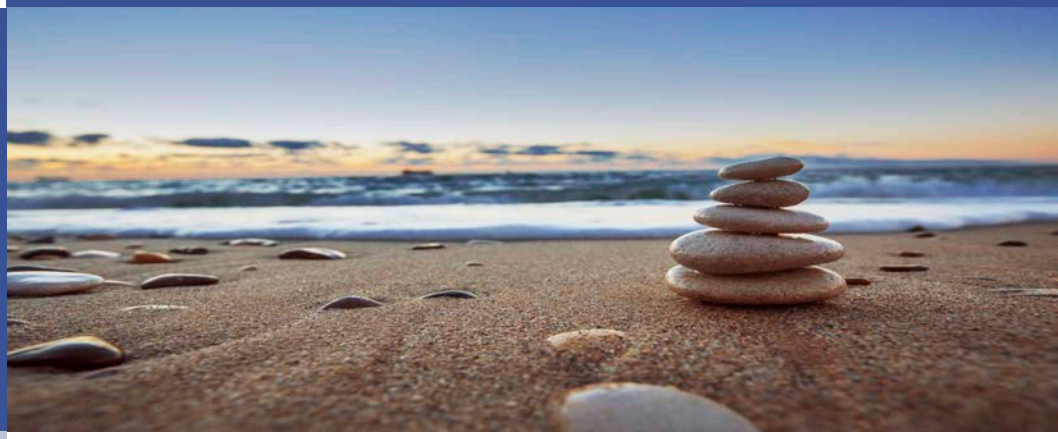
Wolters Kluwer

New Zealand
Trusts & Asset Planning Guide



BULLETIN 1

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IN THIS ISSUE:

Cases considered

This Bulletin includes cases considering the following:

- Trustees faced with major financial decisions particularly with larger trusts can apply for the protection of the Court in regard to that decision. The High Court's willingness to give its blessing to a major financial decision under s 66 of the Trustee Act provides an important protection for trustees under s 69 and brings New Zealand in line with some other equity jurisdictions, *Re PV Trust Services Ltd* (2017) 4 NZTR ¶27-028.
- The importance of a retiring trustee securing an indemnity from the existing or new trustee and the disadvantage the retiring trustee will be under without that indemnity, *LSF Trustees Ltd* v *Footsteps Trustee Company Ltd (in liq)*; *TAL 41 Ltd* v *Footsteps Trustee Company Ltd (in liq)* (2017) 4 NZTR ¶27-024.
- Trustee's costs. A trustee's right to indemnity cannot be taken for granted, especially where litigation is concerned, *Courteney* v *Pratley* (2017) 4 NZTR ¶27-030. (The High Court also commented on *Beddoe* applications at short notice.) Similarly, trustees incurring unnecessary costs due to misunderstanding the trust deed may have to carry those costs on their own, *Mackie Law Independent Trustee Ltd* v *Chaplow* (2017) 4 NZTR ¶27-026. Where the trustee has lost the trust deed it is appropriate to apply to the Court for directions as to distribution of the trust fund, but inappropriate to seek to distribute a family trust to a charity in which the trustees are or have been involved, at the expense of the family. Trustees may not necessarily be fully reimbursed from the trust fund on their directions application, *Davis* v *White* (2017) 4 NZTR ¶27-033.
- Can misappropriated funds be traced into a debt? A recent Court of Appeal decision clarifies the current position in the face of a number of conflicting High Court decisions, *The Fish Man Ltd (in liq)* v *Hadfield* (2017) 4 NZTR ¶27-031.
- Is it owned in trust or not? Steps taken to secure a tax advantage may result in the asset's beneficial interest being owned unfavourably in a relationship property dispute, *Horsfall* v *Potter* (2017) 4 NZTR ¶27-032.
- Appointors and protectors powers, are they fiduciary or personal? It does matter. Trust assets may not be protected from claimants, *Goldie* v *Campbell* (2017) 4 NZTR ¶27-020 and, in comparison, the English High Court decision *Mezhprom* v *Pugachev* [2017] EWHC 2426.
- The disadvantage of life insurance being owned by the life insured on their own life, *Rosenberg* v *AMP Services (NZ) Ltd* [2017] NZHC 2232.

Trustees seeking the Court's blessing to a proposed course of action

Trustees engaging in a major transaction with trust assets may at times be taking their lives in their hands. The ability to apply to the Court for directions, particularly where there is some uncertainty as to the action proposed by the trustee, can provide crucial protection for the trustee. The High Court's willingness to support trustees, where this support is appropriate, is an important development in trust law in New Zealand. An example of this was the decision *Re PV Trust Services Ltd* (2017) 4 NZTR ¶27-028 (30 November 2017). The judgment sets out the approach the Court should adopt considering this type of application and is a very valuable procedure where trustees are making a momentous decision with the trust fund.

Background

Re PV Trust Services Ltd concerned an application by the sole trustee, PV Trust Services Ltd (PVTS), for directions under s 66 of the Trustee Act 1956. The application concerned the appointment by the trustee of final beneficiaries of a New Zealand foreign trust. The trust was governed by New Zealand law, holding cash and securities of approximately US$11m. At the end of 80 years from settlement or the earlier date set by the trustee, the trustee was to hold the unappointed trust capital in such shares and for such of the beneficiaries, as were appointed by the trustee. The trust was prepared by a Uruguayan lawyer and the trust deed failed to identify any default beneficiary or final repository to receive the unappointed trust capital. The settlor and other primary beneficiary (her daughter) were now deceased.

The sole New Zealand corporate trustee was applying for directions under s 66 of the Trustee Act that it was proper and lawful to administer and distribute the trust as proposed. This was not a surrender by the trustee of its powers to the Court, but rather to secure the Court's blessing to the trustee's proposed exercise of discretionary powers (so granting the trustee protection from future claims by beneficiaries or others under s 69 of the Trustee Act). Under s 69 any trustee acting under any direction of the Court is deemed to have discharged his duty as such trustee in the subject matter of the direction, notwithstanding that the direction is subsequently invalidated, provided the trustee has not been guilty of any fraud or wilful concealment or misrepresentation in obtaining the direction.

The problem and the trustee's proposed distribution solution

A second memorandum of wishes by the settlor provided that the trustee was to distribute as much income and capital to the settlor and her daughter as was requested, and after they had both died, to pay US$2,000 per month to MM a family employee for the rest of her life, to pay US $300,000 to one charity and the dividends on the remainder of the trust fund were to be distributed to certain charities. It was intended that further directions would be provided to the trustee as to the distribution of the balance of the fund. The settlor and daughter died before giving those directions.

The problem was that if the trustee gave effect to the settlor's memorandum of wishes it would be holding approximately US$11m until 2090 or such earlier date as the trustee nominated. Because the trust had no final beneficiaries, the trust fund would be held on a resulting trust for the settlor which under her will a daughter was the sole heir and under the daughter's will, distributed to friends, SF and JG. However, by 2090 they would be dead and the trust fund would be distributed to their heirs.

The trustee considered that the solution was to distribute the balance of the trust fund in accordance with the daughter's will, ie appoint the daughter's heirs, SF and JG, as beneficiaries of the trust in equal shares. PVTS proposed to administer and distribute the trust estate by:

(a) setting aside US$1m and pay US$2,000 per month to MM for life as a beneficiary

(b) distributing US$300,000 to the Foundation as a beneficiary

(c) distributing US$3,163,152 (net present value of the trust's income for the trust's remaining lifespan) to certain charities appointed by PVTS

(d) appointing SF and JG as beneficiaries and distributing the remainder of the Trust to them in equal shares, and

(e) on the death of MM to distribute the balance of the funds to SG and JG equally.

The issue for the Court was whether s 66 of the Trustee Act granted the trustee the right to apply to the Court for directions in the nature sought.

The scope of s 66 of the Trustee Act

Here the trustee was not applying on the basis of the Court's inherent jurisdiction, but rather on s 66, which gives a broad right to apply to the Court for directions, and on s 69, which would effectively shield PVTS from future related claims by beneficiaries and/or other parties. The Court acknowledged it was unclear as to the breadth of issues that could be determined by s 66 applications, but the section was not restricted to minor or procedural matters, although it was usually not appropriate where important facts were contested. Could PVTS rely on s 66 here where it accepted it had the powers to administer and distribute the trust estate in the manner proposed, without genuine doubt about the proposed course of action, but given the decision was momentous, sought the Court's approval or blessing? PVTS was not surrendering its discretion, but sought the Court's approval of PVTS's *own* exercise of discretion.

The Court considered that there were at least four distinct categories when the Court has to adjudicate on a course of action proposed or taken by trustees:

(1) Whether the proposed action is within the trustees' powers, being a question of construction of the trust instrument and/or a statute. This must be decided in open court after hearing from both sides.

(2) Whether the proposed course of action is a proper exercise of the trustees' powers, where there is no real doubt as to the trustees' powers, but because the decision is particularly momentous, the trustees wish to obtain the Court's blessing for an action they have resolved is within their powers. There is no surrender of discretion.

(3) Surrender of trustees' discretion to the Court, which the Court will only accept for good reason. The Court is then exercising its own discretion.

(4) The trustees have actually taken action, which is attacked as outside their powers or is an improper exercise of their powers. This is hostile litigation heard in open court.

See *Public Trustee v Cooper* [2001] WTLR 901 (Ch) Hart J quoting from an unreported chambers judgment of Robert Walker J (as he then was).

The present application was within category two. The trustees were not surrendering their discretion to the Court. A question raised was whether the trustees needed to be in "genuine doubt" hence the need for the directions application. The Court noted that in England, trustees do not need to be in "genuine doubt", before approaching the Court for directions under its "broad equitable jurisdiction". Section 66 is an enactment of this jurisdiction. There is no reason why there should be a threshold requiring trustees to be in "genuine doubt". A s 66 application does not necessarily involve a surrender of discretion. The standard of assessment is whether the proposed decision is both lawful and proper and not in bad faith, or ultra vires. The jurisdiction conferred by s 66 applies to the category two type directions, provided appropriate procedural safeguards are in place to minimise potential prejudice to beneficiaries and the Court considered that this approach could be useful in the New Zealand context.

Approach to applications of this kind

The Court noted the potential to disadvantage beneficiaries in circumstances like the present, if "blessing" orders are improperly made. Therefore, it was paramount that applicant trustees provided the Court with all relevant facts, documents and information when making the application. The judge should only make the orders sought after "scrupulous consideration" (*Public Trustee v Cooper* [2001] WTLR 901 (Ch) at 925) of the evidence:

- has the trustee in fact formed the opinion
- is the opinion one a reasonable body of trustees, properly instructed as to the trust deed could properly arrive at, and
- is the opinion vitiated by any conflict of interest?

The consequences of the Court's endorsement of the trustee's decision is to deprive beneficiaries from alleging breach of trust and seeking compensation for any wrong. Therefore, it is important the judge adopts a thorough and active approach to testing the evidence: [55]–[57], [60].

This proposal and decision

PVTS had the discretionary powers to administer and distribute the trust estate in the manner proposed. Was the proposal proper or did it infringe on PVTS duty to act as a reasonable and prudent trustee (although it was not for the Court to say how it would exercise the discretion)? The Court considered it was preferable to distribute the trust, rather than waiting until 2090 and appropriate consideration had been given to the settlor's second memorandum of wishes, although these "run out". It was reasonable to take into account what would happen on the trust's expiry, and that in the circumstances, reasonable to have regard to daughter's will, particularly given the lack of clear evidence as to the settlor's or her daughter's wishes as to the balance of the fund.

The Court noted that the proposal did require the appointment of new beneficiaries, but none of the evidence suggested the full balance of the trust was to go to the existing beneficiaries. The proposal was not one no reasonable body of trustees would have reached, nor was it capacious, in bad faith or exercised for an improper purpose, neither was there any conflict of interest with PVTS. The proposed distribution was proper and lawful for the trustee to administer and distribute the trust as set out in its application.

The importance of a retiring trustee securing an indemnity from the continuing or new trustee

The High Court decision of *LSF Trustees Ltd v Footsteps Trustee Company Ltd (in liq); TAL 41 Ltd v Footsteps Trustee Company Ltd (in liq)* (2017) 4 NZTR ¶27-024 (8 November 2017), highlights in an indirect way, the importance of a retiring trustee securing an indemnity from the continuing or new trustee for previous trust liabilities, and the possible vulnerability of the retiring trustee without that indemnity (notwithstanding a right to be indemnified from the trust assets by way of an equitable charge). The disadvantage is that to implement the equitable charge is cumbersome. It requires judicial process and a court order.

LSF Trustees Ltd v Footsteps Trustee Company Ltd (in liq) also illustrates how creditors of a former corporate trustee may be delayed or defeated, by leaving the former trustee assetless and without any contractual right against the new trustee in respect of liabilities incurred by the former trustee.

Background

Footsteps Trustee Company Ltd (Footsteps Trustee Co) was the corporate trustee of the Footsteps Trust, until Mr Mark Lyon, a property developer under his power as appointor, removed Footsteps Trustee Co and replaced it with TAL 41 Ltd. The deed of appointment and removal vested all trust property in the new trustee, but made no provision for the new trustee to indemnify the removed trustee. The liquidators of Footsteps Trustee Co made statutory demands under s 289 of the Companies Act 1993 for over $379,000 (principally in respect of rates, charges and body corporate levies) against the new trustee, TAL 41 Ltd, and another company, LSF Trustees Ltd, to which property units had been sold to it by the former trustee, although LSF Trustees Ltd denied ever being a trustee of the Footsteps Trust. This judgment is about TAL 41 Ltd and LSF Trustees Ltd who applied to the Court under s 290 of the Companies Act to have the statutory demand by the liquidators set aside.

The liquidators of Footsteps Trustee Co argued that as trustee, it was entitled to be reimbursed for debts it incurred as trustee and indemnified from the assets of the Footsteps Trust. It was argued that this right survived the company's removal as trustee and as LSF Trustee Ltd was the current owner of some trust assets and TAL 41 Ltd was the replacement trustee, they could be looked to for reimbursement. [A subsidiary issue was the agreement by Footsteps Trustee Co transferring property units to LSF

Trustee Ltd. It was argued that was unsound involving the same people and at under value.]

The issue for the Court was whether the former trustee had a claim for previous trust liabilities, against the new trustee, so as to make the new trustee its creditor.

Trustee's right of indemnity

The judgment referred to the summary of a trustee's right of indemnity in equity by Brereton J in *Lemery Holdings Pty Ltd* v *Reliance Financial Services Pty Ltd* [2008] NSWSC 1344, (2008) 74 NSWLR 550. Brereton J noted the weakness of the position of a former trustee in practical terms as regards exercising the indemnity, compared to that of a current trustee. The key points were:

- A former trustee is not necessarily entitled to retain assets for indemnity against a new trustee. (In the present case, the Court considered that this was consistent with the automatic vesting of assets under s 47 of the Trustee Act.)
- In the absence of a contractual indemnity (by the new trustee to the former trustee), there is no personal claim available to the old trustee against the new trustee.
- A trustee's indemnity for expenses goes to reimbursement, exoneration, retention and realisation. A trustee may:
  - met a trust liability personally and then reimburse himself, or
  - pay the liability directly from the trust fund (exoneration), or
  - retain the trust fund or retain the trust fund until he has been indemnified for present, contingent or future liabilities, and
  - may realise trust assets to meet his expenses and liabilities.
- That position changes when the trustee is replaced. The equitable lien allows the former trustee recourse to trust assets, but only with the court's assistance.

In the present case, while the debts incurred by Footsteps Trustee Co as trustee may be the subject of the indemnity, and it may have an equitable lien over trust assets held by the new trustee, the issue was whether that indemnity gave a personal claim against the new trustee, TAL 41 Ltd, such as to make TAL 41 Ltd its creditor. Footsteps Trustee Co had no contractual right against TAL 41 Ltd (there being no indemnity provision in the deed of removal). It can only rely on equity under s 38(2) of the Trustee Act.

The important point to note is that when Footsteps Trustee Co had legal title to trust assets, it could use its powers to reimburse itself from trust property and so exonerate itself from liability. It could also retain assets until liabilities were cleared, and could realise those trust assets. Once the assets vested in the new trustee, all it retained was its equitable lien.

The equitable lien of the former trustee

An equitable lien is a form of equitable charge over property that gives the trustee a right of realisation by the Court appointing a receiver or ordering a sale. If there are no contractual indemnities in the deed of retirement/appointment, (as was the case here) there was no personal liability under the equitable lien, and it was therefore only a charge against assets that may be enforced by judicial process. Consequently, for Footsteps Trustee Co (and its liquidators through it) to enforce its lien, its remedy against trust assets now held by the new trustee, required it to apply to the Court for an order of sale of trust assets (there being no creditor/debtor relationship between Footsteps Trustee Co and TAL 41 Ltd, the new trustee). The Court noted that trustees may at the Court's discretion also have personal rights of indemnity against beneficiaries (although this would not normally be the situation with discretionary beneficiaries).

No rights against the new trustee, unless provided for contractually

The Court concluded that while the former trustee may exercise its powers against trust assets, this did not impose a personal duty on the new trustee to pay the trust debt. A new trustee is not under a personal duty to indemnify a former trustee in the absence of any contractual provision to that effect. In the present case, there was a genuine dispute as to the liability of TAL 41 Ltd under the statutory demand.

In regard to the sale of trust assets to LSF Trustee Ltd, while there may be good grounds to have this set aside there was no evidence that that had been done yet and until set aside, LSF Trustee Ltd was entitled to maintain its position, that it has met its obligations under the sale agreement. Even if the Court was to hold that the transfer to LSF Trustees Ltd was unsound, and subject to an equitable lien in favour of Footsteps Trustee Co, this would still not give Footsteps Trustee Co a personal claim against LSF Trustee Ltd. The equitable lien would only give a right of recourse to the trust assets by judicial process.

Conclusion

The Court concluded that for both TAL 41 Ltd and LSF Trustee Ltd, there were good grounds for disputing whether Footsteps Trustee Co was a creditor of either of them. The claim to be a creditor was genuinely disputable under s 290(4)(a) of the Companies Act. The liquidators' remedies were limited. The Court specifically noted that it was an unsatisfactory feature of the law that assets held in trust could be moved relatively easily from an insolvent corporate trustee and the remedies of trust creditors were cumbersome. The statutory demands against TAL 41 Ltd and LSF Trustee Ltd were set aside.

A further point from the case was that both TAL 41 Ltd and LSF Trustee Ltd sought costs against the liquidators personally. The Court noted that the liquidators had issued statutory demands without taking legal advice in what was a tricky area of law. There were unsatisfactory aspects on the side of both TAL 41 Ltd and LSF Trustee Ltd. The Court instead ordered that costs follow the event, there was nothing in the liquidators' conduct that made them personally responsible for the costs of TAL 41 Ltd and LSF Trustee Ltd applications to have the statutory demand set aside.

Solicitor/trustee failing to be indemnified for litigation and Beddoe order at short notice

There have been several recent decisions involving a solicitor/trustee, where the trustee has failed to be indemnified from the trust fund for costs or expenses incurred. Generally, a trustee is entitled to be indemnified for all reasonable expenses properly incurred in the execution of the trust, and this includes the cost of litigation. However, trustees need to take care that while that litigation may be defending the trust estate, that it is not hostile litigation between a beneficiary and a likely beneficiary, into which the trustee gets dragged, so he is fighting the beneficiary's battle for him, when he needs to stand back and let the beneficiaries fight it out. That the solicitor/trustee was unsuccessful in being reimbursed for that litigation (even though he was a court appointed trustee) was considered by the High Court in *Courteney* v *Pratley* (2017) 4 NZTR ¶27-030 (21 December 2017). Also discussed in the judgment was beneficiary/trustee conflict of interest and trustee protection under a *Beddoe* order at short notice.

Background

The plaintiff, Mr Steven Courtney, had sought reimbursement for $36,000 care expenses he had incurred in respect of his father and his father's estate (which estate had then passed to his mother and formed part of her estate). The plaintiff brought proceedings in the District Court against his mother's estate for the care expenses. The plaintiff with his daughter also brought a successful Family Protection claim (*Courteney v Pratley* [2017] NZHC 1761) against his mother's estate in the High Court. The mother's entire estate (consisting of New Zealand and off-shore assets) had been left to Steven Courteney's only sibling, Stuart Courteney, the executor/trustee of his mother's estate. Stuart Courteney had commenced a defence to the District Court care expenses claim, but subsequently took no further steps. Stuart Courteney also opposed the Family Protection claim. He was removed as executor/trustee by the High Court and replaced by the defendant, a lawyer, Mr Pratley.

Mr Pratley's appointment was made to a dysfunctional trust estate and under time pressure. Although Mr Pratley was aware of the $36,000 care expenses claim in about March 2015, he was not appointed by the Court replacing Stuart Courteney as executor/trustee, until 12 October 2015. He received the files on 30 October and the District Court hearing was on 10 November. Mr Pratley unsuccessfully sought an adjournment. After receiving legal advice from Stuart Courteney's solicitors, Mr Pratley instructed counsel and unsuccessfully defended that claim.

The judgment under discussion is concerned with Mr Pratley's right to be indemnified for the litigation expenses he incurred in continuing the defence to the District Court claim commenced by the previous trustee, Stuart Courteney.

Conflict of interest as trustee/beneficiary

Mr Pratley took trusteeship under what the High Court pointed out had been a conflict of interest situation for the previous trustee/beneficiary. In an earlier High Court minute (*Courteney v Courteney* HC Wellington, CIV-2013-485-5912, 12 August 2015) and then a judgment, Judges expressed concern that Stuart Courteney as the sole executor/trustee and sole beneficiary of his mother's estate failed to act even-handedly as an executor and trustee, having a conflict of interest — as a sole beneficiary of his mother's estate which adversely affected his duties as a trustee towards other potential beneficiaries. Stuart Courteney's conflict of interest was explained by MacKenzie J in his Minute:

> "[2] … the issue before the Court … is how best to achieve an 'equality of arms' … given the superior position of the defendant [Stuart] which derives from his possession of material and information in his capacity as an executor.
>
> [3] The defendant has two distinct and separate roles in these proceedings … as executor … he owes a duty of even-handedness between the plaintiffs, as claimants against the estate, and the beneficiaries under the estate … The second is his role as beneficiary. In that capacity, the defendant is able to take a partisan stand supporting the dispositions in the will.
>
> [4] That dual role of the defendant creates a conflict of interest. The defendant … does not consider he has a conflict of interest. That is wrong. The conflict is, as a matter of law, inherent in the dual role.
>
> …
>
> [7] The duty of even-handedness means that an executor should obtain separate legal advice from a legal adviser who is visibly independent … in a way which will satisfactorily address the inequality of the positions of plaintiffs and defendant …"

This required Stuart Courteney to obtain independent advice. He was found to have failed to discharge his duty of even-handedness as executor and trustee, being adversely affected by his interest as sole beneficiary of his mother's estate. This gave rise to the recall of probate and the appointment by the High Court of Mr Pratley in Stuart Courteney's place. Mr Pratley's appointment included a cautionary warning by the Judge of the need for proportionality in the steps taken as executor and trustee and the cost of protecting the estate with the erosion of trust property by litigation costs.

The present judgment was whether it was necessary for Mr Pratley as executor/trustee to continue the defence started by Stuart Courteney and actively defend the $36,000 claim in the District Court and whether he was entitled to be indemnified for his costs and expenses incurred in defending that claim (in addition to $20,000 already paid towards his overall costs). Mr Pratley submitted that he took legal advice (this included with the previous trustee's solicitors), and that there was nothing further he could have done once the adjournment was declined, but defend the proceedings, Stuart Courteney being the only beneficiary. It was argued that there was no time to bring a *Beddoe* application in the space of a week.

The nature of the litigation and were the litigation expenses "properly incurred"?

While the situation may at first appear to be defence of the trust estate, the Court appointed executor/trustee had to take over from a previous dysfunctional executor/trustee who had failed in his duty to be even-handed. In essence, this was unsuccessful hostile litigation, beneficiary vs beneficiary, continued by the Court appointed trustee (urged on by the former trustee/beneficiary's solicitors).

The Court concluded that this was simply a hostile dispute between two rival claimants to a trust fund, started by the beneficiary/trustee and that the new court appointed trustee unwittingly continued. However, being ordinary hostile litigation, costs follow the event and do not come from the trust estate:

"In a case where the dispute is between rival claimants to a beneficial interest in the subject matter of the trust, rather the duty of the trustee is to remain neutral and ... offer to submit to the court's directions, leaving it to the rivals to fight their battles" Lightman J in *Alsop Wilkinson v Neary* [1995] 1 All ER 431 (Ch).

The Court asked the question, "were Mr Pratley's actions necessary in the circumstances, so that the expenses were reasonably and 'properly incurred'"? Improperly incurred expenses not being met by the trust estate and falling on the trustee personally.

While it was acknowledged that the trustee's function is to assert the interests of the beneficiaries, this is valid only up to a point. It was considered that Mr Pratley incurred costs to the estate that were not necessary or reasonable for the following reasons:

- Stuart Courteney as the previous trustee acted in conflict of interest and contrary to the obligations on him as a trustee to act equally.
- The dispute was hostile.
- The claim was only $36,000, which made litigation uneconomical.
- The trustee's obligation to protect assets had to be measured against the erosion of trust property by litigation costs.
- The Family Protection claim required assessment by the trustee about the likely beneficiaries.
- Stuart Courteney had already made submissions in his defence and had elected to step away from the litigation, so the option of no involvement by the trustee was open to him.
- This was unsuccessful hostile litigation, beneficiary vs beneficiary.

Although Mr Pratley was a Court appointed trustee, if awarded his costs, Steven Courteney would in effect bear the full costs of Stuart Courteney's unsuccessful litigation and Mr Pratley's costs. This would be unfair to Steven producing a disproportionate result. Mr Pratley had already received $20,000 towards his overall costs and would be paid for the administration of the estate. The High Court concluded that his District Court costs should not be met by the estate (ie they would be met by Mr Pratley personally).

Trustee's protection by a Beddoe application

It was submitted for Mr Pratley that there was not time for him to make a *Beddoe* application before the District Court hearing. In response, the Court made several points:

- The Court considered that the English decision *Alsop Wilkinson v Neary* (which required a separate *Beddoe* application) could be distinguished, the necessary parties not being before the Court.
- By contrast with the facts in *Alsop Wilkinson*, an originating application under the High Court Rules and the provisions of the Trustee Act 1956 could be sought, if necessary on an urgent basis, with reference to *Re Beddoe*.
- To the submission that there was no time for Mr Pratley to seek such orders, the Court's response was that the ability of a trustee to seek directions, particularly in urgency is one "the Court can and does accommodate". It will be interesting to see how this works out in practice.
- The Court concluded that ss 66 and 69 of the Trustee Act provide an easy method for trustees to obtain directions and protection for the trustee acting under those directions. Although under exigency it was not necessary for Mr Pratley as executor to defend the District Court proceedings and he was not entitled to be indemnified from the estate in respect of his costs and expenses incurred.

If Mr Pratley was to be reimbursed, Steven Courteney would be funding Mr Pratley's unsuccessful defence to that claim of $73,700 ($36,700 costs award and $37,000 Mr Pratley's costs and legal expenses). The Court concluded that this would be an unjust outcome.

Mackie Law Independent Trustee Ltd v Chaplow — unnecessary costs incurred

Mackie Law Independent Trustee Ltd v *Chaplow (Costs judgment)* (2017) 4 NZTR ¶27-026 (1 December 2017) also involved a solicitor/trustee not being entitled to be indemnified for certain expenses, including part of their costs incurred for an application to be removed as trustee. Normally the costs of the trustees' application to be removed would be met from the trust. The judgment under discussion is the costs judgment following the substantive judgment.

Costs incurred for work not required in the execution of the trust

The trustees had followed the settlor's memorandum of wishes, even though that conflicted with the trust deed. They had also misunderstood the effect of the memorandum of wishes, failed to consult the sole primary beneficiary regarding trust property and then proceeded on a misapprehension as to the terms on which that property should be resettled. The result was significant costs were incurred for work not required in the execution of the trust and therefore the Court held that only a portion of the fees were indemnifiable from the trust property.

The Court held that the trustees in their efforts to administer the trust had acted in breach of their obligations and incurred fees that could not be justified. Had the former trustees stood back from the problem it would have been clear the outcome reached could have been achieved through negotiation rather than expensive litigation. It was noted that Ms Chaplow, the sole beneficiary, had contributed to the difficulties by dealing with the trust property herself and not properly accounting for rent received from it.

In regard to the trustees' application to the High Court; to be removed as trustees, to be indemnified for legal costs and for the costs of the application, the Court considered the application to be premature. Ms Chaplow had sought indemnity costs. She was allowed costs on a 2B basis with a 25% uplift to reflect the trustees' unreasonable conduct in relation to the trustees' application.

Davis v White (CA) — appeal by trustees from costs judgment requiring trustees to meet part of costs personally

Davis v *White* (2017) 4 NZTR ¶27-033 (12 December 2017) was an appeal from a High Court costs judgment, that had for specific reasons declined to order that all of the trustees' legal costs in an application for directions be met from the trust fund.

Background

Mr and Mrs White married in 1984 and Mr White died in 2001. It was Mr White's second marriage. They had no children from that marriage. In 1992 Mr White established a discretionary family trust. The appellants, Mr Davis and Mr McNiece (the solicitor who prepared the trust deed), were the trustees of the trust. Mrs White had inherited Mr White's estate on his death in 2001 and understood she was the sole beneficiary of the trust. Annual income from the trust was paid to Mrs White (then living in Australia) and several distributions of capital were made to her when she requested financial assistance. In June 2014, Mrs White consulted an Australian law firm who requested a copy of the trust deed from the trustees and expressed Mrs White's wish that the trust vest and the trust funds be paid to her. Mr McNiece replied advising that Mrs White was a discretionary beneficiary, not a final beneficiary and that there was power under the trust deed to make capital distribution to "various charities".

Application for directions

In 2016 the trustees had applied to the High Court for directions under s 66 of the Trustee Act , as no executed copies of the trust deed existed. The trustees sought orders that:

(a) the trust was valid and subsisting, and

(b) on Mrs White's death, the trustees could distribute the trust fund to the Freemasons New Zealand.

While there was an unexecuted draft trust deed, this was based on a precedent for another client of Mr McNiece, and contained numerous errors including in regard to beneficiaries. The draft deed contained no reference to Freemasons New Zealand as a discretionary or primary beneficiary, although Mr White and the trustees were or had been members of that organisation and one of the trustees asserted Mr White wished to benefit that charity. There were no contemporary documentation, notes or file notes, these having been lost or destroyed.

High Court — Substantive judgment and costs judgment

In the substantive judgment, *Davis* v *White* (2016) 4 NZTR ¶26-012 the application for directions by the trustees failed. The High Court held that the trust failed for lack of certainty of objects, and trust funds reverted on a resulting trust to the estate of the settlor to be held for the respondent as sole beneficiary of that estate. In the costs judgment that followed, the Court ordered:

(a) the trustees to pay Mrs White's costs on an increased scale 2B basis

(b) the trustees to meet 50% of their legal costs (including counsel's fees), and

(c) in paying costs, the trustees were not to have recourse to the funds previously held by them for the trust.

Mr Davis died in December 2016. Mr McNiece appealed the costs judgment, that the trustees pay the costs personally. The substantive judgment was not appealed. This discussion concerns the appeal from the High Court costs judgment.

Court of Appeal judgment

In regard to the general principle of trustees being indemnified, the Court of Appeal noted that generally a trustee will be entitled to pay expenses incurred in the execution of the trust (including costs awards and legal costs) from trust property, Trustee Act, s 38(2) [provided the expenses incurred are reasonable and properly incurred]. The Court also noted that it was hesitant to direct a trustee bear the costs burden personally, unless he has been so unreasonable and should pay costs personally.

In regard to the absence of an executed copy of the trust deed, the Court noted that it was appropriate for the trustees to apply to the High Court for directions. What made the trustees' actions unreasonable were:

- Seeking to rely on a plainly defective document as evidence of the trust.
- Taking an untenable position that the whole of the trust fund be paid to Freemasons New Zealand (a charity in which they had involvement) in direct conflict with Mr McNiece's earlier written advice to Mrs White that she was the sole beneficiary, and
- Misinforming her solicitors that there was provision in the trust deed for the capital to be distributed among various charities.

There was no or insufficient evidence of Mr White instructions to benefit Freemasons New Zealand and this was contrary to the will Mr White made a year before the trust was established, leaving his estate to Mrs White.

It was considered that this was a proper case to deny the trustees indemnity for costs from the trust funds. The uplift in costs to Mrs White to reflect the unreasonable approach of the trustee would be of no practical value to Mrs White, if the trustees could resort to trust funds to pay it, similarly it was not appropriate the trustees recover all their own legal costs from the trust estate. Although unreasonable, the trustees had taken advice before issuing direction proceedings, entitling the trustees to take 50% of their legal fees from the trust fund. The Court noted that the trustees could consider themselves fortunate. The appeal was dismissed, Mr McNiece was to meet his own legal costs of this appeal personally.

Tracing misappropriated trust property into debt

Tracing misappropriated trust property was considered in *New Zealand Trusts & Asset Planning Bulletin* September 2016 "Tracing — some recent cases", and in the *New Zealand Trusts & Asset Planning Guide* at ¶142-050. However, the New Zealand cases discussed were all from the High Court and some are in conflict with each other on key points of law, in particular, tracing into debt. The appeal to the Court of Appeal in *The Fish Man Ltd (in liq)* v *Hadfield* (2017) 4 NZTR ¶27-031 (14 December 2017) clarifies the important issue of whether it is possible to trace property into debt and the exception to this.

Background

The Fish Man Ltd was placed into liquidation in 2010 over debts due to Inland Revenue. Mr Hadfield, the former sole director and shareholder, had carried on the Fish Man Ltd business from his Auckland property and had used money from the company to meet bank mortgage payments on the property. Mrs Hadfield, Mr Hadfield's wife, had also met mortgage payments on the property.

The liquidators of The Fish Man Ltd obtained a default judgment against Mr Hadfield in the District Court for $133,457. Mr Hadfield was adjudicated bankrupt in 2013 following which the property vested in the Official Assignee. The Official Assignee later disclaimed the property, it being subject to a bank mortgage and having no equity. Three years after the disclaimer, the property had increased in value with the increase in Auckland property prices. The liquidators now brought proceedings seeking to claim the increase in value in the property. The liquidators contended The Fish Man Ltd had a beneficial interest in the property, arising from breach of fiduciary duties by Mr Hadfield to the company. In the meantime, Mr Hadfield had been discharged from bankruptcy.

High Court

In the High Court, *The Fish Man Ltd (in liq)* v *Hadfield* (2016) 4 NZTR ¶26-014, there were three competing claims for the equity in the property:

(1) The liquidators of The Fish Man Ltd sought an order under s 119 of the Insolvency Act 2006 vesting the property in the company on the ground that it had a proprietary interest in the property because of $49,159 applied to the mortgage.

(2) Mr Hadfield applied that the property be vested in him.

(3) Mrs Hadfield claimed a half interest or a protected interest under s 20B of the Property (Relationships) Act 1976 (the PRA).

The High Court held that The Fish Man Ltd had no claim to the property under s 119. It held that Mr Hadfield could make a claim for the property to be vested in him under s 119(2) and that Mrs Hadfield had a "substantial argument" for a half share in the property. Leave was granted to Mr and Mrs Hadfield to file submissions. Mr Hadfield's costs and the costs of counsel appointed to assist the Court, to be met by "the liquidator" who was understood to be acting for the Inland Revenue. In a later Minute the Court provided counsel's costs were to be met by the Registrar, with the liquidators reimbursing the Crown. The liquidators appealed.

Submissions and issues on the appeal

The liquidators for The Fish Man Ltd submitted that the company had suffered loss as a result of the Official Assignee's disclaimer and that the property should be vested in The Fish Man Ltd with orders for sale. It was also submitted that the company had a proprietary, equitable interest in the property through:

- a constructive trust
- an equitable lien, or
- subrogation to the rights of the ANZ Bank as mortgagee.

The misappropriated company funds being traced into the mortgage and into the property itself.

The issues on appeal were whether the company had suffered loss or damage as a result of the disclaimer by the Official Assignee, and whether the company had a propriety interest in the property.

The effect of the disclaimer by the Official Assignee

The Court of Appeal held that under s 101(1)(a) of the Insolvency Act 2006 all property belonging to the bankrupt vests in the Official Assignee. The disclaimer provisions enabled unprofitable contracts, onerous obligations (including mortgaged land) to be disposed of. Following the Assignee's disclaimer, the bankrupt no longer had any rights to that property. Interests and liabilities of the Assignee and the bankrupt in that property came to an end. Under the doctrine of tenure, the Crown has always been the continuous owner of the land and once the fee simple estate of the registered proprietor was terminated by disclaimer, the use of the land reverts to the Crown, the bankrupt holding the title as trustee for the benefit of the Crown. If orders were not made vesting the property in a party, it will be owned by the Crown.

Whether the company had suffered loss or damage as a result of the OA's disclaimer

The Court held that while a creditor can make a claim under s 119(1) of the Insolvency Act, the loss merely as an unpaid creditor is not enough. There must be specific loss (given a wide interpretation), arising directly from the disclaimer. There was no loss at the time of disclaimer and there was no principled basis on which to suggest a change at a later date should be treated as the loss or damage resulting from the disclaimer.

The effect of the disclaimer was to bring to an end the Official Assignee or bankrupt's interest. Any loss or damage must be considered at that time. Creditors dissatisfied with the Assignee's decision have a time limited right of appeal under s 226. A creditor cannot sit on his right of appeal. The Fish Man Ltd had suffered no loss or damage under s 119. Mr Hadfield's conduct was not fraud or fraudulent breach of trust as referred to in s 304(2)(a) and the party to disgorge the property was not the bankrupt but the Crown. No loss or damage was suffered by The Fish Man Ltd under s 119 and therefore no vesting order in favour of the company should be made.

The Fish Man Ltd proprietary claims

The Court of Appeal agreed with the position taken by the High Court that it had recognised that Mr Hadfield had breached his fiduciary duty to The Fish Man Ltd by using company funds to meet his mortgage payments and a constructive trust arose in relation to those funds. However, a breach of trust by a fiduciary did not of itself give a beneficiary an interest in all the fiduciary's property, nor did it necessarily create a traceable interest in the mortgaged property. The Court of Appeal endorsed the general rule:

"The usual rule is that misappropriated funds cannot be traced further after they have been paid to discharge a debt. *However, the position may be different when it can be shown that the debt was incurred to purchase a specific, identifiable asset and the plaintiff can trace the debt into the asset that was purchased. … [i.e.] 'backwards tracing'*": [59].

Emphasis added. This aspect of "backwards tracing" is discussed further below under *R v Love*.

"What tracing can do for a company is to transform the unsecured breach of fiduciary duty claim into a proprietary interest in property by showing that company funds have, in breach of constructive trust, been put into a property which represents those funds in whole or in part, and from which they can be recovered. It is a process that can be used by a claimant to show what has happened to misappropriated property and where it is now": [62].

Court of Appeal's comments on tracing

In regard to tracing, the points made by the Court of Appeal were:

- It is wrong to say that all money used to pay a debt can in principle be traced into whatever was acquired in return for the debt, *Federal Republic of Brazil v Durant International Corp* [2015] UKPC 35, [2016] AC 297 at [33].
- A court should look at the substance of a transaction, rather than the strict order in which events occur. However, a claimant has to establish a coordination between the depletion of the trust fund and the acquisition of the asset that is the subject of the tracing claim: [69].
- There has to be a direct and substantial link between acquiring the property and the use of the misappropriated money: [70]–[71] (referring to Fogarty J in the High Court decision).
- The Court disagreed with *Torbay Holdings Ltd* v *Napier* (2015) 4 NZTR ¶25-030 that regular mortgage payments after a property's purchase can be traced to the secured property, there not being:

  "the necessary coordination between the depletion of the trust fund and the acquisition of the asset. The focus must be on what the payment of the trust funds actually achieves and in particular whether it leads to the acquisition of ownership of the asset": [71].

  The Court noted that *Torbay Holdings Ltd* was followed by *Taj Construction (in Liq)* v *Singh* (2016) 4 NZTR ¶26-015 and *Shannon Agricultural Consulting Ltd* v *Shannon* [2015] NZHC 1133, and contrasted this with the High Court decisions of *The Fish Man Ltd (in liq)* and *Intext Coatings (in Liq)* v *Deo* (2016) 4 NZTR ¶26-030.
- Here, there was not the transactional connection. If tracing mortgage payments as the liquidators proposed then:

  "the creditor from whom the funds were taken is elevated to a level of security beyond that of other unsecured creditors whose funds are used to pay other debts": [72].

  This would give an unfair advantage to an otherwise unsecured creditor.

The Court concluded that the mortgage repayments were not used to acquire the property and could not be traced to an interest in the property. While the company was entitled to recover from Mr Hadfield, that was a personal claim against him. The Fish Man Ltd could not trace its funds into the property and had no proprietary interest in it.

Equitable lien

In the alternative, the liquidators argued equitable lien — the mortgage repayments improving the property. However, equitable lien requires the plaintiff to show a specific interest in the property. The mortgage repayments had no direct connection to the acquisition of the property. The Fish Man Ltd had no equitable interest in the property. Subrogation was also raised by the liquidators, but this was not argued or pleaded in the High Court. There was not sufficient evidence as to the terms of the mortgage or the rights to which The Fish Man Ltd could be subrogated. In the circumstances, the Court of Appeal was not prepared to consider this submission.

Mrs Hadfield's claim

In regard to Mrs Hadfield's claim it was accepted that she had a claim to a protected interest on Mr Hadfield's bankruptcy under s 20B of the PRA, and she had suffered loss or damage as a consequence of the disclaimer. It was held that she would be entitled to a vesting order for at least a part interest in the property and the matter would need to be remitted back to the High Court to determine how title was to be constituted between Mr and Mrs Hadfield.

Costs and result

In regard to costs it was held that the Court did not have jurisdiction under s 99A of the Judicature Act 1908 to order a non-party to be liable for costs of counsel assisting. The costs of counsel assisting should be met from the public fund under s 99A(1)(b). The appeal was allowed on this point. The appeal against the substantive orders was dismissed.

Comment

Generally, misappropriated funds cannot be traced into debt (such as the payment of a mortgage in respect of an existing asset). However, if the substance of the transactions results in the acquisition of an asset, and this may include debt in that asset's acquisition, then the misappropriated funds can be traced to that asset. An example of this would appear to be *R* v *Love* (2016) 4 NZTR ¶26-020. Dr Love and his partner Ms Skiffington diverted and misappropriated $1.5m of an upfront fee that was paid to two trusts established by the couple and applied to reduce the mortgage on a property purchased approximately a month earlier, apparently in anticipation

of the $1.5m payment. However, the Court in that case made the property subject to a restraining order under the Criminal Proceeds (Recovery) Act 2009, rather than tracing and a propriety interest.

The Court supported the *Intext Coatings (in Liq)* v *Deo* (2016) 4 NZTR ¶26-030 decision that had followed the High Court in *The Fish Man Ltd*, that it was not possible to trace into existing debt. But no direct comment was made regarding the concept raised in *Intext Coatings Ltd* of equitable subrogation. In the present case, this had been raised only at the appeal stage and with insufficient evidence as to the mortgage terms of The Fish Man Ltd's rights. It was a submission the Court was not willing to consider.

Can you have it both ways?

In the Supreme Court appeal of *Horsfall* v *Potter* (2017) 4 NZTR ¶27-032 (21 December 2017) the appellant, Mr Horsfall, had told Inland Revenue (to avoid GST and "tainting") that he and his wife jointly owned a property personally. When his wife's relationship property claim came, he said the property had been held by her on a resulting trust for one of his companies (although it was not clear which company). Can you have it both ways?

Background

Mr Horsfall, a property developer and land agent, and Ms Potter the first respondent, commenced a de facto relationship in 1998 and married in 2002. Their marriage ended in 2008. During their relationship, a commercial property in College St Wellington was registered in their joint names (the property). The property was originally acquired in the course of a business venture between one of Mr Horsfall's business interests and a third party. The funds for the purchase came from; Mr Horsfall, 168 Group Ltd (controlled by Mr Horsfall) and 88 Riddiford Holdings Ltd owned by a family trust. Ms Potter did not contribute directly to the purchase price, however, she understood that a home was to be built on the top floor of this property (the family home having been sold previously). Mr Horsfall denied this claim despite stating in a letter the parties intended the property to become their home. Mr Horsfall represented to Inland Revenue that the parties owned the property beneficially and took advantage of the tax benefits: Family Court [200]. Accounting evidence for Mr Horsfall showed that there was considerable flexibility in relation to the accounting treatment of transactions involving the property.

After about a year the property was sold for a good profit. Of the sale price of $1,575,000, $50,000 was paid to Ms Potter (Mr Horsfall asserted for the use of her name, the Family Court considered the payment was possibly to safeguard against a claim by her) and the balance of the net sale proceeds were disposed by Mr Horsfall to 168 Group Ltd. The parties subsequently separated and sought orders for the division of relationship property.

Family Court and High Court

The Family Court held that at the point of purchase, Mr Horsfall determined that the parties in their personal capacities would complete the purchase in their joint names so as to take advantage of a GST loophole and to assist avoid "tainting" for tax purposes. Ms Potter maintained the property was purchased with a view to becoming their home. The Court accepted there was a conflict of evidence on this issue. The Court held that there was no evidence to uphold a finding that Ms Potter held her interest in the property as a trustee under an alleged resulting trust for 168 Group Ltd, 88 Riddiford Holdings Ltd and the appellant, but acquired beneficially and was relationship property. The Court held that the transfer of the sale proceeds to 168 Group Ltd was in order to defeat Ms Potter's rights under s 44 of the Property (Relationships) Act 1976 (the PRA) and ordered 168 Group Ltd to transfer one-half of the net sale proceeds to her with interest.

Mr Horsfall appealed to the High Court, who considered the overall context was consistent with Mr Horsfall's version, in particular that to add residential facilities to the commercial property was not feasible and that Ms Potter did not contribute any funds. The High Court allowed the appeal and held that the disposal of the proceeds of sale did not defeat Ms Potter's claim or rights as she did not have a beneficial interest in the property, but held it on a resulting trust, although it was not certain that 168 Group Ltd was entitled to all the proceeds. The order of the Family Court was set aside. The Court of Appeal granted Ms Potter leave to appeal.

Court of Appeal

The Court of Appeal in *Potter* v *Horsfall* (2016) 4 NZTR ¶26-025, concluded:

(1) joint registration in the parties' names was to avoid a potential tax liability and this could only be achieved if the parties were beneficial owners of the property, antithetical to a resulting trust, applying *Potter* v *Potter* [2003] 3 NZLR 145 (CA).

(2) Mr Horsfall contributed a portion of the purchase monies from his personal, separate property to purchase a property registered in the parties' joint names. Rather than support a resulting trust in favour of the two companies, it pointed away from one.

(3) There was none of the evidence the Court might expect if there was a resulting trust. The Court allowed the appeal and the High Court judgment was set aside.

Mr Horsfall appealed.

Supreme Court majority judges dismissed the appeal

William Young, Glazebrook, O'Regan and McGrath JJ dismissed Mr Horsfall's appeal. Key to their judgment was the earlier Court of Appeal *Potter* v *Potter* [2003] 3 NZLR 145 (CA) and Privy Council decisions [2004] UKPC 41, [2005] 2 NZLR 1 (no relationship to the present respondent). In *Potter v Potter*, Mr Potter had transferred one-half of a property into the name of Ms Potter under a property sharing agreement so that both of them could make gifts to a trust and benefit from the double gift duty exemption. When the marriage broke down (not long after the transfer of one-half of the property), Mr Potter asserted that Ms Potter held her interest in the property on a resulting trust for him. In *Potter v Potter*, the Court of Appeal had held that any revenue benefits could only lawfully be achieved if Ms Potter beneficially owned the property. The Privy Council upheld that decision.

The majority judges in the present case followed that decision. Having deliberately registered the property in the parties' joint names, the Court will not permit a party to avoid the consequences of a course of action deliberately taken by adducing evidence that the course of action was taken for an unlawful purpose such as avoiding tax or defeating creditors, ie "trying to have it both ways". (Although relief may be available under ss 75–82 of the Contract and Commercial Law Act 2017 (formerly the Illegal Contracts Act 1970), see below.)

Contract and Commercial Law Act 2017

The majority judges noted that s 73 of the Contract and Commercial Law Act 2017 (formerly the Illegal Contracts Act 1970) renders such a resulting trust of no effect, but subject to possible relief under ss 75–82. Here, Mr Horsfall and Ms Potter were the beneficial owners of the property. A number of cases were considered, for example:

- *Tinsley v Milligan* [1994] 1 AC 340 (HL) where the wife could show she had contributed to the property and show a common understanding that it was owned equally.
- *Nelson v Nelson* (1995) 184 CLR 538 where to secure the benefit of a concessional interest loan, Mrs Nelson's name did not appear on the title to a property she owned with her husband, but to which she had contributed. The High Court of Australia held that Mrs Nelson was entitled to a beneficial interest, less repayment to the Bank of the amount of the benefit of the concessional loan.

Circumstances such as these should be addressed in terms of the Illegal Contracts Act and a party to such a transaction may advance a claim for relief, notwithstanding the claim may be based on his or her own fraud.

Older cases still relevant where the evidence is equivocal

The Court concluded that cases such as *Potter v Potter* (double gift duty exemptions) and *Tinker (No 1)* [1970] 2 WLR 331 (CA) (property transferred to one spouse for protection from creditors) nonetheless are of continuing relevance, in cases like the present, where the circumstances and the evidence are equivocal. It may be that the only reason for putting the property in the name of the transferee was to secure a tax advantage and a trust rests on this basis. *In such a situation, a court could conclude that, such an advantage could legally be obtained only if beneficial as well as legal ownership were transferred, and construe the parties understanding accordingly.* (The writer understands this to mean that to secure the tax advantage, the spouse had to own a beneficial interest in that property, so that is what the parties must have intended.)

Was the College St property relationship property?

The majority judges noted that the case was determined on the common intention of the parties and particularly Ms Potter's understanding in regard to joint ownership. The case did not turn on Mr Horsfall's intentions in respect of the property, but that beneficial ownership was acquired jointly, unless this was inconsistent with Mr Horsfall's and Ms Potter's common intention. Mr Horsfall retained complete flexibility as to who was to take ownership of the property and that the money put into the property, (particularly the $100,000 deposit by him) which must be treated as his money. The joint venture interest was Mr Horsfall's to dispose of as he chose and as property acquired after marriage, it was relationship property under s 8(1)(e) of the PRA. Their Honours concluded that the High Court did not come to terms with the inconsistency between Mr Horsfall's evidence as to beneficial ownership and the tax advantages he sought to obtain. The Family Court made a credibility finding that on the evidence was well available to it and there was not an adequate basis for reversing that finding by the High Court. When the property was placed in joint names there was no resulting or other trust in favour of 168 Group Ltd or any other party: [94].

Payment of the property sale proceeds to 168 Group Ltd

The majority judges held that Mr Horsfall's actions in transferring the property sale proceeds to 168 Group Ltd were for the purpose of defeating Ms Potter's claims and liability under s 44 of the PRA. It was also noted that s 44(1) encompasses claims or rights in respect of transactions that occur before separation. The appeal was dismissed.

Dissenting judgment — Elias CJ

The Chief Justice agreed with the High Court decision. Her Honour considered that Ms Potter was not the beneficial owner of the property, so it was not relationship property under s 8(1)(c) and there was no secure basis on which it could be inferred the payment of the sale proceeds to 168 Group Ltd was a disposition to defeat the wife's rights under s 44 of the PRA. It was considered that care is required if s 44 is to be applied to a transaction occurring four years before the parties separated; it was a commercial property and the husband's business was dealing a developing properties. Payment to an entity that was probably a part-owner does not of itself justify an inference of a payment in order to defeat a relationship property claim. The High Court was correct to analyse the case as it did. It was immaterial how the property was acquired if the wife was not beneficially interested in it, rather the appeal was based solely on whether the joint ownership of the husband and wife was beneficial ownership. This was the only basis on which the s 44 application was justified: [131]–[132].

Can the husband contend that the wife was not a beneficial owner — "estoppel"

The Family Court, Court of Appeal and the majority in this Court accepted that the husband could not have it "both ways" — asserting the couple were joint owners and then asserting for relationship property purposes the property was held on trust. The Chief Justice disagreed with the majority judges:

- Treating the avoidance of the potential tax liability as an abuse of process in a claim between the husband and wife, rather than a just division of relationship property when their relationship ends.
- The Chief Justice would not apply the reasoning of *Potter v Potter*. Only proof of actual illegality or something amounting to abuse of process would justify preventing the husband asserting the wife was not the beneficial owner of the property, preferring the reasoning of *Nelson v Nelson* (1995) 184 CLR 538 and *Patel v Mirza* [2017] AC 467. There was no evidence of actual fraud or deception of Inland Revenue. There was no basis for the Illegal Contracts Act 1970 or common law cases on illegality. It would be a retrograde step to reintroduce

into the relationship property regime questions of "common intention" and contractual analogies. The only question in application of s 44 was whether the wife was a beneficial owner of the property at the time of sale.

Was the wife a beneficial owner of the College St property at the time of sale?

The Chief Justice noted that the husband appeared to preserve maximum flexibility including suspending determinations about the ownership of assets until it was convenient to the husband. However, this had little direct bearing on the substantive issue between the husband and the wife. The prospect of a relationship property claim in the future does not support an inference that disposal four years earlier was to defeat the wife's potential claim. Both parties came into the relationship with an established business and kept their businesses distinct during the relationship. An earlier home was purchased by contribution by the parties in equal shares. The husband and wife dealt separately with their assets, the husband dealing through companies he had set up. Disposal of property in those circumstances by sale or transfer does not readily give rise to an inference that disposal was with the intention of defeating a relationship property interest. How the parties conducted their property affairs bears significantly on the understanding the wife had in agreeing to take joint ownership of the property. The Chief Justice did not agree with the majority, that identification of the trust beneficial owner was too vague for the property to be held on a resulting trust. Her Honour considered that identifying the actual beneficial owner was unnecessary, if it can be concluded the wife was not a beneficial owner. There was reason to be sceptical of the wife's evidence that the property was intended to be a home. The history of the property told against the wife's version. It was concluded the wife was not the beneficial owner and the s 44 order should not have been made.

Comment

It should be noted that there have been a number of cases where steps taken as a part of asset planning have resulted in assets being transferred to a spouse to gain a modest tax advantage, but this has exposed the assets transferred to a relationship property claim when those assets would otherwise have remained separate property.

Whether powers as an appointor and trustee are fettered (ie a fiduciary) power

Background

In 1995, Mr Campbell and his then wife, Mrs Campbell, established two mirror trusts for the benefit of each other and their two daughters as discretionary and final beneficiaries. Mr and Mrs Campbell separated in 2000 and subsequently divorced. In about 1998, Mr Campbell commenced a relationship with Ms Goldie and they began living together permanently in 2001, married in 2006 and separated in 2010.

In July 2007, the trustees of the mirror trusts resolved to re-settle the assets of each of the trusts on new trusts, that included giving effect to the agreement between Mr and Mrs Campbell as to their relationship property. The trust established for the benefit of their two daughters and Mr Campbell was the Robin Campbell Family Trust (RCFT). In October 2007, Mr Campbell in a memorandum of wishes to the trustees of the RCFT requested the trustees after meeting his reasonable needs, to consider the reasonable needs and requirements of the two daughters to be paramount. In a further memorandum to the trustees in 2012, Mr Campbell requested that the needs of his new partner, Ms Leon and her children be taken into account and they were added as discretionary beneficiaries of the RCFT.

Ms Goldie claimed that Mr Campbell had property interests by virtue of his powers in relation to the RCFT. It was asserted Mr Campbell had the power to control the assets of the trust for his own purposes or his own ultimate benefit with the effect that the trust property was relationship property under the Property (Relationships) Act 1976 (the PRA).

The trust deed

The trust deed contained a number of key provisions:

- No benefit clause. No trustee who was also a beneficiary may exercise any power or discretion in his favour.
- Inability of trustees to act alone. "Except where a corporation is sole trustee … where there is only one trustee no power or discretion … other than appointing a new trustee may be exercised until the new trustee is appointed."
- Power to appoint or remove beneficiaries. The appointor may "appoint any person to become a member of the class of Discretionary Beneficiaries … remove such person from the class of Discretionary Beneficiary". "Such" was interpreted by the Family Court to restrict removal to those persons appointed under the clause as discretionary beneficiaries.

Family Court

The Family Court found that Mr Campbell as trustee and appointor owed fiduciary duties to the beneficiaries of the RCFT and these duties imposed a restraint on his powers and the potential assets of the RCFT. The RCFT was distinguished from the trust deed in *Clayton* v *Clayton* (2016) 4 NZTR ¶26-002 (Vaughan Road Property Trust) by four factors:

(a) the history and consistently stated intention to benefit the two daughters (the discretionary and final beneficiaries)

(b) the no benefit clause

(c) the inability of trustees to act alone (other than a corporate trustee), and

(d) the inability of Mr Campbell to remove the original discretionary beneficiaries.

Ms Goldie appealed to the High Court.

Ms Goldie argued that:

- Mr Campbell's power to appoint and remove trustees was unfettered under the RCFT
- the power was not fiduciary in nature and not subject to the doctrine of fraud on a power
- Mr Campbell's degree of control over the assets was comparable to Mr Clayton in *Clayton v Clayton*, and

- Mr Campbell could make himself the sole beneficiary and with his ability to add and remove trustees meant he could bring about a situation where the trust assets would be applied for his sole benefit.

Legal principles — Clayton v Clayton

The Court compared the powers held by Mr Campbell with those held by Mr Clayton in *Clayton v Clayton* (VRPT). Mr Clayton was settlor, sole trustee and discretionary beneficiary, with power to appoint discretionary beneficiaries and trustees, and to change management and administrative trust provisions. Mr Campbell also had these powers under the RCFT. However, the Supreme Court found three additional clauses demonstrated decisively that Mr Clayton had sufficient control over the assets of the trust, that it classified those powers as property under the PRA:

(a) power to pay trust capital to a discretionary beneficiary and as trustee and a discretionary beneficiary he could pay the entire trust capital to himself

(b) power to resettle the trust fund on a trust of which he was the beneficiary

(c) power to bring forward the vesting day (so excluding the final beneficiaries) and appoint the trust capital to himself.

The trust deed also authorised the trustee to exercise a discretion without considering the interests of all beneficiaries, to do so in his own favour notwithstanding any conflict of interest. The Supreme Court concluded that with these provisions, Mr Clayton was not constrained by any fiduciary duty in exercising powers in his own favour, and they amounted to a general power of appointment that was property under s 2 of the PRA.

This case

Commenting on the Family Court judgment, the High Court noted that in this case Mr Campbell did not have power to remove his daughters as discretionary beneficiaries and the trust had distinct relationship property benefits. If the trust had not been established, the daughters' interests in the trust assets would have been eroded by 50% by a claim by Ms Goldie under the PRA and potentially a further 50% by Ms Leon. The memoranda of wishes revealed a consistently stated intention to benefit Mr Campbell and his daughters. It would be inconsistent with this intention if the appointor was empowered to remove the daughters as discretionary beneficiaries. This was not changed by the appointment of Ms Leon and her daughter as beneficiaries and Mr Campbell's expressed desire that the trustees make substantial provision for them in the event of his death. The Court noted that Mr Campbell could not make himself a sole beneficiary and this was a significant difference between the RCFT and the deed in *Clayton v Clayton*.

Fiduciary obligations

It was argued that fiduciary obligations would not apply if Mr Campbell exercised his power to appoint a sole corporate trustee, exercising the power as appointor rather than trustee and that where the power was conferred on a discretionary beneficiary it was so they could look after their own interests. The Court did not agree. Precedent and *New Zealand Maori Council* v *Foulkes* (2015) 4 NZTR ¶25-025 at [27] precluded a finding that Mr Campbell's powers of appointment and removal were unfettered by fiduciary obligation.

In addition, there were the trust terms and the underlying context:

- There was the no self-benefit clause.
- There must be two or more trustees or a sole corporate trustee.
- The consistently stated intention of the trust was to benefit Mr Campbell and the daughters.
- The trust was established as a resettlement of two mirror trusts with that intention.

Mr Campbell could not exercise his powers without constraint. Mr Campbell's power to appoint and remove trustees was a fiduciary power.

In answer to the submission that Mr Campbell could appoint a sole corporate trustee, the Court noted that the trust deed prohibited a trustee from exercising a power or discretion in his favour. If Mr Campbell was to appoint a sole corporate trustee under his control so he could procure the trustee's exercise of discretion in his favour, that would be "a clandestine excessive execution", ie a fraud on a power, appearing regular on its face, but undertaken for a purpose not within the donor's mandate and such an appointment would be an improper use of the power of appointment and removal. While the trustees could apply assets to Mr Campbell's benefit, the powers he held as trustee and/or appointor did not permit him to do this. He could not remove the original discretionary beneficiaries, could not appoint a sole corporate trustee under his direction and as a trustee was fettered by the no self-benefit clause.

The key conclusions of the High Court were:

- Mr Campbell could not bring about a situation where the trust assets would be applied for his sole benefit prior to vesting day.
- "The fetters restraining Mr Campbell were derived largely from the no self-benefit clause, without which it would be arguable the powers Mr Campbell held were sufficiently similar to those in *Clayton v Clayton* that they would constitute property under the PRA": [73].

The appeal was dismissed, *Goldie* v *Campbell* (2017) 4 NZTR ¶27-020.

Settlor's/protector's power held to be unfettered — settlor having control of trust — assets held on bare trust for settlor — Mezhprom v Pugachev

The New Zealand High Court decision of *Goldie v Campbell*, that the settlor/discretionary beneficiary held his powers as appointor under a fiduciary obligation and consequently the trust assets were protected from a relationship property claimant can be compared to the English High Court decision *Mezhprom v Pugachev* [2017] EWHC 2426 which held that the settlor/discretionary beneficiary held his powers as protector, was not under a fiduciary obligation in the exercise of those powers, and

that the trust assets were held on a bare trust for him, unprotected from his creditors.

Background

Mr Pugachev was an oligarch. He founded Mezhprom Bank in 1992. He fled Russia in early 2011. The claimants (liquidators of the Mezhprom Bank) contended Mr Pugachev misappropriated large sums of money from the Bank. Over the period 2011–2013, five discretionary New Zealand trusts were established primarily for the benefit of Mr Pugachev, his then wife, Ms Tolstoy and their children. The trustee was a New Zealand company with a NZ solicitor as principal director and shareholder. The trusts held properties in London, Wiltshire and the Caribbean. The alleged intention of the trusts was to protect assets for Ms Tolstoy and their children. Before being depleted, the value of trust assets was over $95m.

Some of the assets were transferred into the trusts by Mr Pugachev's son, Victor, but it was claimed he received those assets from Mr Pugachev. A worldwide asset freezing injunction was made by the UK Courts against Mr Pugachev on July 2014. There were numerous interlocutory proceedings. The original trustees were removed by Mr Pugachev in July 2015. In October 2015, the original trustees applied to the New Zealand High Court to determine whether their removal was valid. The High Court held they were validly removed and not in breach of any fiduciary obligation, *Kea Trust Co Ltd v Pugachev* [2015] NZHC 2412.

Protector

The claimants alleged that the beneficial interest in all the trust assets belonged to Mr Pugachev. A key feature of the Pugachev trusts was that Mr Pugachev was the trusts' protector and the trustee's powers were only exercisable after the protector had given his consent. These circumstances included:

- early distribution of the trust
- distribution of income and/or capital
- investment of the trust fund
- removing a beneficiary
- varying the trust, and
- revoking any power conferred on the trustee under the deed.

The protector could also direct the trustee to sell the London residential property, part of the trust fund. The Court noted that the protector's consent was required before the trustee could exercise many of the powers normally vested in the trustee. The power of appointment or removal of trustees (with or without cause) was also vested in the protector.

Protectors and fiduciary duty

The English High Court (Birss J) at [454] considered that Mr Pugachev's powers as the protector were not fettered, ie that the protector did not have to exercise his powers in a fiduciary capacity (for the benefit of all the beneficiaries), but could exercise them selfishly. Heath J in the New Zealand application by the trustees questioning their removal by Mr Pugachev considered the removal of the trustees was a fiduciary power and properly exercised. Birss J disagreed at [267] but considered a different conclusion may have been possible if the Protector was a third party.

In *Kea Trust Co Ltd v Pugachev*, Heath J at [48]–[49] noted that whether the protector exercises a fiduciary or personal power, the issue may be rather pointless:

"The debate about whether, in any given case, a protector exercises a fiduciary or personal power may be arid because of the need, in either event, for the power to be exercised for proper purposes. The doctrine of fraud on a power is equally applicable to both types of power. The inquiry focuses on whether the power has been exercised for a purpose, or with an intention, that goes beyond the scope of or is not justified by the instrument creating the power ... a fraud on a power ... means that the power has been exercised for a purpose, or with an intention, beyond the scope of, or not justified by, the instrument creating the power."

Control of the trust and beneficial ownership of the trust assets

Birss J considered that the trust terms did not divest Mr Pugachev of the beneficial ownership of the assets transferred to the trust, "the deeds allow Mr Pugachev to retain his beneficial ownership of the assets". The "true effect of the trusts" "means that these trusts are not shams. They fulfil Mr Pugachev true intention not to lose control". "While the trustees of these deeds are properly appointed as trustees, effective control of the actions of the trustees is held by the Protector through the protector's powers. In this respect, the Protector has ultimate control of the trusts": [436].

Comment

- That control is equated to beneficial ownership and invalidating a trust is the fundamental flaw in this judgment. Control is not necessarily evidence of a sham, or that there is not a valid trust in existence:

  "... once the Court accepts a valid trust has been established (with no sham), it should not be able to be treated as non-existent because the trustee has wide powers of control over the trust property. In short, '[t]here is either a valid trust or there is not'", *Clayton* v *Clayton* (2015) 4 NZTR ¶25-001 at [80], [85], quoted on appeal by the Supreme Court in *Clayton* v *Clayton* (2016) 4 NZTR ¶26-002 (Vaughan Road Property Trust) at [122].

- The powers held (be they as appointor or protector) and the roles held — as settlor, trustee (or director of the corporate trustee) and/or beneficiary need to be seen as a whole.
- In the view of this writer the test as to whether there is a valid trust is not so much whether the powers held by the settlor are properly exercised within the terms of the trust instrument (ie whether or not there has been a fraud on a power), but rather can the donor/settlor by the exercise of powers or position held restore or appoint beneficial ownership of the trust property to himself? In such a situation the trust is effectively revokable by the settlor, or it negates certainty of intention to establish a trust, because the settlor never parts with the beneficial interest.
- In *TMSF v Merrill Lynch* [2011] UKPC 17, Mr Demirel could exercise the power of revocation and restore the trust property to himself. In the *Clayton v Clayton* (VRPT) Mr Clayton could restore or appoint the trust property

to himself in a number of ways. In the VRPT deed was provision that Mr Clayton did not need to consider other beneficiaries, so the power clearly had no fetter. But the fact that the power is subject to a fiduciary obligation and therefore to be exercised in good faith and for a proper purpose is not to this writer necessarily conclusive and would only fail if exercised in bad faith, unreasonably or for an improper purpose, ie is shown to be a fraud on a power, *Kea Trust Co Ltd v Pugachev (No 3)* [2015] NZHC 2412 at [47]–[48].

- In *Mezhprom v Pugachev*, notwithstanding all the powers and positions held, unlike Mr Clayton, and Mr Demirel in *TMSF*, Mr Pugachev could not directly get his hands on the trust assets. He could only stop them going to someone else. Nothing Mr Pugachev could do, could restore or appoint the trust property to himself. Mr Pugachev had parted with the beneficial interest.
- To this writer the issue is whether the holder of the power (and/or the position) can legally restore the trust property to himself, ie whether he has parted with the beneficial ownership. If the settlor has not parted with the beneficial interest, this calls in question the settlor's certainty of intention to establish the trust. If the beneficial interest is not held by the trustee for the beneficiaries, there is no trust.

Proceedings in respect of an estate or a trust against a third party

Background

In 2001, Mr Rosenberg effected a life insurance policy on his life for $105,000 with the defendant (then AXA). Mr Rosenberg died intestate on 18 April 2006. On 15 April 2016, his daughter Ms Rosenberg brought proceedings claiming that the life insurance company did not pay out a life insurance benefit on the death of her father. (It is understood that an administrator had not been appointed to the estate.)

Pleadings

The plaintiff pleaded that Mr Rosenberg had been unwell before he died. The plaintiff's mother called AXA on 18 April 2006 when Mr Rosenberg was still alive and was told the policy was in force and was told to send a premium of $56.70 to stop the policy lapsing before 19 May 2006. (A term life insurance contract would normally have a period of grace of 30 days for the payment of the due premium, after which if not paid the policy and the cover under it would lapse.) The mother immediately sent a cheque that AXA accepted and banked on 20 April. The plaintiff's mother subsequently contacted the insurance company regarding Mr Rosenberg's life insurance, but AXA denied the claim asserting he was not alive at the time of the 18 April 2006 conversation. AXA had subsequently lost the recording of the 18 April 2006 phone conversation. Ms Rosenberg sought damages and an order for disclosure of information. The defendant applied to strike out the proceedings or security for costs. The defendant insurance company argued that the plaintiff, not being a party or beneficiary of the policy, nor the executor of administrator of Mr Rosenberg's estate, did not have standing to bring the proceeding. Alternatively, it was asserted that the claim was time barred under the Limitation Act 1950.

The right to bring proceedings

As Mr Rosenberg died without a will, the right to pursue any claim lay with any administrator appointed under the Administration Act 1969 and without which no one may legally act on behalf of the estate. Ms Rosenberg argued that as the daughter of her intestate father's estate, she and her siblings were entitled to share equally in two-thirds of the estate [under the Administration Act the share divided among siblings of an intestate's estate] and that she was an equitable and property owner of her share.

The Court referred to *Cowan v Martin* [2014] NZCA 593 at [53]:

> "Where a claim is based on a duty owed to a trust, a beneficiary of the trust does not have a separate cause of action in their own right against a third party wrongdoer. The beneficiary cannot supplant the trustee and bring a separate action."

In the present case, the Court held that the above quote applied equally to the rights of executors and administrators. If an executor or administrator has not been appointed to the estate, a person wanting to have a claim pursued on behalf of the estate, must have letters of administration issued, or where a will exists, probate granted. The Court concluded that Ms Rosenberg although a beneficiary of her father's estate, had no direct claim on the insurance policy (or any other rights her father may have had under contracts with the defendant). The beneficiary of an estate has no equitable interest in the estate property until administration of the estate is complete, *Guardian Trust & Executors Company of New Zealand Ltd v Hall* [1938] NZLR 1020 at 1026. It was held that Ms Rosenberg did not have standing to pursue the claims. Because of this finding it was not necessary to consider the issue of limitation. The defendant's application was granted and the claims were struck out, *Rosenberg v AMP Services (NZ) Ltd* [2017] NZHC 2232 (15 September 2017).

Comment

The ownership of life insurance (of a policy paying a sum insured on the death of the life insured) has specific asset planning and legal ownership issues. Generally, life insurance payable on the death of the life insured would be better held by a family trust.

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