by saying that it "related to an association formed only for the purpose of a particular and limited speculation in building" and on that basis was distinguishable. Turner LJ distinguished it on a similar basis (43 of 4 De G M & G, 424 of 43 ER). The explanation for how the two cases could be distinguished appears most clearly from the remarks of Turner LJ concerning the first type of liability that was in issue in *German Mining Co* 4 De G M & G at 42, 43 ER at 423-4):

> It was said that this was a concern with limited capital, and that the directors could not be justified in expenditure beyond the capital; but this deed must be construed like other partnership deeds. In all such cases the capital is limited, but the engagements of the partnership cannot be measured by the extent of the capital. New undertakings were not indeed to be entered into after the full capital has been expended, nor is it suggested that any such were entered into, but how was the expenditure upon the existing undertakings to be measured by the extent of the capital? Was the concern to be stopped at the moment when the expenditure equal to the capital, and how in a concern of this nature was it to be ascertained when that moment had arrived?

He returned to the theme concerning the second type of disputed liability (4 De G M & G at 53, 43 ER at 427-8):

> It was argued on the part of the Appellants that the right [of the directors to be indemnified concerning the advances they had made] was excluded, because the capital of the company was limited to £50,000, and no call could be made beyond that amount, except in respect of further capital raised according to the provisions of the deed from which circumstances this conclusion was deduced, that it was the duty of the directors so to conduct the concern, as that a sufficient portion of the capital should always remain in hand to meet the expenses. But in the first place, it was impossible, from the nature of this concern, to foresee what expenses might be incurred or what portion of the capital might be required to meet them; and in the next place the provisions of this deed demonstrate that the parties to it looked to the produce of the mines as a fund to meet the expenses. … The directors, therefore, could not be bound to conduct this concern upon the strict principle contended for by the Appellants, and if they were entitled to look to the produce of the mines as a fund to meet the expenses, how with the expenses to be met if the produce was at any time insufficient for the purpose, and the directors were not at liberty, as between them and the shareholders, to make any advances for the purpose?

However, if one accepts the distinction between the extent of the powers of the directors to deal with third parties, and their powers for the purpose of the rights against the shareholders, *German Mining Co* was a situation where the shareholders in question, by becoming shareholders, had agreed to the directors having power to operate the business. Further, Turner LJ held that as a matter of construction of the deed, the liability of the shareholders was not limited to their capital contributions. Thus they had the usual liability of partners to contribute to partnership liabilities.

Turner LJ then dealt with another argument[38]:

> "it was strongly argued by the appellant's counsel that, whatever might be the right of the directors to indemnity against the property of the company, they could have no such right against the shareholders personally; that the liability of the shareholders was limited to their respective shares of the £50,000. But I think that, where parties place others in the position of trustees for them, they are in equity personally bound to indemnify them against the consequences resulting from that position. I may refer to the case of *Balsh v Hyhan*[39] as a strong authority in support of that position."

This is a narrower proposition than his earlier statement that "all trustees are entitled to be indemnified against expenses bona fide incurred by them in the due execution of the trust." All the shareholders against whom contribution was sought would have been original shareholders in the company. It was accurate to say that the shareholders had "placed the directors in the position of being Trustees for them" because the shareholders would have applied for and been granted their shares on the terms of the deed of settlement. Thus each of the shareholders would have agreed to these trustees becoming trustees, with the powers that the deed of settlement gave to them.

Turner LJ finished his judgement by saying: "I have treated the case throughout as if all the respondents were directors. One of them, I observe, was a shareholder only; but I do not think that this varies the case.[40]" At first sight this remark is puzzling, but an explanation can be found for it. Even though the shareholder-guarantor was not himself a director, and thus had no authority from the other shareholders to carry on the business, he had guaranteed debts that were also guaranteed by the directors. For the directors to enter the guarantee on their own behalf was within the powers conferred on them. To the extent that the non-director guarantor had paid more than other shareholders to meet the debts that the directors had incurred, he would be entitled to contribution from the other shareholders.

This final remark of Turner LJ brings to light a looseness in his analysis. What the directors were entitled to from the other shareholders was not full indemnity, but contribution. Turner LJ's allowing the amounts they had paid to discharge the guarantees as proved debts in the winding up of the company had the effect of granting them contribution, not indemnity.

When Lindley LJ said[41] that "the principle acted upon in *Balsh v Hyham*" was recognised in *Re German Mining Co* he did not notice that the principle articulated by Turner LJ, which depended on the shareholders having placed the directors in the position of trustees, was narrower than the rule that Lindley LJ had articulated. Nor did he give any weight to the extent to which the outcome of *Re German Mining Co* depended on the nature of a deed of settlement company, and the law of partnership. The directors were a special type of trustee, namely trustees who were also partners

[38] 4 De G M & G at 54, 43 ER at428
[39] [sic] 2 P Wms 453
[40] 4 De G M & G at 56, 43 ER at 429
[41] *Hardoon* at 124

with their cestuis que trust. Other types of trustees need not have the same rights as that type of trustee.

1.3.4 The four share transfer cases

Lord Lindley also relied upon four cases[42] that had held that a trustee of shares was liable to be indemnified for calls by his *cestui que trust*. Those cases fall into two different categories.

1.3.4.1 The Stock Jobber Cases

In two of the cases[43], a plaintiff had sold shares on the stock exchange to a jobber, who on-sold them. A transfer to the defendant, the eventual purchaser, had been carried through almost completely, but not to the extent of the plaintiff ceasing to be the registered holder, before the company went into liquidation and a call was made on the plaintiff. In those cases it was argued that the intervention of the jobber had the consequence that there was no privity of contract between the plaintiff and the defendant, and so there could be no implied term requiring indemnity in any contract of sale. In both of the cases the judge spoke as though the defendant being a trustee for the plaintiff was the reason why the defendant had an obligation to indemnify the plaintiff concerning the call.

These two cases should be understood bearing in mind the obligations that arise when there is a transfer of partly paid shares pursuant to an agreement for sale, and how sales of shares on the London stock exchange operated at the time.

When there is an agreement for sale of property that can generate liabilities there is an implied term that the purchaser will indemnify the vendor against any liabilities that arise after the purchaser obtains the benefit of the property. Sir William Grant MR explained it in *Wilkins v Fry*[44] concerning the covenants implied in an agreement to transfer a lease:

> "When I speak of covenants that may be exacted independently of positive stipulation, I mean such as are incident to the nature of the contract, and presumably therefore in the contemplation of both the parties to that contract. When a lessee carries his lease to market, his intention must be, at one and the same time, to get quit of the burthen, as well as of the benefit, of his lease; and, although he cannot do that effectually as between himself and his lessor, to whom he must still continue bound, yet he can obtain an indemnity from the vendee of the lease, and it is reasonable that that indemnity should be given by the person who is to be immediately invested with all the beneficial interest in that lease."

A similar implied term to indemnify against calls which might be made arises concerning agreements to transfer shares. In *Kellock v Enthoven*[45] A, a registered holder of company shares, transferred them to B, who also became registered holder. B then transferred them to C, who became registered holder. The company went into liquidation. C, as a contributory, was liable to pay calls, but did not do so. Because A and B had both been registered holders within a year prior to the liquidation the liquidator placed each upon the B list of contributories, and made a demand to each of them for the calls. A compromised with the liquidator, and paid a reduced amount in full

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[42] *Castellan v Hobson* (1870) LR 10 Eq 47; *Loring v Davis* (1886) 32 Ch D 625; *James v May* (1873) LR 6 HL 328 and *Hughes-Hallett v Indian Mammoth Gold Mines Co* (1882) 22 Ch D 561

[43] *Castellan v Hobson* and *Loring v Davis*

[44] (1816) 1 Mer 244 at 263-264, 35 ER 665 at 672

[45] (1873) LR 8 QB 458, affirmed in the Exchequer Chamber (1874) LR 9 QB 241 on the same basis of principle.

satisfaction of his liability. He then sought indemnity for that amount from B. The Court of Queen's Bench held that B was liable to indemnify A, on the basis of an implied contract of indemnity. The implication that arose was that when A transferred the entire benefit of the shares to B, B became obliged to indemnify A against all burdens of that property[46].

In *Grissell v Bristowe*[47] Cockburn CJ[48] explained how stock jobbers operated on the Stock Exchange in London in the mid nineteenth century. He said that jobbers were:

> "… persons who buy stock and shares on the Stock-Exchange, not for the purpose of investment or of speculation, but for that of immediate sale at a slight advance of price to persons wanting to buy, making a profit by what is termed the turn of the market. It is the practice of the Stock-Exchange for jobbers, on the re-sale of stock or shares bought by them, to give the name of the party from whom, together with the price at which, they have bought, to the brokers of the parties buying from them, on a ticket used for that purpose. When the time for completing the purchase with the original seller arrives, the broker of any sub-vendee hands the ticket, on which he has inserted the name of such sub-vendee, together with the quantity of stock bought, and the price, to the broker of the original seller, who thereupon makes out a transfer of the stock or shares from his principal, the seller, to the sub-vendee named on the ticket, and, having procured the execution by his principal, hands over the transfer to the broker of the sub-vendee, on receiving the price due to the original vendor, – any difference in the price being accounted for on settlement between the jobber and the brokers. By this means, the last purchaser obtains the shares at the price he has agreed to pay, and the seller, who parts with his shares, receives the price at which he has sold. The transaction is frequently multiplied by intermediate sales, often at varying prices, of all which the particulars are entered on the ticket: but the result is the same; in the end the transaction becomes one which is to be carried out between the last vendee and the original seller, as though such vendee had purchased immediately of such seller."

While the matter remained one merely of a contract between the vendor and the jobber, the jobber would have had the usual obligation of a purchaser to indemnify the vendor against liabilities that arose after the purchaser had the benefit of the shares. However the practice of the Stock Exchange was that the jobber has[49]:

> " … a right to transfer the contract, and claim exemption from liability in respect of it, only on his giving the name of a buyer to whom the seller has no reasonable ground to object. … it is only when the nominee or nominees of the jobber have paid for the shares, – in other

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[46] The implied term is clearly stated in 8 QB by Blackburn J at 464, Quain J at 466 and Archibald J at 467, and in 9 QB at 246-248. In *Wynne v Price* (1849) 3 De G M & G 310; 64 ER 493 a similar result was reached concerning a contract for the sale of shares that had been reached between the broker for the plaintiff and the broker for the defendant, each acting with the authority of his client. The vendor executed a transfer, received the price, gave authority to the company secretary to deliver the share certificate (which had not yet issued) to the purchaser and received a written undertaking by the secretary to do so. The defendant did not register the transfer, and the plaintiff was later required to pay a call. Sir J L Knight Bruce VC, at 3 De G M & G 315, 64 ER 495 began his brief judgement with terse directness: "The facts of this case effectually precluded the Defendant from denying privity between him and the Plaintiff. The defence is without apology or excuse. The Defendant must pay the calls that have been made since the sale. He must indemnify the Plaintiff against all future calls in respect of the shares, and must take proper measures to procure himself to be registered."

[47] (1868) LR 4 CP 36, a decision of the Court of Exchequer Chamber, delivered by Cockburn CJ with whom Kelly CB, Channell and Piggott BB and Lush J concurred

[48] At 42- 43

[49] Ibid at 46

> words, have accepted the transfer, and placed themselves in the position of buyers, and taken upon themselves the obligations of the contract, – that the jobber is held to be released."

Cockburn CJ said that the jobbers[50]:

> "would not have satisfied the exigency of the contract, as qualified by the usage, by merely giving the names of parties able to carry out the contract, unless those parties had placed themselves under the same obligations as they themselves were under; yet, as soon as they produced persons who paid the price and accepted the transfers, and thereby took upon themselves the ulterior liabilities of the contract, they had done all which according to the contract they undertook to do."

He held that when "the seller adopted the substituted parties as the buyers, and the price was paid by the one and the property transferred by the other, *a contract* and the relation of vendor and vendees immediately arose between them"[51]. This view, that the contract between the vendor and the jobber is novated when the ultimate purchaser is accepted and the price paid, and that it is through an implied term in the contract as so novated that the obligation of the transferee to indemnify arises, can be explained only by reference to the custom of the market[52].

Courts of equity came to the same result by a different route. It was that when the transferor had executed and handed over a transfer of the shares and the appropriate share certificate and the transferee has paid the purchase price, the transferor held the shares as trustee for the transferee, and the transferee came to be under an equitable obligation to indemnify the transferor against liabilities that thereafter arose concerning the shares.

Such an equitable obligation was recognised in the Court of Appeal in Chancery in *Coles v Bristowe*[53]. In *Coles* the plaintiff, through his brokers, sold 200 shares in a company to the defendants, who were jobbers. On the name day, the defendants gave to the plaintiff's broker the names of 17 people as ultimate purchasers. The brokers of the vendor prepared 17 deeds of transfer, had them executed by the vendor, and on the settling day handed them with share certificates to the jobbers, who thereupon paid the agreed price. The 17 transferees in turn had paid the purchase money to the jobbers, and had received but not executed the deeds of transfer. The company then went into liquidation, and calls were made on the plaintiff. The action was one by the plaintiff against the jobbers, seeking indemnity against the calls. The action failed, but in the course of giving the judgement of the Court Lord Cairns LC said[54]:

> "the whole 200 shares and the transfers of them were duly accepted and paid for by the transferees, and that *these transferees were in equity as much bound as if they had executed the deeds.*"

He explained the legal obligations of a jobber as follows [55]:

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[50] at 50
[51] at 51 (emphasis added)
[52] There is support in other cases for such a contract arising through the custom of the market – eg *Hawkins v Maltby* (1867) LR 4 Eq 572 at 577.
[53] (1868) 4 Ch App 3
[54] at 9 (emphasis added)
[55] at 11-12 (emphasis added)

> "the contract of the jobber is that at the settling-day he will either take the shares himself, in which case he would, of course, be bound to accept and register a transfer and to indemnify, or he will give the name of one or more transferees, names to which no reasonable objection can be made, who will accept and pay for the shares. The jobber may perform either alternative; and if, electing to perform the latter alternative, he sends in names which are accepted, and to which transfers are executed, and those transfers are taken and paid for by the transferees or their brokers, the jobber is then and at that stage relieved from further liability, *and the liability to register and indemnify is shifted to the transferees*."

His Lordship summarised certain cases that had been cited in argument as being[56]:

> "cases in which it was held that when, after a contract by a vendor with a jobber or intermediate person, a transfer has been executed by the vendor to, and accepted and paid for by, a third person, the vendor may file a bill against such third person, and oblige him to register and indemnify. From what we have said it will be seen that in the principle of those cases we concur."

When his Lordship said "file a bill" he was using language appropriate to bring an action in Chancery rather than at common law.

It accords with equitable principle that there should be an obligation to indemnify in these circumstances. When the transferor of shares has executed and handed over to the transferee a registrable transfer of the shares, and any share certificate, and has received the purchase price, there has been an effective equitable assignment of the shares, so that the transferor holds them as a trustee for the transferee [57]. When the beneficial interest has passed to the transferee, equity would follow the law in holding that an obligation to indemnify against future liabilities, analogous to the implied term that arises under a contract for the sale of shares, would arise in equity's exclusive jurisdiction.

That the registered holder of shares who has become a bare trustee of them for a transferee has an equitable right to be indemnified concerning future calls was recognised in the speech of Sir Barnes Peacock in the Privy Council in *Levi v Ayers*[58]:

> "The equity of the Plaintiff, if any, against the trustees must be founded upon these two propositions, or one of them, viz.: 1st. That the transferee of shares in a company formed under the Companies Act, 1862 , who takes the beneficial ownership, is bound to indemnify the transferor against all liabilities in respect of them subsequent to the date of the transfer; 2nd. That a trustee whose name is on the register, though personally liable as a shareholder, is entitled to be indemnified by his *cestui que trust.*
>
> These propositions, as general rules, are indisputable."[59]

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[56] at 13-14

[57] the transferor has "done everything which, according to the nature of the property comprised in the settlement, was necessary to be done in order to transfer the property"(*Milroy v Lord* (1862) 4 De G F & J 264 at 274, 45 ER 1185 at 1189 per Turner LJ). Satisfaction of that test is sufficient to effect a voluntary equitable assignment of property assignable at law. That the transferor has received consideration, even if from a person with whom he is not in a contractual relation, should not make the assignment any less effective.

[58] (1878) 3 App Cas 842 at 852-3+

[59] He went on to hold that the equitable right of indemnity did not exist when the transferee was the trustee of a deed who was assigned property for the benefit of the creditors of the transferor. This is not an exception

These propositions are narrower and more precise than Lord Lindley's rule.

The two cases on which Lord Lindley relied that related to sales of shares on the stock exchange through a jobber were both decided by single judges, after *Coles v Bristowe*. It is hardly a surprise that each judge spoke as though it was elementary that a cestui que trust of shares that had been acquired in such a manner had an obligation to indemnify the registered holder against calls[60]. However, that the registered holder of shares, who has become a trustee of them through this sort of dealing on the stock exchange, has a right to be indemnified by his *cestui que trust* against liabilities that arise from the shares after the transfer provides no basis for concluding that trustees of any type of property whatsoever, who become trustees in any type of circumstances whatsoever, are entitled to be indemnified by their *cestui que trust.*

1.3.4.2 Becoming Trustee at Defendant's Request

The other two cases on which Lord Lindley relied concerning the obligation that a *cestui que trust* of shares has to indemnify the trustee against calls each related to a situation where the *cestui que trust* had requested the trustee to become the trustee of the shares. In *James v May*[61] the plaintiff had acquired some shares in the W company at the request of the C company. The C company paid for the shares, and gave the plaintiff £15 for his troubles. The plaintiff executed transfers of the shares, and gave them to the C company. The plaintiff was entitled to be indemnified by the C company[62]. In an extempore judgement Lord Chelmsford said[63] "by a very well-known principle of Equity, he was entitled to be indemnified by his *cestui que trust* against any liability that might arise out of the transaction", and "this is the ordinary case of a trustee being indemnified by his *cestui que trust*"[64]. Lord Cairns said[65] "there is nothing in the case but the ordinary right of a trustee to be indemnified by his *cestui que trust* from liability.". The case is explicable on the basis that the plaintiff became trustee at the request of the defendant of property that had an inherent capacity to give rise to future liability for calls.

Similarly in *Hughes-Hallett v Indian Mammoth Gold Mines Co*[66] the plaintiff applied for shares in the company at the request of the defendant, and on the basis that he would hold the shares as a trustee for the defendant, and that the plaintiff would execute a transfer of the shares to the defendant which would be sent to the company for registration within two or three weeks. The defendant provided the plaintiff with the application money. The plaintiff was held to be entitled to

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to Lord Lindley's rule because the *cestui que trust* does not have an absolute beneficial interest in the property – he is obliged to deal with it for the benefit of the creditors.

[60] In *Loring v Davis* at 634 Chitty J said:

> "If a man makes a transfer, there being no previous contract whatever, and executes a transfer to another of shares or stock, on the face of the transfer it is a sale, and if the intended transferee pays the purchase-money upon the transfers, and takes the transfer into his own possession and keeps it, has not the transferee by thus accepting the transfer of the shares, as between himself and the transferor become the equitable owner of the shares, and that notwithstanding that the transferee does not execute the transfer? I say … that *Davis* has become equitable owner of the shares, and therefore it follows that as equitable owner of the shares he is bound to indemnify the person who legally holds the shares for him as the only and absolute *cestui que trust*."

This statement of principle is more complex, and narrower, than Lord Lindley's rule.

[61] (1873) LR 6 HL 328

[62] the defendant was the liquidator of the C company

[63] At 333

[64] At 333

[65] At 334

[66] (1882) 22 Ch D 561

an indemnity from the defendant for liability connected with the shares, and the only issue was whether the action seeking indemnity was brought prematurely.

1.4 Cases with a narrower or different ratio than Lord Lindley's

There is no shortage of cases before *Hardoon* that put the entitlement of a trustee to an indemnity on a narrower basis than Lord Lindley did. Any number of cases refer to the trustee's right of indemnity from the trust property, without saying anything about a personal right of indemnity from the beneficiaries[67]. Cases that put the basis of a beneficiary's personal obligation to indemnify as arising from the beneficiary having requested the trustee to become trustee include *In re National Financial Co*[68], *Hemming v Maddick*[69], *Jervis v Wolferstan*[70], *Hobbs v Wayet*[71] and *Wynne v Tempest*[72]. However it cannot even be said that all cases where the cestui que trust requests that trustee to become trustee are ones where the there is an obligation to indemnify. In *Fraser v Murdoch* Lord Blackburn said[73]:

> It was argued that the maker of a trust is personally bound to indemnify the trustees for all costs and liabilities properly incurred in the execution of the trust, but I do not think this is the law. No doubt any one who requests another to incur a liability which would otherwise have fallen on himself is, in general, bound, at law as well as in equity, to indemnify him; this principle applies to many cases, and where a trust is for the benefit of the maker of the trust it may apply to a trustee. *Balsh v. Hyam*[74] is a good example of a case where it did apply, and there are many others. In *Jervis v. Wolferstan*[75] the Master of the Rolls goes so far as to say, "I take it to be a general rule that where persons accept at the request of another, and that other is a *cestui que trust*, he is personally liable to indemnify the trustees for any loss accruing in the due execution of the trust." Perhaps this rule is too broadly stated, as something must depend on the nature of the trust and of the interest of the *cestui que trust*, but it is not necessary now to say more than that this rule has no application to a case where the maker of the trust is not a *cestui que trust*.

The passages that I have underlined n this quotation show how undogmatic Lord Blackburn was being.

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[67] *Amand v Bradbourne* (1682) 2 Chan Cas 138; 22 ER 884 and *Worrall v Harford* (1802) 8 Ves Jun 4 at 8, 32 ER 250 at 252 are early examples

[68] (1868) LR 3 Ch 791

[69] (1872) LR 7 Ch 395

[70] (1874) LR 18 Eq 18

[71] (1887) 36 Ch D 256

[72] [1897] 1 Ch 110. Chitty J said at 113:" A right to indemnity may arise under an express or implied contract, or by reason of an obligation resulting from the relation of the parties. Such an obligation arises in equity from the relation of the parties where two trustees are liable for a breach of trust and one has applied the trust fund to his own use: in that case the trustee who has so misapplied the fund is liable to indemnify his co-trustee; so where a man has requested another to hold as trustee for him shares upon which there is a liability for calls or the like, the trustee is entitled to an indemnity, not merely out of the trust property, but by the cestui que trust personally. I give these two cases merely by way of illustration. "

[73] (1881) 6 App Cas 855 at 872 – 3 (my underlining)

[74] [sic] 2 P. Wms. 453

[75] Law Rep. 18 Eq. at p. 24

Other cases had put the obligation to indemnify as arising when the person who was in commercial reality the purchaser of partly paid shares had arranged for an impecunious workman[76] or an infant[77] to become the transferee. Equity is unlikely to let this sort of device succeed, and will look to the substance of the transaction.

In all these circumstances the fact that Lord Lindley's rule has become so well embedded in the law should not dissuade the Commission from abolishing or altering it.

Part 2 Whether the trust instrument can negate a personal obligation to indemnify

I suggest there is no real doubt that it is possible for the terms of a trust instrument to negative any personal right of indemnity from a beneficiary that the trustee might otherwise have. In *Hardoon*[78] Lord Lindley said that in the case where there were "special trusts limiting the right to indemnity":

> "there is no beneficiary who can be justly expected or required personally to indemnify the trustee against the whole of the burdens incidents to his legal ownership; and the trustee accepts the trust knowing that under such circumstances and in the absence of special contract his right to indemnity cannot extend beyond the trust estate, i.e., beyond the respective interests of his *cestui que trustent* [sic][79]"

There have been repeated decisions since then, though usually based in part on *Hardoon*, that it is possible to remove the personal obligation to indemnify[80].

If *Hardoon* is itself under a cloud that might raise a question about whether cases that relied on it are themselves suspect. However it was recognised well before *Hardoon* that the trust deed can remove any personal right of action for indemnity that the trustee has against the beneficiary. In *Gillan v Morrison*[81] the deed establishing a joint-stock company provided expressly that "no person subscribing these resolutions shall be liable for any sum of money beyond the instalments paid upon his shares."[82]. It also provided that the trustees would have the control and management of the fund. When the expenses exceeded those budgeted the trustees sought contribution from the subscribers, but failed. Sir J L Knight Bruce LJ said:

> " … according to the true construction of the contract, the trustees, choosing to undertake the expedition, and to have the conduct of it, undertook, as between themselves and the shareholders, the whole risk of the expedition, exceeding £1500, the amount fixed by the resolutions."

Other cases that held that a sufficiently clear provision in the deed of a deed of settlement company could limit the liability of the shareholders to contribute to liabilities incurred by the trustees are *In*

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[76] *Castellan v Hobson* (1870) LR 10 Eq 47

[77] *Brown v Black* (1873) LR 15 Eq 363, affirmed (as to entitlement to indemnity) *Brown v Black* (1873) 8 Ch 939

[78] at 127

[79] "cestui que trustent" is not the plural of cestui que trust – *Re French Caledonia Travel Service Pty Ltd* [2003] NSW SC 1008, 59 NSWLR 361 at [155]

[80] *RWG Management Ltd v Commissioner for Corporate Affairs (Vic)* [1985] VR 385 at 394; *McLean v Burns Philp Trustee Co Pty Ltd* (1985) 2 NSWLR 623; *Causley v Countryside (No 3) Pty Ltd* (NSW Court of Appeal, 2 September 1996, unreported); *Chief Commissioner of State Revenue v CCM Holdings Trust Pty Ltd* [2014] NSWCA 42 at [72] per Gleeson JA. It is also recognised in JD Heydon and MJ Leeming, *Jacobs' Law of Trusts in Australia* (Lexis-Nexis Butterworths Australia 8th edition 2016) [21-06].

[81] (1847) 1 De G & Sm 421; 63 ER 1131

[82] 1 De G & Sm at 422; 63 ER at 1132

the matter of the Worcester Corn Exchange Company[83] and *German Mining Co*[84]. In *German Mining Co* Turner LJ said[85]:

> "a company's deed, or any other deed, may be so framed as to deprive directors or trustees of the right to indemnity, and, if parties think proper to accept directorships or trusts under deed so framed, they must abide by the consequences; but the right of indemnity is incident to the position of a trustee, and if it is sought to exclude that right, the provisions for that purpose must, as I apprehend, be clearly expressed".

Turner LJ found that a provision in the trust deed of a joint-stock company that stated that the capital of the company was £50,000 and no call could be made beyond that amount (except for further capital raised in accordance with the provisions of the deed itself) was insufficient to exclude the personal right of action against the shareholders.

This outcome is consistent with basic principles of the law of trusts, that the duty of the trustee of a trust is to perform bona fide the office of being trustee of that particular trust[86], and that the beneficiary of the trust has whatever rights the trust deed gives, on the terms on which the trust deed gives those rights. While there are provisions of law that affect the operation of trusts, they are nearly all default rules, capable of modification by the trust instrument, except to the extent that they fall within the irreducible core of a trust. There is no basis for saying that a legal arrangement would not be a trust if it lacked a provision for the beneficiary to provide the trustee with a personal indemnity. Even on Lord Lindley's rule there would be no personal obligation to indemnify in trusts for minors or other incapable people, in trusts that settled property in succession or with defeasible interests, or in discretionary trusts – all unarguable trusts even though they lack any obligation to provide a personal indemnity.

A provision in a trust instrument that negatived a trustee's right to personal indemnity from a beneficiary might be ineffective if there was a basis for attacking the trust deed itself, such as fraud, or misrepresentation, or undue influence, or if the entry of the trust deed, or some provision in it, was contrary to a statute. Such a provision might also be ineffective if, in the circumstances of the particular trust deed and a particular beneficiary, there was an equity which prevented the beneficiary from relying on the provision. Such a situation could arise if the beneficiary was estopped from relying on the provision, or had contracted not to rely on it. The possibility of a provision in the trust deed that negatived any right of indemnity of the trustee being itself found to be inoperative for a reason such as this is not a defect in the law, and does not call for any action on the part of the Commission.

Part 3. Extent of any possible liability of a beneficiary of a superannuation fund to provide a personal indemnity

If Lord Lindley's rule remains unaltered a beneficiary of a superannuation fund will usually not have any obligation to indemnify the trustee, but (subject to the argument raised in part 4 of this submission) there will be some situations where such an obligation to indemnify could arise. The reason why the beneficiary will usually not have any such obligation arises from Lord Lindley's

[83] (1853) 3 De G M & G; 43 ER 71
[84] (1853) 4 De G M & G 19; 43 ER 415
[85] 4 De G M & G at 52; 43 ER at 427
[86] *Segelov v Ernst & Young Services Pty Ltd* [2015] NSWCA 156, 89 NSWLR 431 at [53] [109]

requirement that the beneficiary with the obligation to indemnify be solely entitled to the trust fund.

Usually in a superannuation fund there is no particular asset that is held on trust for a particular person. One reason for this is that in large part the assets of the fund are administered as a pool, to provide the benefits to which various people become entitled under the rules of the fund, without any particular asset or group of assets being appropriated to the payment of any particular benefit to a particular person. Another reason is that at any one time it usually will not be possible to identify a particular person as the one who has a right to receive a particular benefit in the future. Even in relation to the account of a particular member of the fund it is usually not possible to identify the person who will become entitled to a benefit deriving from that account. Commonly, whether any particular person is entitled to receive a benefit depends upon whether certain factual preconditions have arisen. For example, the entitlement of a member to receive a pension or lump sum benefit might depend upon the member having attained a particular age and retired, the entitlement of a member's executor to receive a payment might depend upon the member having died before retiring, the entitlement of a spouse or de facto of the member to receive a benefit might depend upon the member having executed a nomination in favour of that spouse or de facto, or upon the trustee exercising a discretion in favour of that spouse or de facto. Until the conditions have arisen that entitle a particular person to receive a benefit it could not be said that there is any particular person who will receive all the benefit of any trust.

However, once an event has happened which entitles a member or other person to receive a particular benefit from the fund, the member or other person has a specific entitlement to be paid a specific amount from the fund [87]. Drummond J has described such an event as one that "will crystallise the member's "account" into an actual beneficial entitlement"[88]. It will not always happen that a trustee pays a benefit as soon as someone has an entitlement to be paid it[89]. And thus, at least sometimes, the condition laid down by Lord Lindley for the existence of the personal right of indemnity might arise.

In *Caboche v Ramsay*[90] the issue was whether Alan Bond had an entitlement to be paid money from a superannuation fund at a date prior to his bankruptcy. If he had such an entitlement, section 58 *Bankruptcy Act 1966 (Cth)* vested in his trustee in bankruptcy the amount that Mr Bond was entitled to be paid. The fund in question was one of which Mr Bond was the sole member. He retired from the employment of his employer, but not from the workforce, before he reached the age of 55. Under the rules of the fund he became entitled to receive a lump sum of an amount permitted by the legislation governing superannuation, and a preserved benefit of whatever remained of his account balance in the fund[91]. The "preserved benefit" was one that could not be paid to the

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[87] *Re Coram; ex parte Official Trustee in Bankruptcy v Inglis* (1992) 36 FCR 250 at 255 per O'Loughlin J; *Jeffcoat v Queensland Coal & Oil Shale Mining Industry (Superannuation) Ltd* [2000] FCA 655 at [12] per Kiefel J

[88] *Australian Securities & Investments Commission, in the matter of QLS Superannuation Pty Ltd v Parker* [2003] FCA 262; (2003) 21 ACLC 888 at [4].

[89] In *Jeffcoat* a member who was entitled to be paid a benefit upon his retirement requested that it remained in the fund, where it stayed until the member died nearly 5 years later – see at [2]. Leaving benefits in a fund rather than taking them out could sometimes be a successful tax minimisation strategy.

[90] (1993) 119 ALR 215

[91] There was a difference of opinion between the judges as to the precise rule under which his entitlement arose – Ryan and Lee JJ held that the entitlement arose under rule 14(1), while Gummow J held that it arose

member before the member reached the age of 55, unless one of a limited group of circumstances applied[92]. In fact none of those limited circumstances applied. As a matter of the construction of the rules of the particular fund, the vesting of the benefit did not depend on the making of any demand on behalf of Bond[93]. The court held that entitlement to both the lump sum benefit, and the preserved benefit, were rights that Mr Bond had, and that vested in his trustee in bankruptcy.

But that a particular person has a vested right to receive a particular sum from the trustee of a superannuation fund does not necessarily mean that that person has all the benefit of a trust. He or she has an equitable right to be paid a particular sum, and the trustee has an obligation to use the fund assets to pay that sum. However, unless there is particular property appropriated to payment of the benefit (as there was in *Caboche*, where Mr Bond was the only member of the fund) there would not be a trust of which the person had the whole benefit.

However, even in multimember funds sometimes the rules of the fund are such that a particular person has an equitable interest in a particular asset that the trustee holds. For example, there have been superannuation funds in which the trustee is required to take out a policy of life insurance to fund the benefits attributable to each member[94] – when the proceeds of that life policy have been paid or become payable, and the person to whom the proceeds are payable has been ascertained, the trustee holds the entitlement receive the proceeds, or the proceeds themselves, on trust for that person[95]. In that sort of circumstance there could be a personal obligation of the beneficiary to indemnify the trustee, on Lord Lindley's formulation.

That sort of situation would not arise commonly, but it could arise. The liabilities concerning which the obligation to indemnify arose would be liabilities concerning the particular trust in which the beneficiary had the whole interest. The personal right of indemnity could become a live question if there was some expense connected with the particular fund that the trustee had failed to take from the fund before it was paid to the beneficiary.

4. Effect on Lord Lindley's rule of the right to indemnity from the fund

Lord Lindley's formulation of the rule about when there is a personal obligation to indemnify encounters a particular problem from the legal nature of the trustee's right of indemnity from the assets of the trust fund. According to Lord Lindley the personal right to indemnity arises only when the beneficiary has the entire interest in the trust fund.

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under rule 9(2) – but that difference of opinion is not important for present purposes, as the difference between the two rules concerned the triggering events for each rule, while the consequences under each of the rules were the same, namely that Mr Bond had an entitlement to receive a lump sum amount, and a preserved benefit.

[92] including retirement before the age of 55 on the grounds of permanent incapacity or permanent invalidity, death of the member, and permanent departure of the member from Australia- see page 217-218.

[93] P 218 per Ryan J, 230 per Gummow J,

[94] Examples in the case law are *McFadden v Public Trustee for Victoria* [1981] 1 NSWLR 15 at 17, *Benson v Cook* (2001) 114 FCR 542 at [29], which Beaumont J found at [42] to be a form commonly used in the industry.

[95] In *Cook v Benson* [2003] HCA 36, 214 CLR 370 the trustee had received the proceeds of a life policy on the life of a member, and had an obligation to pay the proceeds to the member or as he directed. Gleeson CJ,, Gummow, Hayne and Heydon JJ at [24] approved the statement by Beaumont J in the Full Federal Court that by then the member "was beneficially entitled to that amount as a chose in action indefeasibility vested in him."

It is likely that Lord Lindley would have regarded the trustee's right of indemnity from the assets as giving rise to a lien over the fund, not an interest in it. However the High Court has repeatedly held that the trustee's right of indemnity from the assets gives the trustee a beneficial interest in the trust fund[96]. In *Octavo Investments Pty Ltd v Knight*[97] (Stephen, Mason, Aickin and Wilson JJ spelt out the consequences of this:

> "The trustee's interest in the trust property amounts to a proprietary interest, and is sufficient to render the bald description of the property as "trust property" inadequate. It is no longer held solely in the interests of the beneficiaries of the trust …"

The accepted modern analysis is that the trustee's right of indemnity is not an equitable lien, because one cannot have a lien over property of which one is the legal owner. Rather it is a right of the trustee to resort to the fund in priority to any right of the beneficiaries[98].

But if the trustee's right of indemnity is itself a beneficial interest in the fund, Lord Lindley's statement of the rule could only apply in those trusts concerning which the trust deed had removed the usual right of indemnity from the assets. And, while there is no difficulty of principle about a trust deed removing the general law right of indemnity of the trustee from the assets, the law of each state and territory gives a trustee a statutory right of indemnity from the assets[99]. There are differing decisions in different states about whether it is possible for the statutory right to be removed[100]. The New South Wales position is that the statutory right of indemnity from the assets cannot be removed. This is sufficient to show that Lord Lindley's rule cannot continue to state the law in New South Wales: at the least some modification to it is required.

It would be preferable, in my view, for legislation to state that the beneficiary of a trust has no personal obligation to indemnify a trustee for expenses arising from the administration of the trust

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[96] *Octavo Investments Pty Ltd v Knight* (1979) 144 CLR 361 at 367-370; *Commissioner of Stamp Duties (NSW) v Buckle* [1998] HCA 4; (1998) 192 CLR 226 at [47] – [51]; *CPT Custodian Pty Ltd v Commissioner of State Revenue* [2005] HCA 53; 224 CLR 98 at [49]-[51]. Other authority to the same effect is *Re Enhill Pty Ltd* [1983] 1 VR 561 at 567; *Re Suco Gold Pty Ltd (In liq)* (1982) 33 SASR 99 at 104, 107; *Kemtron Industries Pty Ltd v Commissioner of Stamp Duties (Q)* [1984] 1 Qd R 576 at 580, 584, 587; *Custom Credit Corporation Ltd v Ravi Nominees Pty Ltd* (1992) 8 WAR 42 at 52, 55, 57; *Agusta Pty Ltd v Provident Capital Ltd* [2012] NSWCA 26 ; (2012) 16 BPR 30,397 at [42]. *Dodds v Tuke* (1884) 25 Ch D 617 at 619.

[97] (1979) 144 CLR 361 at 370, a passage quoted in part by Brennan CJ, Toohey, Gaudron, McHugh and Gummow JJ in *Commissioner of Stamp Duties (NSW) v Buckle* [1998] HCA 4; (1998) 192 CLR 226 at [50]

[98] *Chief Commissioner of Stamp Duties (NSW) v Buckle* [1998] HCA 4, 192 CLR 226 at [49]-[51]; *CPT Custodian Pty Ltd v Commissioner of State Revenue* [2005] HCA 53; (2005) 224 CLR 98; *Agusta Pty Ltd v Provident Capital Ltd* [2012] NSWCA 26 ; (2012) 16 BPR 30,397 at [42]. This analysis is not a modern innovation. Bacon V-C gave it in *Dodds v Tuke* (1884) 25 Ch D 617 at 619.

[99] Section 59(4) *Trustee Act 1925 (NSW)*, section 36(2) *Trustee Act 1958 (Vic)*; section 72 *Trusts Act 1973 (Qld)*; section 71 *Trustees Act 1962 (WA)*; section 35 (2) *Trustee Act 1936 (SA)*; section 27 (2) *Trustee Act 1898 (Tas);* section 59 (4) *Trustee Act 1925 (ACT)* and section 26 *Trustee Act (NT)*.

[100] There are decisions in Queensland (*Kemtron Industries Pty Ltd v Commissioner of Stamp Duties* [1984] 1 Qd R 576 at 584-586; *Jessup v Queensland Housing Commission* [2001] QCA 312; [2002] 2 Qd R 270 at 275), NSW (*JA Pty Ltd v Johnco Holdings Pty Ltd* [2000] NSWSC 147; (2001) 33 ACSR 69 at [87]; *Agusta Pty Ltd v Provident Capital Ltd* [2012] NSWCA 26 ; (2012) 16 BPR 30,397 at [39]) and South Australian (*Moyes V J & L Developments Pty Ltd (No 2)* [2007] SASC 261; [2007] 250 LSJS 61 at [38]-[40] that the statutory right of indemnity cannot be excluded, and a Victorian decision (*RWG Management Ltd v Commissioner for Corporate Affairs (Vic)* [1985] VR 385 at 395) that it can be excluded.

by reason only of the beneficiary being sui juris and entitled to the whole trust fund (apart from any interest of the trustee in the fund arising from a trustee's right of indemnity from the assets).

J C Campbell

6 April 2018