Topical trust issues seminar paper

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Introduction

1. This paper will focus largely on the role of the court (Family and High Courts) and Part 7 of the Trusts Bill which contains new powers relating to the review of trustees' decisions and the ability of trustees and the court to refer matters to alternative dispute resolution, ie mediation or arbitration.

2. For more than a decade, superior courts in New Zealand have been facing an onslaught of challenging cases around the vexed and topical questions relating to the interface between trusts and relationship property, where the protagonists have sought to make new law by pushing the outdated and constrained barriers of existing law and the jurisprudence which has shaped it.

3. Many of those here today who have attended our annual Topical Trust Issues seminar in earlier times will recall papers being given on a number of seminal superior court decisions many of which were and continue to be authoritative and widely reported in the public arena such as:

   (a) ***Official Assignee v Wilson*** [2008] NZCA 122: alter ego/sham trusts.

   (b) ***Ward v Ward*** [2009] NZSC 125: the application of section 182 of the Family Proceedings Act 1980 to vary a post nuptial (trust) settlement.

   (c) ***Carmine v Ritchie*** [2012] NZHC 1514: a challenge to the exercise of a power to remove and replace a trustee.

   (d) ***Thurston v Thurston*** [2013] NZHC 1886: the need for well thought out trust and estate structures especially with blended families; the impartiality and independence of trustees.

   (e) ***Murrell v Hamilton*** [2014] NZCA 377: delegation of powers/responsibility by independent trustee; whether trustees bound by actions and/or steps taken by only one trustee; whether the Court could impose a constructive trust over an express trust.

   (f) ***Judd v Hawke's Bay Trustee Co Limited*** [2014] NZHC 3298: where the Court followed *Murrell v Hamilton.*

   (g) ***Vervoort v Forrest*** [2016] NZCA 375: constructive trust claim against express trust; possible sham trust; trustees leaving management of trust to settlor; trustees' conscience and knowledge.

   (h) ***Green v Green*** [2016] NZCA 486: a vulnerable aged and infirm settlor – undue influence, lack of capacity and applications to remove and replace trustees.

   (i) ***Erceg v Erceg*** [2017] NZSC 28: request for information by beneficiary.

(j) ***Clayton v Clayton*** [2016] NZSC 29; [2016] NZSC 30: sham or illusory trust; status of a power of appointment and removal of trustee – personal property or fiduciary power; whether *Ward* v *Ward* still good law in relation to the test to be applied under section 182 of the Family Proceedings Act 1980.

4. A veritable array of issues then, and why in the explanatory note to the Trusts Bill, it is said:

> *..The Trustee Act 1956 is outdated and no longer reflects current trust practice. Many of the provisions are difficult to understand and need to be read alongside a considerable body of case law. One of the policy objectives of the Bill is to provide clear, simple and accessible trust law. The Bill sets out important principles of trust law that have been established through centuries of case law.*
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> *…*
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> *The Bill will not codify trust law in New Zealand and, with a few exceptions, is intended to largely capture and reflect the existing common law position. The aim of the general provisions of the Bill is to retain the ability of the courts in interpreting and applying the Bill to refer to many aspects of the common law and equity that relates to trusts..*"

5. I will also round off with reference to the Law Commission's Issues Paper handed down on Monday 16 October 2017, aptly titled with a question: *Dividing relationship property; time for change?* Chapters 20 – 22 of that paper address the intersection between the Property (Relationships) Act 1976 ("**the PRA**") and the laws governing trusts, and areas of likely reform.

6. The Commission reminds itself that Parliament has sought a balance between the division of relationship property under the PRA and the rules that apply to property held on trusts. The Commission considers whether the right balance has been struck between enabling a just division of property and enabling the preservation of trusts.

7. The release of the Issues Paper is therefore timely and ought properly to be mentioned today as part of this presentation on the Trusts Bill.

The Bill – new jurisdictional considerations

8. The High Court retains its inherent jurisdiction to supervise and intervene in the administration of a trust, except to the extent that the legislation provides otherwise. Clause 8, however, goes on to require the High Court to have regard to the purposes and the principles of the Act when exercising its inherent jurisdiction.

Clause 3

9. Clause 3 provides that the purpose of the Bill is to restate and reform New Zealand trust law by:

   (a) setting out the core principles of the law relating to express trusts; and

   (b) providing for default administrative rules for express trusts; and

   (c) providing for mechanisms to resolve trust related disputes; and

   (d) making the law of trusts more accessible.

Clause 4

10. Clause 4 details the *principles* that every person or court performing a function or duty or exercising a power under the Act *must* have regard to. They are:

    (a) a trust should be administered in a way that is consistent with its terms and objectives; and

    (a) a trust should be administered in a way that avoids unnecessary costs and complexity.

11. It follows then that the High Court's inherent jurisdiction to supervise and intervene where necessary is fettered to the extent that it must now have regard to the Act's purposes and principles mentioned.

12. Under the Trustee Act 1956, all matters arising must proceed in the High Court at first instance. The Family Court has no jurisdiction under that Act, but under Part 7 of the Bill limited jurisdiction would be reserved to the Family Court in circumstances where it is already seized of jurisdiction under the Family Courts Act 1980. Section 11 of that Act gives the Family Court jurisdiction to hear and determine proceedings under various Acts, including the PRA and the Family Proceedings Act 1980 ("**the FPA**").

13. Clause 136(2) of the Bill provides:

    The Family Court may during the proceeding make any order or give any direction available under this Act if the Family Court considers the order or direction is necessary –

    (a) to protect or preserve any property or interest until the proceeding before the Family Court can be properly resolved; or

    (a) to give proper effect to any determination of the proceeding.

14. Clause 136(3) provides:

    If the parties to the proceeding consent, the Family Court may make any order available under this Act to resolve an issue or a dispute between the parties that is closely related to the proceeding (but only if the Family Court considers that making the order is necessary or desirable to assist the resolution of the proceeding).

15. For the avoidance of doubt, clause 136(5) confirms that in exercising its jurisdiction, the Family Court is not subject to financial limitations in relation to the value of any property or interests.

The takeaways

16. So what are the takeaways?

    (a) Although the High Court retains its inherent jurisdiction it will need to have regard to the purposes and principles set out at clauses 3 and 4 of the Bill.

    (b) In circumstances where the Family Court is already seized of a proceeding (eg under the PRA or FPA) in which issues also arise under the Bill, and it considers it necessary, the Court may make certain interlocutory orders to protect or preserve property or an interest in the same, pending a final determination and/or make

orders to give effect or better effect to a substantive determination. Although one can only speculate at this time, the likely orders which might arise are:

(i) injunctive relief akin to freezing or preservation orders in respect of trust assets;

(ii) restraining and/or directing trustees to do certain things; and

(iii) vesting use of trust assets in one or other of the parties to the proceeding in a manner or to the extent that would bind the trustees.[1]

(c) Where parties to a proceeding in the Family Court consent, and the Family Court considers it necessary or desirable to assist in the resolution of the proceeding, it may resolve issues relating to trust matters as part of the proceeding.

(d) Expanding the jurisdiction of the Family Court to deal with matters under the Act as part of an extant proceeding is likely to obviate the need to have proceedings transferred to the High Court and potentially save time and money.

(e) However, it follows that under the Bill the Family Court does not have originating jurisdiction. If it is to consider a matter under the Bill, it can only do so in circumstances where it is already seized of jurisdiction in an existing proceeding.

17. It is fair to say that the extent of the powers proposed in clause 136 are not entirely clear. Certainly there would seem to be wide scope for the Family Court to make reasonably extensive interlocutory/interim orders against trust assets or trustees so as to preserve property pending a final determination, but as well, reasonably wide scope to make ancillary orders against trust assets and/or trustees to give effect or better effect to final determinations made in proceedings before it. ***Query:*** *How this provision might sit alongside current provisions that presently provide jurisdiction for the issue of injunctive remedies in the nature of freezing orders in circumstances where intent and/or evidence that there is a risk of an imminent dissipation of property (see rule 182 the Family Courts Rules 2002 and section 43 PRA).*

The Bill – Review of Trustees' Decisions

Current Position

18. Section 68 of the Trustee Act 1956 provides a limited power for trustees and trustees' actions to be reviewed. But case law has held that the only actions that are subject to review under the Act are those carried out by trustees in accordance with the terms of the Act rather than the terms of a trust deed. The review power therefore had been regarded as somewhat limited under existing law and has been seldom used.

New Provisions

19. Clauses 118 and 119 of the Bill are new provisions which give a greater opportunity for beneficiaries to ask the High Court to review *the act, omission or decision* of a trustee on the ground that these things were not *reasonably open* to the trustee in the circumstances.

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[1] See *R v R* [2010] NZFLR 555 at [60]. In that case the family home was owned in partnership between two mirror trusts established by the partners during the marriage. The Family Court held that it had jurisdiction to make an occupation order under the PRA applying the "bundle of rights" doctrine referred to by the Court of Appeal *M v B* [2006] 3 NZLR 660 (CA) at [112]-[119].

20. Only a beneficiary may request a review and must produce evidence that raises a *genuine and substantial dispute as to whether the act, omission or decision in question was or is reasonably open to the trustee in the circumstances.*

21. It is for the Court then to satisfy itself that the applicant beneficiary has established a substantial and genuine dispute at which point the onus falls on the trustee to establish that his or her actions were reasonably open to him or her in the circumstances.

22. After hearing the matter, if satisfied on the balance of probabilities, that a trustee's action was not reasonably open to him or her in the circumstances, the Court may:

    (a) set aside the act or decision, or direct the trustee to act in the case of an omission;

    (b) restrain the trustee from acting in the case of a proposed act or decision, and direct the trustee to act in the case of a proposed omission;

    (c) make any other orders that it considers necessary.

23. However, the Court does not have the jurisdiction to make any orders that affect:

    (a) a valid distribution of trust property made before the trustee had notice of the application; or

    (b) any right or title acquired by a person in good faith and for value.

24. It is likely that these extended powers will lead to more litigation, more particularly so in the early stages of the legislation, as the High Court is called upon to determine the nature and extent of the powers.

The Bill – Alternate Dispute Resolution

Current Position

25. There has always been some doubt as to whether trustees can engage in alternate dispute resolution or refer matters to arbitration for a final determination.

New Position

26. Clauses 137-142 of the Bill provide for an opt in/opt out alternate dispute resolution (**ADR**) process, which would include mediation or arbitration.

27. Clause 137 speaks to *external* and *internal* matters:

    (a) An internal matter is one in which the parties are a trustee and one or more third parties.

    (b) An external matter is one in which the parties are a trustee and one or more beneficiaries.

    (c) A *matter* means:

        (i) a legal proceeding brought by or against a trustee in relation to the trust; or

        (ii) a dispute in relation to the trust between a trustee and a beneficiary, or between a trustee and a third party, or between two or more trustees, that may give rise to a legal proceeding; but

does not include a legal proceeding or a dispute about the validity of all or part of a trust.

28. Clause 138 provides that a trustee, with the agreement of each party affected, may refer the matter to an ADR process.

29. Clause 139 provides that if it is an internal matter and the trust has unascertained (unborn) or incapacitated beneficiaries then the court must appoint representatives for those beneficiaries. These representatives may agree to an ADR settlement on the beneficiaries' behalf, but any ADR settlement must be approved by the court. Note that the court is not required to approve an ADR settlement in respect of an external matter.

30. Clause 140 provides that the court (in relation to an internal matter) may, at the request of a trustee or beneficiary or of its own motion, enforce any provision in the terms of a trust that requires the matter to be subject to an ADR process or otherwise direct that the matter be dealt with by ADR (except if the terms of the trust indicate a contrary intention).

31. The court may also make a range of appropriate orders such as directing participation, directing that costs be paid from the trust property or appointing a particular person as mediator, arbitrator or facilitator.

32. Clause 141 provides that notwithstanding clause 31 (which binds trustees not to commit to the future exercise of a discretion) a trustee may, for the purposes of an ADR settlement give binding undertakings in relation to the trustee's future actions as trustee.

33. Clause 142 provides where a proceeding is brought by or on behalf of a beneficiary which arises from or relates to an ADR settlement, the ADR settlement is valid, and the trustee is not liable in that proceeding unless the trustee failed to comply with the mandatory duty imposed under clause 24 to act honestly and in good faith or any duties specified in the terms of the trust for the purposes of establishing liability. Moreover, a trustee is not liable in the proceeding by reason only that the settlement was not consistent with the terms of the trust.

34. This provision appears to be designed to avoid the situation where following an ADR process a disgruntled beneficiary decides to take action against the trustee on the basis that the matter should not have been settled the way it was.

The takeaways

35. So what are the takeaways?

    (a) In respect of external matters, and with the agreement of all parties, a trustee may refer a matter in dispute to ADR.

    (b) In respect of internal matters, the court may, at the request of a trustee or beneficiary or on its own motion either enforce an ADR provision in the terms of a trust or submit a matter in dispute to ADR except if the terms of the trust indicate a contrary intention.

    (c) By inference, therefore, it would seem permissible to expressly contract in or out of ADR.

The Law Commission's Issues Paper October 2017

36. This is a substantial and comprehensive publication.

37. The Commission notes that New Zealand has one of the highest number of trusts in the world as a proportion of its population. It estimates there may be anywhere between 300,000 to 500,000 trusts in New Zealand; that in the 2013 Census 14.8% of households reported that their home was held on trust; that in 2015 Statistics New Zealand found that 19% of households had involvement with a trust, meaning at least one member of a household was involved as a settlor, beneficiary or trustee.

38. The Commission sees the widespread use of trusts as a big issue because as a general rule property held on trust is not divided equally between the partners when a relationship ends.

39. The Commission begins by asking the question:

> *If New Zealand has changed so much in the 40 years since the Matrimonial Property Act 1976 was passed into law – substantially repealed and amended in 2001 by the PRA – is the policy of the PRA still sound, and are the right principles still guiding its rules?*

40. It sets out to identify what it calls the "big questions" for review. One of the questions asked is how should the PRA deal with trusts. Having recognised that the PRA does not apply to a significant amount of property attributable to relationships, thereby undermining the policy of a *just division*, and the principle that all property central to a relationship ought to be divided equally, the Commission makes some preliminary observations:

   (a) The existing provisions of the PRA designed to expose trust property and require the partner who disposed of property to a trust to pay compensation to the other partner has been widely criticised for being of limited effect and easy to avoid.

   (b) While there are a number of possible remedies outside the PRA regime that a partner could pursue in relation to trust property, they generally depend on different principles leaving the law fragmented, complex and sometimes conflicted. Their existence also undermines the principle that a single, accessible and comprehensive statute should regulate the division of property at the end of a relationship.

   (c) A significant option for reform is to amend the definition of relationship property in the PRA so that certain interests in a trust or even trust property itself, could, in defined circumstances, be divided. This, says the Commission, would enable partners to share property that had a connection to the relationship and would prevent the policy of the PRA being undermined by the use of trusts to hold property that would otherwise be attributable to the relationship and subject to equal division.

   (d) That section 182 of the FPA - which relates to the setting aside of nuptial settlements - should be either repealed or brought within the PRA and amended, consistent with the principle that a single, accessible and comprehensive statute should regulate the division of property at the end of a relationship.

41. The Commission goes on to discuss the so called trust busting provisions of the PRA (sections 44 and 44C), section 182 the FPA, and the High Court's powers to ensure a trust operates properly under existing law and its inherent jurisdiction to determine claims such as alter ego/sham and/or implied and/or constructive trust claims over property held on an express trust.

42. In chapter 21 of the Issues Paper, the Commission considers the priority trusts have over rights under the PRA and suggests that this may be causing problems. It says that except in narrow circumstances, a partner's entitlement to relationship property does not justify

interfering with property held on a trust; that the PRA should have limited powers to interfere with the capital of a trust because trusts were created for legitimate purposes and the PRA ought to ensure that trusts are respected so that these purposes can be fulfilled.

43. That said, the Commission says the issue arising is whether this approach remains appropriate. In other words, should the purpose that trusts achieve, and the interests of beneficiaries be given first priority? Or, is a partner's right to the trust property that he or she would otherwise have had under the PRA – but for the trust – be more deserving?

44. The Commission says that its intention is to promote discussion on these issues to assist it in assessing whether the current approach of the PRA and prioritising trusts needs reform.

45. In chapter 22 the Commission considers options for reform. Its preliminary view being that the PRA should be reformed so that partner's rights under the PRA more readily prevail against trusts. It says that while it has considered the option of making no change to the law as it stands, it does not consider this to be a real alternative.

46. The options for reform, it says, would ideally have several characteristics:

    (a) Reforms should enhance the PRA's ability to provide for a just division of property when property is held on trust.

    (b) Not all trust property should be subject to the PRA, eg trusts that have been established out of separate property or inheritances during the course of a relationship.

    (c) Any provision that makes trust property available to meet relationship property entitlements should interfere with the trust to the least extent possible.

    (d) Any provision that makes trust property available to meet relationship property entitlements should be simple and lead to predictable outcomes as far as is possible.

    (e) Remedies – in whatever form they may ultimately take – should be within the PRA – in line with the thinking that a single, accessible and comprehensive statute should regulate the division of property when partners separate.

47. One's overall sense is that the Commission is concerned about the fragmentation of the law and the rules applicable to division of assets connected to a relationship on its breakdown. Although only a discussion paper, it is my sense that comprehensive reform will come – it is only a matter of time.

This presentation was prepared by Ross Knight for TGT Legal's topical trust issues seminar on 19 October 2017.