A 'CLEARER' ACCOUNTS RULE: CHALLENGING THE INFLEXIBLE APPLICATION OF THE CLEAR ACCOUNTS RULE

PRANAY JHA*

The clear accounts rule, as applied in a trusts setting, reduces the value of a trustee's right of indemnity by the value of their obligation to restore trust funds. The rule has often frustrated unsecured trust creditors subrogating to a trustee's right of indemnity as the creditors may be unable to have the debts owed to them satisfied as a result of the rule's operation. Much of the case law and academic writing on the clear accounts rule seems to assume that it is a rule of fixed application, applying automatically wherever an errant trustee seeks recourse to their rights of indemnity. This article challenges that understanding of the clear accounts rule by suggesting two alternative bases on which its inflexible application may be avoided. First, the clear accounts rule is examined from a historical perspective, which reveals that the rule and its antecedents were intended to be applied on a presumptive rather than fixed basis. Second, the rule is examined from a normative perspective. It is suggested that, given equity's mandate to achieve practical justice in the taking of accounts, a flexible and discretionary approach to the clear accounts rule that is sensitive to the interests of unsecured trust creditors is justified. Recognising the possibility of circumventing the clear accounts rule has significant implications for unsecured trust creditors. It possibly removes a key obstacle from their only (indirect) route to accessing trust assets in satisfaction of the debts owed to them by the trustee.

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* BA, LLB (Hons I) (Sydney); BCL candidate (Oxon). I am grateful to the Hon Joseph Campbell KC FAAL, Dr Nuncio D'Angelo, Professor Matthew Conaglen and Dr Jeevan Hariharan for their insightful comments and feedback on earlier drafts. All errors remain my own.

I Introduction

The so-called 'clear accounts rule' has been applied in Australia on numerous occasions to reduce the value of an errant trustee's right of indemnity.[1] The authorities to date appear to have assumed that the clear accounts rule has fixed application wherever a trustee seeking to exercise their right of indemnity has caused a loss to the trust estate which the trustee is obliged to make good. Contrary to that assumption, this article argues that an inflexible application of the clear accounts rule is unjustified. It does so on two bases. First, it considers the historical antecedents of the modern clear accounts rule and suggests that the cases from which the rule emanates were intending to lay down rules of presumptive rather than fixed application. In particular, the cases were presuming an errant trustee's intention to pay their indemnity 'by anticipation' through the funds they had misappropriated. That presumption is a weak one, which is capable of displacement by evidence of the trustee's actual intention or the

[1] Relatively recent examples include: *Staatz (as liquidator of Wollumbin Horizons Pty Ltd (in liq)) v Berry [No 3]* (2019) 138 ACSR 231, 284–5 [204]–[206] (Derrington J); *Park v Whyte [No 3]* [2018] 2 Qd R 475, 504–7 [125]–[144] (Jackson J) ('*Park [No 3]*'); *Lane v Deputy Commissioner of Taxation* (2017) 253 FCR 46, 52 [5], 68–9 [54]–[59] (Derrington J) ('*Lane*'); *De Santis v Aravanis* (2014) 227 FCR 404, 424–5 [74]–[77], 426 [82], 432 [106] (Farrell J); *Chu v Lin; Re Gold Stone Capital Pty Ltd (Trial Judgment)* [2024] FCA 766, [246] (Jackman J) ('*Re Gold Stone Capital*').

nature and circumstances in which the breach of trust occurred. Second, recognising that the clear accounts rule need not be tethered to its historical origins and may instead be treated as a freestanding principle of modern equity, this article also challenges the rule from a normative perspective. It is suggested that in light of equity's general mandate to achieve practical justice when taking accounts, a flexible and discretionary approach to the clear accounts rule is justified. That discretion is said to be capable of considering the interests of unsecured trust creditors and their contributions to the state of the trust assets.[2] This article proceeds in five substantive Parts.

Part II frames the discussion by explaining some of the fundamental concepts in this article. It begins by briefly outlining what the clear accounts rule is, before providing the wider context of trustee insolvency, which grants relevance to debates about the application of the rule. This Part explains the position of trust creditors in Australia, who are only able to indirectly access trust assets in satisfaction of their claims by standing in the shoes of an insolvent trustee and receiving the proceeds of their indemnity (ie subrogation). It then shows how those trust creditors are prejudiced by the clear accounts rule, which creates an obstacle in their only path to accessing trust assets.

Part III considers the clear accounts rule from a historical perspective and suggests that the historical foundations of the rule lie in matters of presumption. The Part begins by providing an overview of the clear accounts rule's development in Australia across the 20th century. It shows how the clear accounts rule moved from being expressed as a broad, principled limitation on the trustee's right of indemnity to a more formulaic and mathematical rule. What becomes apparent is that many of the Australian cases justify the clear accounts rule on a historical basis by suggesting the rule is premised on a series of 19th century English cases. An examination of those 19th century cases reveals that the foundation of the clear accounts rule was in presumption — that is, a presumption that the trustee intended to pay their right of indemnity in anticipation through the funds they had earlier misappropriated. The Part also recognises that, independently of such cases, the rule in *Cherry v Boultbee* ('*Cherry*') is also cited as the historical foundation for the

[2] The term 'trust creditor' is defined below in Part II(A). Put simply, a 'trust creditor' is a party to whom a trustee has incurred a debt in their capacity as a trustee. The discussed issues apply only in relation to unsecured trust creditors; those that are secured do not access trust assets via subrogation to the trustee's indemnity but rather do so directly via their security. From here on, 'trust creditor' refers only to those that are unsecured, unless otherwise stated.

clear accounts rule.[3] It suggests, however, that this alternative historical explanation for the clear accounts rule does not advance matters any further, because the rule in *Cherry* itself emanated from rules of presumption. Specifically, the rule in *Cherry* is traced back to cases applying the presumptive doctrine of satisfaction in the context of the administration of deceased estates. It follows that, regardless of which historical account for the clear accounts rule one adopts, the rule's origins lies in presumption. Therefore, there is no historical reason to treat the rule as one of fixed application.

Recognising that the clear accounts rule may now be treated as a freestanding principle of modern equity no longer constrained by its historical origins, Part IV examines the rule from a normative perspective. It considers the function of the clear accounts rule as a technique used by courts of equity in the administration of complex accounts. This Part suggests that in taking accounts, equity is guided by a mandate to achieve practical justice between the parties. This mandate necessitates a flexible and discretionary approach to the clear accounts rule. While the discretion is no longer exercised by reference to abstract notions of justice, this article suggests that two lines of equitable principle provide guidance on how the discretion may be exercised. The first is equity's general concern for third-party interests, as evidenced in cases involving constructive trusts, rescission and rectification. The second is equity's willingness to ensure that parties seeking equitable relief account for all the benefits they have received, as evidenced through the 'just allowances' doctrine applied when ordering an account of profits, occupation rent to co-owners or rescission. It is argued by analogy that beneficiaries seeking equitable relief ought to account for the contributions made by trust creditors to the trust fund.

Part V then considers the broader practical implications of equity exercising its discretion not to apply the clear accounts rule. It notes that, in effect, by not applying the clear accounts rule, courts would be prioritising the position of trust creditors over that of beneficiaries. It also addresses broader debates about the role of equity in insolvency settings. The conclusion reached is that, notwithstanding these concerns, the discretionary non-application of the clear accounts rule is justified.

Finally, in Part VI, this article concludes by briefly raising two further exceptions to the clear accounts rule that could be explored in the future. The first is the notion that the operation of the clear accounts rule may be inconsistent with the statutory right of indemnity in certain Australian jurisdictions.

[3] (1839) 4 My & Cr 442; 41 ER 171 ('*Cherry*'). See below nn 110–24 and accompanying text.

The second is where a trust deed has been drafted specifically to exclude the operation of the clear accounts rule. It is argued that there is no reason to hold such deeds unenforceable, and thus a well-drafted trust deed should be capable of ousting the clear accounts rule.

II Context and Foundational Principles

This article is primarily concerned with how the clear accounts rule may be circumvented in light of its prejudicial implications on trust creditors. However, before diving into an analysis of the clear accounts rule, it is useful to address two questions that are foundational to the remainder of this article: (a) what is the clear accounts rule?; and (b) how exactly is it said to prejudice trust creditors?

The first question can be answered immediately. The clear accounts rule provides that the value of an indemnity that a trustee may recover from the trust fund is subject to *any* liability that the trustee has incurred to increase the trust fund, either by making good a loss or by disgorging an unauthorised profit or gain.[4] In simple terms, the rule suggests that the court will subtract the value of the trustee's liability to increase the trust fund from the value of the trustee's indemnity.[5] The trustee's liability to increase the trust fund need not be connected with the liability giving rise to the trustee's right of indemnity.[6] Any liability incurred by the trustee to restore trust funds will attract the operation of the rule.

The second question requires some further context. For those unfamiliar with trusts and insolvency law, it would be entirely reasonable to query how such a rule, which on its face appears to settle the state of the account between trustees and beneficiaries, could impact trust creditors at all. To appreciate the prejudice of the clear accounts rule on trust creditors, it is necessary to understand something of the nature of a trustee's liability to trust creditors, the function of the trustee's right of indemnity, and what happens to those liabilities and

[4] *Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth* (2019) 268 CLR 524, 543–4 [31] (Kiefel CJ, Keane and Edelman JJ) ('*Re Amerind*'); *Lane* (n 1) 68 [54] (Derrington J), citing *Cherry* (n 3).

[5] *Australian Securities and Investments Commission v Letten [No 17]* (2011) 286 ALR 346, 353 [20] (Gordon J) ('*Letten*').

[6] *RWG Management Ltd v Commissioner for Corporate Affairs* [1985] 1 VR 385, 397 (Brooking J) ('*RWG Management*'); *Lane* (n 1) 68 [55] (Derrington J).

indemnity rights when a trustee is made insolvent. Each of those matters is addressed below.

A *The Nature of a Trustee's Liabilities to Trust Creditors and the Role of the Indemnity*

While trusts, particularly those that engage in trading, business and other commercial activities, are often thought of as distinct economic entities,[7] under Anglo-Australian law they have no separate legal personality.[8] The trustee has legal title to the assets that are held on trust for others (or for a purpose), and the trustee is the legal entity that enters into contracts with third parties as principal and not as agent.[9] It follows that the trustee is personally liable to creditors for debts incurred in the administration of the trust.[10] As is conventional, throughout this article, debts incurred by the trustee in the proper administration of the trust are described as 'trust debts', and 'trust creditors' are parties to whom such debts are owed.[11]

Although trustees are personally liable for trust debts, equity assists them by conferring on trustees a right to an indemnity out of trust property.[12] The right to an indemnity, which allows the trustee to use trust assets to discharge trust

[7] See, eg, *Provident Capital Ltd v Zone Development Pty Ltd* (2001) 10 BPR 19133, 19140–1 [49] (Young CJ in Eq); *Kelly v Mina* [2014] NSWCA 9, [103] (Leeming JA, Ward JA agreeing at [100]) ('*Kelly*'); Nuncio D'Angelo, 'The Trust as a Surrogate Company: The Challenge of Insolvency' (2014) 8(3) *Journal of Equity* 299, 301–2.

[8] *Re Amerind* (n 4) 540 [24] (Kiefel CJ, Keane and Edelman JJ), 577 [129] (Gordon J); *Equity Trust (Jersey) Ltd v Halabi* [2023] AC 877, 893 [58] (Lord Richards JSC and Sir Nicholas Patten, Lord Stephens JSC agreeing), 934 [256] (Lord Briggs JSC, Lord Reed PSC and Lady Rose JSC agreeing), 941 [281] (Lady Arden) ('*Equity Trust (Jersey)*'). See also *Octavo Investments Pty Ltd v Knight* (1979) 144 CLR 360, 367 (Stephen, Mason, Aickin and Wilson JJ) ('*Octavo Investments*').

[9] See, eg, *Re Amerind* (n 4) 540 [24] (Kiefel CJ, Keane and Edelman JJ), 560–1 [82] (Bell, Gageler and Nettle JJ), 577 [129] (Gordon J); *Kelly* (n 7) [103] (Leeming JA, Ward JA agreeing at [100]).

[10] See, eg, *Re Johnson; Shearman v Robinson* (1880) 15 Ch D 548, 552 (Jessel MR) ('*Re Johnson*'); *Vacuum Oil Company Pty Ltd v Wiltshire* (1945) 72 CLR 319, 324 (Latham CJ) ('*Vacuum Oil*').

[11] Language to a similar effect was used by the High Court of Australia in *Re Amerind* (n 4): see, eg, at 585 [156] (Gordon J).

[12] *Chief Commissioner of Stamp Duties (NSW) v Buckle* (1998) 192 CLR 226, 245–6 [47] (Brennan CJ, Toohey, Gaudron, McHugh and Gummow JJ) ('*Buckle*'); JD Heydon and MJ Leeming, *Jacobs' Law of Trusts in Australia* (LexisNexis Butterworths, 8th ed, 2016) 510–11 [21-02].

debts,[13] has been described as being 'in the nature of the office of a trustee'.[14] The right of indemnity can be exercised in two alternative ways — reimbursement or exoneration.[15] The right of reimbursement allows a trustee who has discharged a trust debt out of their personal funds to recoup that amount out of the trust assets. However, usually the trustee is not obliged to use its own funds like this. Thus, the right of exoneration arises where a trustee has incurred a trust debt that has not yet been discharged. In those circumstances, the trustee can resort to the trust fund directly to pay trust creditors.[16] In *Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth* ('*Re Amerind*'), the High Court of Australia recognised that the right of indemnity also confers on the trustee a correlative proprietary interest in the trust assets that takes priority over the interests of beneficiaries.[17] That proprietary interest has been likened to a lien over trust property.[18] It should be noted that while the trustee's right of indemnity was originally recognised in general law, it has now been enshrined in statute.[19] The implications of the statutory recognition of the trustee's right of indemnity are considered further in Part VI.

Because the trustee is personally liable for trust debts, they are obliged to pay trust debts regardless of the state of the trust fund.[20] Therefore, it is useful to think of two pools of assets from which trust debts may be satisfied: the assets subject to the trust relationship and the trustee's personal assets.[21] Ordinarily, the trustee will seek to discharge trust debts by resorting to the trust assets via

[13] See, eg, *Re Blundell; Blundell v Blundell* (1888) 40 Ch D 370, 376–7 (Stirling J).

[14] *Worrall v Harford* (1802) 8 Ves Jun 4; 32 ER 250, 252 (Lord Eldon LC).

[15] *Buckle* (n 12) 245 [47] (Brennan CJ, Toohey, Gaudron, McHugh and Gummow JJ), quoting Austin Wakeman Scott and William Franklin Fratcher, *The Law of Trusts* (Little, Brown and Company, 4th ed, 1988) vol 3A, 345.

[16] See above n 15.

[17] *Re Amerind* (n 4) 544 [32] (Kiefel CJ, Keane and Edelman JJ), 561–2 [83]–[85] (Bell, Gageler and Nettle JJ), 582 [142] (Gordon J).

[18] See, eg, *Jennings v Mather* [1902] 1 KB 1, 6 (Collins MR) ('*Jennings (KB)*'), cited in ibid 544 [32] n 70 (Kiefel CJ, Keane and Edelman JJ). For further discussion, see generally RW White, 'Insolvent Trusts: Implications of *Buckle* and *CPT Custodian*' (2017) 44(1) *Australian Bar Review* 1, 1–13.

[19] See, eg, *Trustee Act 1925* (NSW) s 59(4); *Trusts Act 1973* (Qld) s 72; *Trustee Act 1958* (Vic) s 36(2).

[20] See, eg, *Re Johnson* (n 10) 552 (Jessel MR); *Vacuum Oil* (n 10) 324 (Latham CJ), 335 (Dixon J).

[21] See especially, Nuncio D'Angelo, *Transacting with Trusts and Trustees* (LexisNexis, 2020) 415–16 [10.98]–[10.99].

their right of exoneration.[22] However, because the trust is not a separate legal entity, where the trust assets are insufficient to meet trust debts, 'the trust' cannot be made insolvent or wound up.[23] Instead, two scenarios may arise.

First, the trustee may have managed to successfully protect their personal assets from trust debts by including a limitation of liability clause directly into its contracts with trust creditors.[24] Under a limitation of liability clause, the trustee's personal liability for trust debts may be limited to the extent of their ability to discharge the debt out of the trust assets.[25] If the limitation of liability is effective, the insufficiency of the trust assets to satisfy the trust debts cannot push the trustee into insolvency because, as a matter of contract, the trustee will not be personally liable for the shortfall. Accordingly, a scenario where a trustee benefits from a limitation of liability falls outside of the scope of this article.

However, trustees will not always be able to shield their personal assets from trust creditors through a limitation of liability clause.[26] Australian courts construe attempts to limit liability strictly against trustees.[27] Thus, a defect in the drafting of the limitation of liability clause may render it ineffective. Additionally, in some situations, a trust creditor may be in a superior bargaining position to the trustee and refuse to include a limitation of liability clause in the contract,[28] or it may not have occurred to the parties to include a limitation of

[22] Nuncio D'Angelo, *Commercial Trusts* (LexisNexis Butterworths, 2014) 299–300 [6.60]–[6.62].

[23] See *Horwath Corporate Pty Ltd v Huie* (1999) 32 ACSR 413, 414–15 [8]–[17] (Young J); *Park & Muller (liquidators of LM Investment Management Ltd) v Whyte (receiver of the LM First Mortgage Investment Fund)* [2015] QSC 283, [18]–[19] (Jackson J); *Re Austec Wagga Wagga Pty Ltd (in liq)* [2018] NSWSC 1476, [13], [18] (Brereton J).

[24] *Elders Trustee & Executor Co Ltd v E G Reeves Pty Ltd* (1987) 78 ALR 193, 253 (Gummow J) ('*Elders Trustee & Executor*'); Heydon and Leeming (n 12) 511–12 [21-03]. See generally D'Angelo, *Transacting with Trusts and Trustees* (n 21) ch 3, 416 [10.102]. Trustees may also attempt to embed a limitation of liability clause into the trust instrument itself. However, such a provision is unlikely to be effective where trust creditors do not have notice of the clause: *Austrust Ltd v Astley* (1996) 67 SASR 207, 228 (Doyle CJ and Olsson J, Duggan J agreeing at 243), affd (1999) 197 CLR 1, 38 [89]–[90] (Gleeson CJ, McHugh, Gummow and Hayne JJ). The position where trust creditors have notice of such a clause is less settled: D'Angelo, *Transacting with Trusts and Trustees* (n 21) 152–3 [3.24].

[25] *Muir v City of Glasgow Bank* (1879) 4 App Cas 337, 355 (Earl Cairns LC) ('*Muir*'); *Elders Trustee & Executor* (n 24) 253 (Gummow J).

[26] This may either be due to commercial realities or because the clause is held unenforceable. For further discussion, see D'Angelo, *Transacting with Trusts and Trustees* (n 21) 149 [3.13], 417 [10.103].

[27] See, eg, *Helvetic Investment Corporation Pty Ltd v Knight* (1984) 9 ACLR 773, 778 (Mahoney JA) ('*Helvetic Investment*'); *Elders Trustee & Executor* (n 24) 253 (Gummow J).

[28] D'Angelo, *Transacting with Trusts and Trustees* (n 21) 149 [3.13].

liability clause in their agreements. Accordingly, it is relevant to consider the second scenario — that is, where the trust fund is insufficient and where the trustee must resort to their personal assets to satisfy trust debts. In the second scenario, if the trustee is solvent, they may pay the trust creditors out of their own assets and subsequently seek reimbursement from the trust assets as and when that becomes possible (if ever). However, if the trustee's personal assets are insufficient to meet trust debts after the trust fund is exhausted (or if it is illiquid), the trustee will be insolvent, and the trust creditors can seek judgment against the trustee and push them into formal insolvent administration.[29] This second scenario is at the heart of discussions concerning the operation of the clear accounts rule.

B *The Impacts of Insolvency*

As the High Court recognised in *Re Amerind*, it is an established principle of bankruptcy law that 'rights held by a bankrupt on trust do not generally form part of the bankrupt's estate that is available for general distribution amongst creditors'.[30] While Australian bankruptcy legislation has explicitly adopted the exclusion of trust property from a trustee's estate in bankruptcy,[31] a similar exclusion does not appear in the *Corporations Act 2001* (Cth) ('*Corporations Act*') which governs the insolvency of corporate trustees.[32] Nonetheless, the High Court has held that the same principle of bankruptcy law applies, so trust assets held by corporate trustees are not available for distribution amongst a corporate trustee's personal creditors.[33]

Unlike trust assets, however, a trustee's right of indemnity forms part of the bankrupt or insolvent trustee's estate.[34] Therefore, the trustee in bankruptcy or liquidator who takes control of the insolvent trustee's estate also takes control of their right of indemnity against the trust assets. Historically, there was some

[29] *Re Johnson* (n 10) 552 (Jessel MR).

[30] *Re Amerind* (n 4) 540 [25] (Kiefel CJ, Keane and Edelman JJ), citing *Scott v Surman* (1742) Willes 400; 125 ER 1235, 1236 (Willes CJ), *Winch v Keeley* (1787) 1 Term R 619; 99 ER 1284, 1286 (Buller J), and *Boddington v Castelli* (1853) 1 El & Bl 879; 118 ER 665, 667 (Parke B).

[31] *Bankruptcy Act 1966* (Cth) s 116(2)(a). See also *Bankruptcy Act 1924* (Cth) s 91(a), as at 30 July 1928.

[32] *Re Amerind* (n 4) 541 [26] (Kiefel CJ, Keane and Edelman JJ), discussing *Corporations Act 2001* (Cth) s 9 (definition of 'property') ('*Corporations Act*').

[33] *Re Amerind* (n 4) 541–2 [26]–[27], 546 [36] (Kiefel CJ, Keane and Edelman JJ), 567–8 [94]–[95] (Bell, Gageler and Nettle JJ).

[34] Ibid 542 [28] (Kiefel CJ, Keane and Edelman JJ).

debate as to whether the proceeds from the trustee's right of indemnity could only be distributed amongst trust creditors, or whether they were also available to the trustee's personal creditors.[35] However, in *Re Amerind*, the High Court settled that debate, endorsing the view that the proceeds from the trustee's right of exoneration are only to be distributed amongst trust creditors.[36] Therefore, the trust creditors (and not the trustee's personal creditors) are said to be 'subrogated' to the trustee's right of indemnity.[37] In simple terms, this means that the trustee's creditors 'stand in the shoes' of the trustee and take the proceeds from the realised right of exoneration.[38]

C *Subrogation, Clear Accounts Rule and Prejudice to Creditors*

Although upon insolvency, it is the trust creditors in whose pockets the proceeds of the right of exoneration end up (rather than trustees), the ordinary limitations on the trustee's right of indemnity subsist. The subrogating trust creditors do not enjoy a 'better right' of indemnity than the trustees did.[39] Accordingly, the clear accounts rule continues to apply to the exoneration limb of the trustee's right of indemnity even once the trust creditors have stepped into the trustee's shoes through subrogation.[40] Thus, returning to the question posed at the beginning of Part II, the upshot is that the clear accounts rule, which operates prima facie between trustees and beneficiaries, can also impact trust creditors when a trustee is insolvent. The outstanding point to address

[35] See, eg, *Re Enhill Pty Ltd* [1983] 1 VR 561, 564 (Young CJ). See generally Justice James Allsop, 'The Intersection of Companies and Trusts' (2020) 43(3) *Melbourne University Law Review* 1128, 1136–48.

[36] *Re Amerind* (n 4) 549 [44] (Kiefel CJ, Keane and Edelman JJ), 565–6 [92] (Bell, Gageler and Nettle JJ), 585 [156]–[158] (Gordon J). Proceeds from the right of reimbursement are available for distribution amongst all the trustee's creditors: at 549 [43] (Kiefel CJ, Keane and Edelman JJ), 565–6 [92] (Bell, Gageler and Nettle JJ), 584–5 [155] (Gordon J).

[37] Ibid 545 [34] (Kiefel CJ, Keane and Edelman JJ), 578 [132] (Gordon J).

[38] JD Heydon, MJ Leeming and PG Turner, *Meagher, Gummow and Lehane's Equity: Doctrines and Remedies* (LexisNexis Butterworths, 5th ed, 2015) 365 [9-005], quoting Denis Browne, *Ashburner's Principles of Equity* (Butterworth, 2nd ed, 1933) 243.

[39] *Re Johnson* (n 10) 555 (Jessel MR).

[40] Ibid; *Re Amerind* (n 4) 543–4 [31], 545 [34] (Kiefel CJ, Keane and Edelman JJ).

then is how that impact is prejudicial. That is a point that has been made by various commentators[41] and can be illustrated using a simple example.

Imagine a trustee incurs a trust debt to a trust creditor worth $100,000. Their right of indemnity confers on the trustee a right under the exoneration limb to apply trust funds towards the repayment of that debt. However, before meeting that debt, the trustee becomes insolvent. Accordingly, the trust creditor is subrogated to the trustee's right of indemnity. Imagine further that the trustee also expends $100,000 in an unrelated transaction found to be in breach of trust. In that situation, the trustee would be liable to increase (or restore) the trust funds by $100,000. Under the clear accounts rule, this amount would be netted off against the trustee's right of indemnity, such that the value of the indemnity would be reduced to $0. The trust creditor, subrogated to the right of indemnity, would be unable to recover the debt owed through the right of exoneration; instead, they would be left with a personal claim against an insolvent trustee.[42] The prejudice suffered by the trust creditor is manifest — their ability to satisfy the debt owed to them is undermined by the trustee committing a breach of duty completely unrelated to their transaction with the trust creditor.

Before proceeding, it is worth noting two points of qualification on the prejudice suffered by unsecured trust creditors. First, the right of unsecured creditors is always vulnerable to the presence of claims by other unsecured trust creditors. While that may be true, it does not necessarily stand in the way of attempting to avoid the distinct impact of the clear accounts rule. Second, at least in some circumstances, the trust creditors may be able to avail themselves of the benefits conferred by s 197 of the *Corporations Act*. Under s 197, directors of a corporate trustee are personally liable for debts incurred by the trustee provided the corporation cannot discharge the liability or any part of it and is not entitled to be indemnified against the liability out of the trust assets.[43] A

[41] See, eg, D'Angelo, *Transacting with Trusts and Trustees* (n 21) 253 [5.129]; White (n 18) 18–22; Nuncio D'Angelo, 'The Unsecured Creditor's Perilous Path to a Trust's Assets: Is a Safer, More Direct US-Style Route Available?' (2010) 84(12) *Australian Law Journal* 833, 833 ('The Unsecured Creditor's Perilous Path to a Trust's Assets'); Harlan F Stone, 'A Theory of Liability of Trust Estates for the Contracts and Torts of the Trustee' (1922) 22(6) *Columbia Law Review* 527, 528; Diccon Loxton and Nuncio D'Angelo, 'Trustees' Limitation of Liability: Myths, Mysteries and a Model Clause' (2013) 41(3) *Australian Business Law Review* 142, 145. But see Bajul Shah, 'Trustee's Indemnity and Creditors' Rights' (2013) 19(1) *Trusts and Trustees* 79, 83.

[42] *Letten* (n 5) 361 [43] (Gordon J); D'Angelo, *Transacting with Trusts and Trustees* (n 21) 249–50 [5.117]–[5.118].

[43] *Corporations Act* (n 32) s 197(1).

detailed discussion of the circumstances in which s 197 will apply is unnecessary for present purposes. Instead, it suffices to note that while there are certainly situations in which s 197 will allow trust creditors to avoid the prejudice described above, the provision is far from a universal solution. Most notably, where the directors of the corporate trustee are themselves impecunious or uninsured, s 197 will not assist trust creditors in satisfying the debts owed to them.[44]

D *Circumventing the Prejudice: The Existing Debate*

In light of the prejudicial effect of the clear accounts rule on trust creditors, there have been calls to limit its operation, at least insofar as it applies to the trustee's right of exoneration.[45] The arguments in favour of limiting the application of the clear accounts rule have often focused on the nature and purpose of the trustee's right of exoneration. They have noted that the exercise of the right of exoneration is in effect an exercise of the power to apply trust assets towards the discharge of the trust debt.[46] As D'Angelo puts it, the right of exoneration never confers on the trustee beneficial ownership of trust assets.[47] The trustee is merely a 'conduit' through whom trust assets are passed on to trust creditors to discharge trust debts.[48] As the right of exoneration does not result in the beneficial ownership of any trust funds being passed onto trustees (as distinguished from the right of reimbursement), it is argued that the value of a right of exoneration should not be 'netted off' against the trustee's outstanding liabilities to increase the trust fund because it appears (economically at least) to 'punish' innocent parties that are external to the trust, that is, trust creditors.

[44] D'Angelo, *Transacting with Trusts and Trustees* (n 21) 249 [5.117].

[45] See, eg, D'Angelo, *Commercial Trusts* (n 22) 268–9 [5.125]. See also HAJ Ford, 'Trading Trusts and Creditors' Rights' (1981) 13(1) *Melbourne University Law Review* 1, 29–30; Stone (n 41) 528, 535–6; Ronald Sackville, 'The Trustee's Right of Indemnity and the Creditor's Right of Subrogation: The Hardening of Equity' (2013) 7(1) *Journal of Equity* 34, 40–2.

[46] Ford (n 45) 4, 20; D'Angelo, *Commercial Trusts* (n 22) 268 [5.124]. But see Diccon Loxton, 'In with the Old, out with the New? The Rights of a Replaced Trustee against Its Successor, and the Characterisation of Trustees' Proprietary Rights of Indemnity' (2017) 45(4) *Australian Business Law Review* 285, 290. See also White (n 18) 22–3.

[47] D'Angelo, *Commercial Trusts* (n 22) 267 [5.123], 270 [5.128].

[48] Ibid.

However, the foregoing view does not necessarily reflect academic consensus.[49] For example, Silink argues in favour of the right of exoneration being subject to the clear accounts rule.[50] In her view, the benefit to creditors from the trustee exercising their right of exoneration is merely an incidental one.[51] Instead, the purpose of the right of exoneration is to relieve the trustee from their personal liability to trust creditors.[52] Although the right of exoneration does not confer 'beneficial ownership' of the trust assets on trustees,[53] they are entitled to any of the trust assets to meet their liabilities incurred qua trustee and are able to do so regardless of any existing proprietary rights of beneficiaries in those assets.[54] Understood this way, it seems reasonable for the trustee's right of exoneration to be characterised as 'for the trustee's benefit' such that it is subject to the clear accounts rule or that its impact on trust creditors should be disregarded as merely incidental.

The foregoing debates seem to presuppose the fixed application of the clear accounts rule, and then consider whether it is appropriate to subject the trustee's right of exoneration to that rule. That in turn leads to an analysis of the nature and purpose of the trustee's right of exoneration. Indeed, to some extent, shades of this debate were also apparent in the divide between the majority and minority positions in the Privy Council's decision in *Equity Trust (Jersey) Ltd v Halabi* ('*Equity Trust (Jersey)*').[55] There, the Privy Council was concerned with, inter alia, the distinct question of whether 'a former trustee's proprietary interest in the trust assets [should] take priority over the equivalent interests of successor trustees' (rather than considering whether the clear accounts rule should extend to the right of exoneration).[56] However, a key point of distinction between the majority and minority positions in that case was whether the right of indemnity was conferred onto trustees not only for their personal benefit but also for the benefit of trust creditors (which in turn affected whether the interests of trust creditors should affect the formulation of priority rules regarding the respective trustees' liens). Lord Briggs JSC of the majority considered that

[49] See, eg, Allison Silink, 'Trustee Exoneration from Trust Assets: Out on a Limb?' (2018) 12(1) *Journal of Equity* 58, 60–1; Shah (n 41) 83.

[50] Silink (n 49) 60–1.

[51] Ibid 61.

[52] Ibid 60–1.

[53] D'Angelo, *Commercial Trusts* (n 22) 270 [5.128].

[54] See above nn 16–17 and accompanying text.

[55] *Equity Trust (Jersey)* (n 8) 882–3 [2], [4] (Lord Reed PSC).

[56] Ibid 882 [2].

'[p]art of the purpose of the trustees' lien is to provide a mechanism by which trust creditors get paid'.[57] By contrast, Lord Richards JSC and Sir Nicholas Patten of the minority considered 'the purpose of the indemnity as being protection of the trustee, not of its trust or indeed personal creditors'.[58] Notwithstanding this difference of opinion, it was accepted by both sides that the clear accounts rule applied so as to reduce the value of a trustee's right of indemnity and by extension the trust creditor's right of subrogation.[59] The relevance of trust creditors' interests in *Equity Trust (Jersey)* will be considered further in Part IV.

With respect, while there is certainly value in having such debates, in the following Parts, this article will aim to resolve the issues posed by the operation of the clear accounts rule by taking a different approach. Instead of attempting to determine whether the trustee's right of exoneration fits within the ambit of the clear accounts rule, this article will examine the nature of the rule itself. It will suggest that there is neither a historical nor normative basis for applying the clear accounts rule inflexibly.

III Historical Justification for the Clear Accounts Rule

Starting with the historical justification for the clear accounts rule, various Australian cases have suggested that the rule is rooted in history, citing a series of 19th and early 20th century cases in its support.[60] However, an examination of the clear accounts rule's history reveals that the rule is grounded in presumption, rather than inflexible application. Accordingly, if one is to justify the clear accounts rule on the basis that it is historically entrenched, fidelity to the rule's history would require recognising the presumptive, rather than fixed, nature of the rule. It should be noted from the outset that the argument here is not that the clear accounts rule *must* be justified by reference to history — indeed

[57] Ibid 939 [275] (Lord Briggs JSC, Lord Reed PSC and Lady Rose JSC agreeing). See also at 948 [295] (Lady Arden).

[58] Ibid 895 [66] (Lord Richards JSC and Sir Nicholas Patten, Lord Stephens JSC agreeing).

[59] Ibid 895 [66] (Lord Richards JSC and Sir Nicholas Patten, Lord Stephens JSC agreeing), 939 [276] (Lord Briggs JSC, Lord Reed PSC and Lady Rose JSC agreeing).

[60] See, eg, *RWG Management* (n 6) 397 (Brooking J) (citations omitted); *JD & KJ Zohs Properties Pty Ltd v Ferme* (2015) 16 ASTLR 167, 183 [71] (Stanley J) ('*JD & KJ Zohs Properties*') (citations omitted); *HBSY Pty Ltd v Lewis* (2022) 108 NSWLR 558, 566–7 [47]–[50] (Kunc J) ('*HBSY*') (citations omitted).

Part IV considers normative arguments against a fixed application of the clear accounts rule that are not grounded in history.

To illustrate the point, this Part will begin with a historical overview of the clear accounts rule's development in Australia. It will then consider the 19th century (and early 20th century) cases which are often cited as a historical justification for the clear accounts rule. Those earlier cases disclose two bases on which the clear accounts rule was being applied: (a) as a presumption that the trustee was paying out their indemnity by anticipation through the trust funds they had misappropriated; or (b) as an extension of the rule in *Cherry*. However, further historical analysis of the rule in *Cherry* will reveal that the rule emanated from cases applying the doctrine of satisfaction, which itself turned on the presumed intention of testators. Accordingly, the conclusion reached is that on either view of the clear accounts rule's history, the rule appears to be grounded in presumption. Thus, if courts are indeed applying the historical version of the clear accounts rule, trust creditors subrogated to the trustee's right of indemnity should be able to circumvent the rule's operation by adducing evidence that displaces the presumed intention behind the trustee's breach of trust.

A *Development of the Clear Accounts Rule in Australia*

In Australia, one of the first judicial endorsements of what resembles the clear accounts rule (though not described as such) came from the Full Court of the Supreme Court of Victoria in *Cumming v Austin* ('*Cumming*'), where Holroyd J (for the Court) observed that 'a defaulting trustee who has a beneficial interest in the trust estate cannot claim anything against it without making good his defalcations'.[61] A few years later, Barton J of the High Court expressed a similar principle in *Savage v Union Bank of Australia Ltd* ('*Savage*').[62] There, his Honour relied on Kennedy J's judgment in *Jennings v Mather* ('*Jennings (QB)*'), which in turn quoted *Re Evans; Evans v Evans*, to note that a creditor could subrogate to the right of indemnity belonging to the

[61] (1902) 28 VLR 622, 628 ('*Cumming*'), citing *Doering v Doering* (1889) 42 Ch D 203, 207–8 (Stirling J) ('*Doering*').

[62] (1906) 3 CLR 1170, 1192 (Barton J) ('*Savage*').

administrator of an estate, provided they had '*not lost such right by being a debtor to the estate*'.[63]

A similar exposition of the principle was also put forward by Dixon J of the High Court in *Vacuum Oil Co Pty Ltd v Wiltshire* ('*Vacuum Oil*').[64] In that case, his Honour observed that creditors must depend on the rights of the executor and may lose their subrogated right to an indemnity where the executor is required to make good a loss caused to the estate.[65] Both *Savage* and *Vacuum Oil* were subsequently cited with approval by the High Court in *Octavo Investments Pty Ltd v Knight* where it discussed trust creditors' rights of subrogation.[66] Notably, however, those cases referred to the trustee losing their right of indemnity rather than describing the mathematical process of netting off obligations discussed above.[67]

The more formulaic approach to the clear accounts rule was expressed by Brooking J in *RWG Management Ltd v Commissioner for Corporate Affairs* ('*RWG Management*').[68] In that case, his Honour clarified that Dixon J's statement in *Vacuum Oil* was not intended to suggest that the trustee absolutely loses their right of indemnity upon causing a loss to the trust estate.[69] Rather, Brooking J suggested 'that a balance is to be struck between what is due by way of compensation and what is due by way of indemnity and that if the balance is in favour of the trustee he may recover from the estate to that extent'.[70] *RWG Management* was followed by Gordon J in *Australian Securities Investments Commission v Letten [No 17]*, where her Honour stated that 'the clear accounts rule is essentially a mathematical exercise setting off the trustee's right to indemnity against its liability with respect to previous breaches of trust'.[71] Additionally, there are numerous examples of modern cases citing *RWG*

[63] Ibid 1191 (emphasis added), quoting *Jennings v Mather* [1901] 1 QB 108, 113 (Lawrance J agreeing at 117) ('*Jennings (QB)*'), which in turn quoted *Re Evans; Evans v Evans* (1887) 34 Ch D 597, 601 (Cotton LJ). Note that *Savage* (n 62) erroneously cites *Jennings (QB)* (n 63) as having been reported in the *King's Bench Division Reports* when in fact it was reported in the *Queen's Bench Division Reports*: ibid 1191 n 1. The citation has been corrected here.

[64] *Vacuum Oil* (n 10).

[65] Ibid 336.

[66] *Octavo Investments* (n 8) 367–8 (Stephen, Mason, Aickin and Wilson JJ), citing *Savage* (n 62) 1186, 1188 (Griffiths CJ), and *Vacuum Oil* (n 10).

[67] *Savage* (n 62) 1191 (Barton J); *Vacuum Oil* (n 10) 336 (Dixon J).

[68] *RWG Management* (n 6) 397–8.

[69] Ibid, discussing *Vacuum Oil* (n 10) 336 (Dixon J).

[70] *RWG Management* (n 6) 397–8.

[71] *Letten* (n 5) 353 [20], citing ibid 397 (Brooking J).

Management when discussing the clear accounts rule such as *JD & KJ Zohs Properties Pty Ltd v Ferme*,[72] *Park v Whyte [No 3]* ('*Park [No 3]*'),[73] *Lane v Deputy Commissioner of Taxation* ('*Lane*')[74] and *Chu v Lin; Re Gold Stone Capital Pty Ltd (Trial Judgment)*.[75] Indeed, the method of 'striking a balance' described by Brooking J accords with the High Court's articulation of the clear accounts rule in *Re Amerind*, which cited *Lane* as a relevant authority for that proposition.[76]

1 *Origins in the English Cases*

The preponderance of the Australian authorities cite Jessel MR's speech in *Re Johnson* as the historical basis for the clear accounts rule.[77] In *Jennings (QB)* (which was cited by the High Court of Australia in *Savage*),[78] Kennedy J noted that the 'clearest exposition' of the rule was by Jessel MR in *Re Johnson*.[79]

In *Re Johnson*, Peter Johnson appointed the defendant as an executor under his will.[80] The defendant's instructions were to call in the debts of two businesses (in Cambridge and London) run by Johnson and convert all stock (except for that of the London business) to money.[81] A quarter of the proceeds were then to be divided amongst the two children of Johnson's deceased sister.[82] However, the will allowed for one of these children, John Neill, to carry on the Cambridge business in his own name until he reached the age of 21; at that point, John Neill

[72] *JD & KJ Zohs Properties* (n 60) 183 [70] (Stanley J), citing *RWG Management* (n 6) 398 (Brooking J).

[73] *Park [No 3]* (n 1) 506 [139] (Jackson J), citing *RWG Management* (n 6) 397–8 (Brooking J).

[74] *Re Gold Stone Capital* (n 1) [246] (Jackman J), citing *RWG Management* (n 6) 397–8 (Brooking J).

[75] *Lane* (n 1) 68 [55] (Derrington J), citing *RWG Management* (n 6) 397 (Brooking J).

[76] *Re Amerind* (n 4) 544 [31] n 68 (Kiefel CJ, Keane and Edelman JJ), citing *Lane* (n 1) 68 [54] (Derrington J).

[77] See, eg, *RWG Management* (n 6) 398 (Brooking J); *Vacuum Oil* (n 10) 336 (Dixon J); *Lane* (n 1) 68 [54] (Derrington J); *Re Amerind Pty Ltd; Commonwealth v Byrnes* (2018) 54 VR 230, 238 [29] (Ferguson CJ, Whelan, Kyrou, McLeish and Dodds-Streeton JJA).

[78] *Savage* (n 62) 1187 (Griffiths CJ), 1190–1 (Barton J), citing *Jennings (QB)* (n 63). Note that *Savage* (n 62) erroneously cites *Jennings (QB)* (n 63) as having been reported in the *King's Bench Division Reports* when in fact it was reported in the *Queen's Bench Division Reports*: *Savage* (n 62) 1187 n 2 (Griffiths CJ), 1191 n 1 (Barton J). The citation has been corrected here.

[79] *Jennings (QB)* (n 63) 114 (Lawrance J agreeing at 117), discussing *Re Johnson* (n 10) 552.

[80] *Re Johnson* (n 10) 548 (headnote).

[81] Ibid.

[82] Ibid 548–9.

would have an option to take the stock in accordance with an earlier valuation or bring the proceeds from selling the stock into hotchpot.[83]

Contrary to Johnson's instructions under the will, the defendant carried on the Cambridge business in his own name and failed to call in the debts. He also used money advanced from John Neill's share of the estate to carry on the business but never kept separate accounts.[84] The defendant subsequently became insolvent and the creditors of the Cambridge business who had supplied goods to the defendant sought access to the trust assets to pay their claims.[85]

In what has been described as one of the first judgments to discuss the right of creditors in the language we use today,[86] Jessel MR held that although they could not directly access the trust assets, the creditors had a right to be 'put in [the] place' of the trustee against the trust estate.[87] Therefore, the creditors had a right to enjoy the benefit of the trustee's indemnity. Crucially however, Jessel MR qualified this right of the creditors by noting:

> But if the trustee has wronged the trust estate, that is, if he has taken money out of the assets more than sufficient to pay the debts, and instead of applying them to the payment of the debts has put them into his own pocket, then it appears to me there is no such equity.[88]

In *Jacubs v Rylance* ('*Jacubs*'), a case predating *Re Johnson* and cited in *RWG Management*,[89] Jessel MR explained the rationale for applying the limitation on the trustee's right of indemnity:

> [T]he trustee, who is indebted to the estate in a sum largely exceeding this fund, must be taken to have paid himself all that he can claim out of the moneys which have come to his hands, and for which he has not accounted.[90]

The Master of the Rolls went on to note that this was not an instance of 'impounding a trust fund'.[91] Rather, the trustee already had all that he could

[83] Ibid. See also at 556 (Jessel MR).

[84] Ibid 556 (Jessel MR).

[85] Ibid 550–1 (headnote).

[86] Aleksi Ollikainen, 'Asset Partitioning in the Trust' (DPhil Thesis, University of Oxford, 2018) 27, citing *Re Johnson* (n 10).

[87] *Re Johnson* (n 10) 552.

[88] Ibid.

[89] (1874) LR 17 Eq 341 ('*Jacubs*'), cited in *RWG Management* (n 6) 398 (Brooking J).

[90] *Jacubs* (n 89) 342.

[91] Ibid.

claim and had 'paid himself'.[92] In *Doering v Doering* ('*Doering*') (cited in *Cumming*),[93] Stirling J followed *Jacubs* and stated that the answer to any claim by a trustee was that the trustee had already received their share — they had in their hands what they claimed.[94] In *Re Gorton; Dowse v Gorton* ('*Re Gorton*'), Cotton LJ reached a similar conclusion, stating that a defaulting executor had gotten 'in their pocket the money out of which the indemnity to which they are entitled ought to be paid'.[95]

There are various other 19th century cases which appear to apply a principle consistent with what is now called the clear accounts rule. In *Lewis v Trask*, North J held that a defaulting executor could only be paid their costs out of the estate once they had made good their default.[96] In *Bowyer v Griffin*, Malins V-C noted that the costs of a trustee's suit for the execution of the trust could be set-off against a debt he owed to the trust estate.[97] In *McEwan v Crombie*, North J held that the costs a trustee was seeking to recoup could be 'set off' against the amount he owed to the trust estate (which exceeded his costs).[98] In *Taylor v Popham*, Eldon LC held that where there were sums to be paid from each party to the other, a solicitor's lien for their costs only extended to the balance once all the costs were considered as a whole.[99]

In *Re Frith; Newton v Rolfe*, another case cited in *RWG Management*, Kekewich J used the language of 'clearing … accounts' to explain the foregoing principles.[100] Citing *Re Johnson* and *Re Gorton*, his Honour stated the following:

> [T]here may be some money owing by the trustees to the estate, and the creditors may be willing to pay that in order to make the trustees' account clear; and in that case the creditors are entitled to an assignment of the equity to which the trustees succeed on clearing their accounts.[101]

[92] Ibid.

[93] *Cumming* (n 61) 628–9 (Holroyd J for the Court), citing *Doering* (n 61).

[94] *Doering* (n 61) 208, citing *Jacubs* (n 89) 342 (Jessel MR).

[95] (1889) 40 Ch D 536, 540–1 (Lopes LJ agreeing at 543) ('*Re Gorton*'). See also at 541–2 (Lindley LJ, Lopes LJ agreeing at 543).

[96] (1882) 21 Ch D 862, 864.

[97] (1869) LR 9 Eq 340, 342.

[98] (1883) 25 Ch D 175, 178. The use of 'set off' in this instance does not appear to have been invoking the doctrine of set-off.

[99] (1808) 15 Ves Jun 72; 33 ER 682, 683.

[100] [1902] 1 Ch 342, 345 ('*Re Frith*'), cited in *RWG Management* (n 6) 399 (Brooking J).

[101] *Re Frith* (n 100) 345, citing *Re Johnson* (n 10) 553, 555 (Jessel MR), and *Re Gorton* (n 95).

B *Identifying the Underlying Principle*

One explanation for the rule expressed in the 19th and early 20th century cases discussed above is that there is a presumption that the trustee had already paid themselves their indemnity through the misappropriated funds ('the presumption theory').[102] That certainly appears to be the rationale expressed in *Jacubs*, *Doering* and *Re Gorton* where the courts variously expressed the view that the trustee had already taken what was owed to them through the funds they had misappropriated.[103] Relying on these cases, Australian courts have, on occasion, similarly endorsed the presumption theory underlying the clear accounts rule. For example, in *Cumming*, the Full Court of the Supreme Court of Victoria noted that a defaulting trustee was to be considered as having paid themselves what would come to them 'by anticipation'.[104] In *Re Tolley (deceased)*, Walters J similarly explained that the 'theory underlying the rule' was based on the trustee having paid themselves by anticipation.[105] And, in *RWG Management*, Brooking J stated that 'it is clear' that the clear accounts rule was founded on the principle that a trustee must be taken to have paid themselves the amount due to them.[106] More recently, in *Park [No 3]*, Jackson J recognised the historical support for the presumption theory,[107] before commenting that modern authorities 'do not gainsay those propositions'.[108]

As White has observed extra-curially, the presumption that the trustee has paid out their indemnity through misappropriated funds is problematic.[109] If,

[102] See, eg, Aleksi Ollikainen-Read, 'Creditors' Claims against Trustees and Trust Funds' (2018) 24(2) *Trusts and Trustees* 177, 184, 188–9, citing *Jacubs* (n 89); Silink (n 49) 86–7, citing *Re Dacre; Whitaker v Dacre* [1916] 1 Ch 344, 347 (Lord Cozens-Hardy MR) ('*Re Dacre*'); Thomson Reuters, *Ford and Lee: The Law of Trusts* (online at 22 July 2024) [14.3910], citing *RWG Management* (n 6) 398 (Brooking J).

[103] See above nn 89–95 and accompanying text.

[104] *Cumming* (n 61) 629 (Holroyd J for the Court).

[105] (1972) 5 SASR 466, 472.

[106] *RWG Management* (n 6) 398 (Brooking J).

[107] *Park [No 3]* (n 1) 506 [138] n 70, citing *Jeffs v Wood* (1723) 2 P Wms 128; 24 ER 668 ('*Jeffs*').

[108] *Park [No 3]* (n 1) 506 [138], citing *Re Kaupthing Singer & Friedlander Ltd (in admin) [No 2]* [2012] 1 AC 804, 815–26 [13]–[53] (Lord Walker JSC, Baroness Hale, Lord Clarke JJSC and Lord Collins agreeing, Lord Hope DPSC agreeing at 826 [55]). Some other more modern examples (which were not referred to by Jackson J in *Park [No 3]* (n 1)) include: *Hunters Beach Investments Pty Ltd v Braams* (2001) 38 ACSR 701, 712–13 [94]–[95] (Young CJ in Eq) (citations omitted); *HBSY* (n 60) 566–7 [47]–[48] (Kunc J) (citations omitted). The presumption theory has also been referred to in English case law: see, eg, *Selangor United Rubber Estates Ltd v Cradock [No 4]* [1969] 1 WLR 1773, 1778–9 (Ungoed-Thomas J).

[109] White (n 18) 22.

indeed, the courts were presuming the trustee's intention to pay their indemnity through misappropriated funds, there is no reason why the actual facts of the case could not displace that presumption. An example that immediately comes to mind is where the trustee's default preceded the expense giving rise to the right of exoneration. In that case, it could not be said that a trustee was attempting to pay off an expense they had incurred through misappropriated funds given the expense in question did not exist at the time of their default. Moreover, in circumstances where the trustee has made an unauthorised investment that becomes valueless, or the trustee has paid funds to someone not entitled to them, there would be no misappropriated funds in the trustee's hands which could be presumed to have been taken in payment of the indemnity.

Proponents of a fixed application of the clear accounts rule may reject the presumption theory of the clear accounts rule and instead suggest that its historical origins lie in the rule in *Cherry*. There is certainly a significant body of authority that refers to the rule in *Cherry* as the basis for the application of the clear accounts rule.[110] For example, in *Lane*, Derrington J stated that *Re Johnson* (and the clear accounts rule) was in fact an application of the rule in *Cherry*.[111] Similar explanations of the clear accounts rule have been proffered in *JD & KJ Zohs Properties*[112] and *Park v Whyte [No 5]*.[113] Authoritative texts such as *Derham on the Law of Set-Off*[114] and *Jacobs' Law of Trusts in Australia*[115] have also referred to *Cherry* as the basis for the clear accounts rule. While support for the view that the clear accounts rule is an application of the rule in *Cherry* is not universal,[116] it is unnecessary to digress into the debate here. For present purposes, it suffices to note that pointing to the rule in *Cherry* as the historical origin for the clear accounts rule provides little support for the view that the rule should be applied inflexibly. As will be shown below, the rule in *Cherry* itself emanated from cases applying the doctrine of satisfaction, which turned

[110] This recently occurred in *Lane* (n 1) 68–9 [54]–[59] (Derrington J). See also Heydon and Leeming (n 12) 514 [21-04], citing *Cherry* (n 3); Loxton and D'Angelo (n 41) 144 n 10, citing *Cherry* (n 3).

[111] *Lane* (n 1) 68 [54], discussing *Cherry* (n 3), and *Re Johnson* (n 10) 552–3 (Jessel MR).

[112] *JD & KJ Zohs Properties* (n 60) 183–4 [72] (Stanley J).

[113] (2020) 3 QR 409, 415–16 [18]–[19] (Jackson J).

[114] Rory Derham, *Derham on the Law of Set-Off* (Oxford University Press, 4th ed, 2010) 664–5 [14.88], citing *Cherry* (n 3).

[115] Heydon and Leeming (n 12) 514 [21-04], citing *Cherry* (n 3).

[116] See, eg, White (n 18) 22.

on presumptions regarding a testator's intent when granting a legacy to their creditors.

In *Cherry*, Thomas Boultbee owed money to his sister, Catherine, who subsequently made a will leaving him an amount greater than the debt he owed to her.[117] During Catherine's life, Thomas became bankrupt and the plaintiff, his assignee, sued the executors of Catherine's will for the legacy.[118] The executors of Catherine's estate sought to set-off the plaintiff's claim against the debts owed by Thomas. Lord Chancellor Cottenham rejected the right of the executors to 'set-off' the plaintiff's claim as, strictly speaking, the right of 'set-off' only applies to mutual demands.[119] This case concerned the right of an executor of a creditor to pay out of the fund in hand. The relevant right was '[t]he right of an executor of a creditor to retain a sufficient part of a legacy given by the creditor to the debtor, to pay a debt due from him to the creditor's estate'.[120] However, ultimately as Thomas had become bankrupt during Catherine's life, there was never any single person in whom both the right to receive the legacy and the obligation to pay the debt were vested, and the right to retain had no application.[121]

Cases that have subsequently applied the rule in *Cherry* have described it as setting down the conditions under which entitlement to a fund may be claimed. For example, in *Re Akerman; Akerman v Akerman*, Kekewich J described the rule as follows: 'A person who owes an estate money … cannot claim an aliquot share given to him out of that mass without first making the contribution which completes it'.[122] In *Re Peruvian Railway Construction Co Ltd* ('*Re Peruvian Railway Construction*'), Sargant J similarly stated that the rule precludes a person from participating in a fund until they have fulfilled their duty to contribute to that fund.[123] Justice Sargant's formulation was also quoted by Palmer J in *Otis Elevator Co Pty Ltd v Guide Rails Pty Ltd (in liq)*.[124]

117 *Cherry* (n 3) 173 (Cottenham LC).

118 Ibid.

119 Ibid.

120 Ibid.

121 Ibid.

122 [1891] 3 Ch 212, 219, discussing *Cherry* (n 3).

123 [1915] 2 Ch 144, 150 ('*Re Peruvian Railway Construction*'), citing *Cherry* (n 3).

124 (2004) 49 ACSR 531, 536 [33] ('*Otis Elevator*'), quoting *Re Peruvian Railway Construction* (n 123) 150.

C *The Presumptive Basis for the Rule in* Cherry v Boultbee

While the presumed intention of the trustee and the rule in *Cherry* may be thought of as separate historical bases for the clear accounts rule, arguably the two rationales are closely connected. As has been noted in academic commentary and case law alike, in *Cherry*, Cottenham LC did not divine any new principles of law.[125] Rather his Lordship was applying more general principles that are said to be traced back to *Jeffs v Woods* ('*Jeffs*').[126] However, as will be observed below, the principles discussed in *Jeffs* were themselves premised on the presumed intention of the testator and were not intended to operate as fixed, equitable rules.

In *Jeffs*, a testator left a £500 legacy to the defendant.[127] The plaintiff executor of the testator's estate advanced credit for goods to the defendant before disbursing the £500 legacy to the defendant. In response to a suit brought by the defendant to enforce payment, the executor of the testator's estate sought to retain out of the legacy the money which the defendant owed to the testator's estate.[128] Master of the Rolls Jekyll held that 'it is very just and equitable' for the executor to say that the legatee has the testator's assets in their own hands and the debt is consequently satisfied *pro tanto*.[129]

At least occasionally, *Jeffs* is cited as a case concerning set-off by agreement.[130] That view appears to be premised on Jekyll MR's comments that although

> stoppage is no payment at law, nor is it, of itself, a payment in equity, but then a very slender agreement for discounting or allowing the one debt out of the other, will make it a payment … equity will take hold of a very slight thing to do both parties right.[131]

However, for the same reasons provided above regarding *Cherry*, it is inapposite to speak of the rights of the executor in that case as a right of 'set-off'. Instead,

[125] See, eg, Lee Aitken, 'Recent Applications of the Rule in Cherry v Boultbee (or Jeffs v Wood)' (2010) 84(3) *Australian Law Journal* 191, 191; *Otis Elevator* (n 124) 536 [33] (Palmer J); Derham, *Derham on the Law of Set-Off* (n 114) 615–16 [14.03].

[126] See below n 156 and accompanying text.

[127] *Jeffs* (n 107) 669 (Jekyll MR).

[128] Ibid.

[129] Ibid.

[130] See, eg, Derham, *Derham on the Law of Set-Off* (n 114) 10 [2.01], citing *Jeffs* (n 107).

[131] *Jeffs* (n 107) 669 (Jekyll MR).

as Derham suggests, the right described in both cases is 'a right to appropriate a particular asset as payment'.[132] To that extent, the principle described in *Jeffs* and applied in *Cherry* more closely resembles the doctrine of satisfaction of a debt by a legacy, under which equity will presume that where a person owes a debt and gives a legacy to their creditor, the legacy is in satisfaction of the debt.[133] That is, the legacy is appropriated as substantially equivalent to the payment of the debt.[134]

Various contemporary secondary sources which refer to *Jeffs* treat the case as an application of the doctrine of satisfaction. For example, Story's *Commentaries on Equity Jurisprudence: As Administered in England and America* cites *Jeffs* as an application of the doctrine of satisfaction.[135] Likewise, Toller, Whitmarsh and Ingraham's *The Law of Executors and Administrators* cites *Jeffs* as a case concerning the doctrine of satisfaction, being an example of money lent by the executor to a legatee being held as part payment of the legacy.[136] Similarly, *The Principles of Equity Jurisprudence: Embracing the Concurrent, Exclusive and Auxiliary Jurisdiction of Courts of Equity* refers to *Jeffs* as a part of a class of cases 'connected with the doctrine of satisfaction'.[137] While Roper and White's *A Treatise on the Law of Legacies* discusses the case as an example of the executor's right to retain a legacy 'by way of set-off', the term 'set-off' appears to be used loosely,[138] and multiple references are subsequently made to the use of the legacy in 'satisfaction of the legatee's debt'.[139] Finally, in Lowndes' *A Treatise on the Law of Legacies*, *Jeffs* is again cited in a chapter concerning the satisfaction of debt by legacy.[140]

132 Derham, *Derham on the Law of Set-Off* (n 114) 616 [14.03].

133 See, eg, *Hassell v Hawkins* (1859) 4 Drewry 468; 62 ER 180, 181 (Kindersley V-C) ('*Hassell*').

134 Heydon, Leeming and Turner (n 38) 1016 [32-005].

135 Joseph Story, *Commentaries on Equity Jurisprudence: As Administered in England and America* (Charles C Little & James Brown, 3rd ed, 1843) vol 2, 472 [1119], citing *Jeffs* (n 107) 670 (Jekyll MR).

136 Sir Samuel Toller and Francis Whitmarsh, *The Law of Executors and Administrators*, ed Edward D Ingraham (John Grigg, 3rd ed, 1829) 338, citing *Jeffs* (n 107).

137 The Editors of the Law Students' Magazine, *The Principles of Equity Jurisprudence: Embracing the Concurrent, Exclusive and Auxiliary Jurisdiction of Courts of Equity* (Robert Hastings, 1848) 325, citing *Jeffs* (n 107).

138 RS Donnison Roper, *A Treatise on the Law of Legacies*, ed Henry Hopley White (Joseph Butterworth and Son, 3rd ed, 1828) vol 1, 789–90, discussing *Jeffs* (n 107).

139 Roper and White (n 138) 790.

140 William Lowndes, *A Treatise on the Law of Legacies* (Joseph Butterworth and Son, 1824) 313, citing *Jeffs* (n 107).

While the foregoing texts are by no means intended to be an exhaustive list of the sources considering *Jeffs*, they demonstrate substantial support across the 19th century for a reading of *Jeffs* as an application of the doctrine of satisfaction. Indeed, support for this reading can be found in Jekyll MR's comments in the case itself: '[I]f a man gives a legacy to his creditor to the amount of his debt, this has been construed a payment or *satisfaction of the debt*, because a man must be supposed to be just before he is bountiful'.[141]

The principle described there by Jekyll MR was one arising out of the presumed intention of the testator. Parenthetically, Jekyll MR noted: 'Notwithstanding this general doctrine, yet where the testator has left wherewithal, and shewed his intentions so to be, he has been construed to be both just and bountiful.'[142] This suggests that the principle was one of presumptive application, which could be displaced by evidence of the actual intentions of the testator. The contemporary sources discussed above take a similar view. For example, Story observed that the doctrine of satisfaction, as applied in this context, was a mere presumption that could be displaced even by the slightest of circumstances.[143] Accordingly, he noted that the rule would not apply in various scenarios, such as where the legacy was less than the amount of the debt, where a particular motive was assigned for the gift or where the debt was incurred subsequent to the will.[144] Adams and Ralston similarly referred to the presumption described in *Jeffs* as being a weak one that was capable of displacement where the legacy was 'less than the debt' or 'payable at a different time'.[145] Roper and White observed that the presumptive payment of legacies must be read subject to the actual intention of the testator.[146] Similarly, in Snell and Griffith's *The Principles of Equity: Intended for the Use of Students and the Profession*, the basis for the treatment of a debt to be paid *pro tanto* out of a legacy was said to be, inter alia, the 'presumed intention of the parties'.[147] Additionally, Lowndes observed that the 'implication' of the testator's intention to treat the legacy as

[141] *Jeffs* (n 107) 670 (emphasis added).

[142] Ibid.

[143] Story (n 135) 474–5 [1122].

[144] Ibid.

[145] John Adams and Robert Ralston, *The Doctrine of Equity: A Commentary on the Law as Administered by the Court of Chancery* (T & JW Johnson, 8th ed, 1890) 105, citing *Jeffs* (n 107).

[146] Roper and White (n 138) 790.

[147] Edmund Henry Turner Snell and JR Griffith, *The Principles of Equity: Intended for the Use of Students and the Profession* (Stevens & Haynes, 2nd ed, 1872) 428.

satisfaction of a debt would not arise in circumstances similar to those described by Story.[148]

The status of the presumptive application of the rule was also affirmed in various cases in the 17th and 18th centuries. In *Goodfellow v Burchett*, a case considering whether a testamentary devise of land could be used in satisfaction of a bond owed to the legatee, the Court noted that the principle turns on the circumstances of the case and relies on a presumption of the testator's intention.[149] In *Talbott v Duke of Shrewsbury*, another case concerning a legacy granted to a creditor of the deceased, the Court noted that the particular circumstances evincing the testator's intention, that the legacy should not be used in satisfaction of the debt, could displace the application of the rule.[150] In *Richardson v Greese*, the Court found that the particular circumstances in which the legacy was granted, as well as the specific terms on which it was granted, displaced the presumption that it should be used in satisfaction of the debt.[151] In *Fowler v Fowler*, although no circumstances were found to displace the presumption, the Court similarly recognised the 'rule' as being one of presumption rather than fixed application.[152] Even in cases that did not concern testamentary legacies, courts found that the application of the rule as extended turned on the intention of the parties. For example, in *Downam v Matthews*, a case concerning the administration of the estate of a deceased dryer, the Court held that the interactions between the deceased and the plaintiff clothier over the course of the years evinced an intention to set-off the debts they each owed to one another.[153]

The treatment of the doctrine of satisfaction as a rule of presumption continued beyond the 17th and 18th centuries. In *Hassell v Hawkins*, a case from the mid 19th century, Kindersley V-C observed that courts will 'rely on the minutest shade of difference' to escape from the presumption of satisfaction.[154] To a similar effect, in *Lambert v Waters*, a 20th century case, the Full Court of the Supreme Court of Queensland held that the presumption of satisfaction was displaced by the fact that the legacy was smaller than the debt owed.[155] While

[148] Lowndes (n 140) 313. See also Story (n 135) 474–5 [1122].

[149] (1693) 2 Vern 298; 23 ER 792, 792–3.

[150] (1714) Prec Ch 394; 24 ER 177, 177–8.

[151] (1743) 3 Atk 65; 26 ER 840, 842.

[152] (1735) 3 P Wms 353; 24 ER 1098, 1098 (Talbot LC).

[153] (1721) Prec Ch 580; 24 ER 260, 260–1.

[154] *Hassell* (n 133) 470.

[155] [1954] St R Qd 212, 222–4 (Macrossan CJ), 228 (Philp J). For further examples of 20th century cases applying the doctrine as a 'presumption', see Heydon, Leeming and Turner (n 38) ch 32.

various modern cases continue to note that *Jeffs* is the basis for the rule in *Cherry*, the cases applying the rule very rarely speak of any presumed intention of the parties.[156] Even in *Cherry* itself, little regard was given to the presumed intention of the parties, or the surrounding facts which could displace that intention.[157] Instead, Cottenham LC spoke of the '*right* of an executor' to retain a sufficient part of the legacy in payment of a debt.[158] Early cases referring to *Cherry* seemed to assume that they were dealing with a fixed and established equitable principle, rather than a mere displaceable presumption. So much seems clear from the exposition of the rule in cases like *Turner v Turner*[159] and *Re Peruvian Railway Construction*.[160] The modern Australian authorities similarly make scant reference (if any) to a 'presumption', instead treating the rule in *Cherry* as an established principle. Thus, for example in *Gray v Gray*, Young CJ in Eq referred to the rule as constituting a 'general equitable principle'[161] that was an illustration of the more fundamental maxim that 'he who seeks equity must do equity'.[162] His Honour made no reference to the presumed intention of the parties. More recently, in *Re Hawden Property Group Pty Ltd (in liq)*, Gleeson JA provided a detailed account of the rule in *Cherry*.[163] While his Honour acknowledged the rule's origins in cases concerning the administration of deceased estates,[164] no reference was made to the rule being a presumption. Instead, his Honour spoke of a 'principle' in equity and the *right* of a party to appropriate a particular asset as payment.[165]

156 See, eg, *Steiner v Strang* [2014] NSWSC 1250, [44] (Sackar J); *Ansett Australia Ltd v Travel Software Solutions Pty Ltd* (2007) 214 FLR 203, 224 [96] (Hargrave J), quoting *Otis Elevator* (n 124) 536 [33] (Palmer J); *Perpetual Trustees (WA) Ltd v Equus Corp Pty Ltd* (Supreme Court of New South Wales, Young J, 5 March 1998) 4–5 ('*Perpetual Trustees (WA)*').

157 See *Cherry* (n 3) 173 (Cottenham LC).

158 Ibid (emphasis added).

159 [1911] 1 Ch 716, 721 (Cozens-Hardy MR, Fletcher Moulton LJ agreeing at 722).

160 *Re Peruvian Railway Construction* (n 123) 150 (Sargant J).

161 (2004) 12 BPR 22755, 22767 [97] (Sheller JA agreeing at 22755 [1], Bryson JA agreeing at 22755 [2]) ('*Gray*'). See also Austin J's first instance judgment in *Gray v Guardian Trust Australia* [2002] NSWSC 1218, [108].

162 *Gray* (n 161) 22767 [91], quoting Rory Derham, *The Law of Set-Off* (Oxford University Press, 3rd ed, 2003) 585 [14.01].

163 (2018) 125 ACSR 355, 361–4 [36]–[50] ('*Re Hawden Property Group*'), discussing *Cherry* (n 3).

164 *Re Hawden Property Group* (n 163) 361–2 [37].

165 Ibid 362 [43].

If indeed the rule in *Cherry* is an application of the principle discussed in *Jeffs*, then its treatment as some sort of inflexible, established rule of equity appears to be a misstep. Moreover, insofar as the rule in *Cherry* is invoked as a *historical* basis for the clear accounts rule, it seems inappropriate to disregard the former rule's history. Therefore, if one is attempting to apply the clear accounts rule as some sort of historically entrenched principle, it seems necessary to recognise the presumptive nature of the rule. Of course, as foreshadowed earlier, one may argue that the rule in *Cherry*, and indeed, the clear accounts rule, has taken a modern form that is no longer tied to its historical origins. That argument may now be addressed.

IV Discretionary Approach to the Clear Accounts Rule

If the clear accounts rule was treated as a freestanding principle of modern equity, pointing to the historical basis on which the rule was applied would not stand in the way of treating the modern rule as a rule of fixed application. However, this Part will suggest that even if such a characterisation of the clear accounts rule were accepted, the rule should (as is characteristic of equitable principles) be subject to discretionary considerations rather than being applied inflexibly.

Importantly, it is not suggested that such a discretion should be an unstructured or absolute one. Instead, this Part suggests that the discretion should be grounded in equity's conscience as understood in the modern context — that is, it should be exercised with reference to established equitable principles. Specifically, the principles this Part draws on are equity's concern for third-party interests when granting remedies and the allowances equity makes when taking accounts. Having regard to those principles, as well as the function of the clear accounts rule as a tool used by courts of equity to administer complex accounts, this Part suggests that there is a strong normative basis for the clear accounts rule to be applied in a manner that is sensitive to the interests of trust creditors.

A *The Mandate for Flexibility in Accounts*

Before considering the equitable principles that should guide the court's approach when applying the clear accounts rule, it is necessary to briefly set out why a discretionary approach is needed to begin with. As has long been recognised, in taking accounts, equity is guided by a mandate to achieve *practical*

justice between the parties.[166] There are various circumstances in which equity may be called upon to take accounts and, especially in the case of commercial trustees, there will often be a complex array of transactions and interests that courts must consider. In those circumstances, to fulfil its mandate to achieve practical justice between the parties, equity cannot tie its hands behind its back.[167] Instead, it must apply accounting principles in a manner that is sufficiently discretionary and flexible so as to be adaptable to the particularities of the cases before it.[168] Thus, for example, in *Huang v Wei [No 3]*, Kunc J observed that '[t]he remedy of account is a flexible one, intended ultimately to achieve a fair and just result between the parties'.[169] The clear accounts rule should be no exception to that position — an inflexible application of the rule would be unjustifiably contrary to equity's general approach when taking accounts. Insofar as the clear accounts rule is functionally an accounting principle applied by equity in the examination of a trustee's account,[170] it too should be applied in a flexible and discretionary manner so as to achieve practical justice.

V How the Discretion Should Be Exercised

The notion that equity should administer accounts in a flexible manner is certainly not novel. As Watson has noted, historically, the taking of accounts was to be done according to the requirements of equity and good faith.[171] Indeed, early cases concerning the remedy of account noted that the account was to be taken according to the dictates of equity and justice rather than the rigour of the law.[172] However, as has been observed in case law and academia alike, equity no longer resolves cases at a high level of abstraction by reference to vague

166 JA Watson, *The Duty To Account: Development and Principles* (Federation Press, 2016) 69–70 [188]–[191]. See especially at 69–70 [191] n 43, citing *Lord Provost of Edinburgh v The Lord Advocate; Ex parte M'Laren* (1879) LR 4 App Cas 823, 838–9 (Lord Hatherley) ('*Lord Provost of Edinburgh*'), and *National Commercial Banking Corporation of Australia Ltd v Batty* (1986) 160 CLR 251, 268 (Gibbs CJ).

167 *Spence v Crawford* [1939] 3 All ER 271, 288 (Lord Wright, Lord MacMillan agreeing at 286) ('*Spence*').

168 Heydon, Leeming and Turner (n 38) 901 [25-065].

169 [2022] NSWSC 662, [29].

170 See *Re Frith* (n 100) 345 (Kekewich J).

171 Watson (n 166) 69 [189].

172 Ibid, citing RM Jackson, *The History of Quasi-Contract in English Law* (Cambridge University Press, 1936) 36 n 4. See also at 35–6.

notions of 'justice'.[173] Instead, modern equity's discretion is 'rules-based' in that it is exercised by reference to an established body of equitable principles.[174] That view accords with the manner in which the concept of 'conscience' has evolved in equity as the source of equitable obligations. While in medieval times, chancellors were concerned with 'prevent[ing] peril to the soul by sin',[175] in the modern context 'conscience' invokes a set of well-established principles developed by the courts of equity over time.[176] Thus, one cannot simply rely on the invocation of notions of 'good faith' or 'justice' in medieval cases to assert that similar notions will operate at such a high level today to dictate the operation of the clear accounts rule.[177] Instead, any argument that the clear accounts rule should not apply where its operation would be 'unconscionable' should generally be made through an inductive approach by reference to established equitable principles.

Consistently with that approach, there are two established lines of equitable principle on which trust creditors could rely when attempting to resist the application of the clear accounts rule. First, in formulating appropriate remedies, courts of equity are sensitive to the interests of third parties.[178] While prejudice to third parties is not necessarily determinative of equity's discretion, it is useful to examine the circumstances in which third-party interests have guided the court's decision to award a particular remedy. Second, in various modern contexts, equity has made 'just allowances' when determining the amount payable from one party to another. In making such allowances, equity has been minded to making the party seeking equitable relief account for the benefits that they have received (drawing on the maxim that one who seeks equity must

[173] See, eg, Sackville (n 45) 38–42; *Tanwar Enterprises Pty Ltd v Cauchi* (2003) 217 CLR 315, 324 [20] (Gleeson CJ, McHugh, Gummow, Hayne and Heydon JJ) ('*Tanwar Enterprises*').

[174] James Edelman, 'Judicial Discretion in Australia' (2000) 19(3) *Australian Bar Review* 285, 296–7.

[175] Rohan Havelock, 'The Evolution of Equitable "Conscience"' (2014) 8(2) *Journal of Equity* 128, 135.

[176] Richard Hedlund, 'Conscience and Unconscionability in English Equity' (PhD Thesis, University of York, February 2016) 105.

[177] See also *Tanwar Enterprises* (n 173) 324 [20] (Gleeson CJ, McHugh, Gummow, Hayne and Heydon JJ). See generally Joe Campbell, '*The Duty To Account: Development and Principles* by JA Watson' (2017) 39(3) *Sydney Law Review* 429, 430–2.

[178] See, eg, Elise Bant and Michael Bryan, 'Defences, Bars and Discretionary Factors' in Elise Bant and Michael Bryan (eds), *Principles of Proprietary Remedies* (Lawbook, 2013) 185, 201–2 [11.100]; Keith Mason, 'Deconstructing Constructive Trusts in Australia' (2010) 4(2) *Journal of Equity* 98, 110.

do equity). In making parties account for the benefit they have received, equity has been willing to prioritise the achievement of practical justice between the parties rather than being bound by stringent accounting procedures.

A *Equity's Consideration of Third-Party Interests*

Starting with the consideration of third-party interests generally, Wright has observed that equity is willing to consider third-party interests in a range of circumstances[179] such as when imposing constructive trusts,[180] rescinding contracts,[181] rectifying mistakes[182] and awarding injunctions.[183] An examination of how third-party interests are considered in these contexts may inform how courts should treat the interests of trust creditors who are functionally 'third parties' so far as the trustee-beneficiary relationship is concerned.

In the sphere of constructive trusts, numerous cases have acknowledged the importance of considering third-party interests before a remedy is awarded. In *Giumelli v Giumelli*, a majority of the High Court recognised that when determining whether a constructive trust ought to be imposed, the court is obliged to consider 'all the circumstances of the case',[184] including the implications of the remedy on third parties.[185] That decision was cited with approval in *John Alexander's Clubs Pty Ltd v White City Tennis Club Ltd*,[186] where the High Court noted that before deciding whether to declare a constructive trust, the

[179] David Wright, 'Third Parties and the Australian Remedial Constructive Trust' (2013) 37(2) *University of Western Australia Law Review* 31, 40–2.

[180] *Muschinski v Dodds* (1985) 160 CLR 583, 623 (Deane J), cited in ibid 54–5.

[181] *CMG Equity Investments Pty Ltd v Australia & New Zealand Banking Group Ltd* (2008) 65 ACSR 650, 657 [26] (Finkelstein J) ('*CMG Equity Investments*'), quoted in Wright (n 179) 40–1. See also *Re Clarke; Ex parte the Debtor v S Aston & Son Ltd* [1967] 1 Ch 1121, 1136 (Cross J for the Court).

[182] *CMG Equity Investments* (n 181) 657 [26] (Finkelstein J), cited in Wright (n 179) 40–1.

[183] *Patrick Stevedores Operations No 2 Pty Ltd v Maritime Union of Australia* (1998) 195 CLR 1, 42–3 [66] (Brennan CJ, McHugh, Gummow, Kirby and Hayne JJ), cited in Wright (n 179) 41.

[184] (1999) 196 CLR 101, 125 [49] (Gleeson CJ, McHugh, Gummow and Callinan JJ) ('*Giumelli*').

[185] Ibid 113–14 [10], 125 [49]–[50]. But see Ying Khai Liew, 'Constructive Trusts and Discretion in Australia: Taking Stock' (2021) 44(3) *Melbourne University Law Review* 963, 980–82, discussing ibid.

[186] (2010) 241 CLR 1, 44–5 [126] (French CJ, Gummow, Hayne, Heydon and Kiefel JJ) ('*John Alexander's Clubs*'), citing *Giumelli* (n 184) 113–14 [10], 125 [49]–[50] (Gleeson CJ, McHugh, Gummow and Callinan JJ).

interests of third parties must be 'borne in mind'.[187] To a similar effect, the High Court in *Bathurst City Council v PWC Properties Pty Ltd* unanimously noted the need to avoid a 'result whereby the plaintiff gains a beneficial proprietary interest which gives an unfair priority over other equally deserving creditors of the defendant'.[188]

In the context of rectifying mistakes, courts have refused relief where it would prejudice the interests of an innocent third party who has acquired interests under the document for value.[189] Similar circumstances have also justified the refusal to rescind a contract. For example, in *Hunter BNZ Finance Ltd v C G Maloney Pty Ltd*, Giles J suggested that equity would consider whether undoing the contract would prejudicially affect the interests of an innocent third party who had in good faith and for value acquired rights under the relevant contract.[190] His Honour noted that equity's rationale was to avoid unduly punishing the innocent third party for conduct in which they had no part.[191] His Honour observed that notwithstanding the fact that there were two innocent parties (the party subjected to a misrepresentation and the innocent third party), it was the prejudice to the innocent third party that was to be avoided.[192] A similar rationale has also been applied to the protections afforded to bona fide purchasers for value of real property[193] and personal property.[194]

One apparent distinction between the position of trust creditors and the third parties referred to above is that trust creditors have not acquired an interest in the trust property. For example, in the context of rectification and rescission, the relevant third parties have acquired interests under the instrument

[187] *John Alexander's Clubs* (n 186) 44 [126], 46 [129] (French CJ, Gummow, Hayne, Heydon and Kiefel JJ). See also at 44–6 [126]–[130].

[188] (1998) 195 CLR 566, 585 [42] (Gaudron, McHugh, Gummow, Hayne and Callinan JJ) ('*Bathurst City Council*').

[189] See, eg, *Smith v Jones* [1954] 1 WLR 1089, 1092–3 (Upjohn J); *CMG Equity Investments* (n 181) 657 [24]–[26] (Finkelstein J).

[190] (1988) 18 NSWLR 420, 433–4 ('*Hunter BNZ Finance*').

[191] Ibid 434, quoting George Spencer Bower, *The Law of Actionable Misrepresentation: Stated in the Form of a Code* (Butterworth, 2nd ed, 1927) 280 [307].

[192] *Hunter BNZ Finance* (n 190) 433–4.

[193] See, eg, *Redman v Permanent Trustee Co of New South Wales Ltd* (1916) 22 CLR 84, 92 (Griffiths CJ and Barton J).

[194] See, eg, *Joseph v Lyons* (1884) 15 QBD 280, 286 (Cotton LJ). On one view, the prioritisation of third-party interests is not a matter of discretion and will apply wherever the interests of third parties are impacted. However, an acceptance of that view does not detract from the position taken in this Part — if anything, it elevates the status of third-party interests.

with which equity would be interfering. However, this distinction does not appear to be material to the exercise of equity's discretion. What is relevant is that a third party has acquired rights for value (rather than as a volunteer) and that the equitable remedy sought would directly and prejudicially interfere with those rights. Understood this way, it is unclear why the rights of trust creditors should not be considered by equity when deciding whether to apply the clear accounts rule. They too have acquired rights for value against the trustee (acting in performance of the trust). And, as explained above, their ability to satisfy those rights too is directly and prejudicially affected by the invocation of the clear accounts rule.[195]

Perhaps the better objection to equity accounting for the interests of trust creditors is the 'acceptance of risk theory'.[196] The acceptance of risk theory has been applied when courts have considered whether to impose a constructive trust upon property owned by an insolvent person.[197] In such circumstances, a constructive trust would prejudice the constructive trustee's general creditors who would lose recourse to the property subject to the constructive trust. However, the acceptance of risk theory suggests that the general creditors of the constructive trustee should be taken to have accepted the risk that they may cease to be the owner of the property because by failing to take security the general creditors have accepted the risk.[198] The same could be said of unsecured trust creditors — in dealing with the trustee they have accepted the risk that the trustee may become insolvent and failed to secure their debts against the trust property.[199] Accordingly, unsecured creditors should not be given priority over the beneficiaries in order to satisfy their claims against the trustee.

As Paciocco notes, although the acceptance of risk theory is compelling, it does not always justify giving preference to beneficiaries.[200] The theory turns on the assumption that only the trustee's creditors, and not the beneficiaries, have had the opportunity to deal with the trustee in the past. However, where

[195] See above Part II(C).

[196] See generally Wright (n 179) 47.

[197] See, eg, *Stephenson Nominees Pty Ltd v Official Receiver* (1987) 16 FCR 536, 556 (Gummow J); *Australian Securities Commission v Melbourne Asset Management Nominees Pty Ltd (rec and mgr apptd)* (1994) 49 FCR 334, 358–9 (Northrop J).

[198] *Space Investments Ltd v Canadian Imperial Bank of Commerce Trust Co (Bahamas) Ltd* [1986] 1 WLR 1072, 1074 (Lord Templeman for the Court); Wright (n 179) 47.

[199] Elements of this theory also appear in *Re Johnson* (n 10) to the extent that there is discussion of the fact that the creditors did not take security: see at 552–3 (Jessel MR).

[200] David M Paciocco, 'The Remedial Constructive Trust: A Principled Basis for Priorities over Creditors' (1989) 68(2) *Canadian Bar Review* 315, 324–5.

beneficiaries have had an opportunity to deal with the trustees, there is 'nothing of substance' to distinguish their position from that of the creditors.[201] So far as commercial trusts are concerned, the beneficiaries of the trusts have often dealt with the trustees (eg when purchasing units in a unit trust).[202] They also have rights with regards to the administration of the trust. For example, the trust deed may confer on beneficiaries a power to replace the trustee.[203] Alternatively, the beneficiaries may apply to the court for it to exercise its inherent jurisdiction to remove a trustee.[204] In deciding whether to remove a trustee, the court will consider the welfare of beneficiaries and the preservation of the trust estate.[205]

Finally, it is worth noting that support for considering the interests of trust creditors was also expressed by Lord Briggs JSC and Lady Arden in *Equity Trust (Jersey)*. Lord Briggs JSC considered the prejudice suffered by trust creditors as being material to how the priorities between the liens of initial and successor trustees should be determined.[206] His Lordship recognised the invidious position of trust creditors who are 'exposed to the unknowable state of account between the trustee with whom they deal and the trust'.[207] To similar effect, Lady Arden emphasised the need to consider the effect of a trustee's insolvency on the ability of trust creditors to enforce the debts owed to them.[208] Her Ladyship went on to note that courts of equity have 'sought to uphold creditors' rights which [may] have already accrued'.[209] As already observed, in *Equity Trust (Jersey)*, all members of the Privy Council seemed to presuppose the application of the clear accounts rule, and a consideration of the rule's application was not in issue.[210] Nonetheless, the majority's concern for the prejudice

[201] Ibid 341.

[202] See, eg, *Fitzwood Pty Ltd v Unique Goal Pty Ltd (in liq)* (2001) 188 ALR 566, 567 [1] (Finkelstein J).

[203] See, eg, ibid 593 [94]; *Trustee Act 1925* (NSW) s 6(2)(f).

[204] See, eg, *Letterstedt v Broers* (1884) 9 App Cas 371, 385–6 (Lord Blackburn for the Court) ('*Letterstedt*'); *Miller v Cameron* (1936) 54 CLR 572, 575, 578 (Latham CJ), 579 (Starke J), 580–1 (Dixon J, Evatt J agreeing at 582, McTiernan J agreeing at 582) ('*Miller*').

[205] *Letterstedt* (n 204) 387, 389 (Lord Blackburn for the Court); *Miller* (n 204) 575 (Latham CJ), 579 (Starke J), 580 (Dixon J, Evatt J agreeing at 582, McTiernan J agreeing at 582).

[206] *Equity Trust (Jersey)* (n 8) 939 [276] (Lord Briggs JSC, Lord Reed PSC and Lady Rose JSC agreeing).

[207] Ibid.

[208] Ibid 944 [295].

[209] Ibid 948 [311].

[210] See above n 59 and accompanying text.

suffered by trust creditors, and its direct impact on how priority rules were formulated, remains illuminating.

B *Just Allowances Doctrine*

The second line of principle that justifies consideration of trust creditors' interests is the rationale underpinning the 'just allowances' doctrine. The just allowances doctrine allows a fiduciary who is subject to an order to account for profits or an order declaring a constructive trust to invoke the discretionary power of the court to make deductions from the amount owing to the principal.[211] The court has wide latitude to exercise its discretion, being able to make allowances for any matter that it might think is 'just and proper'.[212] Thus, for example, it was held that a trustee liable to account for profits made from a trust was entitled to make allowances for the time, energy and skill the trustee expended in generating that profit.[213]

As the learned authors of *Meagher, Gummow and Lehane's Equity: Doctrines and Remedies* note, there are various justifications for the just allowances doctrine.[214] One common justification is that without the relevant allowance, the beneficiaries seeking an account of profits would be able to retain benefits for which they have not paid.[215] For example, in *Re Berkeley Applegate (Investment Consultants) Ltd (in liq); Harris v Conway*, Edward Nugee QC (sitting as a deputy judge for the High Court) noted that the fact that 'work ha[d] been of substantial benefit to the trust property and to the persons interested in it in equity' was a key factor in the award of just allowances for the value of that work.[216] To a similar effect in *Phipps v Boardman*, Wilberforce J explained that it would be 'inequitable' for beneficiaries seeking an account of profits 'to step in and take

[211] See, eg, *Warman International Ltd v Dwyer* (1995) 182 CLR 544, 562 (Mason CJ, Brennan, Deane, Dawson and Gaudron JJ); *Harris v Digital Pulse Pty Ltd* (2003) 56 NSWLR 298, 310–11 [48]–[53] (Spigelman J), 371–84 [312]–[336] (Heydon JA); *Lord Provost of Edinburgh* (n 166) 839 (Lord Hatherley); *Grimaldi v Chameleon Mining NL [No 2]* (2012) 200 FCR 296, 409–10 [529]–[530] (Finn, Stone and Perram JJ).

[212] *Lord Provost of Edinburgh* (n 166) 839 (Lord Hatherley). See generally Heydon, Leeming and Turner (n 38) 190–7 [5-280].

[213] *Re Jarvis (deceased); Edge v Jarvis* [1958] 1 WLR 815, 820 (Upjohn J).

[214] Heydon, Leeming and Turner (n 38) 190–7 [5-280].

[215] Ibid 196 [5-280].

[216] [1989] 1 Ch 32, 51 ('*Re Berkeley Applegate*'). See also at 50.

the profit without paying for the skill and labour which has produced it'.[217] Additionally, in *O'Sullivan v Management Agency & Music*, Dunn LJ noted that in assessing the advantage gained by a wrongdoer, equity will look at the 'whole situation'.[218] At a more fundamental level, this explanation for the just allowances doctrine in the foregoing cases is consistent with the maxim 'he who seeks equity must do equity'.[219] In other words, the principal seeking an account of profits is seeking equity and must therefore do equity by submitting to allowances made on 'just terms'.[220]

A similar explanation has been proffered for the 'just allowances' that equity makes in other circumstances. For example, when ordering rescission, courts of equity have not been constrained by any stringent requirement to restore the parties precisely to the state they were in before the contract.[221] Instead, equity has sought to achieve practical justice between the parties by making allowances for improvements or deteriorations of the property to be returned.[222] The basis for making such allowances has also been explained as turning on the maxim 'he who seeks equity must do equity',[223] and courts have been wary of the injustice arising from a party taking possession of property without accounting for the benefits they may have received.[224] When considering equity's discretion to rescind a contract for unconscionable conduct, the High Court in *Vadasz v Pioneer Concrete (SA) Pty Ltd* ('*Vadasz*')[225] discussed at some length equity's mandate to achieve 'practical justice'.[226] There, the Court approved Lord Wright's comments in *Spence v Crawford*,[227] where his Lordship

217 [1964] 1 WLR 993, 1018, affd [1965] 1 Ch 992, 1021 (Lord Denning MR), 1031 (Pearson LJ), 1031 (Russell LJ). The approach of Wilberforce J in relation to the allowance for skill and labour was also cited with approval in the Privy Council appeal: *Boardman v Phipps* [1967] 2 AC 46, 104 (Lord Cohen), 112 (Lord Hodson).

218 [1985] 1 QB 428, 458.

219 Ibid; *Re Berkeley Applegate* (n 216) 50 (Edward Nugee QC); *Hagan v Waterhouse* (1991) 34 NSWLR 308, 391 (Kearney J). See also Heydon, Leeming and Turner (n 38) 195–6 [5-280].

220 Heydon, Leeming and Turner (n 38) 195–6 [5-280].

221 *Brown v Smitt* (1924) 34 CLR 160, 164 (Knox CJ, Gavan Duffy and Starke JJ), 169 (Isaacs and Rich JJ) ('*Brown*').

222 Ibid.

223 Ibid 172 (Isaacs and Rich JJ).

224 *Erlanger v New Sombrero Phosphate Co* (1878) 3 App Cas 1218, 1278–9 (Lord Blackburn) ('*Erlanger*').

225 (1995) 184 CLR 102, 109–11 (Deane, Dawson, Toohey, Gaudron and McHugh JJ) ('*Vadasz*').

226 Ibid 113. See also at 114–15.

227 Ibid 114, quoting *Spence* (n 167) 288 (Lord MacMillan agreeing at 286).

noted the importance of not 'ty[ing] the hands of the court by attempting to form any rigid rules'.[228] The Court in *Vadasz* noted that a party seeking equitable rescission was seeking the court of equity's assistance and was therefore bound to do equity.[229] It followed that the Court's mandate was to look at what was practically just for both parties and not just the appellant.[230]

To a similar effect, when taking the accounts of a co-owner, equity has granted the co-owner, liable to pay occupation fees, an allowance for the improvements made to the property.[231] Again, the basis for making such allowances has also been recognised as the maxim of one who seeks equity must do equity.[232] In other words, a co-owner seeking equitable relief in the form of occupation fees must do equity by accounting for improvements made to the property. The courts have noted that they do not wish to allow a party to be unfairly benefited under an order in equity.[233]

C *Application of Principles to Trust Creditors*

Pulling these threads together, the two principles to be abstracted from the foregoing analysis are that: (a) equity will generally consider the prejudice to third parties when exercising its remedial discretion; and (b) the maxim of 'one who seeks equity must do equity' requires parties seeking equitable relief to account for the benefits that have been conferred on them.

As third parties to the trustee-beneficiary relationship, trust creditors can rely on these principles to justify a discretionary refusal to apply the clear accounts rule. As already observed, the application of the clear accounts rule is prejudicial to their position — it is capable of rendering their only avenue to access trust assets, in the execution of their claims, valueless. Additionally, trust creditors can also call upon beneficiaries seeking equitable relief for breach of trust to 'do equity'. Take, for example, a trust creditor who provides a banking

228 *Spence* (n 167) 288 (Lord MacMillan agreeing at 286), discussing *Erlanger* (n 224) 1278–9 (Lord Blackburn).

229 *Vadasz* (n 225) 115 (Deane, Dawson, Toohey, Gaudron and McHugh JJ).

230 Ibid.

231 *Ryan v Dries* (2002) 10 BPR 19497, 19498 [2] (Sheller JA), 19500 [12] (Giles JA), 19510 [61] (Hodgson JA).

232 Ibid; *Forgeard v Shanahan* (1994) 35 NSWLR 206, 223 (Meagher JA, Mahoney JA agreeing at 219). See generally *Myers v Clark* [2018] NSWSC 1029, [95]–[109] (Ward CJ in Eq).

233 *Squire v Rogers* (1979) 39 FLR 106, 125 (Deane J, Forster J agreeing at 108, Brennan J agreeing at 108).

facility to the trustee, which in turn enables the trustee to acquire a trust asset or carry out some profitable enterprise for the benefit of the trust. Assume also that the trustee has engaged in some other breach of trust unrelated to their transaction with this trust creditor. The trust creditor can certainly assert that the finance they provided enabled the trustee to acquire a trust asset or engage in a profitable enterprise, which in turn increased the value of the trust fund. That is a material benefit enjoyed by the beneficiaries of the trust. As with co-owners, parties seeking rescission of a contract or principals seeking an account of profits, the beneficiaries seeking the intervention of equity should do equity by accounting for the benefit they have received as a result of the trust creditors' contributions. That is, they should be required to allow the subrogating trust creditors to recover the full value of their indemnity rather than seeking to net that indemnity off against an unrelated breach of trust committed by the trustees. This view of the clear accounts rule also seems consistent with the exception recognised in *Re Johnson* towards the end of Jessel MR's judgment.[234] The Master of the Rolls noted that a possible exception to the clear accounts rule would exist if the creditors could demonstrate that there was a profit to the carrying on of the business which exceeded the deficit owed by the trustee, thereby showing that 'something was gained by the use' of the creditors' contributions.[235] Thus, at least where the 'credit' provided by a trust creditor has profitably contributed to the state of the trust fund, there is a strong argument in favour of not applying the clear accounts rule to the creditors' disadvantage.

VI Implications of the Discretion: The Role of Equity in Insolvency Law?

Before proceeding to a discussion of the other grounds on which the clear accounts rule may be resisted, it is worth briefly commenting on the broader implications of the argument made in Part IV. If accepted, the argument would not only affect how the clear accounts rule is understood academically but would also have significant practical consequences for trust creditors in insolvency settings. As will be recalled from Part II, unsecured trust creditors do not have a prima facie right to resort directly to trust assets in the execution of their claims. Instead, their means of accessing trust assets is the indirect route

[234] *Re Johnson* (n 10) 556–7.

[235] Ibid 557.

provided to them by their right to subrogate to the trustee's right of exoneration.[236] As the law currently stands, the clear accounts rule is a major practical obstacle in that indirect route to trust assets. However, if the argument in Part IV is accepted, it opens the possibility of having that obstacle removed. That is, the trust creditors can finally detach the value of their right of subrogation from other breaches the trustee may have committed.

The benefit to trust creditors does, however, come at the expense of letting beneficiaries' claims against trustees go unsatisfied. Where the discretionary consideration of trust creditors' interests is found to be determinative, the court would make separate orders for the trustee to restore the trust funds and for the trust assets to be realised in satisfaction of the trustee's right of indemnity. Insofar as the trustee is insolvent, they would not be able to meet their obligation to restore the trust funds. Thus, in effect, Part IV advocates for shifting the burden of the trustee's insolvency from the trust creditors to the beneficiaries. Part IV already raised arguments as to why, from an acceptance of risk perspective, it is justifiable for beneficiaries to bear this burden. However, it is also worthwhile considering the recourse to equity's discretion in light of broader debates regarding the role of equity in insolvency settings. Concerns have been raised about equity unduly adjusting priorities between equally deserving creditors in the context of courts imposing remedial constructive trusts,[237] and *Quistclose* trusts.[238] Those with such concerns may also be cautious of equity exercising its discretion to adjust priorities between trust creditors and beneficiaries.

In response, however, it should be observed that it is the clear accounts rule, and not its discretionary non-application, that constitutes equity's intervention to effectively adjust priorities between the parties. Absent the application of the clear accounts rule, the trustee's right of indemnity would take priority over the rights of beneficiaries in the trust fund. It is through the clear accounts rule that equity intervenes and puts the trust creditors in a worse position than they otherwise would have been. It follows that a desire for equity to take a conservative approach to the rights of parties in insolvency would support the non-application of the clear accounts rule.

[236] D'Angelo, 'The Unsecured Creditor's Perilous Path to a Trust's Assets' (n 41) 840.

[237] See, eg, *Bathurst City Council* (n 188) 585 [42] (Gaudron, McHugh, Gummow, Hayne and Callinan JJ); Paciocco (n 200) 321–2.

[238] See, eg, Rohan Balani, 'Abandoning the *Quistclose* Trust in Insolvency' (2021) 42(1) *Adelaide Law Review* 259, 278–91.

Moreover, if accepted, the argument in the preceding Part would not have the effect of all trust creditors automatically avoiding the operation of the rule. Instead, the trust creditor would need to demonstrate that they contributed assets that benefited the trust fund. Thus, for example, a plaintiff entitled to damages against the trustee qua trustee would struggle to demonstrate a beneficial contribution to the trust assets. Similarly, the principle would not extend to trust creditors whose credit was never converted into a profit for the trust. The court's discretion would turn on questions of fact determined on a case-by-case basis. However, ultimately there would be certain deserving creditors who contributed valuably to the trust assets and as such would be entitled to have their right of subrogation take priority over the claims of the beneficiaries against the trustees.

VII Two Final Exceptions to the Clear Accounts Rule

Beyond the bases for resisting the clear accounts rule outlined above, there are two further circumstances in which the operation of the clear accounts rule could be avoided: (a) where the clear accounts rule is found to be contrary to statute; and (b) where its application is ousted by the trust deed. Each circumstance is considered below (although in the interests of brevity, the points raised are not intended to be exhaustive).

A *Statutory Intervention into the Right of Indemnity*

While an account of the general law right of a trustee's indemnity has already been provided in Part II of this article, the intervention of statute into a trustee's right of indemnity also poses interesting questions regarding the operation of the clear accounts rule.

Statutory provisions that confer on trustees a right of indemnity are not uniform across all Australian jurisdictions. While a detailed analysis of each jurisdiction is beyond the scope of this article, it should be noted that, at least in some jurisdictions, a trustee's statutory right of indemnity is cast in wide terms and without reference to general law restrictions.[239] For example, s 59(4) of the *Trustee Act 1925* (NSW) ('*NSW Trustee Act*') provides that '[a] trustee may reimburse himself or herself, or pay or discharge out of the trust property all

[239] See eg, *Trustee Act 1925* (NSW) s 59(4); *Trusts Act 1973* (Qld) s 72; *Trustees Act 1962* (WA) s 71; *Trustee Act 1958* (Vic) s 36(2).

expenses incurred in or about execution of the trustee's trusts or powers'. In *Free Serbian Orthodox Church Diocese for Australia and New Zealand Property Trust v Dobrijevic [No 3]*, Payne JA noted that s 59(4) was an 'embodiment' of the general law principle concerning a trustee's right to indemnity.[240] However, a question remains as to whether this 'embodiment' of the general law principle also embraces general law exceptions or limitations on that right of indemnity, such as the clear accounts rule.

On one view, the absence of any reference to the clear accounts rule in s 59(4) suggests that there was no statutory intention to incorporate the rule as a qualification on the trustee's statutory right of indemnity. Elsewhere, the *NSW Trustee Act* is not silent on the role of law and equity in regulating the rights of indemnity conferred by the Act. For example, s 14B(3) of the *NSW Trustee Act* explicitly enshrines the continued application of '[a]ny rules and principles of law or equity that relate to a provision in an instrument creating a trust that purports to exempt, limit the liability of, or indemnify a trustee in respect of a breach of trust'. Similarly, s 14B(1) preserves '[a]ny rules and principles of law or equity that impose a duty on a trustee exercising a power of investment … except to the extent that they are inconsistent' with the *NSW Trustee Act* or any instrument creating the trust. Arguably then, the absence of any express preservation of general law limitations on the trustee's right of indemnity (beyond the limitations recognised in s 59(4)) leaves little room for the continued application of the clear accounts rule on the statutory right of indemnity. That view would appear to be consistent with Spigelman CJ's judgment in *Gatsios Holdings v Kritharas Holdings (in liq)* ('*Gatsios Holdings*') where his Honour noted that the historical general law test for indemnifiable expenses to be 'proper' and 'reasonable' must now be understood in light of the statutory context.[241] Ultimately, in that case, the New South Wales Court of Appeal concluded that the 'proper' and 'reasonable' expenses test, which had been recognised historically at general law, was no longer determinative on whether an expense incurred by a trustee was indemnifiable.[242]

It should be noted that the conclusion reached by the Court of Appeal in *Gatsios Holdings* was doubted by the Victorian Court of Appeal in *Nolan v Collie* ('*Nolan*').[243] Additionally, in *Gatsios Holdings*, Spiegelman CJ expressly

[240] [2017] NSWCA 109, [28] (Ward JA agreeing at [1], Gleeson JA agreeing at [2]).

[241] (2002) ATPR ¶41-864, 44798 [9] ('*Gatsios Holdings*').

[242] Ibid 44798 [8], 44799 [17]. See also at 44802 [47] (Meagher JA).

[243] (2003) 7 VR 287, 306 (Ormiston JA). See also at 303–5 [44]–[46].

noted that the 'statutory provision itself must be understood in light of the pre-existing law, which it did not purport to change'.[244] Thus, *Gatsios Holdings* should not be relied on as authority for the proposition that s 59(4) completely displaces the general law. However, it is unnecessary to digress into a detailed discussion of the positions set out in *Gastios Holdings* and *Nolan* for the purposes of this article.[245] Rather, it is simply relevant to observe that the statutory right is a distinct source of the trustee's right of indemnity. While the clear accounts rule has traditionally applied to the general law right of indemnity, a question remains as to whether the rule can also be applied in circumstances where a party invokes the statutory right of indemnity given the absence of any reference to the rule in the Act.

B *Exclusion of the Clear Accounts Rule through the Trust Deed*

The second possible exception to the clear accounts rule occurs when it is contrary to the agreement of the parties. As the foregoing analysis has demonstrated, there is no reason to believe that the 'clear accounts rule' is a mandatory rule of trusts law.[246] Instead, as noted above, it should be considered a discretionary accounting technique available to the courts of equity. It follows that the rule can be displaced by specific drafting of the trust instrument.[247] While the exact combination of words to be used is a question for transactional lawyers,[248] in theory it is possible that a trust deed could explicitly provide that the value of a trustee's right of exoneration is not to be netted off or otherwise affected by the value of any obligation of the trustee to restore trust funds.[249]

244 *Gatsios Holdings* (n 241) 44798 [9].

245 Although, in the author's view, the approach taken by the Victorian Court of Appeal, in *Di Benedetto v Kilton Grange Pty Ltd* (2017) 16 ASTLR 463, is preferable — the Court held that the inquiry turns on the nature of the duty with which the trustee was required to comply or the power they were exercising: at 479 [64] (Ferguson and McLeish JJA and Cameron AJA).

246 In *Perpetual Trustees (WA)* (n 156) 7–8 (Young J), the Court noted that the application of *Cherry* (n 3) could be displaced by the agreement of the parties.

247 See Richard C Nolan, 'Some Particular and Some General Reflections on Trustee Contracts' in Hans Tjio (ed), *The Regulation of Wealth Management* (National University of Singapore, 2008) 247, 250–1.

248 See generally D'Angelo, *Transacting with Trusts and Trustees* (n 21) 310–12 [7.80]–[7.87].

249 The situation is complicated where the right of indemnity relied on is the statutory right. There, a question will arise as to the extent to which the statutory right can be modified by the trust deed. Campbell provides a useful list of cases that set out the positions in various states: JC

Additionally, the trust deed could provide that beneficiaries may only bring claims against an insolvent trustee once the trustee's right of exoneration has been satisfied out of the trust assets.

There does not appear to be any case law to date on attempts to modify the operation of the clear accounts rule through the trust instrument. However, at least in principle, there is no reason why such drafting should be rendered ineffective by courts of equity. To appreciate that point, it is important to recall that there are few fixed rights with general characteristics that are universally enjoyed by all beneficiaries.[250] Instead, the trust instrument, as given effect by equity, is the source of a beneficiary's rights.[251] While trust law recognises an 'irreducible core' of a trustee's duties that cannot be ousted by the trust instrument,[252] the aforementioned drafting does not purport to exclude the operation of a trustee's duties or the corresponding rights of beneficiaries. Instead, it simply sets an order of priority as to when the beneficiaries' rights can be exercised and how the value of those rights will be calculated.

VIII Conclusion

The clear accounts rule has significant implications for trust creditors. It impacts their only route to accessing trust assets in satisfaction of the debts owed to them. This article has examined the clear accounts rule from both a historical and modern doctrinal perspective. It has suggested that a fidelity to history would require the clear accounts rule to be applied on a presumptive basis, such that its application could be circumvented by adducing evidence of a trustee's actual intentions when misappropriating trust funds. Alternatively, it has suggested that from a modern perspective, a discretionary approach to the clear accounts rule is justifiable. Such a discretion ought to be exercised in a manner that is sensitive to the prejudice suffered by trust creditors and their beneficial contributions to the state of the trust assets. Finally, this article has

Campbell, 'Some Aspects of the Civil Liability Arising from a Breach of Duty by a Superannuation Trustee' (2017) 44(1) *Australian Bar Review* 24, 34–5 n 44 (citations omitted). However, the issue may be avoided if, as this author suggests may be the case, the clear accounts rule does not apply to the statutory right of indemnity to begin with.

[250] See, eg, *CPT Custodian Pty Ltd v Commissioner of State Revenue (Vic)* (2005) 224 CLR 98, 109–10 [15] (Gleeson CJ, McHugh, Gummow, Callinan and Heydon JJ).

[251] David Fox, 'Definition and Classification of Trusts' in John McGhee and Steven Elliott (eds), *Snell's Equity* (Sweet & Maxwell, 34th ed, 2020) 635, 636–7 [21-004].

[252] *Armitage v Nurse* [1998] Ch 241, 253 (Millett LJ, Hutchison LJ agreeing at 264, Hirst LJ agreeing at 264).

observed that one further possibility to explore for transactional lawyers is the way in which a trust deed or governing rules of a trust can be drafted so as to avoid the clear accounts rule entirely.