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2012, Wellington, New Zealand | ISSUES PAPER 31

REVIEW OF THE LAW OF TRUSTS

PREFERRED APPROACH

A stylized, semi-transparent image of the Law Commission logo and text, tilted at an angle. It features the coat of arms and the text "LAW · COMMISSION" and "TE · AKA · MATUA · O · TE · TURE" in a serif font, set against a background of intricate, swirling patterns.

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The Law Commission is an independent, publicly funded, central advisory body established by statute to undertake the systematic review, reform and development of the law of New Zealand. Its purpose is to help achieve law that is just, principled, and accessible, and that reflects the heritage and aspirations of the peoples of New Zealand.

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Call for submissions

Submissions or comments (formal or informal) on this Issues Paper should be sent to Marion Clifford, Senior Legal and Policy Adviser, by **22 February 2013**.

**Law Commission,
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or by email to trusts@lawcom.govt.nz

The Law Commission asks for submissions or comments on this Issues Paper on the review of the law of trusts. The submission can be set out in any format but it is helpful to specify the number of the proposal you are discussing.

Submitters are invited to focus on any of the proposals, particularly in areas that especially concern them, or about which they have particular views. It is certainly not expected that each submitter will provide feedback on every proposal.

Alternatively, submitters may like to make a comment about the review of the law of trusts that is not in response to a proposal in the paper and this is also welcomed.

Official Information Act 1982

The Law Commission's processes are essentially public, and it is subject to the Official Information Act 1982. Thus copies of submissions made to the Law Commission will normally be made available on request, and the Commission may refer to submissions in its reports. Any requests for withholding of information on grounds of confidentiality or for any other reason will be determined in accordance with the Official Information Act 1982.

Foreword

This project is sizeable and significant. Trust law is in need of reform as much of it is no longer suited to the modern trusts context in New Zealand. Trust use is prolific in both private and business settings. Because of the importance of trusts to individuals, as a way of managing personal and family property, and to the business community, as a business and investment structure, it is vital that New Zealand is seen to have robust trust law. The Law Commission is devoting considerable time and resources to this wide-ranging and complex project in order to get this important work right.

In this paper we present the options we consider best address the issues and problems with the law of trusts following extensive research, consultation and submissions. The proposals cover all of the ground traversed in the previous five issues papers. Rather than proceeding directly to a final report, we want to give those interested an opportunity to see and provide feedback on our preferred options as a package. In our view, these proposals best meet the objectives of this review: the modernisation and clarification of trust law; providing a more useful trusts statute; reducing administrative difficulties and costs; ensuring fairness; and making sure the law is fit for the New Zealand context but consistent with relevant overseas trust law.

The general approach taken with this review has been to focus on getting core trust law right. It must be clear, coherent and practical. We want the range of New Zealanders who interact with trusts to have better access to and understanding of trust law. Legislation needs to give appropriate emphasis to the key elements that make a trust a trust.

The intention with this paper is to set our proposed package of reforms before a wide audience of interested parties and to encourage feedback. We invite feedback on whether people agree with the proposals or not. We are certainly open to altering the proposals if it is shown that they will not work as intended or that there is a better approach. We intend to publish our final report and recommendations in 2013.



Grant Hammond
President

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The Law Commission gratefully acknowledges the contribution of members of our Trusts Review Reference Group who have generously given, and continue to give, their time and expertise to assist with this review.

Members of the reference group are:

- Kerry Ayers, Helmore Ayers
- Andrew Butler, Russell McVeagh
- Chris Kelly, Greg Kelly Law
- Greg Kelly, Greg Kelly Law
- Jessica Palmer, Senior Lecturer, University of Otago
- Bill Patterson, Patterson Hopkins
- Professor Nicola Peart, University of Otago

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The Commissioners responsible for this reference are Honourable Sir Grant Hammond and Dr Geoff McLay. The legal and policy advisers for this paper were Marion Clifford, Jo Dinsdale, Sophie Klinger and Eliza Prestidge-Oldfield.

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Introduction

THE LAW COMMISSION'S REVIEW

- 1 The Law Commission is undertaking a comprehensive review of trust law and the Trustee Act 1956. This review follows the publication of the 2002 Law Commission report *Some Problems in the Law of Trusts*,¹ which resulted in the Trustee Amendment Bill 2007. That review was narrowly focused and pinpointed particular issues that were considered problematic. When the Justice and Electoral Select Committee considered the Bill its view was that the Bill did not reform the law relating to trusts extensively enough. The Select Committee urged the Government to conduct a comprehensive review. This current review is a result of the Government subsequently referring trust law to the Law Commission for review. The Bill has not progressed further.
- 2 Trust law is a broad topic covering doctrines of equity that have been developed by the courts over the centuries and matters that are legislated in the Trustee Act and Perpetuities Act 1964. We have considered whether reforms are necessary or would be beneficial to the operation of trusts in New Zealand. The review primarily focuses on the core principles of trusts, the duties, powers and role of trustees, and the powers of the court in relation to trusts.
- 3 Consideration of these matters has necessarily led to reviewing how trusts are handled within the court structure and whether other supervisory structures could usefully assist, and the potential need for public regulatory requirements to control the creation and ongoing management of trusts. Because they are a mechanism for holding property, trusts interact with other areas of law in circumstances stretching from the personal to the commercial. While the scope of this review does not extend beyond trusts themselves, it has been necessary for us to consider whether this interaction between trusts and other areas of law is creating any pressure points that can and should be addressed within trust law.
- 4 We have approached this review by presenting a series of Issues Papers that have sought to explore the background and context of trusts in New Zealand and raised issues regarding the areas of trust law that may be in

1 Law Commission *Some Problems in the Law of Trusts* (NZLC PP48, 2002).

need of reform or about which there is debate or concern. The Issues Papers published in this review are:

- *Review of Trust Law in New Zealand: Introductory Issues Paper* (November 2010) (referred to throughout this paper as the *Introductory Issues Paper*);²
- *Some Issues with the Use of Trusts: Review of the Law of Trusts – Second Issues Paper* (December 2010) (referred to throughout this paper as the *Second Issues Paper*);³
- *Perpetuities and the Revocation and Variation of Trusts: Review of the Law of Trusts – Third Issues Paper* (April 2011) (referred to throughout this paper as the *Third Issues Paper*);⁴
- *The Duties, Office and Powers of a Trustee: Review of the Law of Trusts – Fourth Issues Paper* (June 2011) (referred to throughout this paper as the *Fourth Issues Paper*);⁵ and
- *Court Jurisdiction, Trading Trusts and Other Issues: Review of the Law of Trusts – Fifth Issues Paper* (December 2011) (referred to throughout this paper as the *Fifth Issues Paper*).⁶

5 We sought submissions on each of these papers and have received 98 in total. We received submissions from law firms, accountancy firms, the judiciary, statutory trustee corporations, energy trusts, trustee and trust practitioner associations, law societies, trustee service providers, government departments, non-governmental organisations, private sector companies working in relevant fields, and a few individuals. Based on the comments received, as well as further research, consultation and expert advice we have refined our consideration into the concrete proposals contained in this paper. We recognise that our submissions have predominantly come from those representing the perspective of trustees. The nature of this type of consultation is such that we are more likely to receive responses from those with a more defined, active role in relation to trusts. This has meant that we have needed to keep in mind the interests of other stakeholders, such as beneficiaries, when formulating the preferred approach. At points the preferred approach does not align with the option favoured by the majority

2 Law Commission *Review of Trust Law in New Zealand: Introductory Issues Paper* (NZLC IP19, 2010). All Issues Papers in the review of the law of trusts are available at < www.lawcom.govt.nz/project/review-law-trusts?quicktabs_23=issues_paper > .

3 Law Commission *Some Issues with the Use of Trusts: Review of the Law of Trusts – Second Issues Paper* (NZLC IP20, 2010).

4 Law Commission *Perpetuities and the Revocation and Variation of Trusts: Review of the Law of Trusts – Third Issues Paper* (NZLC IP22, 2011).

5 Law Commission *The Duties, Office and Powers of a Trustee: Review of the Law of Trusts – Fourth Issues Paper* (NZLC IP26, 2011).

6 Law Commission *Court Jurisdiction, Trading Trusts and Other Issues: Review of the Law of Trusts – Fifth Issues Paper* (NZLC IP28, 2011).

of submitters. In these cases, we were of the view that the law and the overall interests of all of those affected would be better served by an alternate approach.

- 6 Because of the wide-ranging, complex and significant nature of trust law and the reforms being proposed, we are providing one final opportunity for submissions before we finalise our recommendations in our final report.
- 7 The review of the Trustee Act 1956, the Perpetuities Act 1964, and trust law generally is **stage one** of the Commission's trusts project. **Stage two** will be a review of charitable trusts and the Charitable Trusts Act 1957, and purpose trusts generally. **Stage three** will be a review of trustee companies and the trustee companies' legislation.

OBJECTIVES OF THE REVIEW

- 8 Because there is a significant amount of content to trust law, and because trusts, as a form of property holding, interact with many other areas of law, it has been necessary to focus the project on the aim of getting core trust law right. We believe that trust law can be improved for the benefit of the many New Zealanders involved with trusts. The following objectives for reform of trust law, which we would like to see achieved from the review, are used in analysing the options for reform:
 - (a) *Modernisation* – Trust law needs to be fit for the modern context. Trusts are widely used in twenty-first century New Zealand and therefore relevant legislation is needed. The current legislation is outdated in its language and some of the concepts used. It is difficult to understand.
 - (b) *Clarification* – Trust law is far from clear. Much of it is found only in complex case law. There are also many parts of the Trustee Act that are unclear and difficult to understand and apply because of the Act's age and drafting style. Some aspects of trust law, whether statutory or judge-made, are uncertain and in need of clarification to ensure the smooth running of trusts. It is especially important that legislation make obligations and powers clear. Many New Zealanders without legal training or experience are involved in trusts. It is important that those involved can access clear information about what the trust relationship requires. Clear legislation can help to alleviate confusion or uncertainty about the roles and requirements of participants in a trust.
 - (c) *A more useful trusts statute* – Many of the provisions of the Trustee Act are irrelevant and these should be removed. The Trustee Act does not assist with the creation and management of trusts, and many of the default positions in the Trustee Act are now undesirable. There are matters not covered by the Trustee Act that it would be helpful to include because they are relevant to a large number of trusts. More useful provisions in the statute can allow greater reliance on its default positions rather than most trust deeds overriding the legislation.

Including general explanations and principles in the statute would make the legislation more understandable and useful to non-lawyers, and set clear benchmarks for how a trust is to be used and managed.

- (d) *Reduction of administrative difficulties and costs* – Many of the procedures in trust law and under the Trustee Act lead to administrative difficulties and costs. It is necessary in many cases for trustees to apply to the High Court regarding straightforward procedural matters. The resulting costs deplete trust assets and can be time-consuming for those involved. It should be possible for some procedures to be carried out independently of the courts. The legislation should facilitate the resolution of disputes in an efficient way, particularly because of the large number of trusts with limited assets and the use of trusts for commercial purposes.
- (e) *Fairness* – The law should facilitate the fair use of trusts. It should not hinder people’s freedom to deal with their property as they choose, but should also provide ways to protect the rights of those involved in trusts and those interacting with trusts, including settlors, trustees, beneficiaries and creditors.
- (f) *Fit for New Zealand context but consistent with overseas trust law* – Trust law should reflect the unique features of the New Zealand trust context, which have implications for how the law should be shaped. The context means that there is need for legislation that is efficient and is flexible enough to contemplate a variety of types and uses of trusts. There is a need to be cautious about new costs for trusts because many New Zealanders would be affected. New Zealand law needs to take account of the prevalence of discretionary trusts. However, because New Zealand is a small nation with relatively limited trusts jurisprudence it is important for New Zealand law not to move too far out of line with internationally accepted trust law principles. Departure from the law in jurisdictions such as England, Australia and Canada should occur only where it is justifiable based on the New Zealand context.⁷

- 9 The scope of this review is limited to the law that is required for trusts to be established and managed successfully. This includes the concept of a trust, the obligations of those in trust relationships, the powers and role of a trustee, the powers of the court in addressing these matters, and the processes available for resolving problems. We have been interested in the interaction of trusts with other areas of law and policy, such as relationship property, creditors and insolvency, taxation and government assistance, to the extent that they illuminate the use of trusts and potential areas of concern within trust law. However, it is not within the scope of this review to resolve problems that

⁷ In its submission on the *Introductory Issues Paper*, the New Zealand Law Society commented on the importance of New Zealand trust law being consistent with trust laws in other comparable jurisdictions, as far as possible, and the ability to draw on the existing body of authoritative precedent of direct relevance from other jurisdictions.

might have arisen in these areas due to the existence of trusts as a particular form of property holding.

- 10 This stage of the review has primarily focussed on private express trusts. We suggest that implied trusts, such as resulting and constructive trusts, should not be covered by the definition of a trust or the new statute. These court-made or court-acknowledged “trusts” are considerably different from the trusts targeted by trusts legislation. We acknowledge that in some situations the courts may continue to choose to use provisions of trusts legislation as a reference for the law applying to non-express trusts.
- 11 The proposals in this paper do apply to public trusts (charitable and other purpose trusts) as well as private trusts to the same extent as the Trustee Act currently applies. Some of our proposals address beneficiaries and so are clearly not relevant to purpose trusts, but we expect that much of the new legislation would be drafted in such a way that it would apply to all express trusts where relevant. Where there are issues specifically affecting charitable and other purpose trusts, these will be addressed in stage two of the project.

GENERAL APPROACH TO REFORMS

- 12 We have aimed to present sensible practical proposals for trust law, focusing on private express trusts. For the most part we have not tailored the proposals to particular types of other trusts, such as the various types of trust established by statute, which do rely on some of the provisions of the Trustee Act and trust law generally. We invite comment from those involved with these trusts on whether they see the proposals that are relevant in their contexts operating successfully.
- 13 Below we set out some key features and themes of our proposals which reflect the aim and objectives of the review.

A new trusts statute

- 14 We propose that there should be new legislation to replace the Trustee Act. The reforms being considered in this review cover much of the content of the existing Act. The language and structure of the Trustee Act are in need of modernisation. Every section of the Trustee Act would benefit from being redrafted in intelligible language taking into account modern practices and conventions. The best way to achieve a coherent, useful statute is to introduce a brand new Act.
- 15 In our view, it would be beneficial to make the new Act a Trusts Act, rather than a Trustee Act. The current Act focuses on trustees primarily. We consider that the legislation should focus more broadly on the trust relationship. We are proposing broadening the subject matter covered by legislation so that it would include general trust concepts and relationships. We intend that new legislation would give a fuller picture of what trust law addresses.

Not a complete codification

- 16 While the subject matter covered will be broader than that covered by the Trustee Act, it is not possible to go as far as codifying all trust law. This is because of trust law's complexity, the nuances that apply to different types of trusts, and the desire for continued development of trust law by the courts. For instance, the proposals regarding trustees' duties are to have provisions that summarise the general principles of the existing case law. We do not propose specific rules about how the duties apply in different circumstances. The main area of trust law not covered by our proposals is the remedies that apply if there is a breach of trust. We have chosen not to explore this as equitable remedies are a broad area of law that covers more than trusts.

Inclusion of core trust principles

- 17 We propose that the new Act should restate some existing case law trust principles in general terms for the purposes of informing and educating people about trust law and clarifying trust law. Setting out those principles would guide the many trustees who are not trust professionals. It would meet the objectives of introducing a more useful statute that fits the New Zealand context of large numbers of family trusts. The proposed new Act would aim to make core trust law clear and accessible. In some cases this will mean the inclusion of subject matter in the new legislation that it could be considered unusual to cover in statute, but that is so central to the trust relationship that we believe it needs to be stated in a way that is readily understandable. Some of the proposals for principles of core trust law in the new legislation, such as those relating to the duties of trustees, are for provisions that summarise and express the case law without overriding it.

Addressing trust law rather than other areas of law

- 18 The proposals for a new Trusts Act address only core trust law. In our view the new Act is not the right place to address problems that arise solely at the point of the interaction of trusts with other policy areas. These matters are better dealt with in the individual policy areas so that different policy values can be taken into account and different solutions taken depending on the nature of the policy area and the impact of trusts on that area. The scope of this review means that we have generally not been able to address trust-related problems in other statutes. Only where the interaction of trust law and another area of law is creating problems with fundamental trust law do we suggest that reform measures may be warranted or there may be a need for a separate review of the other area of law.

Mandatory and default provisions

- 19 Like the Trustee Act, we propose that the new legislation would include both mandatory and default provisions. Some sections would apply in every trust, while others would be capable of being overridden by individual trust deeds. Where a provision is capable of being overridden, it would set out the

default position that applies in the absence of any statements on the issue in a trust deed. The new legislation should clearly identify which provisions are mandatory and which are default so that there is no room for confusion.

- 20 We propose that new legislation would go further than the current Act in making mandatory requirements clear. It is essential that all those using and interacting with trusts recognise that the existence of a trust means certain duties and requirements will always need to be met.

Application to existing and new trusts

- 21 Generally the provisions of the proposed new Act would apply to all express trusts, including existing trusts. Most of the proposals update existing provisions or restate existing judge-made law so there would be no real change to the legal position of most trusts. All trusts can benefit from the improved procedures we propose. Where there are proposals that would have the effect of materially altering the terms of a trust in a way that is detrimental, these would only apply to trusts established after the commencement of the new Act.

Enhanced trustee accountability

- 22 Our proposals take the approach of enhancing the accountability of trustees. In a trust relationship it is the beneficiaries that are owed the duties and have the ability to hold trustees to account. This is the primary way of ensuring that a trust is enforced. However, it has not always been clear what obligations trustees owe, whether trustees can avoid liability and how beneficiaries can go about enforcing their rights. Our proposals to set out trustees' duties and the law relating to clauses exempting trustees from liability in legislation will make the relationship clearer. We propose that beneficiaries should have a broader ability to apply to the court to have trustee decisions reviewed.

Enabling trustees

- 23 The proposed approach taken to trustee powers, including the investment powers, is to empower trustees broadly so that they have the authority to do all that they need to do as the default position if the terms of trust do not set the powers in another way. This is a change from the current Act which limits some powers with protective restrictions and conditions as the default position. The emphasis should be on the trustees' duties and the objects of the particular trust to control a trustee's actions rather than on the limitations to trustees' powers.

Streamlined law and processes to minimise court involvement

- 24 Where possible we make proposals that provide sufficient clarity and direction in the law so that there is less need for applications to the court to make a decision or formalise a process. We want the court's supervisory role in relation to trusts to be concentrated on disputes or situations where

the interests of beneficiaries who cannot protect their own interests are at risk. Where the court's supervision and direction is not necessary, trustees and beneficiaries should be able to avoid the cost, time and effort of a court application.

- 25 We propose that new legislation expand the role of the Public Trust. We suggest that the Public Trust can provide independent supervision and advice to trustees in certain situations. The Public Trust can have an official role to formalise a decision or process, where there is agreement among the parties involved. In some cases this would avoid the need for an application to be made to the court, reducing cost and delay for those involved. The Public Trust would be able to charge for its services.

Minimal new regulatory requirements and structures

- 26 The proposals do not introduce a new regulatory or supervisory body for either trustees or those providing trustee services. We do not propose that more information about individual trusts be submitted to a public body than is the case currently. This approach is based on the desire to avoid introducing unnecessary costs where a significant problem has not been identified. It also reflects the traditional private nature of trusts.

STRUCTURE OF THIS PAPER

- 27 This paper is divided into four parts. Part 1 addresses core trust concepts, including the context and features of trust use in New Zealand, core principles of trust law and the duties of trustees.
- 28 Part 2 focuses on trustees. It includes chapters on general powers of trustees, investment powers, the appointment and removal of trustees, and custodian and advisory trustees. It also contains a chapter looking at issues that arise in the context of corporate trustees and insolvent trusts, although some of these proposals have application to all trusts and trustees.
- 29 The powers and jurisdiction of the courts is discussed in Part 3, which includes the revocation and variation of trusts, the power to review the exercise of a trustee's discretion, and a variety of miscellaneous court powers. Part 3 also looks at the type of trusts jurisdiction that different courts should have and methods for resolving disputes outside of the courts.
- 30 Part 4 contains chapters considering trust issues of general application, including the rule against perpetuities and the duration of trusts, and regulation, such as the registration of trusts and requirements for trust service providers. The final two chapters of Part 4 look at the interaction of trusts with other policy areas, and in particular trusts and relationship property.

Part 1

CORE TRUST CONCEPTS



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Chapter 1

The trusts context in New Zealand

INTRODUCTION

- 1.1 This chapter outlines the context of trust use in New Zealand including types of trusts, reasons for which people establish trusts and for the popularity of trusts, key features that make trust use in New Zealand distinctive and the reasons trusts are necessary. While the reform proposals in this paper primarily focus on core trust law and private express trusts, it is useful to explore the nature and variety of trusts and trust use in New Zealand.
- 1.2 Trusts are with us as a part of New Zealand’s legal, social and business context and they are undoubtedly here to stay. They are here as a result of hundreds of years of legal development in England, and later, other countries of the Commonwealth. They are primarily governed by the judge-made law of equity, which was brought to New Zealand with British settlers. Legislation, like the Trustee Act 1956, provides an overlay to the concepts and rules that already exist in our law. In order for trusts to function efficiently and sensibly, it is necessary to have some rules on the administration and management of trusts and processes for decision-making and resolution of trust problems and disputes.
- 1.3 New Zealanders have keenly utilised trusts. There are a large number of trusts being used for a range of purposes. The use of trusts in New Zealand appears to be more widespread than in comparable countries.⁸ Through consultation and submissions on our Issues Papers we have sought to find out more about the trusts context in New Zealand. We have asked why people settle trusts and why there are so many in New Zealand. While it is

⁸ The number of tax returns filed by trusts in the 2009–2010 tax year was 253,800 (Inland Revenue “Returns Filed 2001 to 2010” <<http://www.ird.govt.nz/aboutir/external-stats/tax-returns/filed/tax-returns-filed.html>>). This number includes charitable trusts that are income earning. This means that in 2010 there was at least one trust for every 17 people in New Zealand. See Law Commission *Some Issues with the Use of Trusts in New Zealand: Review of the Law of Trusts – Second Issues Paper* (NZLC IP20, 2010) at [2.1]–[2.4] for comparisons with other countries.

impossible to determine a comprehensive answer to these questions as there are no official records of trusts, we have learned what are believed to be the common reasons people settle trusts and key features of how trusts are used. This chapter first looks at the basic trust concept.

WHAT IS A TRUST?

- 1.4 At its most simple, a trust is a legal relationship whereby someone (the settlor) gives property to someone (the trustee) to look after it and use it for the benefit of someone (the beneficiary). The relationship places legally enforceable obligations on the person holding the property to manage it for the benefit of the person entitled to receive the benefits of the property. For example, person A gives property to person B, who becomes the legal owner of the property and is under an obligation to deal with the property for the benefit of person C. At the heart of the concept of a trust is a separation between the person holding and managing the property, and the person or persons receiving the benefits of the property. The beneficiary and trustee have different sets of rights in relation to the same property, whereas when a person owns property outright, he or she has all of the rights in the property.
- 1.5 We recognise that this is an over-simplified characterisation of a trust and one that focuses on a private trust. Trusts come in almost infinite forms and are in almost all cases more complex than in this example. In many cases the identity of the trustee is not completely separate from the beneficiaries – the trustee may also be a beneficiary. In some cases the settlor continues to have a role, perhaps as a trustee or as a beneficiary or as someone with a power to make some decisions, for instance the power to appoint or remove a trustee or beneficiary. Despite the complexity and flexibility evident in trusts today, it is important to remember this basic starting point in what characterises a trust. Below we discuss different types of trust, all of which are built upon this basic concept of the trust.

TYPES OF TRUST

- 1.6 At points in this review we have focussed on express private trusts, and in particular family trusts, in the discussion of the issues and possible reforms to trust law. We want to make it clear that trust law applies to a variety of types of trusts and to emphasise the variety of circumstances in which trusts can be involved.

- 1.7 Trusts may be **public (charitable)** or **private**. Private trusts benefit individuals and may be enforced by the beneficiaries. Charitable trusts aim to benefit the public by achieving a charitable purpose and are enforced by the Attorney-General.⁹ Charitable trusts are a form of **purpose trust**. New Zealand law only allows limited purpose trusts other than charitable trusts, such as trusts for animals or for the maintenance of monuments.¹⁰
- 1.8 **Express trusts** are created deliberately because of a settlor's intention to create a trust. Some express trusts are intended to come into effect after the settlor's death (**testamentary trusts**). Testamentary trusts are nearly always created by a will.¹¹ An express trust that takes effect during a settlor's lifetime is known as an **inter vivos trust**. Express trusts may also be either **fixed** or **discretionary**. In a fixed trust, the trustee has no discretion about which beneficiaries will receive trust property and in what shares, while in a discretionary trust, the trustee does have these discretions. **Family trusts** are a form of express trust. They can be fixed or discretionary, but are commonly discretionary. They are set up by families for a range of purposes that benefit family members. Some family trusts and other express trusts are established to run a business. In these **business trusts**, the trust holds the shares in a company which owns the business assets. **Protective trusts**, which can prevent a beneficiary's interest from being lost in the event of bankruptcy, are a form of express discretionary trust.¹²
- 1.9 Different types of trusts for commercial purposes, including **unit trusts** and **trading trusts**, were discussed in the *Introductory Issues Paper*.¹³ Trusts can be used as a vehicle for managing collective investments. **Superannuation trusts** are trusts for managing retirement benefits for employees. All superannuation schemes that register under the Superannuation Schemes Act 1989 must have a trust deed.¹⁴ A member of a scheme is effectively a beneficiary of the trust. Trustees are responsible for the management and

9 Andrew S Butler "The Trust Concept, Classification and Interpretation" in Andrew S Butler (ed) *Equity and Trusts in New Zealand* (2nd ed, Thomson Reuters, Wellington, 2009) 43 at 58 [*Equity and Trusts*]. Where there is a legacy to a named charitable organisation, the organisation itself can undertake proceedings to enforce it.

10 At 58.

11 At 61.

12 Law Commission *Review of Trust Law in New Zealand: Introductory Issues Paper* (NZLC IP19, 2010) at [2.73]–[2.74].

13 At [2.67]–[2.72].

14 Superannuation Schemes Act 1989, s 3. The Unit Trusts Act 1960 and the Superannuation Schemes Act 1989 would be repealed by the Financial Markets Conducts Bill 2011 (342-2) which is currently before the Parliament. This Bill replaces the existing schemes for these statutory investment trusts with a new scheme that regulates matters including misleading or deceptive conduct, disclosure of information to investors, duties of persons associated with such schemes, powers of supervision, the licensing of certain financial market securities providers, and financial reporting obligations. As with the existing statutory trust schemes, where provisions of this legislation conflict with trusts legislation and trust law, they will prevail.

investment decisions. Other sorts of **employer trusts** are used for holding long term benefits for employees, such as shares or share options. These trusts enable shares or options to be held until a distribution date, held in individual packages within the trust, or held for long-term dividend income for the benefit of existing or retired employees. KPMG said in its submission on the *Second Issues Paper* that employer trusts can be more flexible and have fewer administration costs and reporting obligations than superannuation trusts.

- 1.10 **Energy trusts** were formed after the Energy Companies Act 1992 required all municipal electricity departments and power boards to be incorporated and allowed individual communities to determine how the shares in the new energy companies were to be held. Many local communities allocated shares to a local energy trust.¹⁵ Energy trusts vary considerably. Some are charitable trusts where the income of the trust, which is principally in the form of dividends from its shareholding in the electricity lines company, is used for charitable purposes. Others distribute directly to electricity consumers or members of the local community, for instance, through an annual rebate.¹⁶
- 1.11 Trusts may also be **simple** or **special**. The classification of a simple trust (**bare trust**) is legislatively created and so can vary from one statute to another, but there are several views of what bare trusteeship involves.¹⁷ The most common view of a bare trustee is that it refers to a trustee who has no duties, or if he or she did originally have duties the trustee can be compelled in equity by the beneficiary to convey the trust property to the beneficiary or by the beneficiary's direction.¹⁸ Bare trusts are often used in the acquisition of assets where it is desirable that the legal owner's identity remains undisclosed during the acquisition process. A special trust is one where the trustee has duties.
- 1.12 **Statutory trusts** are created or implied by statute. Examples include trusts created under section 77 of the Administration Act 1969 for children of the deceased when he or she dies intestate or partially intestate, trusts relating to land held by local bodies for public purposes,¹⁹ and community trusts established to acquire the shares in the capital of the trustee banks' successor companies for community benefits.²⁰ In addition, trusts are established for Treaty of Waitangi settlement claims and utilised by the statutes carrying out these settlements.²¹

15 Andrew S Butler "Trusts and Commerce" in Butler (ed) *Equity and Trusts*, above n 9, 1107 at 1120.

16 At 1120.

17 Andrew S Butler "The Trust Concept, Classification and Interpretation" in Butler (ed) *Equity and Trusts*, above n 9, at 58–59.

18 *Christie v Ovington* (1875) Ch D 279 at 281.

19 Butler, above n 9, at 59.

20 See Trustee Banks Restructuring Act 1988 (now repealed) and Community Trusts Act 1999.

21 For instance, Ngāi Tahu Claims Settlement Act 1998, Waikato-Tainui Raupatu Claims (Waikato River) Settlement Act 2010 and Ngāti Pāhauwera Treaty Claims Settlement Act 2012.

- 1.13 There are also trusts that are not express trusts in that they do not require an express intention to create a trust. **Resulting trusts** occur when a transferor of the property can be presumed not to have intended the recipient of the legal title to be the beneficial owner. As a result the recipient of the legal title must retain the property for the transferor, in the absence of any contrary intention.²² Palmer places resulting trusts in two categories: “apparent gifts” which covers voluntary conveyance and purchase of property in the name of another person, and “failing trusts” which covers express trusts that fail because of uncertainty and other invalidating reasons, and incomplete disposal of a beneficial interest.²³ **Constructive trusts** arise when no trust has been declared, either directly or indirectly, but it would be unconscionable for the person on whom the court imposes the trust to assert a beneficial ownership.²⁴ An **institutional constructive trust** arises on the happening of certain events by operation of the principles of equity. The court recognises its existence in a declaratory way but does not create the trust. A **remedial constructive trust** is imposed by the court as a remedy in circumstances where previously no trust existed, and so depends on the court for its very existence.²⁵ While they are covered by the current Trustee Act, the Act’s provisions and most of the matters discussed in this review are of little relevance to resulting and constructive trusts. It seems likely that the courts will continue to develop the law in this area.

Māori land trusts

- 1.14 Māori land trusts are unique to New Zealand and make up a significant proportion of New Zealand’s trusts. Unlike the express trusts discussed above, Māori land trusts are generally not settlor-made but are created by order of the Māori Land Court. They are primarily land management structures. They continue in perpetuity and are mostly fixed trusts.²⁶

22 Jessica Palmer “Resulting Trusts” in Butler (ed) *Equity and Trusts*, above n 9, 307 at 308.

23 At 314. It can be difficult to distinguish between different types of resulting and constructive trusts, and commentators differ in their views as to whether different situations that are said to fall into these categories actually qualify as trusts.

24 Noel C Kelly, Chris Kelly and Greg Kelly *Garrow and Kelly Law of Trusts and Trustees* (6th ed, LexisNexis, Wellington, 2005) at [15.1.2].

25 *Fortex Group Ltd (in rec & liq) v Macintosh* [1998] 3 NZLR 171 (CA) at 172–173.

26 Te Ture Whenua Māori Act 1993, s 235. Additionally some of the text in this chapter is based on information provided by the Māori Land Court in its submission on the *Fourth Issues Paper*.

- 1.15 Māori land trusts have a different historical origin from other trusts. There is evidence that trusteeship of Māori land may have arisen from the cultural institution of rangatira who made decisions in relation to land and communities on behalf of the communities, which means they are more akin to implied trusts.²⁷
- 1.16 Under Part 12 of Te Ture Whenua Māori Act 1993 (TTWMA), the Māori Land Court has exclusive jurisdiction to constitute the following five types of Māori land trusts:
- **Whānau trusts** – discretionary trusts primarily aimed at enabling interest in Māori land or general land owned by Māori to be held in perpetuity under the name of a tupuna (ancestor). The beneficiaries are the descendants of the tupuna, though none have a fixed interest. The trust is intended to prevent ongoing succession to land interests and their consequential fragmentation.²⁸
 - **Ahu whenua trusts** – fixed trusts that are the primary land management trusts under the Act. The trustees hold the land and assets on trust for the beneficial owners in proportion to their several interests and the beneficial owners are free to deal with their interests independently of the trustees, subject to the Act.²⁹
 - **Whenua topu trusts** – discretionary land management trusts that operate to promote and facilitate the use and administration of land in the interests of the iwi or hapū, rather than specifically for the persons beneficially entitled to the land.³⁰
 - **Putea trusts** – fixed share management trusts for managing impractical or otherwise undesirable minimal value interests, or interests where the beneficiary is unknown.³¹
 - **Kaitiaki trusts** – fixed trusts that can constitute Māori land or other land or property. Any persons under a disability, including minors under 20 years, are beneficially entitled.³²

27 Commentary on this is included in Waitangi Tribunal *Report of the Waitangi Tribunal on The Orakei Claim* (Wai 0009, 1987) at 5.1; *Rekohu – A Report on Moriori and Ngāti Mutunga Claims in the Chatham Islands* (Wai 0064, 2001) at 9.7.2; *Mohaka ki Ahuriri Report* (Wai 0201, 2004) at 6.7.6 and 12.7; *Hauraki Report* (Wai 0686, 2006) Vol 2 at 685, 697 and 698; and *He Maunga Rongo – Report on the Central North Island Claims* (Wai 1200, 2008) at 447 and 523.

28 Te Ture Whenua Māori Act 1993, s 214.

29 Te Ture Whenua Māori Act 1993, s 215. The Wellington Tenths Trust is an example of an Ahu Whenua trust set up over Māori reserved land.

30 Te Ture Whenua Māori Act 1993, s 216.

31 Te Ture Whenua Māori Act 1993, s 212.

32 Te Ture Whenua Māori Act 1993, s 217.

- 1.17 The Registrar of the Māori Land Court maintains a record of the legal and beneficial ownership of Māori land.³³ The Court has advised us that there are currently 9,230 whānau trusts, 5,575 ahu whenua trusts, 33 whenua topu trusts, three putea trusts, and 2,726 kaitiaki trusts. TTWMA provides much of the law regarding the constitution and administration of Māori land trusts and powers of the court in relation to these trusts. The provisions of the Trustee Act and general trust law are applicable to Māori land trusts where TTWMA is silent. The Government has announced a review of TTWMA to consider legislative intervention to enable the best use of Māori land.³⁴

Foreign trusts

- 1.18 A number of the trusts in New Zealand are settled by settlors who are resident overseas. Like other “onshore” trusts jurisdictions, such as the England, Canada and Australia, New Zealand has a long tradition of resident trusts and a taxation system that imposes tax on income from those trusts.³⁵ Since 1987 the New Zealand Government has made the policy decision to allow trusts to be settled by non-resident individuals and administered by trustees within New Zealand without incurring New Zealand tax.³⁶ This means that New Zealand is an attractive jurisdiction for foreign individuals wishing to make investments through the use of trusts. New Zealand has traditionally been seen as an “onshore” trusts jurisdiction where the traditional plurality of trusts has been for domestic as opposed to foreign wealth.³⁷ However, in not imposing tax on foreign trusts, New Zealand has a feature in common with the “offshore” jurisdictions that have traditionally been used for the settlement of trusts by foreign investors with foreign wealth, such as jurisdictions in the Channel Islands and Caribbean. Unlike some of the offshore jurisdictions, New Zealand has retained the traditional concept of a trust without extending its bounds far outside its historical starting point and has relatively light regulation of the trust industry.³⁸ New Zealand is considered to have sophisticated levels of advice from lawyers and accountants and a judiciary that is relatively advanced in understanding trusts.³⁹

33 Te Ture Whenua Māori Act 1993, s 127.

34 New Zealand Government “Te Ture Whenua Māori Act Review Announced” (press release, 3 June 2012).

35 Mark Bridges “Recent international trust cases that will have a material impact on the trust industry” (paper presented to Society of Trust and Estate Practitioners New Zealand Trust Conference, Auckland, March 2012).

36 John Prebble “The New Zealand offshore trust regime” (2012) 2 VUWLRP 28/2012 at 1.

37 Tim Hunter “NZ foreign trusts among global tax havens” *stuff.co.nz Business Day* (online ed, 22 August 2012).

38 Bridges, above n 35.

39 Bridges, above n 35.

- 1.19 Tax legislation requires the disclosure of details of foreign trusts by New Zealand resident trustees of foreign trusts. The Inland Revenue advise that since October 2006 when a registration requirement for foreign trusts was introduced there have been 7,738 foreign trust registrations.⁴⁰ The New Zealand resident trustee must belong to an approved organisation, such as the New Zealand Institute of Chartered Accountants, the New Zealand Law Society and the Society of Trust and Estate Practitioners (New Zealand branch). The trustee is also required to keep financial and other records relating to each foreign trust for New Zealand tax purposes and is obliged to provide these details to the Inland Revenue if requested.⁴¹ If the trustee does not comply with these requirements he or she may be subject to sanctions, such as prosecution for knowingly failing to disclose or keep the required information. In certain circumstances, the resident foreign trustee may be taxed in New Zealand on the foreign trust's worldwide income.⁴²

WHY DO PEOPLE SETTLE TRUSTS?

- 1.20 In the *Second Issues Paper* we outlined several historical reasons why New Zealanders have been so partial to trusts, including the estate duty rules that applied before estate duty was abolished in 1993, the relationship property statutes, and the misalignment of the trust tax rate and personal tax rates. We also raised the possibility that trusts were being established for the purposes of qualifying under social assistance policies and avoiding creditors and because there had been active promotion of trusts.⁴³
- 1.21 From the submissions received on the *Second Issues Paper* and consultation undertaken, it appears that trusts are being established for the following main reasons:⁴⁴
- to allow self-employed persons to separate business assets from personal assets. This can protect personal assets from ordinary business risks, and personal liability arising from negligence (such as a leaky home claim against a builder). Ordinarily, the trust and the company through which the business will be operated are established at the outset. Assets that

40 Data as at 30 June 2012, provided by Inland Revenue (Email from Graham Tubb (Inland Revenue) to Marion Clifford (Law Commission) regarding foreign trusts (10 July 2012)).

41 Prebble, above n 36, at 1–2.

42 Tax Administration Act 1994, ss 3(1), 22(2)(fb) and (m), 22(2C), 22(7)(d), 59B, 61(1B), 81(4)(mb), 143(1B), 143(IC), 147(2B) and 147B.

43 Law Commission *Some Issues with the Use of Trusts in New Zealand: Review of the Law of Trusts – Second Issues Paper* (NZLC IP20, 2010) at [2.8]–[2.22].

44 Key submissions in providing information on why people settle trusts were received from the New Zealand Law Society, Ayers Legal, Chapman Tripp, the Trustee Corporations Association, WHK, Harris Tate, Taylor Grant Tesiram, John Tripe, Martin Riley, KPMG, Gary Thomas, Peter Kellaway and Jennifer Dalziel.

have been acquired before the beginning of the business venture will be transferred to the trust, to protect these “personal assets” regardless of the success or failure of the business. The New Zealand Law Society (NZLS) suggests that many trusts have been set up in New Zealand for this purpose.

- for traditional estate planning. For example, a trust may be used to keep a farm within a family for successive generations. The orderly control and transmission of wealth was described as the most important reason many people establish trusts. The discretionary trust provides a high degree of flexibility that is useful for regulating the destiny and transmission of property in the future, in a world where lives and circumstances change over time.
 - to protect separate assets from relationship property claims. Two circumstances are frequently mentioned. First, a settlor may settle the family home on a trust for the benefit of themselves and their children and grandchildren after a first relationship ends, but before a subsequent relationship begins. Second, instead of making an outright gift, a settlor may settle assets on a trust for the benefit of their children and grandchildren to prevent the assets becoming subject to a claim from a child’s spouse or partner in the event of a future relationship breakdown.
 - for the efficient operation of a business. This applies particularly to family businesses, where proceeds can be shared with family members who have no control over the business. For example, a trust may own the shares in the company which operates the family business, meaning that the profits can be distributed to the beneficiaries on a flexible basis. The NZLS points out that trusts have been used as a legitimate business vehicle in a wide variety of commercial contexts and that they are used for the same reasons as limited liability companies and partnerships.
 - to provide for family members with special needs, or to provide a particular benefit to a class of persons, for example, the education of the settlor’s grandchildren.
 - for investment schemes and innovative commercial arrangements, including energy trusts, unit trusts, and superannuation trusts.
 - to provide for philanthropic or charitable activities.
- 1.22 There is also some evidence that trusts have been used for purposes that may be considered less acceptable, including:
- to obtain tax advantages. Since the decision of the Supreme Court in *Penny v Commissioner of Inland Revenue*⁴⁵ and the realignment of top tax rates, it is likely that fewer trusts are now being used to obtain otherwise

45 *Penny v Commissioner of Inland Revenue* [2011] NZSC 95, [2012] 1 NZLR 433.

unavailable tax advantages. However, some trusts established for this purpose may still exist. A number of submitters did not view tax minimisation as problematic.

- to qualify for state assistance. The Ministry of Social Development considers it is common for trusts to be established to avoid the income and asset tests it uses to assess eligibility. Some settlors and their families may be using trusts in an attempt to appear less wealthy and therefore eligible for government support, such as the Residential Care Subsidy, the Student Allowance, and Working for Families. However, trusts do not always achieve this purpose. Many of the different rules regulating different types of government assistance allow the government to consider dispositions to trusts as part of a settlor's assets. Other submitters have suggested that it is rare for trusts to be settled for this purpose.
- to attempt to defeat known creditors, though this is probably uncommon because of the strength of the "look-through" provisions in the Property Law Act 2007.
- to defeat the equal sharing regime under the Property (Relationships) Act 1976 (PRA). For example, after relationship difficulties begin one party might settle a trust for the benefit of themselves and their children, to the exclusion of their spouse, and begin to transfer relationship property to the trust.

WHY ARE TRUSTS SO POPULAR IN NEW ZEALAND?

- 1.23 In the *Second Issues Paper* we asked why there are such a comparatively large number of trusts in New Zealand and submitters were able to give us some useful insights on this question.⁴⁶
- 1.24 One reason for the popularity of trusts is that there is favourable tax treatment of trusts in New Zealand compared with other jurisdictions, which have tax disincentives. New Zealand now does not have any estate duty, gift duty, stamp duty or capital gains tax. Tax laws in a number of countries effectively discourage the settlement of trusts by imposing high tax rates on trusts.⁴⁷ In countries where the corporate tax rate is lower than the trust tax rate, companies are likely to be used more frequently than trusts for investments. At times tax rates in New Zealand have been set in such a way that they have effectively encouraged the use of trusts to minimise taxation.

46 Key submissions commenting on why trusts are popular in New Zealand were received from Taylor Grant Tesiram, the Trustee Corporations Association, KPMG, Harris Tate, WHK, the NZLS, Chapman Tripp, Martin Riley, the Auckland District Law Society, Ayers Legal, Peter Kellaway and Lawler & Co.

47 For instance, in the United Kingdom, most income over £1,000 accumulated by a trust is taxed at 50% (HM Revenue and Customs "Tax on different types of trust income" < www.hmrc.gov.uk >).

For instance, from 2000 until 2010 the highest personal tax rate was 39 %, while trust income was taxed at 33 %.⁴⁸

- 1.25 Submitters also pointed to the ease and low costs of establishing and maintaining trusts. There are few compliance requirements associated with operating a trust in New Zealand. The process for settling a trust is generally private and there is no official public record of trusts or ongoing obligation to submit information to a public body.
- 1.26 In recent years there appears to have been active promotion and advocacy for trusts. Some have described this as a “commodification” and “marketing” of trusts by the “trusts industry”. Trusts are sometimes seen as a status symbol, and something that every property owner should have (Ayers Legal described this as the need to “keep up with the neighbours”). While in many countries trusts are seen as a structure for the wealthy only, there is widespread settlement of trusts amongst middle income New Zealanders. KPMG suggested that one reason for this is that New Zealand has relatively high levels of investment in real property and trusts have been promoted as a useful structure for property investment. Ayers Legal submitted that “[i]t is possible that the New Zealand obsession with trusts also represents in part a refusal to accept that trusts are the preserve of the wealthy” and goes on to describe the New Zealand experience as “an egalitarian response to the establishment of trusts”. As the legal and accounting professions have become more familiar with trusts, there has been a tendency to advise the establishment of a trust as “part of the package” when other work is being done.
- 1.27 Another reason posited is that New Zealanders are wary of future changes in government policy, such as changes to tax rates, which could make their financial position uncertain. It has been suggested that maintaining a trust allows taxpayers to have greater flexibility in how they structure their finances. One submitter went as far as directing attention to “the legislative and judicial decision making background that forces ordinary people to have to set up trusts to try and protect themselves, their children and their assets” rather than to any improper use of trusts.⁴⁹

FEATURES OF TRUST USE

- 1.28 As mentioned above, a key feature of New Zealand’s trust use is its prevalence. There are a high number of trusts per capita. However, it has been suggested that the number of trusts is no longer increasing as rapidly as it has in past, and that trust formation was at its peak from 2005 to 2007.⁵⁰

48 *Second Issues Paper*, above n 43, at [2.13].

49 Law firm Lawler & Co refers to policies on residential care subsidies, taxation, and relationship property creating the impetus for trusts.

50 Suggestion made by law firm Harris Tate in its submission.

- 1.29 There is great variation in the structure and nature of trusts in New Zealand. The Trustee Corporations Association notes that “[e]ven within the context of personal and family trusts, no two trusts are the same”.
- 1.30 Another major feature of the New Zealand trust context is that many private express trusts are discretionary trusts. This means that the trust deed provides either the trustee or another person with the discretion to decide how trust assets are to be distributed. This power of appointment may limit the prospective beneficiaries to specified persons or a particular class, or it may leave it open. The appointor may also have the discretion to decide when, if at all, to distribute assets and in what shares. In a discretionary trust, some or all of the beneficiaries will only have a hope or expectation of receiving from the trust. In some trusts, despite the apparently wide discretion of the trustees to distribute trust property to a broad group of beneficiaries, the settlor’s intentions will be made clear to the trustees through a letter or memorandum of wishes or some other means.
- 1.31 A large number of New Zealand’s trusts appear to be family trusts with limited trust property. Many of these family trusts have a single asset – a family home. While historically trusts have primarily been utilised by wealthy families, it appears that in New Zealand trusts are commonly settled by families with more modest means.
- 1.32 Trusts are used by Māori for a variety of purposes, including Treaty of Waitangi settlements and for managing Māori land. Trusts are a useful vehicle for managing land which has a large number of interest holders as is common in relation to Māori land.
- 1.33 The large number of trusts in New Zealand and the variety of professional trust advisers offering trust services and, in some cases, actively promoting the settlement of trusts, has been described as representing a “trusts industry”.
- 1.34 The comment was made in Chapman Tripp’s submission that because some trusts were settled without the settlors having a clear purpose or a solid understanding of what the trust relationship fully involves, there are trusts that have been “sent out to graze without continuing external legal or accounting advice”. It appears that a proportion of trusts are not well-administered in that annual accounts may not be prepared and records of trustee decisions may not have been kept. Some trustees do not fully understand the obligations that their role entails.
- 1.35 Another feature is the common use by law or accounting firms of trustee companies to act as trustee for their clients. These companies may be established for the purpose of acting as a trustee for an individual trust, so that the firm has many trustee companies, or for acting as trustee for many trusts.⁵¹

51 For instance, law firm Harris Tate described its practice of establishing a new trustee company each year for the purpose of becoming trustee to the up to 100 trusts established by clients each year.

DO WE NEED TRUSTS?

- 1.36 A few people have raised the question of whether New Zealand law should continue to allow trusts at all. A small minority have been concerned about certain uses of trusts, particularly for purposes that are considered less acceptable, and they see the existence of the trust itself as the problem.
- 1.37 It has never been the Commission's intention to propose the abolition of trusts given their long history of development and entrenchment within New Zealand's society and economy. However, it is worthwhile to examine the value of trusts.
- 1.38 The trust is a valuable mechanism for structuring property in a different way from outright ownership, such that those responsible for the management and control of the property are not the same as the people or purposes that receive the benefits of that property. Trusts allow settlors to direct with some precision how dispositions of property are to be managed into the future, even well beyond the settlor's death. Trusts ensure that the management of property is treated with a considerable degree of care and responsibility by clearly assigning the task to trustees who are under fiduciary and non-fiduciary duties. Trusts are flexible arrangements that can be adapted to changing needs. The mechanism of separating the legal and beneficial rights and interests in property appears to be one that will continue to be considered useful and is not inherently problematic. Trusts are a sophisticated way of splitting and managing rights in property, but they are not the only way of achieving these purposes. If trusts did not exist, it is likely that existing mechanisms would be used or new mechanisms devised to achieve similar effects.
- 1.39 We are mindful of the concern from some people about the problematic use of trusts and about "trusts" that stretch the bounds of what trusts actually are. In this project we have considered whether there were problems sufficiently associated with our focus on core trust law that could be addressed by this review. We have looked at the options of a statutory restriction on the purposes for which trusts can be used, a general look-through provisions setting out factors that indicate when dispositions to a trust may be set aside for a particular purpose, and a statutory provision defining or indicating when a trust is a sham.⁵² After careful consideration we have decided not to pursue these options. It would be impossible to limit trust purposes in a way that maintains the flexibility of the trust and only targets the purposes that should not be lawful. Similarly, it is not feasible to define a look-through provision that is appropriate for all of the policy contexts where dispositions to trusts could be disregarded. The circumstances in which trust dispositions can be disregarded need to reflect the particular balancing of values and interests in each policy context. We found that the sham doctrine could not

⁵² Discussed in chs 2 and 16.

sensibly be codified in trusts legislation as it developed in the common law and applies much more widely than just to trusts.

- 1.40 To the extent that there is a problem, we have reached the conclusion that the trust device is not itself the cause. Improvements can be made by clarifying the real nature of trusts and the roles and responsibilities that arise in trusts. Our reform proposals regarding definitions, when a trust is not a trust and trustees' duties,⁵³ along with having a statute that is generally clearer and more accessible will have a beneficial impact.

⁵³ Discussed in chs 2 and 3.

Chapter 2

Core principles of trust law

INTRODUCTION

- 2.1 This chapter discusses how proposed new legislation should address the concept of a trust. We see value in new legislation including sections that outline what a trust is and how a trust is created. This would provide general guidance on the nature of the trust relationship. The intention of these provisions would not be to override the traditional case law understanding of a trust in New Zealand law generally, but to summarise in one place the key features of trusts that it is important that people settling trusts and interacting with trusts comprehend.
- 2.2 This chapter includes a proposal to restate the circumstances in which a trust is created, including the three certainties. It considers the inclusion of a provision to make it clear that the courts can declare a trust to be invalid if it fails to meet basic requirements, and the option of including a provision on sham trusts. We also discuss the option, raised in the *Second Issues Paper*,⁵⁴ of placing statutory restrictions on the purposes for which trusts may be settled.

DEFINITION AND CREATION OF A TRUST

Proposal

- P1 (1) New legislation should define “trust” for the purposes of the Act. The definition should be confined to express trusts. It should describe a trust’s core features and make it clear what types of trusts are covered by the Act. The definition should comprise the following:

54 Law Commission *Some Issues with the Use of Trusts in New Zealand: Review of the Law of Trusts – Second Issues Paper* (NZLC IP20, 2010).

- (a) A trust is an equitable obligation binding a person or persons (the trustee) to deal with property (the trust property) for:
 - (i) the benefit of the beneficiaries, any one of whom may enforce the obligation owed to them; or
 - (ii) such purposes as are permitted at law.
- (b) Trust property is held by the trustee in a way that is identifiably separate from his or her own private property.
- (c) The trustee has the power and the duty, in respect of which he or she is accountable, to manage, employ or dispose of the assets in accordance with the terms of the trust and the duties imposed on trustees by law.
- (d) A trust may take effect either within the settlor's lifetime or upon his or her death.
- (e) A trustee may have a beneficial interest in the trust property.
- (f) No trust exists if the sole beneficiary is also the sole trustee.
- (2) The legislation should include a provision restating the general principles of how a trust may be created, including that a trust may be created:
 - (a) by a person (settlor) when he or she indicates with reasonable certainty by any words or actions the following (collectively known as "the three certainties"):
 - (i) the settlor's intention to create a trust;
 - (ii) the beneficiary or beneficiaries, or permitted purpose; and
 - (iii) the trust property; or
 - (b) in accordance with any statute.

The requirements for the creation of a trust are subject to the Wills Act 2007 and the Property Law Act 2007 where applicable.

- (3) The new legislation should define "trustee" and "beneficiary" broadly in a way that explains their role, for instance:

A "trustee" should include anyone who holds property under a trust.

A "beneficiary" should include anyone who has received or who will or may receive an interest in trust property under a trust in accordance with a trust deed. It should include a discretionary beneficiary, that is, a person who may benefit under a trust at the trustee's discretion or power of appointment, but who does not hold a fixed, vested or contingent interest in the trust property, and a trustee or settlor may also be a beneficiary.

Note: in these proposals "settlor" includes a will-maker.

Please give us your views on this proposal.

Current law

- 2.3 Section 2 of the Trustee Act 1956 defines "trust" for the purposes of that Act as follows:

trust does not include the duties incidental to an estate conveyed by way of mortgage, but with this exception it extends to implied and constructive trusts, and to cases where the trustee has a beneficial interest in the trust property, and to the duties incidental to the office of an administrator within the meaning of the Administration Act 1969, or a manager or person authorised to administer the estate of any person under the Protection of Personal and Property Rights Act 1988, or a manager of a protected estate appointed under the Protection of Personal and Property Rights Act 1988;

- 2.4 Clearly this definition is not intended to explain what a trust is. It is more a statement of what trusts are covered by the Trustee Act and is necessary to the functioning of the Act. The Trustee Act does not explain the core principles of what a trust is and the nature of the relationships it establishes. However, the judge-made law on the key features of a trust is generally accepted.
- 2.5 “Trustee” is defined in section 2 of the Trustee Act as having a corresponding meaning to “trust” and includes a trustee corporation and every other corporation in which property subject to a trust is vested. “Beneficiary” is not currently defined in the Act.

Issues

- 2.6 Trusts are in widespread use in New Zealand and many people with no legal training are involved in trusts as settlors, trustees and beneficiaries. The trust concept is complex, involving several relationships which create obligations. While lawyers may understand what a trust is or have ready access to texts that explain the concept, the definition of a trust is not readily accessible to many New Zealanders. The Trustee Act is a collection of administrative and procedural provisions and powers that presumes a certain sort of relationship is in existence. There is no authoritative statement of how that relationship is established and the role of the people involved. Some of the issues discussed here were raised in the *Introductory Issues Paper*.⁵⁵

Options for reform

- 2.7 The options considered were to include a definition that explained the key features of the trust in proposed new legislation or to continue the status quo. We have considered whether the provision outlining the key features of a trust should be a definition of what a trust is for the purposes of the Act, or whether it should be a restatement of the case law position that is separate to a definition like the existing definition.

Discussion

- 2.8 We consider that it would be beneficial to include explanatory provisions about the core features of the trust in new legislation as they would have a significant educative impact among those involved in trusts that do not

55 Law Commission *Review of Trust Law in New Zealand: Introductory Issues Paper* (NZLC IP19, 2010).

have legal training. It would make the legislation much clearer on its face because it would explain the type of relationship that is regulated by the Act. We have heard evidence that the concept of a trust is not widely understood by the general population or even the business community. If new trusts legislation is to restate established principles of trust law, improve the clarity and accessibility of trust law, and have an educative impact on trustees, beneficiaries and settlors, the requirements for creating a trust should also be clearly set out.

- 2.9 Unlike the current Act, the proposal would not cover implied and constructive trusts. We consider that attempting to include implied, constructive or resulting trusts unnecessarily complicates the definition in the proposed Act. Implied, constructive and resulting trusts are created by the court or by operation of law, and have little in common with express trusts. Most provisions of the trusts statute will not be relevant. Excluding these forms of trust from the definition would not prevent the courts making reference to trusts legislation when making a decision or giving a direction in relation to an implied, constructive or resulting trust.
- 2.10 There might be some concern the definition and creation provisions could have the unintentional effect of altering the law or excluding some relationships which previously would have qualified as trusts, and that this could limit the development of case law. However, we believe that these concerns can be alleviated by carefully drafting the provisions broadly so they encompass the full ambit of express trusts. While in general, New Zealand statutes do not define or explain general concepts, such as a contract or defamation, but rely on judge-made law to do this, the complexity combined with the ubiquity of trusts mean that a definition is warranted. We recognise that a definition for the purpose of a trusts statute does not define a trust for every aspect of trust law, as some trust law will remain outside of the Act. However, we do not expect that this will cause problems. The definition is intended to cover any express trust that is covered by trust law. The definition in the Act will also be available as a guide for what a trust is under all trust law in New Zealand.
- 2.11 Submitters mostly favoured the approach of restating general trust law principles in legislation because of the helpful educative impact it would have. The New Zealand Law Society's (NZLS) view was that, although potentially difficult to achieve, it may be worthwhile to restate these principles in statute. It was less convinced about the benefits of a formal definition of a trust, however. The submission detailed many arguments for and against including a definition,⁵⁶ before giving the view that it did not consider a definition was necessary and that it would have little practical impact. The Trustee Corporations Association considered that the educative impact of restating key trust law concepts in legislation would be valuable and that a definition could assist lay trustees and beneficiaries to understand the trust better.
- 2.12 We presented several options for the definition of a trust in the *Introductory Issues Paper*, including some that attempted to set out the generally

understood equity-based definition of a trust (such as Hayton’s definition)⁵⁷ and others that were not limited to beneficiary trusts, but included purpose trusts (such as the Hague Convention definition).⁵⁸

- 2.13 The proposed explanatory provisions are a combination of aspects of these two definitions. The aim is to encompass the variety of express trust forms that are used, including express beneficiary trusts (such as discretionary family trusts), testamentary trusts, purpose trusts (such as charitable trusts), and trusts created under other statutes (such as Māori land trusts). We consider that the legislation should make it clear that a trust can be for the benefit of beneficiaries or for a purpose. At this stage of the review, we are not considering the ambit of permitted purpose trusts.⁵⁹ As purpose trusts are only lawful for certain purposes, the legislation should explain that trusts may be for a “permitted purpose” and define this term. It is intended that if the decision is made to alter the law regarding which purpose trusts are permitted following stage two of our review, the definition of “permitted purpose” could be altered.
- 2.14 We also asked the question of whether the traditional description of the concept of a trust, the title split into a legal interest held by trustees and an equitable or beneficial interest held by beneficiaries, should be included in a definition. This understanding of the trust arises from the history of trusts and their development in the courts of equity. The interest of a beneficiary in trust property was called equitable because it was originally only recognised by these courts.⁶⁰ Equitable interests are not so much carved out of a full legal interest, but are new rights “engrafted” upon it.⁶¹
- 2.15 The split legal and beneficial title description is a useful way of understanding what happens in a trust and makes it clear that it is something quite different from usual ownership of property. The difficulty with including this in a definition is that the concept is not seen as fitting all trusts. Sometimes the

56 Including: advantages – clarifying the type of legal relationship, providing the general public with a better understanding of what a trust is and is not, assisting with interpretation and administration of thousands of trusts in New Zealand by providing guidance as to what those relationships comprise; and disadvantages – tension between the purpose and role of the legislation and what have always been private unregulated legal relationships, unduly restricting the court’s findings and ongoing development of the law, creating difficulties for more specific statutory notions of trust, might constrain judges in cases from finding the existence of a trust.

57 David J Hayton, Paul Matthews and Charles Mitchell *Underhill and Hayton Law of Trusts and Trustees* (17th ed, LexisNexis Butterworths, London, 2007) at [1.1] [*Underhill and Hayton*].

58 Hague Convention on the Law Applicable to Trusts and On Their Recognition 1664 UNTS 92 (concluded 1 July 1985, entered into force 1 January 1992), art 2.

59 This question will be addressed in stage two of the review.

60 *Underhill and Hayton*, above n 57, at [2.1].

61 Andrew S Butler “Basic Concepts” in Andrew S Butler (ed) *Equity and Trusts in New Zealand* (2nd ed, Thomson Reuters, Wellington, 2009) 21 at 23 [*Equity and Trusts*] citing K Gray “Equitable property” [1994] CLP 157 at 163.

trustee does not hold the legal title to the trust property.⁶² The title split concept does not work easily with discretionary trusts. A beneficiary under a discretionary trust does not have a full equitable proprietary interest. If a discretionary beneficiary's interest is subject to the trustee's discretion, all he or she has is a mere hope or expectancy of an interest in the property, which gives the beneficiary some personal rights against the trustee to ensure that the trustee distributes within the class.⁶³ This expectancy is not an equitable property interest. Most submitters considered that the title split concept no longer accurately portrays the trust, but some, including the NZLS, did consider that this was an important element of what makes a trust a trust. It may be possible to include the flavour of this understanding of the trust, without stating that beneficiaries have the beneficial ownership.

- 2.16 The issue of whether New Zealand should ratify the Hague Convention was raised in the *Introductory Issues Paper*. The convention is intended to clarify which law will apply where trusts cross international boundaries. In its 2002 review, the Law Commission recommended ratification of the convention, although it indicated that doing so may indirectly permit the establishment of a much greater range of non-charitable purpose trusts because these are legal in other jurisdictions and are contemplated within the Convention's definition. We consider that the question of ratification of the Hague Convention could be revisited following stage two of the Commission's review of trusts. The Commission would consider as part of stage two whether all purpose trusts permitted elsewhere should be recognised in New Zealand.
- 2.17 The option of including a standard definition of trust in the nature of the definition in the current Act and having separate explanatory provision that restate the case law on what a trust is was rejected because it could create confusion about the status of the explanatory provision. It would be similar to a definition but without being authoritative. We consider that it is better to propose a firm and comprehensive definition of trust for the purpose of the new Act.
- 2.18 We consider that definitions for "trustee" and "beneficiary" should be included in the interpretation section also. The definition of "trustee" can be made more useful by including a brief explanation of the trustee's role. We suggest that it would be helpful to define "beneficiary" also. Many of our proposals refer to beneficiaries and we are consistently taking a broad view of who a beneficiary is for the purposes of the Act. The definition of "beneficiary" in this Act should include a discretionary beneficiary.

62 *Underhill and Hayton*, above n 57, at [2.5].

63 At [2.14]; Andrew S Butler "The Trust Concept, Classification and Interpretation" in Butler (ed) *Equity and Trusts*, above n 61, 43 at 52.

FINDING THAT NO TRUST EXISTS

Proposal

P2 New legislation should provide that a purported trust that does not satisfy one or more of the three certainties (mentioned in P1(2)(a) above) is not a trust for the purposes of this Act or for any purpose, and is void. The provision would state that it does not limit the court's ability to find that a trust is invalid on any other basis recognised at law.

Please give us your views on this proposal.

Current law

- 2.19 It is open to the courts to find that a trust was not validly established and therefore that it does not exist. In order for a valid express trust to exist, in addition to any necessary formalities, such as the requirements under the Wills Act 2007 for the valid creation of a will and the requirements under the Property Law Act for trusts including land as trust property,⁶⁴ the “three certainties” as mentioned in P1(2)(a) above must be met. These are the certainty of intention, the certainty of subject matter and the certainty of objects.⁶⁵
- 2.20 If the certainty of intention to create a trust is not present, the court may find, depending on the circumstances in which the purported trust was established, that instead of a trust a valid outright gift has been made, or that the gift is imperfect and the property remains with the original owner.⁶⁶
- 2.21 The certainty of subject matter requires certainty of the property that is to be subject to the trust and the extent of the beneficial interest of each beneficiary. Uncertainty of subject matter means that the trust does not exist and either the property will remain with the alleged settlor (or his or her estate) or, if there was a gift to an intended trustee, the intended trustee will be the absolute owner of the property.⁶⁷
- 2.22 The certainty of objects means that the beneficiaries (or charitable or other permitted purpose) of a trust must be identifiable. If it is not possible to ascertain the object of the trust, although the other certainties are satisfied, a court will find that the trustees hold the property on a resulting trust for the settlor or the testator's estate.⁶⁸

64 Wills Act 2007, s 7; Property Law Act 2007, s 25.

65 Andrew S Butler “Creation of an Express Trust” in Butler (ed) *Equity and Trusts*, above n 61, 69 at 73.

66 At 77.

67 At 80.

68 At 84.

Issues

- 2.23 There is a concern that the law lacks a means of addressing arrangements purporting to be trusts but lacking fundamental elements of a trust, such as the intention to create a trust, the duties on a trustee and any separation of beneficial and legal ownership. The law needs to ensure that people who gain the protection and benefits of not being considered the legal owners of property, but who have or will have a beneficial entitlement to the property, are subject to the full legal consequences of the property being in trust, that is the management by the trustees subject to the duties of trustees for the benefit of the beneficiaries (or purpose). The property is no longer at the settlor's beck and call, even if the settlor is a beneficiary.

Options for reform

- 2.24 One option that we have explored for addressing this type of concern is to include a statutory provision setting out factors that indicate when a “trust” is a sham. We have decided not to pursue this option, which is discussed in detail below. An alternative, more moderate option is for the legislation to confirm that the court must find that there is no trust if the elements required for the establishment of a trust are not present. In making such a finding, the court would also determine the legal consequences depending on the circumstances of the case. For instance, the court may find that the legal owner of the property is also the beneficial owner or that he or she holds the property on a resulting trust for the settlor.

Discussion

- 2.25 The corollary of having principles of law about what is required for an express trust to be established is that the courts must be able to find that a trust does not exist if those requirements are not satisfied. We propose that a legislative provision should remove any doubt that this is an option open to the courts for addressing problem “trusts”. This approach still allows significant court discretion. It would not constrain the court's ability to assess the situation and make orders responding appropriately, and to find that a trust does not exist on any other basis. We want to make it clear that a finding that no trust exists does not apply solely for the purposes of the new legislation, but for any purpose.
- 2.26 The Commission has considered proposals for legislative interventions to expand and clarify sham trusts, to restrict the purposes for which trusts can be used, to include a general look-through provision whereby trusts can be set aside or trust property considered to belong to the settlor, and to limit settlor control.⁶⁹ We have decided against each of these approaches because they would have the effect of undermining the concept of the trust and subverting trust principles when they come up against competing public

⁶⁹ See below [2.30]–[2.50], and ch 16.

policy considerations. We have concluded that the purpose of this review is to improve the clarity and functioning of trust law and not to alter the concept of a trust, which has been developed over hundreds of years. The courts will be able to continue to develop the sham doctrine relating to trusts separately to the legislation.

- 2.27 Yet we are cognisant that at a time when trusts are at times receiving bad press for being used for purposes some consider unethical and for overriding policies of other legislation, it is essential that the trust concept is seen to have integrity. In other words, if a trust is validly created then all the legal consequences of a trust must flow from that. If a trust is not validly created then the legal consequences from which a settlor or beneficiary may receive an advantage, including the protection of trust assets from creditors and ostensibly lower levels of personal assets and income, cannot apply. This is the case under the current law. If the three certainties were not present when a purported trust is established the court must find that there is no trust. The consequences of a finding that any of the certainties were not fulfilled would be those available to the court under the current law.
- 2.28 While there have been several recent cases in which the validity of a trust has been in question, arguments and judgments have focused on considering whether a trust was a sham or whether despite the existence of a trust, a settlor or discretionary beneficiary has property rights in trust property. We consider that it is worthwhile giving more prominence to the power of the courts to find that a purported trust was never properly established in accordance with the core principles of trust law. A legislative provision is the best way to achieve this. The courts would be able to find that no trust has been created when, for instance, a settlor has failed to identify which of several bank accounts is intended to be trust property,⁷⁰ or a settlor tries to leave “the bulk of my residual estate” on trust for a beneficiary.⁷¹
- 2.29 This approach is preferred because it does not alter the law but confirms the existing law. It does not relate to an aspect of the law about which there is contention, such as sham trusts or the bundle of rights, but relies on settled trust law principles. This option does not alter the balance of how trusts interact with other policy areas, but leaves these matters to the particular statutes governing these areas.

70 *Wilkerson v McClary* 647 SW 2d 79 (Texas Ct App 1983).

71 *Palmer v Simmonds* (1854) 2 Drew 221; 61 ER 704.

SHAM TRUSTS

Proposal

P3 It is proposed that trusts legislation should not contain any provisions relating to finding that a trust is a sham trust.

Please give us your views on this proposal.

Current law

- 2.30 Sham trusts and alter egos were addressed in the *Second Issues Paper*.⁷² A sham arises where a “trust” is created and is intended to appear to be a legitimate trust, but is not intended to affect rights and obligations of the relevant parties in the way that a valid trust would.⁷³ The object of a sham claim is to attack the validity of the trust so that the assets will be considered the property of the settlor against whom a proprietary claim can then be made.⁷⁴
- 2.31 The leading New Zealand case on sham trusts is the Court of Appeal’s decision in *Official Assignee v Wilson*.⁷⁵ In this case the Court dismissed the appeal on the technical ground that the Assignee had no standing to make a claim of sham. However, in obiter the majority considered the elements required for a sham, including common intention between the settlor and trustees to create a sham,⁷⁶ particularly an intention to mislead.⁷⁷ Other evidence may also be relevant to establishing a sham, including evidence of excessive control by the settlor and poor trust administration or documentation. The majority also concluded that alter ego trusts were not an independent cause of action, although evidence of settlor control was relevant to showing a lack of true intention to establish a trust, which may in turn

⁷² *Second Issues Paper*, above n 54, at ch 4.

⁷³ J Palmer “Sham Trusts” in Butler (ed) *Equity and Trusts*, above n 61, 393 at 396; based on the sham concept as discussed in a general commercial context by Lord Diplock in *Snook v London and West Riding Investments Ltd* [1967] 2 QB 786 at 802.

⁷⁴ Palmer, above n 73, at 394.

⁷⁵ *Official Assignee v Wilson* [2008] NZCA 122.

⁷⁶ This requirement of common intention has been the subject of some debate and criticism: see for example, J Palmer “Dealing with the Emerging Popularity of Sham Trusts” [2007] NZLR 81; J Palmer “What makes a trust a sham?” (2008) NZLJ 319 and Matthew Conaglen “Shams, Trusts and Mutual Intention” [2008] NZLJ 227.

⁷⁷ *Official Assignee v Wilson* [2008] NZCA 122 at [26].

help establish a sham.⁷⁸ The decision in *Wilson* sets a high evidential bar for asserting that a trust is a sham.

- 2.32 There is no provision on sham trusts in current legislation. There is a question as to whether the law on sham trusts, including the effect of a sham finding, should be addressed through legislation or left to the courts to develop.

Issues

- 2.33 Submitters to the *Second Issues Paper* were divided as to whether the current law on sham and alter ego trusts was satisfactory.⁷⁹ Issues raised with the state of the current law included the view that it was unclear and uncertain; that it allowed trusts to defeat broader public policy objectives; that *Wilson* required too high a standard for proving a sham trust such that it was virtually impossible to do so; and that the ratio of *Wilson* was incorrect as to the standing of the Official Assignee to challenge a trust when the settlor is the bankrupt.
- 2.34 There is also the more general concern that there are some trusts that have not been set up to run as proper trusts, or are not functioning as such. This includes the situation where settlors/beneficiaries are receiving the benefits of access to the property or directing the management of the property, as if they were the legal owners, but are protected from the responsibilities and liabilities of legal ownership. The sham argument has been used to try to address these types of situations, albeit usually unsuccessfully. There is a further issue as to the effect of a failure to comply with certain elements of proper formal trust management, such as resolutions, minutes and accounts.

Discussion

- 2.35 The Commission has considered the option of a provision on sham trusts that would set out a list of relevant factors for a court to look at when assessing whether or not a trust is a sham.⁸⁰ Submitters had differing views on whether sham trusts should be addressed in legislation. Some submitters considered a legislative definition or statutory test for a sham would be helpful. Other submitters were reluctant to see the law on sham trusts included in legislation and considered it should be left to the courts to develop.

78 At [72]. Sham trusts were considered recently in *KA No 4 Trustee Ltd v Financial Markets Authority* [2012] NZCA 370, albeit only in a strike-out application. Here the Court of Appeal declined an appeal against the High Court's decision not to strike out a claim that a trust was a sham. The Court considered there was an arguable case of sham (although the pleadings needed amendment regarding the consequences of a finding of sham, at [53]).

79 Submitters that considered it satisfactory included Auckland District Law Society, WHK, Ernst & Young, KPMG; those that considered it unsatisfactory included the Ministry of Economic Development, the Ministry of Social Development, the NZLS, Tobias Barkley, Chapman Tripp, Peter Kellaway, and the Trustee Corporations Association.

80 Based on those set out in the *Second Issues Paper*, above n 54, at [5.47].

- 2.36 Our view is that a provision on sham trusts is unnecessary. Other proposed reforms to trusts legislation, including setting out the definition of a trust, the requirement of the three certainties for the creation of a trust, and trustees' duties,⁸¹ are sufficient to clarify the roles of settlor and trustees and encourage proper trust management.
- 2.37 Nevertheless, we have weighed the competing arguments for and against setting out a legislative provision on sham trusts. The advantages would be to provide guidance and education to settlors and trustees; to clarify the law and provide more guidance about considerations for whether a trust is a sham; and to give more certainty about the appropriate evidential standard. More widely, it could prevent the undermining of public policy objectives in terms of people avoiding the responsibilities associated with a trust, and provide an effective mechanism to respond when a trust is not operating as a genuine trust. It could also better preserve the integrity of the trust concept. A legislative provision could be a faster way of addressing these issues than waiting for the courts to develop principles through case law.
- 2.38 There are also a number of disadvantages or difficulties with such a provision. There is a concern that it could be inflexible compared with a judicial response, and could constrain judges from making appropriate findings in some cases. A number of submitters considered that shams are more effectively dealt with in the courts under existing law. They considered that the existing law is adequate and courts are better placed to respond since issues are likely to be fact-specific and involve a variety of scenarios, which would be hard to cater for in legislation.
- 2.39 Some submitters also held the view that the concept of a sham is not well developed enough in a trust context to warrant legislative intervention. A provision could raise conceptual disputes that it would be helpful for the courts to develop and resolve rather than a legislative intervention. It could also present practical and operational issues that could be hard to resolve adequately in legislation, and could involve technically difficult drafting.
- 2.40 There is a further concern that a sham provision could create unintended uncertainty about the validity of large numbers of existing trusts, which would lead to additional disputes requiring judicial resolution. Finally, it is possible that the issues with the use of a trust that underpin a claim of a sham are in fact not issues with the trust at all but rather lie in other areas such as relationship property or insolvency, and the problems are better dealt with in those areas rather than in trusts legislation.

81 See ch 3.

PURPOSE RESTRICTION

Proposal

- P4 New legislation should not include a provision restricting the purpose for which a private trust may be settled.

Please give us your views on this proposal.

Current law

- 2.41 The Trustee Act is silent about why a person might want to establish a trust. Trusts created by way of contract are subject to the general rule in the Illegal Contracts Act 1970 that it is of no effect if the contract is illegal at law or in equity.
- 2.42 At common law, other trusts can be void if they have a purpose contrary to public policy. Generally “contrary to public policy” in this context is equated with illegality or unlawfulness. Certain other purposes are generally not enforceable under the common law, including a trust imposing a condition that is a restraint on marriage, an invasion on the sanctity of marriage, a trust calculated to bring about the separation of a parent and child, conditions against entering the armed forces or public office and conditions as to religious faith.⁸²

Issues

- 2.43 We have considered this issue because of an apparent concern among some in the general public that trusts are being used for objectionable purposes. Addressing these concerns by expressly limiting the purposes for which trusts may be created was an option we raised in the *Second Issues Paper*. It has become apparent to us that the real concerns about the misuse of trusts relate to some of the interactions of trusts with other areas of law. Our findings about the reasons that New Zealanders establish trusts is discussed in chapter 1 and our approach to the ways trusts interact with other areas of law, where the interface may cause problems or create unfairness, is discussed in chapter 16.
- 2.44 The question remains whether there is any benefit to making the case law principles clear by restating them in legislation in this instance.

Options for reform

- 2.45 The options considered are:

⁸² Noel C Kelly, Chris Kelly and Greg Kelly *Garrow and Kelly Law of Trusts and Trustees* (6th ed, LexisNexis, Wellington, 2005) at [7.6]–[7.9].

- (a) not including a statutory provision;
- (b) including a provision codifying the judge-made law, such as the United States' Uniform Trust Code (section 404):⁸³

A trust may be created only to the extent its purposes are lawful, not contrary to public policy, and possible to achieve. A trust and its terms must be for the benefit of its beneficiaries;

- (c) including a list of purposes for which trusts should not be used.

Discussion

- 2.46 Most submitters considered that the purposes of private trusts should not be restricted in legislation. A few submitters who thought that some purposes should be restricted drew attention to the current problematic areas, such as people using trusts to avoid paying creditors, to avoid the equal sharing regime under relationship property legislation, and to meet income and asset testing requirements for eligibility for government assistance. However, most submitters considered that these issues were best addressed in specific legislation relating to each policy area rather than limiting trust law as a whole.
- 2.47 We agree with the majority of submitters. Restricting the purpose of a trust in legislation risks inhibiting the concept of the trust when this is not the real issue. Trusts are legally used to achieve a variety of purposes. In looking at the different rationales for establishing a trust (as set out in chapter 1) it is apparent to us that it is extremely difficult to draw a line between acceptable and unacceptable trust purposes. Whether a purpose for establishing a trust is seen as acceptable or less acceptable can depend on the perspective and interest of the person making the judgement. The same trust that can be described as having the purpose of protecting personal assets from business risks by a settlor may be seen as being for the purpose of defeating creditors by creditors who are unable to recover a debt from the business because it does not have sufficient assets. A trust established for the purpose of estate planning and providing for future generations of a family may be viewed as being for the purpose of defeating the equal sharing regime of the Property (Relationships) Act 1976 as it applies to the relationship of one of the family members. Consequently, it is not realistic to consider introducing significant limitations to the purposes for which trusts may be used along the lines of what some people consider objectionable. These limitations would be open to subjective interpretation and could have the effect of drastically limiting the use of trusts, something for which there is little public or government appetite.
- 2.48 We have given careful consideration to whether it would be helpful to codify the general judge-made rule, as in option (b). More than half of the submitters

⁸³ National Conference of Commissioners on Uniform State Laws *Uniform Trust Code* (National Conference of Commissioners on Uniform State Laws, Chicago, 2005).

did not favour this approach as it was seen as not being useful and too open to unintended interpretations that would unduly limit trusts. A problem with wording like that in the United States' Uniform Trust Code is that the phrase "contrary to public policy" is open to different interpretations. A strict legal interpretation would limit its meaning to unlawfulness and the case law public policy rules, in which case there is little advantage in including it in legislation. Submitters and commentators recognised the risk of a court interpreting "public policy" more broadly and subjectively to invalidate trusts that are viewed by some as unfair. Some were even uneasy about using the concept of "lawfulness" in statute for the same reason.

- 2.49 The phrase "public policy" does have the advantage of being a flexible term that allows the law to keep pace with changing social norms. It is used in existing Acts, such as the Arbitration Act 1996, the Charitable Trusts Act 1957 and the Health Sector (Transfers) Act 1993.
- 2.50 On balance introducing a "contrary to public policy" or "unlawfulness" restriction would have the potential to create uncertainty and is not worthwhile. Further, our view was that there is little to be gained by having a minimalist purpose restriction, such as a prohibition against trusts for illegal purposes. The courts have already made it clear that trusts cannot be used for illegal purposes and having only this in legislation would risk misrepresenting the current legal position.

Chapter 3

Trustees' duties

INTRODUCTION

- 3.1 The duties that a trustee owes to beneficiaries are a key facet of the trust relationship. Trustees' duties are referred to very little in trusts legislation,⁸⁴ but we considered that the scope of trusts legislation could usefully expand in this area. It is difficult to understand the trust without understanding trustees' obligations.
- 3.2 Different types of duties apply to the trust relationship. In this chapter we look at which duties are mandatory parts of every trust and which can be left out in a particular case. We also consider to what extent a trustee can avoid the consequences of a breach of trust. This is integrally related to the duties, as the effect of trustees being able to exclude liability for the breach of a duty may mean that the duty will have little real effect. This chapter also discusses the obligations on trustees to inform beneficiaries and to retain information.

DUTIES OF TRUSTEES

Proposals

Overview: Our proposals are that new legislation should state the duties of trustees. The duties fall into three categories:

- conduct duties;
- mandatory (non-excludable) content duties; and
- default (excludable or modifiable) content duties.

Content duties need to be carried out with the standard of conduct set by the conduct duties. The conduct duties are the duty of honesty and good faith and the duty of care. The duty of honesty and good faith can never be excluded from application in a trust. The duty of care in the exercise of a mandatory content duty cannot be excluded, but as it applies to every other exercise of a duty, power

⁸⁴ Sections 13B and 13C of the Trustee Act 1956 address the duty of prudence in relation to investments by trustees.

or discretion by a trustee, the duty of care can be excluded.

P5 Conduct duties

- (1) New legislation should provide that in exercising any of the duties (including those listed in P6 and P7), powers or discretions that apply to a trustee in a particular trust, the trustee must:
 - (a) act honestly and in good faith for the benefit of the beneficiaries or a permitted purpose; and
 - (b) exercise such care and skill as is reasonable in the circumstances, having regard in particular –
 - (i) to any special knowledge or experience that the trustee has or holds himself or herself out as having; and
 - (ii) if the trustee is paid for services as a trustee, to any special knowledge or experience that it is reasonable to expect of a person in that role.
- (2) New legislation should provide that the conduct obligation in (1)(a) will be implied into every trust and cannot be excluded from the trust relationship.
- (3) New legislation should provide that the duty of care and skill in (1)(b) applies:
 - (a) to every exercise of a mandatory duty in P6(1) regardless of anything in the terms of the trust; and
 - (b) to every other exercise of a duty, power or discretion only to the extent that it has not been excluded or modified by the terms of the trust.
- (4) New legislation should provide that the trustee's liability for:
 - (a) any breach of trust that arises from a failure to carry out the conduct obligation in (1)(a), and
 - (b) a breach of a mandatory duty listed in P6(1) that arises from failure to carry out either of the conduct obligations in (1)(a) and (1)(b),
 cannot be excluded by the terms of the trust.

P6 Mandatory content duties

- (1) New legislation should provide that the following duties will be implied into every trust:
 - (a) the duty to understand and adhere to the terms of the trust;
 - (b) the duty to account to the beneficiaries for the trust property; and
 - (c) the duty to exercise the powers of a trustee for a proper purpose.
- (2) New legislation should provide that if a trust deed includes a clause that attempts to exclude the application of any of these duties to the trust, that clause will have no effect, provided that it is clear that the settlor's overall intention was to create a trust.

P7 Default content duties

- (1) New legislation should provide that unless otherwise stated in the terms of the trust, the following duties will be implied into every trust:

- (a) the duty to maintain impartiality or evenhandedness between beneficiaries;
 - (b) the duty not to make profit from the trusteeship;
 - (c) the duty to act without reward;
 - (d) the duty to avoid a conflict of interest;
 - (e) the duty to be active (meaning the duty to consider the exercise of the trustees' discretions regularly and not to fetter these discretions);
 - (f) the duty to act personally;
 - (g) the duty to act unanimously;
 - (h) the duty to manage the trust;
 - (i) the duty to invest;
 - (j) the duty to keep trust property separate from the trustee's own property;
 - (k) the duty to keep and render accounts, and to provide information to beneficiaries; and
 - (l) the duty to transfer property only to beneficiaries or persons legally authorised to receive property.
- (2) New legislation should provide that the duties in P7(1) may be excluded or modified by the terms of the trust. Duties P7(1)(c) and (g) may be excluded completely. With the remaining duties, the terms of the trust may modify the extent to which the duty is met, but only insofar as the mandatory duties are not breached.
- (3) New legislation should provide that the terms of a trust may include additional duties for the trustee.

Please give us your views on these proposals.

Current law

- 3.3 The duties of trustees are not set out in the Trustee Act 1956 or any other Act. They are found in centuries of case law. It is generally accepted that there are some fundamental duties which if excluded mean that the relationship does not constitute a trust. There are some duties which do not apply to every trust as trust deeds may alter the trustees' obligations by explicitly including some duties and excluding others.
- 3.4 The mandatory "irreducible core" of trustees' duties was described in the English Court of Appeal by Millett LJ in the case of *Armitage v Nurse* as being to act honestly and in good faith for the benefit of the beneficiaries.⁸⁵ Millett LJ described this as the minimum obligation necessary to give substance to a trust.

⁸⁵ *Armitage v Nurse* [1998] Ch 241.

- 3.5 The courts have held that trustees are subject to a duty of care.⁸⁶ Trustees are obliged to take the care of an ordinary prudent person of business in the circumstances of the trust. A professional trustee, that is, one who is paid to act as a trustee, is expected to exercise a higher standard of diligence and knowledge than an unpaid trustee, while a professional corporate trustee is expected to use the special skill and care which it professed itself to have in its advertising literature and dealings with the settlor.⁸⁷

Issues

- 3.6 Although the trustees' duties are of central importance in a trust and a large number of New Zealanders, including those without legal training, are trustees, the duties are not clearly set out or easily accessible. We understand that many trustees do not fully understand their obligations.
- 3.7 A further issue is whether the case law statement of the irreducible core of a trust from *Armitage v Nurse* sufficiently outlines all of the duties that must be present in a trust. The *Armitage v Nurse* duty has been criticised by some commentators for not being sufficiently full to give substance to the trust relationship.⁸⁸ Several commentators have suggested "unpackaging" the core duty so that it is broken down into several elements that are essential to the role of the trustee.⁸⁹
- 3.8 The law of trustees' duties has been developed through many cases over hundreds of years. Many of the duties are nuanced and apply differently in different circumstances. If it is not to alter the current legal position, any statutory representation of the duties would need to clearly state that it is a summary only, and intended to restate the case law position.

86 David Hayton, Paul Mathews and Charles Mitchell (eds) *Underhill and Hayton: Law Relating to Trusts and Trustees* (17th ed, LexisNexis Butterworths, London, 2007) at [52.3] [*Underhill and Hayton*] citing *Brice v Stokes* (1805) 11 Ves 319; *Speight v Gaunt* (1883) 22 Ch D 727.

87 At [52.3]; *National Trustees Co of Australasia Ltd v General Finance Co of Australasia Ltd* [1905] AC 373 (PC), *Re Windsor Steam Coal Co (1901) Ltd* [1928] Ch 609; [1929] 1 Ch 151 (CA); *Steel v Wellcome Custodian Trustees Ltd* [1988] 1 WLR 167.

88 J Penner "Exemptions" in P Birks and A Pretto *Breach of Trust* (Hart Publishing, Oxford, 2002) at 252.

89 D Hayton "The irreducible core content in trusteeship" in A J Oakley (ed) *Trends in Contemporary Trust Law* (Oxford University Press, Oxford, 1996) at 57; HAJ Ford and WA Lee *Principles of the Law of Trusts* (Law Book Co, North Ryde, NSW, 1990); AS Butler and DJ Flinn "What is the least that we can expect of a trustee?" [2010] NZ Law Review 459 at 476.

Options for reform

- 3.9 The options considered are including trustees' duties in legislation, or retaining the status quo of leaving it to the case law to explain the duties. We based our consideration of the content of the duties on the "Butler list",⁹⁰ and the "irreducible core" from *Armitage v Nurse*. We considered which of the duties are mandatory and which may be modified or excluded. We looked at how to include the trustees' duty of care, and whether to distinguish between the duty of care owed by professional trustees and by lay trustees.

Discussion

Including trustees' duties in legislation

- 3.10 In line with the objectives of clarification and creating a more useful Act, we consider that it is worthwhile to include simplified summaries in legislation of what the duties of trustees are. This would provide a clear and accessible base from which trustees can gain an understanding of their duties. It would have educative value and may encourage improved standards among trustees because of the greater prominence given to the duties in the law. It could be argued that the duties are sufficiently clear in the case law and that there would be little practical benefit in expressing the duties in a statute. However, our view is that the significance of the duties to the trust relationship warrants them being given greater attention, even if they are in summary form only. Most submitters to the *Fourth Issues Paper*,⁹¹ including the New Zealand Law Society (NZLS), Auckland District Law Society (ADLS) and the Trustee Corporations Association (TCA), agreed as it would make the duties more accessible to non-lawyers, many of whom are ignorant of trustees' obligations or do not fully understand what trusteeship entails. The Māori Land Court commented that lay trustees and beneficiaries in Māori land trusts often struggle to identify the duties, and it would be useful to set them out in legislation.

Nature of the duty provisions

- 3.11 We intend that the duty provisions would express in general terms the principles of law about the duties trustees owe that can be gleaned from case law. They would not be a code of the law of trustees' duties. The detail of how the law requires the duties to apply in practice would come from case law.
- 3.12 We see this as being similar to the nature of the provisions on company directors' duties in the Companies Act 1993. In its 1989 report upon which the reforms enacted in the Companies Act 1993 were based, the Law

90 We describe the list of duties set out in Andrew S Butler "Trustees and Beneficiaries" in Andrew S Butler (ed) *Equity and Trusts in New Zealand* (2nd ed, Thomson Reuters, Wellington, 2009) at 124 as the "Butler list" in Law Commission *The Duties, Office and Powers of a Trustee: Review of the Law of Trusts – Fourth Issues Paper* (NZLC IP26, 2011) at [1.5].

91 *Fourth Issues Paper*, above n 90.

Commission described the intention of the recommendations relating to director's duties as to:⁹²

... distil the general principles from the cases and express them in the statute, to make them more accessible. Such a statement of general principle was recommended by the Macarthur Committee and has been adopted by the Canadian and Australian Acts. The response to the [Law Commission's] discussion paper indicated overwhelming support for similar reform.

- 3.13 It is generally considered that the common law continues to be relevant in the law of company directors' duties as an aid to the interpretation of the general principles in the Companies Act and to the extent that the Companies Act does not address a particular duty or remedy for breach of a duty.⁹³
- 3.14 All submitters clearly preferred that the duties be expressed in general terms as summaries, rather than purporting to codify the law in this area. The Office of the Māori Trustee commented that because Māori land, by its nature, is handed down through generations, and trustees need to be able to take into account a wide range of short and long term circumstances and changing interests, a wide degree of flexibility is required in the duties.⁹⁴ We agree that it would be too difficult to encompass in statute the exact meaning of each duty in all of the varying circumstances they apply.
- 3.15 Law firms Chapman Tripp and Taylor Grant Tesiram both raised the option of only specifying mandatory duties in the legislation as these are the core obligations from which all others flow and there is a risk that the full meaning of the duties will not be fully encapsulated, which could potentially alter their meaning. We recognise that restating case law principles does have this risk, but believe that with careful drafting and clarification that the duties are intended as restatement of the existing law these risks can be mitigated. The benefits of having a full, clear list of duties outweigh these concerns. Because the duties would be in a summarised form their utility will not be in giving a precise indication of the requirements on a trustee. Rather they will be useful in giving trustees, settlors and beneficiaries notice of the existence of all duties

92 Law Commission *Company Law: Reform and Restatement* (NZLC R9, 1989) at [186]. The "Macarthur Committee" refers to the New Zealand Special Committee to Review the Companies Act *Final Report of the Special Committee to Review the Companies Act* (Government Printer, Wellington, 1973).

93 *Company Law* (online looseleaf ed, Brookers) at [CA131.01]. In *Benton v Priore* [2003] 1 NZLR 564; (2003) 9 NZCLC 263,055(HC) at [46], Heath J commented that the duties provisions "should be seen as a restatement of basic duties in an endeavour to promote accessibility to the law". In *Sojourner v Robb* [2006] 3 NZLR 808; (2006) 9 NZCLC 264,108 (HC) at [100], Fogarty J stated: "A statute such as this does not supplant the common law when it enacts a common law standard which is of its character a principle rather than a rule. As a principle it has to be applied in a wide variety of circumstances and such application is appropriately guided by the common law cases which led to the articulation of the principle in the first place."

94 The Office of the Māori Trustee provided separate comments in the TCA's submission.

and outlining the nature of the trust relationship in legislation to a much greater extent than is the case currently.

Classes of duties

- 3.16 One of the difficulties of trying to accurately set out the duties of trustees in legislation is that there are different classes of duties which differ in relation to how fundamental they are to the existence of a trust and the type of requirement they place on trustees. Some duties relate to the type of conduct, including the care, knowledge and intention, which a trustee must have when carrying out their duties and powers (conduct duties). Other duties more directly prescribe what a trustee must do or not do (content duties). The content duties need to be carried out in a way that accords with the conduct duties. It is the level of conduct of the trustee that is established by the conduct duties that determines when a content duty is breached. For instance, the exercise of the duty to account requires the trustee to exercise reasonable skill and care in accounting to beneficiaries. The conduct/content distinction is useful when considering for which duties it is appropriate to allow trust deeds to exclude a trustee's liability for a breach of duty.
- 3.17 A second important distinction is between duties that are mandatory and duties that are default. Mandatory duties are part of every trust relationship. They will be implied into every true trust, even where a trust deed attempts to exclude them. There are other duties that the courts have found arise in a trust unless a trust deed states that they do not apply. We classify these as default duties. They will be implied in the trust relationship if the trust deed is silent on the matter. We consider it is useful to have a list of duties that apply to a trustee in the absence of any trust term to the contrary. Some of these duties may be excluded outright (such as the duty to act without reward) and some may be modified so as to alter the extent to which they must be met (such as the duty of impartiality).

Conduct duties

- 3.18 Conduct duties oblige a trustee to do everything he or she does as a trustee with a certain standard of conduct. The conduct duty to act honestly and in good faith, as confirmed in *Armitage v Nurse*, clearly forms an essential part of a trust. This duty is widely accepted in case law. It is considered to be the irreducible core of a trust. It must be present in every trust. Any attempt to contract out of it is of no effect. Where the terms of a "trust" attempt to exclude the duty of good faith and honesty, the intention to create a trust may be called into question, raising the possibility that the courts may find that no trust exists. All submitters on this issue agreed that the duty described in *Armitage v Nurse* was an essential duty of a trustee.
- 3.19 The duty in P5(1)(b) (the duty of care) is clearly also a conduct obligation owed by trustees to beneficiaries. Trustees must carry out their role with reasonable care and skill. While few overseas jurisdictions have been willing to legislate full lists of trustees' duties, the duty of care has often been included

in their statutes or proposed statutes.⁹⁵ We propose a duty of care based on the wording of the Trustee Act 2000 (UK), which spells out that a professional trustee's special knowledge or experience, or that which a member of his or her profession could be expected to have, will be taken into account. A professional is a trustee who is paid to act as a trustee. This framing of the duty of care accurately represents the existing common law position, and so we do not consider that there is a significant risk that this provision will discourage professional trustees from offering their services. The duty of care in the United Kingdom Act only applies to specific statutory powers and duties of a trustee. We propose that the duty of care in new trusts legislation would be a conduct obligation applying to any exercise of a duty, power or discretion by a trustee.

- 3.20 Unlike the obligation of honesty and good faith, the duty of care seems in law to be generally excludable. We understand that some trust deeds exclude the duty to use reasonable care and skill from a trust relationship or to exclude trustee liability for a breach of this duty. The duty of care is not considered to be fundamental to a trust. It has been held that the trustees' duty of care is not itself fiduciary in nature,⁹⁶ although some aspects of what is likely to fall under the duty of care are covered by the irreducible core and mandatory duties. The trustee's duty of care developed in the late nineteenth century in the context of the increasing use of trusts for commercial investment. It related to the need to ensure trustees invested with care rather than being a principle fundamental to the existence of the trust relationship.⁹⁷ Failure to exercise reasonable skill and care amounts to negligence.
- 3.21 In England, the Court of Appeal's decision in *Armitage v Nurse* has limited the irreducible core of a trust, that is, the completely unexcludable obligations, to the duty to act in good faith and honestly for the benefit of the beneficiaries. This likely represents the current law in New Zealand, although there has been little case law on the issue.⁹⁸ However, there are those that argue that the irreducible core should be wider than the duty of honesty and good faith. The obligations that make a trust a trust are arguably empty without

95 Trustee Act 2000 (UK), s 1; see cl 6 of the proposed *Trustee Act* in British Columbia Law Institute, Committee on the Modernization of the Trustee Act *A Modern Trustee Act for British Columbia* (BCLI Report No 33, 2004) at 31; Trusts (Jersey) Law 1984, art 21(1); Trusts (Guernsey) Law 1989, art 18.

96 *Wilden Pty Ltd v Green* [2005] WASC 83 at [499]; *Spread Trustee Company Ltd v Hutcheson & Ors (Guernsey)* [2011] UKPC 13 at [60]; *Bank of New Zealand v New Zealand Guardian Trust Co Ltd* [1999] 1 NZLR 664 (CA). However some Australian commentators have contended that a trustee's duty of care is a fiduciary duty (Anthony Goldfinch "Trustee's Duty to Exercise Reasonable Care: Fiduciary Duty?" (2004) 78 ALR 678; G E Dal Pont "The Exclusion of Liability for Trustee Fraud" (1998) 6 APLJ 41).

97 M Cope "A Comparative Evaluation of Developments in Equitable Relief for Breach of Fiduciary Duty and Breach of Trust" (2006) 6 QUTLJ 118, discussed in L McNeely "The 'Irreducible Core' of Trusts in New Zealand" OYLR [2011] at 42.

98 *Spencer v Spencer* HC Wellington CIV-2001-485-857, 19 October 2011 at [189].

mandatory content obligations also. In the Privy Council's consideration of trustee exemption clauses in *Spread Trustee v Hutcheson* the minority raised the possibility that the English courts could revisit the law established in *Armitage v Nurse* if the appropriate case came before the courts.⁹⁹

- 3.22 The irreducible core is too bare without other completely mandatory obligations. A true trust requires more than just the duty of good faith and honesty. We consider that there is a risk if the statute states that the duty of care may be excluded in relation to any exercise of a trustee duty, power or discretion, including the most fundamental content duties, that trustee obligations may be too weak. It is appropriate and realistic to use this opportunity to broaden the irreducible core by stating that there are certain mandatory content duties which cannot be excluded themselves and to which the duty of care must always apply. We recognise that this does likely alter the existing law, but believe it only does so in a way that brings the mandatory standard of trustee conduct and obligations to the level that should be sensibly implied by the nature of the trust. We are keen to receive feedback on whether this reform is appropriate.

Mandatory content duties

- 3.23 We consider that some of the content duties of trustees are mandatory duties because they must be implied into every trust that meets the requirements for the creation of a trust. This is a shift from the way that trustees' duties are commonly represented. The duty to act in good faith and honestly for the benefit of the beneficiaries (or a permitted purpose) is usually considered the only mandatory obligation on trustees. We would argue that the mandatory content duties we list in our proposal are as vital to the existence of a trust as the obligation of honesty and good faith. They are necessarily implied by the trust relationship. Under our proposal any attempt to exclude these duties from a trust in a trust deed will be unsuccessful and instead trustees will always be under the obligation to carry out these duties. While the conduct duties creates a standard of conduct, it is necessary also to have definite mandatory duties that give content to the trustee's obligation to trust property and the relationship to beneficiaries.
- 3.24 We have carefully considered how to express the duty to account as a mandatory obligation of a trustee. The duty to account is central to the trust relationship as it is necessary for the trust property to be identifiable and for beneficiaries to have access to information about the trust property if the trustees are to be accountable to the beneficiaries. The trust will have no substance if the trustees are not accountable. David Hayton wrote that the right of a beneficiary to monitor and protect his or her interest by obtaining accounts from the trustee is at the core of the trust concept.¹⁰⁰

99 *Spread Trustee Company Limited v Sarah Ann Hutcheson & others* [2011] UKPC 13 at [129].

100 *Underhill and Hayton*, above n 86, at [60.2].

- 3.25 The duty to account for the trust property is a wide-ranging duty that to some extent requires trustees to keep records, provide information to beneficiaries and manage the trust for the benefit of the beneficiaries or a permitted purpose depending on the nature and circumstances of each individual trust. It is not possible to spell out completely what these component duties are. It does not simply mean that there is an obligation to keep accounts. In some single-asset family trusts, it would be unduly expensive and disproportionate to the size and complexity of the trust to require formal annual accounts. In more complex trusts, trustees would need to keep and render detailed accounts. In the same way, the context of the obligation to provide information varies depending on how close or remote a beneficiary's interest is. A trustee may not be required to provide information to all beneficiaries, but must provide information to some. If there is no beneficiary who can hold a trustee to account, there is no trust.¹⁰¹ The obligations on trustees to provide information to beneficiaries and to retain information are considered in more depth below.

Default content duties

- 3.26 The proposed default content duties are a list of commonly accepted duties from judge-made law. We have expanded on the list included in the *Fourth Issues Paper*. Our aim here is to summarise and express the existing duties and not to prescribe how they apply in individual circumstances. We accept that there are different ways of expressing these duties and there may be some variations to the wording of these before we make our final recommendations. We acknowledge that there could be a tension between the broadly stated mandatory duties, which cannot be excluded, and the narrower default duties, which can be modified or excluded by the terms of a trust, where these overlap. For instance, there is some overlap between the mandatory duty to account and the default duty to keep and render accounts and provide information to beneficiaries. While it is possible to modify the default duty to suit the requirements of the particular trust, these elements are necessary for the mandatory duty and so they cannot be completely excluded. It will ultimately be a contextual question for the courts as to whether a particular attempt to modify or exclude a default duty in fact attempts to oust a mandatory duty.
- 3.27 While the default duties are potentially excludable, we note that trust drafters will still need to be cautious when excluding duties. Trust drafters have to draft in such a way that the arrangement falls within the definition of a trust and the requirements for the creation of a trust. The attempted exclusion of too many default duties may be interpreted as an attempt to exclude a mandatory duty or may lead a court to find that no trust was intended.

101 At [8.144] citing *Morice v Bishop of Durham* (1804) 9 Ves 399 at 404-405; *Re Chardon* [1928] Ch 464; *Re Astor's Settlement Trust* [1952] Ch 534, [1952] 1 All ER 1067; *Leahy v A-G for New South Wales* [1959] AC 457 at 478 PC; *Re Denley's Trust Deed* [1969] 1 Ch 373, [1968] 3 All ER 65.

- 3.28 Below we discuss particular duties that have been identified by submitters as being questionable.

Duty to act without reward

- 3.29 Whether the duty to act without reward should continue to be assumed to be a default duty was raised as an issue by Chapman Tripp. It suggested that this duty is almost always varied and that the law should accept the need of trustees to charge a market rate for their services as of right. We considered these concerns, but found that the duty to act without reward was an important part of the traditional understanding of the role of a trustee. It emphasises the personal nature of trusts and the relationship of trust and confidence that is reposed in a trustee. We recognise that many trust deeds will vary this duty, but consider that it is appropriate for it to remain a default duty. Unlike most of the other default duties, this one may be excluded completely, whereas most of the other default duties are more likely to be modified or tailored to the particular situation.

Duty to act unanimously

- 3.30 Historically there has been a duty on trustees to act unanimously unless the trust deed provides otherwise.¹⁰² We considered whether this duty should be left out of the default duty list and majority decision-making be made the statutory default position. A majority of submitters were of the view that the duty to act unanimously should remain the default position as this was appropriate for most family trusts. The TCA considered that there would be retrospectivity issues if the default rule was changed as thousands of trust deed have been drafted under the assumption that unanimous decision-making was the default rule. The NZLS's view was that the requirement to have unanimous decision-making provided a safeguard as parties will usually have to go to court to resolve disagreements, which was appropriate in their view. Those in favour of changing the rule, including the ADLS, were of the view that there are many types of trusts where unanimous decision-making is not appropriate and not used, and that allowing dissenting trustees permits their views to be represented and recorded, without leading to the resignation of trustees.
- 3.31 We were convinced by the view that restating the ideal of unanimous decision-making as the default position would be beneficial. It is more appropriate for majority decision-making to be provided for in a trust deed where safeguards for the dissenting trustees, such as protection from liability for the consequences of a decision and exemption from participating in carrying out decisions with which they disagreed, can be included. The rule would continue not to apply to Māori land trusts as under Te Ture Whenua Māori Act 1993 trustees may act by majority.¹⁰³

102 *Luke v South Kensington Hotel Co* (1879) 11 Ch 121 (CA). See *Fourth Issues Paper*, above n 90, at [1.65]–[1.66].

103 Te Ture Whenua Māori Act 1993, s 227.

AVOIDING THE CONSEQUENCES OF A BREACH OF TRUST

- 3.32 If legislation is to assist people in clearly understanding the extent of trustees' obligations, it needs to address potential modifications to the consequences of a breach of trust. By limiting or avoiding liability for a breach of trust or being indemnified against such liability, the importance of the duties can be undermined. Consequently, there are limits to the extent that trust deeds can do this.

Proposal

- P8 (1) New legislation should include a provision stating that the terms of a trust must not:
- (a) limit or exclude a trustee's liability for:
 - (i) breach of a mandatory duty (listed in P6(1)) arising from the trustee's own dishonesty, wilful misconduct, recklessness or negligence; or
 - (ii) any other breach of trust arising from the trustee's own dishonesty, wilful misconduct or recklessness; or
 - (b) grant the trustee any indemnity against the trust property in respect of liability for:
 - (i) breach of a mandatory duty (listed in P6(1)) arising from the trustee's own dishonesty, wilful misconduct, recklessness or negligence; or
 - (ii) any other breach of trust arising from the trustee's own dishonesty, wilful misconduct or recklessness.
- (2) "Recklessness" should mean when a person knows that there is a risk that an event may result from the conduct or that a circumstance may exist, and he or she takes that risk, even though an honest and reasonable person would not in the circumstances take the risk.
- (3) To the extent that any clause of a trust purports to have the effect stated in P8(1)(a) or (1)(b) new legislation should provide that the clause is invalid, provided it is clear that the settlor's overall intention was to create a trust.
- (4) The legislation should imply the following rule into the codes of conduct of professional regulatory bodies relevant to trusts in order to promote settlor awareness of trustee exemption clauses:
- Any paid trustee or paid trust adviser or paid drafter of a trust who causes a settlor to include a clause in a trust deed which has the effect of limiting or excluding liability for negligence, or granting an indemnity against the trust property in respect of liability for negligence, must before the creation of the trust take such steps as are reasonable to ensure that the settlor is aware of the meaning and effect of the clause.
- (5) New legislation should retain an equivalent of section 73 of the Trustee Act 1956, which gives the court the power to relieve a trustee wholly or in part

from personal liability for a breach of trust if the trustee has acted honestly and reasonably, and ought fairly to be excused.

Please give us your views on this proposal.

Current law

- 3.33 Exemption clauses exclude trustee liability for a breach of trust. Breaches of trust may arise when a trustee breaches a duty, or fails to follow the terms of the trust, or fails to perform the trustee's duties or exercise powers adequately.¹⁰⁴ Exemption clauses are not currently regulated by statute in New Zealand. As established by the English Court of Appeal in *Armitage v Nurse*, the law currently allows exemption clauses to be used to exempt a trustee for liability for a breach of trust as long as the trustee acts in good faith and in the honest belief that he or she is acting in the best interests of beneficiaries. This case has established that a trust deed can exclude trustees' liability for a breach of trust arising from conduct that is not fraud (in the sense of dishonesty), including any form of negligence.¹⁰⁵
- 3.34 The Privy Council considered exemption clauses in the recent case of *Spread Trustee v Hutcheson*.¹⁰⁶ The Privy Council upheld by majority the trustee's appeal against the Guernsey Appeal Court's decision that liability for gross negligence was not able to be excluded under an exemption clause prior to the introduction of Guernsey's statutory prohibition against exemption clauses purporting to exclude liability for gross negligence. The majority of the Privy Council approved the current law on exemption clauses as represented by *Armitage v Nurse*. However, the two judges in the minority provided strong dissenting judgments that appear to consider that *Armitage v Nurse* is open to criticism and that trustees ought not to be able to avoid liability for gross negligence.¹⁰⁷

104 Andrew S Butler "Breach of Trust" in Butler (ed) *Equity and Trusts*, above n 90, 255 at 258.

105 *Armitage v Nurse* [1998] Ch 241; *Spread Trustee Company Ltd v Hutcheson* [2011] UKPC 13 (by majority of 3-2). *Spread Trustee Company Ltd v Hutcheson* related to Guernsey trusts legislation. In 1991, the Trusts (Guernsey) Law 1989, s 34(7) was amended so that it read "Nothing in the terms of a trust shall relieve a trustee of liability for a breach of trust arising from his own fraud or wilful misconduct or gross negligence". The first New Zealand case in more than a century to address exemption clauses was *Spencer v Spencer* HC Wellington CIV-2001-485-857, 19 October 2011. Because the trustees acted dishonestly, the question of whether the exemption clause in the trust deed validly excluded liability for gross negligence was not considered (Andrew Butler "What's Topical – Challenging Times, Challenging Trustees" (paper presented to STEP New Zealand Trust Conference, Auckland, March 2012)).

106 *Spread Trustee Company Limited v Hutcheson* [2011] UKPC 13.

107 See also, Daniel Warens and Owen Curry "Gross negligence after *Spread Trustee v Hutcheson*: the transition from vituperative epithet to meaningful standard" (December 2011) 26 JIBFL 671 at 671; Anthony Grant "To what extent can trustees limit their liability for loss?" *NZLawyer* (New Zealand 15 July 2011) at 9.

- 3.35 An indemnity clause in a trust deed allows the trustee indemnity from the trust fund in respect of any liability arising for breach of trust. Indemnity clauses can have the same practical effect as exemption clauses in relieving the consequences of a breach of trust from a trustee. Indemnity clauses cannot relieve a trustee from liability for his or her own deliberate acts or omission in breach of trust.¹⁰⁸
- 3.36 Section 73 of the Trustee Act 1956 gives the court the power to relieve a trustee wholly or in part from personal liability for a breach of trust if the trustee has acted honestly and reasonably, and ought fairly to be excused for the breach of trust and for omitting to obtain the directions of the court in the matter in which the trustee committed the breach.

Issues

- 3.37 The question at the heart of the consideration of exemption clauses is whether or not the current law is fair. It can be argued that the current permissible breadth of exemption clauses is too wide. Some have criticised the law for allowing trustees to avoid liability for a breach of duty that results in conduct for which trustees should be held responsible. For instance, some would consider that trustees should be liable for failing to use reasonable care and skill or for taking action that they know is risky. Beneficiaries are vulnerable to the effects of exemption clauses as their interests in the trust property may not be protected despite trustees owing them obligations. The interests of beneficiaries must be balanced against the freedom of trustees to rely on exemption clauses.¹⁰⁹ We are not convinced that the present law adequately balances the interests and needs of trustees, beneficiaries and settlors.
- 3.38 If legislation were to limit the types of trustee conduct for which their liability could be excluded under an exemption clause, there is a question of whether the same limits should apply to non-professional trustees as would apply to professional trustees. The concern that exemption clauses unfairly limit trustee responsibility is perhaps more acute in relation to independent trustees who are employed and paid to carry out this role. However, many trustees in New Zealand are not paid professional trustees. Allowing exemption clauses to apply more broadly to lay trustees than professional trustees may leave open the concern that the duties of trustees are being undermined by the reduced consequences for a breach of trust.
- 3.39 We understand that some settlors of trusts are unaware of the practical effect of the broad exemption and indemnity clauses that are included in many trust deeds. Exemption and indemnity clauses are often included in standard trust deeds and sometimes settlors are not aware of their practical effect. These

108 Noel C Kelly, Chris Kelly and Greg Kelly *Garrow and Kelly Law of Trusts and Trustees* (6th ed, LexisNexis, Wellington, 2005) at [27.2.1].

109 Law Commission (UK) *Trustee Exemption Clauses* (LAW COM No 301, 2006) at 27.

clauses can be a key part of the arrangement negotiated with paid professional trustees for their services as trustees. This is problematic because settlors may not realise that trustees will not be held liable for breaching the trust and that the benefit that is intended for the beneficiaries may be vulnerable as a result. If one of the reasons for allowing exemption clauses is that settlors should be able to include the terms of trust that they choose as far as is reasonable and as accords with the trust concept, then the problem of settlors not understanding the effect of the clauses needs to be addressed.

- 3.40 The interaction between the mandatory duties and exemption of liability clauses is unclear. It does not seem to be rational for a duty to be considered so central to the trust concept that it is implied into every trust relationship if the trustee is able to avoid having to pay any compensation for loss resulting from a breach of that duty. The law is currently ambiguous with regard to whether liability can be excluded for breach of a mandatory duty. The cases have not analysed exemption clauses as they relate to the positive duties of a trustee. Professor Penner has commented that there is no intellectually coherent stopping point at which trustees must not be relieved of liability for the duties to still apply.¹¹⁰ As a result, any limitation on the ability to limit the liability of trustees needs to be policy-based rather than conceptual.

Options for reform

- 3.41 The options raised in the *Fourth Issues Paper* were:
- (a) retaining the status quo by leaving any limits on exemption clauses to the courts and case law; or
 - (b) introducing some form of statutory regulation of exemption clauses, including:
 - a requirement for settlors to be informed of the effect of an exemption clause;
 - expanding the types of conduct for which liability cannot be excluded; and
 - placing greater limits on the exemption clauses that may apply to professional trustees than to lay trustees; and
 - altering section 73.
- 3.42 In addition, we have considered addressing indemnity clauses as well as exemption clauses.

¹¹⁰ JE Penner “Exemptions” in PBH Birks and A Pretto (eds) *Breach of Trust* (Hart, Oxford 2002) 241 at 259–260.

Discussion

The case for reform of exemption clauses

- 3.43 It can be argued that settlors are free to do what they like with their property when they own it, so they should have extensive powers to exclude trustee liability in a trust deeds. This provides protection for trustees from litigious beneficiaries, and ensures that trusteeship is still attractive and that insurance is available to trustees. However, beneficiaries are vulnerable to the consequences of exemption clauses, because they will potentially lose out if the value of trust assets is reduced by trustees not conducting themselves in a way that trustees should. Where an exemption clause applies, beneficiaries will probably have no effective means of redress for loss to the trust property. While settlors can be seen as representing the interests of beneficiaries when a trust is settled and the exemption clause agreed to, it seems that many settlors are not actually aware of the effect of the exemption clause and the possibility that beneficiaries might lose out as a result.
- 3.44 We are also concerned that allowing broad exemption clauses may undermine the core trust concept, which requires that a trustee has obligations towards beneficiaries in respect of the trust property. Exemption clauses do not remove the obligations from trustees, but they do remove the most significant consequences of a breach of the obligations and leave beneficiaries without the most effective redress for the breach. The effect of these exemption clauses may be to allow trusts that strain the concept of the trust because beneficiaries do not have an effective means of holding trustees to account. While there are some other possible consequences of a breach of trust, such as the removal of the trustee, it can be argued that the duties of trustees are effectively empty if the trustee is exempted from liability for compensation.
- 3.45 Reforms of exemption clauses have occurred in a number of overseas jurisdictions, although usually in a narrow and cautious form.¹¹¹ The majority of submitters thought that there was a case for statutory reform although some, including the NZLS and the ADLS, stated that this should be narrowly focused.

Indemnity clauses

- 3.46 Indemnity clauses should be restricted in the same way as exemption clauses. Trustees who are unable to avoid liability for breach of trust under an exemption clause should not be able to achieve the same effect by relying on an indemnity clause to obtain recompense from the trust property for loss due to the same liability. The same arguments that can be made in respect of exemption clauses as to the effects in undermining the trust concept and in weakening the obligations to beneficiaries relate to indemnity clauses.¹¹²

111 See *Fourth Issues Paper*, above n 90, at [3.13]–[3.24].

112 In ch 8 we make a somewhat related proposal to restate in the new legislation that the trustee's right of indemnity out of trust assets cannot be limited or excluded by a trust deed (see P32(c)).

The types of conduct for which liability cannot be excluded

- 3.47 We propose that legislation should clarify the types of conduct for which liability cannot be excluded by providing more guidance for those involved in trusts. To do this we need to draw a line between the type of conduct leading to breach of trust for which liability should be able to be excluded and the type of conduct for which it should not. It appears from *Armitage v Nurse* that currently the line lies at dishonesty, so that only where a trustee has committed a breach of trust due to dishonest conduct will an exemption clause be of no effect.
- 3.48 A number of submitters considered that the law should not favour trustees to the extent that it does currently. These submitters differed in their views about whether exemption clauses that excuse liability for negligence should be prohibited, or only those that excuse gross negligence. More submitters, including law firms and accountancy firms, considered that fraud, misconduct and gross negligence were the types of behaviours for which liability should not be excluded in a trust deed. Government and non-governmental organisations thought that the prohibition should extend even further to cover exemption clauses purporting to exclude liability for negligence. The TCA considered that it is consistent with the nature of the office of a trustee that liability cannot be excluded for gross negligence, fraud or wilful breach of trust. On the other hand, the ADLS considers that trustees can be vulnerable to litigious beneficiaries and that it is going too far to prevent the exclusion of liability for all negligence. They favour the line being drawn at gross negligence. Chapman Tripp and the Society of Trust and Estate Practitioners New Zealand wanted the law to remain as it is in this area, only prohibiting exemption clauses that exclude liability for fraud.
- 3.49 We agree with the majority of submitters that some shift in the balance of the law on exemption clauses is warranted by the nature of the trust obligation. There is conduct outside of dishonesty which is sufficiently blameworthy and of which the trustee is sufficiently conscious that it needs to be firmly excluded from the bounds of what is acceptable for a trustee. As we pointed out in the *Fourth Issues Paper*, under the current law it is open for a settlor to permit a trustee to be completely incompetent.¹¹³ However, we consider that the law cannot go as far as to prevent the use of exemption clauses to exclude liability for any and every failure to use reasonable care and skill (negligence). That would be a significant shift from the current position. Many trustees in New Zealand do not have professional expertise as trustees and are not paid. There is a strong case for allowing protection from liability for these trustees. Yet our view is that the law should prevent the use of exemption clauses to exclude liability for a breach of a mandatory duty due to negligence. If this were not the case then the mandatory duties are not truly mandatory. We consider that the mandatory duties are essential obligations in a trust and trustees who breach them negligently should be liable for compensation.

113 *Fourth Issues Paper*, above n 90, at [3.6].

- 3.50 For all other breaches of trust, however, our preference is to draw the line at a workable standard of conduct between fraud and negligence. This would provide greater protection for beneficiaries as it would reduce the circumstances in which trustees can be exonerated. It would arguably be more in keeping with the nature of trusteeship and the desire not to empty it of much of its meaning by allowing trustees to avoid liability for blameworthy behaviour. The difficulty is finding a sufficiently clear line.

Gross negligence

- 3.51 In the *Fourth Issues Paper* we proposed prohibiting exemption clauses that exclude trustee liability for gross negligence. In our view, and the view of the majority of submitters, this sets the standard of conduct for which liability cannot be excluded at the right sort of level. It would be a departure from the current English and New Zealand position based on the English Court of Appeal's decision in *Armitage v Nurse*, however. Yet there have been some commentators and judges indicating that a shift away from *Armitage v Nurse* may be warranted. In their dissenting judgments in *Spread v Hutcheson*, Lady Hale and Lord Kerr considered that from a public policy perspective denying trustees the opportunity to avoid liability for their gross negligence would not be "eccentric or unusual"¹¹⁴ and would be entirely in keeping with the essential aim of the concept of trusteeship, "the placing of reliance on a responsible person to manage property so as to promote the interests of the beneficiaries of a trust".¹¹⁵
- 3.52 Several jurisdictions have adopted the standard of gross negligence. A statutory gross negligence standard for exemption clauses has been adopted in Guernsey and Jersey. It is also arguable that the position under Scottish law is that exemption from liability for gross negligence is prohibited.¹¹⁶ Outside of the trusts context, gross negligence is used as a legal test in a number of areas of law. In New Zealand, several statutes have been enacted in the last ten years that refer to gross negligence.¹¹⁷
- 3.53 The strongest argument against gross negligence being included in types of conduct for which liability cannot be excluded is that a statutory provision that relies on a distinction between gross negligence and ordinary negligence would be unlikely to improve the clarity of the law. It is difficult, and some would argue impossible, to delineate between the two. Greg Kelly Law stated that the law should not use gross negligence as it is too vague and subjective a concept. Gross negligence may be too imprecise to be of practical use. This

114 *Spread Trustee Company Limited v Hutcheson* [2011] UKPC 13 at [137] per Lady Hale.

115 At [180] per Lord Kerr.

116 Three of the judgments agreed in *Spread Trustee Company Limited v Hutcheson* [2011] UKPC 13 per Lord Clarke, Lord Kerr and Lady Hale, but Lord Mance disagreed, as did Millet LJ in *Armitage v Nurse* [1998] Ch 241.

117 For instance, Private Security Personnel and Private Investigators Act 2010, ss 73–74 and 80, Corrections Act 2004, s 195, and Retirement Villages Act 2003, s 40.

would undermine the intention of improving the clarity of the legislation for trustees and beneficiaries. In the Supreme Court's decision in *Couch v Attorney General*, which considered whether exemplary damages could be awarded for negligence, Tipping J described gross negligence as "notoriously difficult to define or apply consistently" and found with the majority that subjective recklessness was the necessary standard of misconduct that may warrant exemplary damages.¹¹⁸

- 3.54 The view of the English courts is that the difference between ordinary negligence and gross negligence is a matter of degree.¹¹⁹ It is conceivable that in the not too distant future the English courts may reconsider *Armitage v Nurse* and take a different position if the right case arose.¹²⁰ However at present if New Zealand were to take the approach of prohibiting exemption clauses that remove liability for gross negligence, it would put New Zealand trust law out of step with English law.

Recklessness

- 3.55 For the reason that there does not seem to be sufficient confidence that creating a distinction between negligence, for which exemption clauses would be allowed, and gross negligence, for which they would not, would create a clear and effective dividing line, we prefer an alternative option. We propose to shift away from relying on the language of negligence and instead look to recklessness and knowledge. We propose prohibiting clauses that exonerate a trustee from liability for breach of trust arising from the trustee's own fraud, wilful misconduct or recklessness.¹²¹
- 3.56 We suggest that a standard of recklessness be used, that is, having knowledge that there is risk that by acting or failing to act in a certain way there will be a breach of trust and taking this risk even though an honest and reasonable person would not. A trustee would not be able to avoid liability for a breach of trust resulting from this conduct by relying on an exemption clause. This type of standard means that we can specify the frame of mind that a trustee would need to have, and we can set the line at conduct that is more blameworthy than merely being careless or ignorant. Some guidance can be taken from the equitable principles in the categories of knowledge considered in knowing receipt and accessory liability cases. In this area of law a distinction was drawn between recklessly failing to make inquiries that an

118 *Couch v Attorney General* [2010] NZSC 27 at [170].

119 *Curry and Warents*, above n 107, at 672; *Spread Trustee Company Limited v Hutcheson* [2011] UKPC 13; *Grill v General Iron Screw Collier Co* (1866) LR 1 CP 600.

120 Hon Mr Justice Hilyard "Prudence and Vituperative Epithets" (Lecture to the Chancery Bar Association Annual Conference, London, 21 January 2012); Grant, above n 107; Lee Aitken "Limiting the Trustee's Liability – is "gross negligence" relevant?" (2011) 127 LQR 503 at 505.

121 This is a similar approach to that recommended recently in Hong Kong Financial Services and the Treasury Bureau *Detailed Legislative Proposals on Trust Law Reform* (consultation paper, March 2012) at annex H, 1.

honest and reasonable person would and knowing of circumstances which would indicate facts to an honest and reasonable person.¹²² In criminal cases, the New Zealand courts generally give recklessness a subjective definition. The classic definition for this was provided originally by the United Kingdom Law Commission, and we have used this as a base for the definition of recklessness in our proposal.¹²³

- 3.57 If objective recklessness, that is, acting in a way that a reasonable person would have known created a risk of a breach of trust, were the standard, we consider that exemption clauses would be disallowed more readily than they currently can be. This could be a significant departure from the current law and may mean that, in effect, trustees are unable to rely on exemption clauses where they have been negligent. We consider that it should be possible to protect trustees from the consequences of their own negligence.
- 3.58 Setting the line between conduct for which liability may be excluded and conduct for which it cannot at recklessness may not be that far removed from what Millet LJ had in mind in *Armitage v Nurse*. He took the view that actual fraud:¹²⁴
- ... connotes at the minimum an intention on the part of the trustee to pursue a particular course of action, either knowing that it is contrary to the interest of the beneficiaries or being recklessly indifferent whether it is contrary to their interests or not.
- 3.59 Drawing the line for allowable exemption clauses at recklessness is a more workable and useful test than gross negligence. We accept that there will still be some element of interpretation and resort to court judgment involved. However, it is not possible to find a perfectly clear dividing line, but that the provision we propose is nevertheless worthwhile.

Interaction between duties and exemption clauses

- 3.60 We intend that the law on trustees' duties and the law on exemption clauses accord. Our proposals marry the mandatory conduct obligation to act in good faith and honestly with the limitations on exemption clauses. In our view the obligation of good faith and honesty includes the obligation not to act in a way that is subjectively reckless. Under our proposal it is not possible to exclude the obligation of good faith and honesty from a trust and it is not possible for a trustee's liability for a breach of this obligation to be excluded.

122 *Baden v Société Générale pour Favoriser le Développement du Commerce et de l'Industrie en France SA* [1993] 1 WLR 509 at 575; Tim Clarke "Knowing Receipt and Accessory Liability" in Butler (ed) *Equity and Trusts*, above n 90, 575 at 579–580.

123 *Laws of New Zealand Criminal Law* (online ed) at [22]; see Law Commission (UK) *Codification of the Criminal Law: General Principles: the Mental Element in Crime* (Working Paper No 31, 1970) at 50: "an accused is reckless if, knowing that there is a risk that an event may result from the conduct or that a circumstance may exist, he or she takes that risk, and it is unreasonable to do so having regard to the degree and nature of the risk which he or she knows to be present."

124 *Armitage v Nurse* [1998] Ch 241 at 251.

- 3.61 Just as the duty of care cannot be excluded from applying to the mandatory duties (P5(4)), we propose that liability for a negligent breach of a mandatory duty cannot be excluded. These mandatory duties are essential to the existence of the trust. Their effect would be eroded if it were possible for a trustee to avoid paying compensation for their breach through an exemption clause.
- 3.62 Exemption clauses may remove liability for breach of the duty of care in relation to all other exercises of duties, powers or discretions by a trustee.

Greater restrictions on the use of exemption clauses for professional trustees

- 3.63 We considered the option of prohibiting professional trustees from excluding liability for negligence, while for lay trustees liability could be excluded for negligence. However, this approach seemed too complex. Having one standard for the conduct that cannot be excluded is simpler and easier to understand. The higher standard in what is expected of professional trustees will arise through the duty of care and the court's interpretation of what constitutes fraud or recklessness for professional trustees.

Requirement for settlors to be informed

- 3.64 The option of requiring a trust drafter or adviser to inform a settlor of the meaning and effect of an exemption clause addresses the issue of settlors not understanding the implications of such a clause. Settlors would be given an informed choice about including the clause at the time of settlement. This reform would not affect beneficiaries directly, but if settlors are better informed about exemption clauses they may choose not to include such broad clauses in their deeds or at least have a more accurate understanding of the trust arrangement.
- 3.65 We have considered what the nature of this requirement should be. We prefer the approach of the requirement being implied into practice rules of professional bodies for lawyers, accountants and financial advisors, rather than legislation. A breach of the rule would not have the consequence of invalidating the exemption clause, but would invoke the disciplinary sanctions of the relevant regulatory body. This is the option recommended by the Law Commission for England and Wales and adopted in the United Kingdom.¹²⁵
- 3.66 The alternative approach, a statutory obligation that if not met would mean that an exemption clause would have no effect, would be unnecessarily burdensome and difficult to enforce. Because of the serious consequences of failing to inform a settlor regarding an exemption clause, trust advisers would be concerned to ensure the requirement was complied with by introducing time-consuming and expensive processes in order to avoid doubt about the advice being given. Whether it is required by the law or not, many may insist

125 Law Commission (UK), above n 109, at 69.

that settlors receive independent legal advice. While this would ensure that settlors are well informed, it would significantly increase the overall cost of establishing a trust. Such an approach is likely to be overly onerous. There could also be evidential difficulties in establishing that a settlor was advised about the nature and effect of an indemnity clause, especially when the exemption clause becomes relevant some time after the trust was established. The trustee seeking to rely on an exemption clause may not be the same trustee appointed at the time the trust was created. This difficulty would be more problematic if the consequence of not being able to prove that the advice was given was that an exemption clause would have no effect.

- 3.67 Submitters generally considered requiring a trust drafter or adviser to inform a settlor of the meaning and effect of an exemption clause to be a worthwhile proposal. It seems to have been seen as a cautious step that could be taken to improve the current situation and one that addresses a need. The NZLS considered that beneficiaries are disadvantaged when they do not have full awareness of the existence and meaning of exemption clauses and that this option would be helpful. Submitters that were less in favour of reform to exemption clauses in general, such as Chapman Tripp and Taylor Grant Tesiram, considered that this option had merit.
- 3.68 We accept that it may be appropriate to exclude the application of the rule from some types of trusts. For instance, in superannuation trusts the settlor is the employer who will usually be legally advised and aware of the exemption clause as a matter of course.

Section 73

- 3.69 We consider that section 73 should be retained. It allows the courts to alleviate unfairness created by a rule in the legislation by using their discretion to relieve a trustee of liability. All submitters responding to this question, including the NZLS, thought that section 73 should be retained, because it continues to be useful. The ADLS pointed out that it has been around for many years and there has been no criticism of it. They agreed with its fact specific, objective test. Greg Kelly Law noted that section 73 is useful because not all trustees have comprehensive knowledge of trustee practice.

DUTY TO INFORM

- 3.70 The duty to account includes an obligation to make information available to beneficiaries. While trust deeds can never dispense with the requirement to account to beneficiaries and the need to provide some information to some beneficiaries, what is required in each trust is dependent on the trust's circumstances. Because this is an area where trustees are often required to make difficult decisions and the law can be unclear, it seems to be one where provisions that give further guidance to trustees are warranted. This provision would apply to private trusts only.

Proposal

- P9 (1) Duty to provide information: new legislation should provide that the duty to account in P6(1)(b) includes the obligation to make such information available to beneficiaries upon request as is reasonably necessary to enable the trust to be enforced. The duty to account is a mandatory obligation and will be implied into every trust as stated in P6.
- (2) New legislation should include provisions setting out how the duty and discretions regarding the provision of information to beneficiaries are to be exercised, including the following:
- (a) a presumption that trust information will be given to a beneficiary upon request unless there is good reason for withholding the information;
- (b) in exercising the discretion to find that there is good reason for withholding trust information, a trustee:
- (i) is subject to the general principle from *Schmidt v Rosewood* that all beneficiaries are entitled to receive the information that will allow them to hold trustees to account in the circumstances of the particular trust; and
- (ii) may take into account the following factors:
- whether there are issues of personal or commercial confidentiality;
 - the nature of the interests held by the beneficiaries, including the degree and extent of a beneficiary's interests or a beneficiary's likely prospects of receiving trust property in the future;
 - the impact on the trustees, other beneficiaries, and third parties;
 - whether some or all of the documents can be disclosed in full or in redacted form;
 - whether safeguards can be imposed on the use of the documents (for example, undertakings, professional inspection);
 - whether, in the case of a family trust, disclosure or non-disclosure may embitter family feelings and the relationship between the trustees and beneficiaries to the detriment of the beneficiaries as a whole.
- (3) New legislation should include a default provision that trustees make reasonable efforts to actively notify a qualifying beneficiary or the parent, guardian or property manager of a minor or incapable qualifying beneficiary of the following information:
- (a) that the qualifying beneficiary is a beneficiary of the relevant trust;
- (b) the names and contact details of the trustees;

- (c) that the qualifying beneficiary has the right to make a request and be provided with a copy of the terms of the trust, including any amendments to the terms of the trust; and
- (d) that the qualifying beneficiary has the right to make a request to be provided with other trust information.
- (4) New legislation should define "qualifying beneficiary" as:
 - (a) a beneficiary with a vested or contingent interest; or
 - (b) a beneficiary who trustees reasonably consider has or may have in the future real prospects of receiving trust property.
- (5) New legislation should provide that subject to the duty in P9(1), the default provision in P9(3) may be overridden or modified by the terms of a trust.
- (6) New legislation should define "trust information" as any information regarding.
 - (a) the terms of the trust;
 - (b) the administration of the trust; or
 - (c) the trust assets.
- (7) New legislation should include provision for the terms of a trust to expressly require a trustee to give trust information to a beneficiary.
- (8) New legislation should include provision for a beneficiary to be charged for the reasonable costs of being provided with the trust information.
- (9) New legislation should include provision for a trustee or any beneficiary to apply to court for an order that the trustees supply trust information. The court would be able to review the exercise of the trustees' discretion and the merits of the trustees' decision.
- (10) New legislation should include provision for trustees and beneficiaries to seek advice from the Public Trust about the information that trustees are required to release. Trustees would be protected from liability if they act in reliance on the Public Trust's advice. It would continue to be open for trustees and beneficiaries to seek an order from the court regarding the release of information by trustees. The Public Trust would have the power to charge for carrying out this service.

Please give us your views on this proposal.

Current law

- 3.71 The decision of the Privy Council in *Schmidt v Rosewood* represents the law in this area.¹²⁶ In accordance with this decision beneficiaries are entitled to receive information which will enable them to ensure the accountability of the trustees in terms of the trust deed. Where previously there had been a bright-line division in the right to information held by vested or contingent

¹²⁶ *Schmidt v Rosewood Trust Ltd* [2003] 3 All ER 76.

beneficiaries, who could receive specific trust documents as of right, and the right to information of objects of a power of appointment, this distinction no longer applies. The court will undertake a balancing exercise in considering the circumstances of the claim. The central factor in this consideration is whether the settlor intended the claimant to have a realistic possibility of receiving from the trust fund.¹²⁷ *Schmidt v Rosewood* has been followed by Potter J in *Foreman v Kingston*¹²⁸ and Asher J in *Re Maguire (deceased)*,¹²⁹ and represents the accepted position in New Zealand. In *Foreman v Kingston*, Potter J identified a list of factors derived from *Schmidt* that may be taken into account by the court in the exercise of its supervisory jurisdiction and a list of documents that beneficiaries are likely to have access to unless there are reasons to withhold information.¹³⁰

Issues

- 3.72 There appears to be general satisfaction with the principle in *Schmidt v Rosewood* and no desire to change this. However, there is concern that from a practical perspective it is now difficult for trustees to determine what their obligation to provide beneficiaries with information entails, because the position relies on a discretion of the court. It appears that trustees are commonly required to make decisions about providing information and could do with greater clarification and guidance. The NZLS commented that the law is only partially satisfactory because there is uncertainty. It also pointed to several problems in practice: a lack of awareness among trustees of what the disclosure obligations are; inconsistent disclosure practices; uncertainty about the extent to which a settlor can exclude disclosure obligations; and uncertainty about what age beneficiaries must be before information must be disclosed to them. The TCA and Taylor Grant Tesiram found the decision in *Schmidt* to be unhelpful in practice and considered that more practical guidance in legislation would clarify the law and make it more accessible to trustees.

Options for reform

- 3.73 The options considered are:
- (a) a principles and discretionary approach – restating the principles guiding the exercise of discretion from *Schmidt* in legislation;
 - (b) a list approach – a prescribed list of types of information that beneficiaries are entitled to;

127 See *Fourth Issues Paper*, above n 90, at [2.5]–[2.7] for more details.

128 *Foreman v Kingston* [2004] 1 NZLR 841 (HC).

129 *Re Maguire (deceased)* [2010] 2 NZLR 845 (HC).

130 See *Fourth Issues Paper*, above n 90, at [2.9] and [2.13].

- (c) a combination of principles and list – restating the principle from *Schmidt* and providing guidance about which information should be provided and when a trustee may decline to provide information; or
- (d) a variation on (c) suggested by the NZLS – taking the steps in (c), but in addition:
 - prescribing that certain information must be provided to “qualifying beneficiaries”;
 - allowing trust deeds to limit the trustee’s duty to give information to one or more beneficiary but not all beneficiaries;
 - allowing trust deeds to expressly require a trustee to give information to a particular beneficiary; and
 - providing that any beneficiary may apply to court for an order that the trustees supply information about the trust.

Discussion

- 3.74 Option (c) was the preferred option for most submitters. We agree that the combination of a principled discretion with some guidance seemed to be the best option. Option (b) would be too prescriptive, while option (a) would not make it any easier for trustees to make decisions. The discretionary approach from *Schmidt v Rosewood* seems to be the best method of addressing different types of trusts flexibly. Submitters, such as the NZLS, pointed out that some information could always or nearly always be available to certain beneficiaries, but other information was more sensitive. The need for a distinction between different classes of beneficiaries was also highlighted.
- 3.75 The variation to option (c), suggested by the NZLS, has the added benefit of providing clear direction that certain information needs to be provided to “qualifying beneficiaries”, which would make the law clearer and more straightforward to apply in many cases. Those in the “qualifying beneficiaries” category are those who under the *Schmidt v Rosewood* principle would be effectively guaranteed of being able to receive the information that they are beneficiaries, contact details for trustees, and their right to receive the trust deed. Unlike the rest of this proposal which confirms the current law, the provisions relating to qualifying beneficiaries could not apply retrospectively, although they may be useful guidance for trustees of existing trusts.
- 3.76 We realise that this may require a change in the practice of some trustees and that the notification could increase costs. The principles of trust law require that some information is given to these beneficiaries. If beneficiaries are not to be notified it would need to be justified by their not having a sufficiently close or likely interest in the trust property or that it was unreasonable to inform them, for instance because the class of beneficiaries is large. Trustees are unlikely to ever be justified in not providing information to a beneficiary

- who has a vested or contingent interest. By limiting the obligation to notify to only beneficiaries who meet the category of “qualifying beneficiaries”, who therefore have a proximate and likely interest, this requirement is not unreasonable.
- 3.77 It may be necessary to exclude some trusts from the application of this provision. For instance, the Office of the Māori Trustee and Māori Land Court suggest that Māori land trusts would need to be excluded, because of the large numbers of beneficiaries and the need for sufficient flexibility to consider these trusts.
- 3.78 The intention of including the provision requiring some information to be given to qualifying beneficiaries is to create a general rule that reduces trustee discretion and increases certainty in whether beneficiaries will receive information, making the law clearer and simpler for both trustees and beneficiaries. A weakness with this proposal is that it still relies on the trustee’s judgement about who is a qualifying beneficiary. The trustee decides if he or she reasonably considers that a beneficiary has real prospects of receiving trust property. This could make it hard for beneficiaries to know whether they are qualifying beneficiaries or not, and therefore may impact on their ability to truly enforce the trust. We cannot see a way around this, but are open to feedback on how this proposal can be improved.
- 3.79 The NZLS’s proposal of allowing trust deeds to limit the trustee’s duty to give information to particular beneficiaries has not been followed. This would in many cases be a “flag” to litigate. It seems incorrect in principle to prevent certain beneficiaries from accessing the most basic information that they are a beneficiary and are entitled to request a copy of the deed, accounts and other information. Any later decision on whether to release or withhold information would be subject to the trustee’s discretion to withhold based on factors listed in the legislation.
- 3.80 An alternative approach to including a default provision detailing the duty to inform beneficiaries that has been suggested is to include the provision as guidance in a best practice code instead. This is not our preferred approach as the law would be clearer with the provision in legislation and the proposed provision provides sufficient flexibility to trustees and the courts.

Guidance from the Public Trust

- 3.81 Having a statutory role for the Public Trust was not something that was raised in the Issues Papers but it has emerged as a proposal to act as a lower-level official body that can carry out administrative functions and provide advice. One proposed function for the Public Trust is to provide advice on whether trustees are required to release information to beneficiaries. We would envisage that the Public Trust could provide a trustee with general advice on the information they are required to release as well as advice about specific material which beneficiaries have requested. The legislation would provide that the advice is non-binding but that trustees are protected from liability when relying on it. We consider that beneficiaries should also

be able to ask the Public Trust whether trustees are required to release certain material to them. The Public Trust would then ask the trustees for information to help it to provide this advice to the trustees and beneficiaries concerned. A trustee that did not cooperate with the Public Trust would risk a contrary result if beneficiaries take the issue to court.

- 3.82 This option has the advantage of providing low cost, authoritative guidance for trustees from an independent body, who, even with the additional direction in the new legislation, may want such a mechanism. The Public Trust is in a position to exercise judgement based on experience and expertise. Providing the Public Trust with this role could improve trustees' decision-making regarding the release of information, reduce conflict between trustees and beneficiaries about the release of information, and reduce the need for cases to go to court for a decision on this issue.

RETAINING INFORMATION

Proposal

P10 New legislation should provide that in exercising the mandatory duties of a trustee, a current trustee is required, so far as is reasonable, to retain a copy of the following documents:

- (a) the trust deed;
- (b) any variations made to the trust deed or trust;
- (c) a list of all of the assets currently held as trust property;
- (d) any records of trustee decisions made during that trustee's trusteeship if they exist;
- (e) any written contracts entered into during that trustee's trusteeship; and
- (f) any accounting records and financial statements prepared during that trustee's trusteeship.

Please give us your views on this proposal.

Issues

- 3.83 It appears that some trustees are not clear about what records they are required to keep about the trust and that in some trusts even the most basic records are not being retained. While information keeping obligations can be implied from some of the trustees' duties, there is no clear statutory statement of this.

Options for reform

- 3.84 The option for consideration in the *Fifth Issues Paper* was to introduce a statutory record-keeping requirement for trustees to keep copies of the trust deed and any variations made to it, minutes of decisions made by trustees, contracts entered into and accounts.

Discussion

- 3.85 The proposed statutory provision would be intended to set out a minimum requirement for trustees. It would state what the law is in effect currently. It would not override the requirement on trustees to retain whatever information is necessary to meet their obligations as trustees. It is not possible to set out what is required by the duty to account in all trusts, but this proposal would set out the minimum information that will nearly always be required to be kept by trustees to provide an unequivocal indication to trustees that they must keep sufficient records. The provision would have educative value and may improve the amount and quality of information regarding some trusts. There is a risk that trustees may view the statutory provision as setting out all the information that is necessary for them to retain without giving consideration to what else their duties might require them to retain. In their submission, Taylor Grant Tesiram gave this as a reason they did not support the introduction of such a provision. We consider that this concern can be addressed by drafting the provision so that it is clear that trustees may be obligated by their duties to retain more information.
- 3.86 The majority of submitters commenting on this option agree that this type of provision should be introduced. Ernst & Young thought that this provision could work as a restatement of the existing law in order to educate trustees and improve trust administration. KPMG advised that in many trusts much of this information is lost over time, mainly by lay trustees but also in some professional firms and trustee companies when personnel change. Greg Kelly Law, the TCA and Perpetual considered that a prudent trustee should be doing this, but that there was merit in having the provision to give guidance. The Inland Revenue's view is that this would be useful as it would effectively bring trusts into line with the record-keeping requirements for companies. In their view such a requirement would assist the courts in reviewing trusts when required and assist creditors, including the Inland Revenue, to obtain disclosure of material documents.
- 3.87 The NZLS's view was that a template approach like that proposed would not be suitable because trusts vary so much. Chapman Tripp suggested that the provision could be in the form of non-legislative guidance issued by a professional body, such as the Society of Trust and Estate Practitioners New Zealand, the NZLS or the New Zealand Institute of Chartered Accountants.

- 3.88 Our view is that there is merit in including the provision in the interests of educating non-professional trustees and making the law of trusts clear and accessible to the extent possible. The provision would unequivocally establish that these records must be kept by trustees. One way of adding weight to the enforcement of the provision is for the requirements to be a professional obligation for lawyers, accountants and trustee companies under their own legislation or rules. This would mean that it could be enforced through their disciplinary procedures.

Part 2

TRUSTEES



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Chapter 4

Trustees' powers

INTRODUCTION

- 4.1 A significant proportion of the Trustee Act 1956 is made up of sections that provide trustees with powers to manage trust property. These sections set out the default position and are capable of being overridden by the trust deed. In this chapter we look at reforms to the powers provisions of the Act. In particular, we look at replacing the current approach, which contains various limits to a trustee's powers in relation to trust property, with an approach that gives trustees broader powers.
- 4.2 This chapter addresses:
- administrative powers;
 - distributive powers of maintenance, education, advancement and benefit;
 - age of majority;
 - power to appoint agents; and
 - power to delegate.
- 4.3 Investment powers are addressed separately in chapter 5. It should be noted that the proposals in this chapter relating to the appointment of agents and delegation do not apply to the appointment of an investment manager, as this is dealt with in chapter 5. The trustee's right of indemnity out of trust assets is addressed in chapter 8.
- 4.4 The proposals in this chapter take the general approach of removing the unnecessary restrictions on powers that are in the current provisions of the Trustee Act and instead relying on clear statements of the duties of trustees to guard against inappropriate use of powers by trustees. Our view is that this approach is better at making sure the default powers provisions in the new Act are sufficiently flexible and suitable for the majority of trusts. The broader default powers ensure that trustees can do their job. The interests of beneficiaries or the trust's purpose will be protected by the duties a trustee must adhere to in making any decision or exercising any power as trustee.

The role of the duties would be given prominence by setting them out in the proposed Act (see chapter 3).

- 4.5 The administrative and distributive powers provisions discussed in this chapter are default in that they may be varied or excluded by the terms of a trust. In trust deeds settlors can give the trustees whatever powers they like to manage and distribute the trust property. The proposal would become the default position for existing trusts and so would apply unless the terms of a trust provided for something different.

ADMINISTRATIVE POWERS

Proposal

- P11 (1) The administrative powers of trustees, including business-related powers, in the Trustee Act 1956 (ss 14–21, 24, 32–33 and 42A, 42B and 42D) should be replaced by a general provision giving trustees the same powers in relation to trust property that the trustee would have if the property were vested in the trustee absolutely and for the trustee’s own use. The provision should state that while the trustee has competence to do all that a natural person can do with his or her own property, the trustee is subject to the trustees’ duties and objects of the trust.
- (2) The new legislation should include a schedule which sets out a list of commonly used powers that a trustee has under the new provision. The schedule should be prefaced by wording such as “for the avoidance of doubt, the powers of a trustee granted under [the general powers provision proposed above] include, but are not limited to, the following: ...”. The powers listed in the schedule should include those covered by the following sections of the Act, but state them in general terms and without the restrictions that currently apply:
- s 14 (including the powers to sell, exchange, let, partition, postpone, lease, purchase, build a house);
 - s 15 (including the powers to spend money repairing, maintaining, or developing; subdivide; grant easements; pay rates, insurance and other outgoings; vary a mortgage);
 - s 16 (including the powers to sell by auction or tender);
 - s 17 (including the power to sell by deferred payment);
 - s 18 (power to sell subject to depreciatory conditions);
 - s 19 (power to give receipts);
 - s 20 (power to compound liabilities);
 - s 21 (power to raise money by sale, conversion, calling in or mortgage);
 - s 24 (power to insure and recover the costs of premiums);

- s 32 (powers to carry on a business, trade or occupation; purchase stock, machinery, implements and chattels for the purposes of the business; employ people in the business; enter into a partnership agreement);
 - s 32A (power to acquire or retain shares in any co-operative company);
 - s 33 (powers to convert or join in converting any business into a company; promote a company for taking over the business; sell or transfer the business to a company);
 - s 42A (power to set aside reserve income or profits arising from the business and retain it as capital, and to use this for business or trust purposes);
 - s 42B (power to pay or apply any capital money or asset employed in the business for the maintenance or benefit of an income beneficiary where the income available for distribution is insufficient for the proper maintenance of that beneficiary, and to recoup some or all of that sum from the income arising from the business in a subsequent period); and
 - s 42D (power to adopt an accounting period for the business that commenced before the start of the trust and adopt as a final accounting period a period that ends before the termination of an interest in the trust).
- (3) The schedule should also include the following additional powers:
- the power to seek legal, financial or other advice;
 - the power to open a bank account in the name of another person; and
 - the power to give a guarantee.

Please give us your views on this proposal.

Current law

- 4.6 The Trustee Act includes a number of sections that give trustees administrative powers in respect of trust property. Several of the provisions relate to the power to operate a business. The statutory powers are default powers that can be varied or overridden in a trust deed.

Issues

- 4.7 The powers provisions are lengthy, complex sections that are difficult to follow and understand. Most trust deeds override the statutory powers by including specific powers and do so in detail. The current default powers are not relied upon because they do not reflect modern realities and are usually more restrictive than is desired in a modern trust deed. Because trusts take a greater variety of forms and are used in more numerous ways than was the case when the legislation was enacted, it would be more useful to have more flexibility in the default provisions.

- 4.8 While many of the administrative powers were intended to provide sufficiently wide powers to trustees to enable them to do all they needed to manage trust property, the business-related powers in the Trustee Act deliberately limit the scope of what a trustee can do with a business. The business-related powers are intended to allow a trustee to do what is needed to wind up a testator's business and minimise the risk to the trustee. In particular, section 32, which provides the default power to carry on business, applies only to testamentary trusts and generally applies only for two years. The statutory default business-related powers do not accord with modern practice where many trusts are established in order to run businesses and trustees need broad, flexible powers relating to trust businesses. Modern trust deeds will often opt out of the statutory business-related power provisions.

Options for reform

- 4.9 The options considered for the administrative powers were:
- (a) retaining individual powers provisions, but modernising the language and approach of each;
 - (b) replacing the powers provisions with a general competency provision; or
 - (c) replacing the powers provisions with a general competency provision and a schedule containing a non-exhaustive list of common powers that this includes.

Discussion

- 4.10 Replacing the current myriad of outdated powers provisions with a general competency provision has the benefits of simplifying and modernising the statute, according with common practice in deed drafting and creating more flexibility. Nearly all submitters to the *Fourth Issues Paper*¹³¹ on this topic agreed with this option.¹³² The comments were made that the current provisions are too complicated and not useful, and that this new approach would mean there would be less argument about whether trustees have the power to do something and more focus on the duties that trustees must perform. The Māori Land Court commonly uses the approach of giving trustees general powers to be used within the bounds of trustees' duties while setting out certain powers for many trust orders for Māori land.
- 4.11 We have considered whether the proposed reforms are in beneficiaries' interests. The proposals do give trustees wider powers to do things with trust property. The current limits on trustee powers may provide some protection for beneficiaries or a permitted purpose by potentially limiting the ability of trustees to engage in high risk activities or fail to protect trust property. But

131 Law Commission *The Duties, Office and Powers of a Trustee: Review of the Law of Trusts – Fourth Issues Paper* (NZLC IP26, 2011).

132 Key submissions on this topic were received from Chapman Tripp, the New Zealand Law Society (NZLS), and the Trustee Corporations Association.

the limits imposed are specific and may inhibit what a trustee can do too much or in unwanted ways. Increasing trustees' powers could give them the ability to make better choices in how the trust property is managed. We consider that the better way to ensure that trustees act appropriately in the beneficiaries' interests or for the trust's purpose is to give the duties of trustees prominence in the statute.

- 4.12 There was general support for also including a non-exhaustive list of the powers in the new Act. The New Zealand Law Society (NZLS) thought that this would be useful as a template. Greg Kelly Law and the Trustee Corporations Association commented that lawyers prefer to have specific clauses to point to in order to show a trustee has a particular power. A schedule of included powers would combat the concern that the new approach would be less clear than specific powers provisions. The schedule would make it explicit to third parties dealing with trustees, for instance banks lending to trustees, that the trustees have the requisite powers. While there could be a concern the schedule may cause some confusion as readers may rely on the schedule rather than the general provision, we consider that this can be alleviated by making it clear in the wording that the list is non-exhaustive and for the avoidance of doubt.
- 4.13 Submitters were unanimously supportive of altering the approach to the business-related powers to make them more flexible and enabling. They commented that it is usual to draft trust deeds that empower trustees to carry on a business without the limits imposed by the statutory provisions.
- 4.14 These proposals would work well within our proposed framework of setting out in summary form at the front of the new legislation the key features and requirements for the establishment of a trust and the duties of trustees. The structure of the new Act would make it clear that the powers are subject to the duties of trustees and objects of the trust. This would ensure that, although the powers of a trustee are ostensibly broadened by the new approach, what a trustee may do with trust property is always controlled by their general obligations to beneficiaries or the purpose of the trust.

POWERS OF DISTRIBUTION TO BENEFICIARIES

Proposals

- P12 New legislation should include a provision to replace section 40 that gives trustees the power to pay out the income of any vested or contingent entitlement to or for a minor beneficiary for the beneficiary's maintenance, education, advancement or benefit that re-enacts the current provision, with the following reforms:
- (a) define the phrase "maintenance, education, advancement or benefit" in the legislation in a way that ensures they are interpreted broadly and include the concepts of "comfort" and "wellbeing";
 - (b) remove the current test for the exercise of power, "as may, in all the circumstances, be reasonable"

- (c) remove the requirement to take into account other trust funds to which a beneficiary may have access; and
- (d) reduce the age of majority in the provision to 18 years old.

P13 New legislation should include a provision to replace section 41 that gives trustees the power to pay out the capital of any vested or contingent entitlement to or for a beneficiary for the beneficiary's maintenance, education, advancement or benefit that re-enacts the current provision, with the following reforms:

- (a) define the phrase "maintenance, education, advancement or benefit" as in P12 above;
- (b) remove the limits on the amount of the advancement (currently limited to the greater of \$7,500 or half of that beneficiary's total entitlement); and
- (c) clarify that those who hold contingent interests under a double contingency are not eligible.

Please give us your views on these proposals.

Current law

- 4.15 Sections 40 and 41 are important sections that empower trustees in private trusts to distribute to beneficiaries outside of the explicit distribution requirements in a trust deed for the beneficiary's advancement, education, maintenance or benefit. The sections are detailed and include a number of restrictions on how these powers must be exercised.

Issues

- 4.16 The sections are long-winded and overly complex. Their language is in need of modernisation. We have particularly considered whether the wording "maintenance, education, advancement or benefit" needs to be updated.
- 4.17 Some of the restrictions on how these powers may be exercised are now considered too limiting and many trust deeds override these powers with powers that are less restrictive. Section 40 requires the trustee to apply an objective "reasonableness" test and to consider other trust funds that may provide for a beneficiary in exercising the discretion to pay the beneficiary income. Section 41 limits the amount that may be advanced to a beneficiary to the greater of \$7,500 or half of the beneficiary's total share and requires the consent of a life tenant if capital is going to be paid out. The NZLS commented that section 41 does not make it clear that those who hold contingent interests under a double contingency are not eligible for an advance, but case law has shown this to be the case.

Discussion

- 4.18 The terms "maintenance" and "advancement" may be somewhat out of date, but we are of the view that the best approach is to retain the current wording

to describe the purposes for which payments may be made under sections 40 and 41. Nearly all submitters wanted the terms retained because their meaning is settled and a change could bring unnecessary uncertainty. The courts have interpreted these terms broadly to encompass payments that enhance a beneficiary's comfort and wellbeing. We propose that this broad approach can be made clear in the new legislation by defining the terms to include these wider concepts.

- 4.19 The NZLS commented that the mix of a subjective test (“at his sole discretion”) and an objective test (“as may, in the circumstances, be reasonable”) in section 40(a)(1) results in confusion and is difficult for trustees to apply. We agree that the objective test unhelpfully limits trustees' discretion and should be removed. This is in line with our general proposed approach to trustees' powers of removing restrictions in the default provisions and relying on clear trustees' duties to regulate the exercise of trustees' powers.
- 4.20 The same principle applies to the requirement in the proviso to section 40(1) that where the trustee has notice of another trust fund from which a minor beneficiary may benefit, the trustee should apportion the payment to this beneficiary accordingly. The NZLS also questioned this restriction. We consider that it should be removed because it is a significant fetter on trustees' discretion, and is impractical and potentially costly to carry out in practice. It is almost always overridden in trust deeds.
- 4.21 Submitters advised that most trust deeds override the default limits to the amount that may be advanced to a beneficiary under section 41 and nearly all thought the restriction should be removed. The monetary limits are out of date. Including any monetary limit risks the same problem in the future. We consider that giving trustees a broad power regarding the amount that may be advanced, subject to the trustees' duties of reasonable care and even-handedness, would address any concern that without the limits beneficiaries may suffer because of an erosion of capital. This reform would not be able to apply to existing trust deeds, as settlors of deeds that rely upon the current Act's default provision intended that these limits apply.
- 4.22 We have considered whether the requirement in section 41 for the court or the life tenant to consent if capital is to be paid out to a beneficiary should also be removed in the interests of reducing the restrictions on trustees' powers in the default provisions. However, this remains a significant guard against trustees disregarding a life tenant's interest and acknowledges the life tenant's property interest in the capital of the trust.
- 4.23 Submitters unanimously supported reducing the age of majority for beneficiaries under section 40 from 20 years to 18 years. We consider it is appropriate to reduce the age to reflect the current social and legal context where 18 year olds are generally considered to have capacity (discussed more fully below).

AGE OF MAJORITY

Proposal

P14 New legislation should reduce the age of majority for the purposes of trusts legislation and trust law generally (including wills) from 20 to 18 years. This would include changing the default age at which a beneficiary can give a full discharge to a trustee from 20 to 18 years.

Please give us your views on this proposal.

- 4.24 The age of majority in section 40 (and in the whole of the Act) is 20 years. There are concerns that this is not in line with the Minors' Contracts Act 1969, Care of Children Act 2004 and Wills Act 2007, under which a minor or child is a person under the age of 18 years. The Property Law Act 2007, while not changing the age of majority, does allow persons between 18 and 20 to do certain things.
- 4.25 Consideration of section 40 raises the issue of the age of majority in the Trustee Act generally. Section 40 is the only section of the Trustee Act that specifies an age of majority. Several other sections of the Trustee Act use the terms "full age", "infant" and "infancy" which in accordance with section 4 of the Age of Majority Act 1970 imply an age of majority of 20. These provisions are:
- section 2(2) – a person not of full age is deemed to be under a disability;
 - section 39A – bequeathing of chattels to an infant;
 - section 39B – bequeathing of chattels to an infant;
 - section 54 – vesting order in place of a conveyance by an infant mortgagee;
 - section 57(1) – effect of a vesting order where there is no person of full age appointed as a trustee; and
 - section 64A – the court consenting to a variation on behalf of a person unable to consent by reason of infancy.
- 4.26 For the same reasons that we recommend a change to the age in section 40 of the Trustee Act, we propose that the Age of Majority Act 1970 not apply to the new trusts legislation. This would mean that any reference to a minor (or similar term) would imply a person aged under 18. Any provisions equivalent to those in the above list would presume an age of majority of 18. We consider that under New Zealand law an 18 year old has the same legal capacity and the same capability as a 20 year old for most purposes. It would be discriminatory to leave the age of majority under the trusts statute at 20 years because there is no objectively assessable reason for distinguishing between 18 and 20 year olds.

- 4.27 The new legislation should explicitly provide that the age of majority for the purposes of trusts legislation is 18, or provisions where it is necessary to refer to an age of majority are drafted to refer to the specific age rather than rely on a term such as majority or infancy.
- 4.28 In order for the trust law to operate consistently, the reform should apply to all trust law, including trusts established by wills, rather than just the specific sections of the trusts legislation that refer to an age. It is important that the changes also make clear that the age at which a trustee can pay out a beneficiary as an adult is 18 years.

POWER TO APPOINT AGENTS

Proposal

- P15 New legislation should adopt the approach taken in the Select Committee version of the Trustee Amendment Bill 2007, which proposed new sections 29 to 29E to replace section 29 of the Act. The new provision would:
- (a) allow a trustee to appoint an agent to exercise a trustee's "administrative functions". "Administrative functions" would be defined as any function other than a "trustee function". The provision would define a "trustee function" as:
 - (i) a function related to a decision regarding the distribution, use, possession, or other beneficial enjoyment of trust property;
 - (ii) a power to decide whether any fees should be paid or other payment should be made out of income or capital;
 - (iii) a power to decide whether payments received should be appropriated to income or capital;
 - (iv) a power to appoint a person to be, or to remove, a trustee of the trust;
 - (v) a power of appointment (including a power to appoint a person to be, or to remove, a beneficiary);
 - (vi) a power to appoint or change the distribution date of trust funds;
 - (vii) a power to resettle the trust, or to amend, revoke, or revoke and replace terms or provisions of a trust deed;
 - (viii) a right conferred by this Act to apply to the court;
 - (ix) the power to authorise another person to perform any of the functions of the trustees or trustee.
 - (b) require trustees to keep under review the agency arrangements and the way the arrangements are being put into effect, to consider whether to intervene, and to intervene if necessary. In reviewing the agency and actions of the agent, the trustee must consider whether a trustee exercising reasonable care, diligence and skill would intervene and intervene if such a trustee would consider it necessary to do so.

- (c) provide that trustees are not liable to a beneficiary for the acts or defaults of an agent, unless the appointment was not made in good faith and with reasonable care, diligence and skill, or the trustee failed to review the agency and agent's actions, or an intervention by the trustee was not made in good faith and with reasonable care, diligence and skill.
- (d) make clear what fees and charges the trustee may pay the agent and what the trustee may be paid for employing the agent and reviewing the arrangement.
- (e) differ from the Select Committee's version of the Bill by:
 - (i) removing the list of example professionals that may be appointed as agents;
 - (ii) not stating the duty of care, diligence and skill that applies to professional trustees;
 - (iii) adding a non-exhaustive list of criteria that a trustee must consider when appointing an agent, including:
 - whether the intended agent has the appropriate skills, expertise and experience to carry out the task; and
 - whether employing the intended agent is a cost-effective option.

Please give us your views on this proposal.

Current law

- 4.29 Section 29 of the Trustee Act authorises trustees to employ agents to transact trust business or do anything required in executing the trust or administering trust property. It permits delegation of administrative or ministerial functions, but does not enable a trustee to delegate the trustee's fundamental decision-making powers. A trustee is not liable for the acts of the agent if the agent was employed in good faith. The section also permits a trustee to appoint an agent to carry out the trust outside of New Zealand including exercising any discretion, trust, or power vested in the trustee.
- 4.30 Following the 2002 Law Commission Report, *Some Problems in the Law of Trusts*,¹³³ the Trustee Amendment Bill 2007 was introduced. It proposed new sections to replace section 29. The proposed reforms:
- clarify the functions that an agent can be employed to carry out;
 - require the trustee to keep the arrangement under review, consider whether to intervene, and intervene if necessary; and
 - clarify that the trustee would not be liable for the agent's actions unless the appointment was not made in good faith or with reasonable care, diligence

¹³³ Law Commission *Some Problems in the Law of Trusts* (NZLC PP48, 2002).

and skill, or the trustee failed to review the agency or the intervention was not in good faith.

- 4.31 The Select Committee that considered the Bill recommended making it clearer that in reviewing the agency and the agent's actions the trustee must consider whether a trustee exercising reasonable care would intervene and intervene if such a trustee would consider it necessary to do so.

Issue

- 4.32 The current section 29 is not sufficiently clear in how it describes which of a trustee's functions an agent can be employed to carry out. The list of examples of professionals who may be employed as an agent in section 29(1) is also often interpreted as meaning only professionals can be appointed, despite the phrase "or other person".

Discussion

- 4.33 We consider that it is sensible to make clear the types of functions that can be given to an agent. Nearly all submitters agreed that new legislation should contain the same types of agency provisions as were included in the Select Committee version of the Trustee Amendment Bill 2007. Several, including Chapman Tripp, Greg Kelly Law, Cone Marshall and the Trustee Corporations Association, thought that differentiating between trustee functions and administrative functions was useful and meant that trustees would be required to carry out certain important tasks themselves.
- 4.34 The NZLS raised the concern that the provisions on the payment of fees and charges were too prescriptive. This is a valid concern, but it can be addressed through revised drafting.
- 4.35 The only significant alteration from the Bill's approach that we propose is to include a non-exhaustive list of factors for a trustee to take into account in appointing an agent. We consider that this will help trustees to appoint appropriate agents and to better meet their duties under the Act. It will provide greater guidance to trustees than the law does currently.

POWER TO DELEGATE

Proposal

- P16 New legislation should include a new provision on delegating a trustee's powers, duties and discretions by power of attorney. The provision should:
- (a) add temporary mental incapacity to absence from New Zealand and temporary physical incapability as the circumstances in which the power of delegation can be exercised;
 - (b) restrict the duration that a delegation may be in force to a mandatory maximum of 12 months, with the possibility of one extension of up to an

additional 12 months. The delegation should only be able to be extended by the trustee;

- (c) require trustees delegating their power to notify any co-trustees and any person with a power to appoint and remove trustees;
- (d) retain the current position that the trustee is only liable to beneficiaries for the actions or default of the delegate if he or she did not exercise good faith and reasonable care in the appointment of the delegate;
- (e) clarify that the default position is that a delegate may exercise the power to resign on behalf of a trustee who has delegated his or her powers;
- (f) retain the current position of allowing delegation to a sole co-trustee only if that co-trustee is a statutory trustee corporation;
- (g) require sole trustees who are delegating to notify any person with the power to appoint and remove beneficiaries, or if none, all adult vested beneficiaries (where it is reasonable to do so) or a reasonably representative sample of beneficiaries;
- (h) allow for a co-trustee or a beneficiary to apply to the Public Trust for the Public Trust to consent to become the delegate for a trustee who is unavailable to make a decision, and cannot be contacted for any reason, and there is no delegation in place; and
- (i) provide that any delegation may be limited to some rather than all of the trustee's powers, duties and discretions, and may exclude specific powers, duties and discretions, including the power to resign.

Please give us your views on this proposal.

Current law

- 4.36 A delegation under section 31 of the Trustee Act enables the substitution of a trustee by another person who can take over their duties, powers and discretions. Unlike an agent under section 29, which can only fulfil certain powers of the trustee, a delegate can take the trustee's place in exercising all of the trustee's duties, powers and discretions. This may only occur where the trustee is leaving or is about to leave New Zealand, or expects to be absent from New Zealand from time to time, or is or may become temporarily incapable of performing his or her duties on account of physical infirmity. Under section 31, a delegate has, within the scope of the delegation, the same trusts, powers, authorities, discretions, liabilities, and responsibilities as the trustee would have.

Issues

- 4.37 Concerns have been raised about the limited circumstances in which a delegation can apply, and in particular, its non-application to temporary mental incapacity. Other jurisdictions, such as the United Kingdom and British Columbia, have moved towards introducing additional safeguards on the exercise of this power to strengthen the position of beneficiaries, such as

limiting the duration of a delegation, requiring the trustee to notify others that the delegation has occurred and retaining some liability for the trustee where the delegation is in force. We have considered whether these types of safeguards need to apply in New Zealand also.

Discussion

- 4.38 We considered the option of removing all restrictions on when a trustee may delegate his or her powers and leaving it open. The current position is widely thought to be too restrictive. Yet the desire for flexibility must be balanced against the need to ensure the power does not become overused. There are usually good reasons why a particular person is appointed as trustee, such as the skills and knowledge he or she brings to the role. It is therefore not desirable to make it too easy to allow someone to act in the trustee's place or for such a substitution to persist for a long period. We were not persuaded that it is necessary to greatly widen the circumstances when the power to delegate can be used by completely removing the criteria for when a delegation can be made. The most common comment from submitters in relation to this issue was that temporary mental incapacity should be a circumstance in which a delegation can apply.¹³⁴ Delegation for a trustee suffering from temporary mental incapacity would have to be set up in advance as he or she would not be able to delegate his or her powers when mentally incapacitated. Extending the criteria to cover temporary mental incapacity will alleviate this concern, but means that the doors are not opened to trustees delegating their powers without a justifiable reason.
- 4.39 The United Kingdom statute and British Columbia draft Bill both include a limit of 12 months on the duration of a delegation.¹³⁵ Several submitters suggested that this was a useful restriction on this power. The 12 month period would be a good indicator to a trustee considering delegating his or her powers of when delegation is appropriate and when it would be better to resign. We consider that a 12 month limit reflects the intention that a delegation is only temporary. We favour allowing the trustee to extend a current delegation by a further 12 months as this introduces an added flexibility when circumstances do not exactly fit the 12 month timeframe.
- 4.40 The majority of submitters, including the NZLS, the Trustee Corporations Association and Greg Kelly Law, were of the view that requiring a trustee to inform co-trustees and any person with a power to appoint and remove a trustee was an appropriate safeguard. This is an obligation that will take some time and effort on the trustee's behalf but as the provision would only require

134 Key submissions on the power to delegate were received from Greg Kelly Law, the NZLS, Peter McMenamin, Chapman Tripp, Taylor Grant Tesiram, the Ministry of Social Development and the Trustee Corporations Association.

135 Trustee Act 1925 (UK) 15 & 16 Geo V c 19, s 25; see cl 9 of the proposed *Trustee Act* in British Columbia Law Institute, Committee on the Modernization of the Trustee Act *A Modern Trustee Act for British Columbia* (BCLI Report No 33, 2004), at 35–37.

- notification to certain parties, it would not be overly onerous. Introducing a notification requirement ensures that those who most need to know that the trustee has delegated his or her power do know.
- 4.41 We favour maintaining the current position with regard to the trustee's liability to beneficiaries for the delegate's actions and defaults. This differs from the approaches in the United Kingdom and British Columbia, and some submitters did suggest that trustees should be liable for a delegate's actions. However, it is fairer to the trustee to limit liability to when they have not exercised good faith and reasonable care in the exercise of the delegation as they cannot easily do more than this when they are in the circumstances that allow a delegation. We are also unaware of any problems with this approach to the trustee's liability currently. Most submitters agreed with this approach.
- 4.42 The current approach of allowing trustees to delegate to a sole co-trustee only if that co-trustee is a statutory trustee corporation differs from the approach generally taken in other jurisdictions where a trustee cannot delegate to the sole co-trustee. The more flexible approach that currently exists here is more suitable to the smaller New Zealand context where it may be difficult to find suitable delegates. Maintaining the current approach continues to protect against the risk of an individual becoming sole trustee in a trust that was intended to have at least two trustees.
- 4.43 Most submitters considered that sole trustees should continue to be able to delegate. We consider that this is a practical necessity and that it would be unhelpful to require all sole trustees facing circumstances where they temporarily cannot carry out the role to resign. We consider that a notification requirement should be introduced for delegations by sole trustees. Without this there is a risk that no-one will know of the delegation and beneficiaries will not know who has the power to deal with the property or who they can hold to account. It is straightforward for a sole trustee to notify a person with the power to appoint and remove beneficiaries where there is one, but where there is not, a meaningful notification can only be to some or all of the beneficiaries. A "reasonably representative sample of beneficiaries" has been proposed as the way of determining which beneficiaries should be informed if it is not practical and reasonable to contact all adult vested beneficiaries. This conveys the need to inform the appropriate range of beneficiaries that should know in the given circumstances that a delegation has been made.
- 4.44 The option of having the Public Trust, with its consent, become the delegate where there is no-one else to act as trustee has been suggested as a way of remedying a problem that occurs when a trustee cannot be contacted and has not put a delegation in place. This measure avoids there being no-one available to make a decision. The Public Trust has agreed that this is of a similar nature to their current powers and could be an acceptable extension to their current role.

Chapter 5

Investment powers

INTRODUCTION

- 5.1 In this chapter we consider what amendments, if any, should be made to the current investment provisions in Part 2 of the Trustee Act 1956. We then put forward proposals for addressing issues that have arisen in the following areas:
- the distinction between capital and income;
 - the apportionment of receipts and outgoings between capital and income; and
 - the appointment of investment managers by trustees.

INVESTMENT POWERS

Proposal

- P17 (1) New legislation should retain, largely unchanged, the prudent person principle in Part 2 of the Trustee Act 1956. The replacement provision should provide that:
- (a) a trustee may invest any trust funds in any property;
 - (b) when investing, a trustee should be required to exercise the care, diligence, and skill that a prudent person of business would exercise in managing the affairs of others; and
 - (c) where a trustee has any special knowledge or experience or holds himself or herself out as having special knowledge or experience, he or she must exercise the level of care, diligence, and skill that it is reasonable to expect of a person with that special knowledge or experience.
- (2) The obligations in P17(1) should apply in every trust to the extent they are not overridden or excluded by the trust deed.

- (3) The new legislation should make the following changes to the provisions in Part 2 of the Trustee Act 1956:
- (a) clarify that the power to invest does not preclude a trustee from taking account of other relevant matters when deciding how to manage a trust fund. A trustee may, where it is appropriate to give effect to the objectives or purpose of the trust, purchase or retain property for purposes other than investment;
 - (b) clarify that the higher standard of prudence imposed on a professional trustee applies to any trustee who has any special knowledge or experience or holds himself or herself out as having special knowledge or experience;
 - (c) repeal section 13G and include the requirement that a trustee comply with the provisions of the trust in section 13D (which already provides for the terms of the trust to modify or exclude the default duties in respect of investment);
 - (d) retain the power of the court (in section 13Q) to set off gains and losses in an action for breach of trust and also clarify that the rule of general trust law that requires the assessment of the decisions of a trustee on an investment by investment basis if the decisions are called into question (the anti-netting rule) has been abolished;
 - (e) add the additional factors that the court may take account of in section 13M to the list of matters trustees may have regard to when exercising their powers of investment in section 13E. Trustees would then have regard to their overall investment strategy and whether trust investments have been diversified (as is currently the case under section 13M); and
 - (f) repeal sections 13I, 13J, 13K, 13L, 13N, 13O and 13P on the basis that these provisions are now either outdated or unnecessary.

Please give us your views on this proposal.

Current law

- 5.2 Investment is regulated by Part 2 of the Trustee Act. A trustee may invest in any property¹³⁶ but must exercise the care, diligence, and skill that a prudent person of business would exercise in managing the affairs of others when investing.¹³⁷ If the trustee's profession, employment, or business involves acting as a trustee or investing money for others, the trustee must exercise the level of care, diligence, and skill of a person engaged in that profession, employment, or business.¹³⁸ Professional trustees thus have to meet a higher standard. The prudent person principle¹³⁹ and the duty of a professional to exercise the level of care and skill of a person engaged in their profession¹⁴⁰ apply subject to any contrary intention in the trust instrument.¹⁴¹
- 5.3 Section 13E sets out a non-exhaustive list of factors a trustee may have regard to, including diversification, maintenance of the real value of capital and income, capital appreciation, and inflation. Section 13F preserves the general legal duties of trustees including the duty to act in the best interests of present and future beneficiaries, the duty of even-handedness, and the duty to take advice.
- 5.4 Section 13M allows the court, in considering a trustee's liability as regards investment powers, to have regard to diversification of the trust fund and any investment strategy. Section 13Q provides that in an action for breach of trust, the court may set off a loss arising from an investment against a gain from any other investment. This section does not specifically revoke the anti-netting rule which operated before 1988 to prevent a loss on one investment by a trustee to be offset by a gain on another. Allowing the court to take into account profits from one investment and adjust losses from another was arguably an implicit repeal.
- 5.5 The remaining provisions in Part 2:
- impose a duty on trustees to comply with any requirement imposed on investment by the trust deed (section 13G);
 - give trustees a power to retain any non-compliant investment (section 13H);
 - impose a requirement that redeemable securities must be held in a bank for safekeeping (section 13I);

136 Section 13A.

137 Section 13B.

138 Section 13C.

139 Section 13B.

140 Section 13C.

141 Section 13D.

- regulate the purchase and redemption of redeemable securities (section 13J);
- give trustees powers in relation to company securities (section 13K);
- give trustees the power to apply the trust's capital to pay any calls on shares (section 13L) and the power to make certain loans and investments on the strength of a valuation without breaching the trust (section 13N); and
- provide that trustees will not be liable for losses caused by reason of improperly secured investment and release of part of security (sections 13P and 13O).

Issues

- 5.6 The *Fourth Issues Paper* raised relatively few substantive issues over the current investment powers.¹⁴² The Commission has proceeded on the basis that the prudent person principle, enacted in Part 2 of the Trustee Act, ought to be retained. It is generally considered to be working well, and we have not been made aware of any significant problems with it.
- 5.7 Against that background a number of issues with the current provisions should be addressed in new legislation. The problems, and the options for addressing them, are as follows:
- (a) The current provision is not sufficiently clear that the power to invest (section 13A) and the duty to do so prudently (section 13B) do not preclude trustees from taking account of other relevant matters when deciding how to manage a trust fund. As currently drafted, section 13A, which gives a general permission for trustees to invest in any type of property, could be interpreted as limiting the power of trustees to purchase property for purposes other than investment. There are, however, situations where it would be desirable for trustees to retain property for purposes other than investment. For example, there may be circumstances where trustees wish to purchase a property as a residence for the use and enjoyment of beneficiaries and not as an investment. Retaining a family home is not always a good investment, but it may be an appropriate thing to do for other purposes. Or, as may be the case in respect of Māori land under the scheme of Te Ture Whenua Māori Act 1993, the primary role of the trustees may be to retain and protect land assets for future generations. It would therefore be useful to clarify that powers to manage property (including powers to invest) are subordinate to obligations under the trust and that trustees can purchase and retain property for purposes other than investment.

¹⁴² Law Commission *The Duties, Office and Powers of a Trustee: Review of the Law of Trusts – Fourth Issues Paper* (NZLC IP26, 2011) at ch 5.

- (b) Section 13C currently requires professional trustees to meet a higher standard of prudence. There is a question over whether a professional such as a lawyer or accountant is covered by section 13C. The new Act should clarify that any trustee who has any special knowledge or experience or holds himself or herself out as having special knowledge or experience must comply with the higher standard of prudence imposed by that provision.
- (c) There is some uncertainty as to whether the anti-netting rule (which would seem to have been implicitly repealed by section 13Q) was fully abolished. For the avoidance of any doubt the anti-netting rule should now be expressly abolished.¹⁴³
- (d) Some of the detailed provisions in Part 2 of the Trustee Act that empower trustees to deal with certain types of investment are no longer necessary. Some were enacted to deal with specific historical points and can now be repealed. Others will be unnecessary because, as discussed in chapter 4, trustees will have broad general powers. In this area our specific proposals are:
- repealing section 13G and including the requirement that trustees comply with the provisions of the trust deed within section 13D (which already provides for the trust deed to modify or exclude the default duties in respect of investment);
 - amending section 13E (which lists the matters trustees may have regard to when exercising their powers of investment) to include the additional factors that the court may take account of in section 13M. Trustees would then have regard to their overall investment strategy and whether trust investments have been diversified (section 13M); and
 - repealing sections 13I, 13J, 13K, 13L, 13N, 13O and 13P because these provisions are either historic or unnecessary.

Discussion

- 5.8 Submitters were asked whether the current investment powers required any change. Most submitters said the current prudent person principle should be retained and that the current provisions worked well. The Office of the Māori Trustee submitted that there were particular issues in relation to investment in the context of Māori land, because the scheme of Te Ture Whenua Māori Act 1993 means that the primary role of the trustees is to retain and protect the land assets for future generations. Investment in other assets must give effect to the objectives of the trust. The Māori Trustee (commenting as a part

¹⁴³ This is the approach that was taken in cl 30 of the proposed Trustee Act in British Columbia Law Institute, Committee on the Modernization of the Trustee Act *A Modern Trustee Act for British Columbia* (BCLI Report No 33, 2004) at 49 [*A Modern Trustee Act for British Columbia*].

- of the Trustee Corporations Association submission) considered however that the current provisions are adequate to address this particular situation.
- 5.9 It would be helpful to clarify in new legislation that trustees may, where it is appropriate to give effect to the objectives of a trust, purchase or retain property for purposes other than investment. In practice this is what happens. Many trust deeds already specifically provide trustees with a power to purchase property for the use and enjoyment of beneficiaries to ensure that trustees are able to do this without considering the test for a prudent investment. Other deeds do not, but trustees often assume they have the power to do this. The Office of the Māori Trustee, for example, interprets the provisions in this way. In addition to providing a home for a beneficiary, there are further circumstances where trustees may need to purchase and retain property other than for investment. The purpose of a trust may be to preserve taonga and land assets for future generations. It would be helpful if the new Act was clear that trustees may do this without meeting the standards that apply to investments.
- 5.10 Greg Kelly Law submitted that it should be clearer whether or not the higher standard of care imposed on professional trustees (by section 13C) applies to lawyers and accountants. There are indications from case law that acting as a trustee is not considered part of the practice of the legal profession, while in the case of accountants trusteeship may come within the ordinary course of their business. The submission recommended that where a lawyer or accountant is appointed because of his or her professional relationship with the settlor or trustee they should meet the higher professional trustee standard.
- 5.11 We agree this matter needs clarification. However, our proposed approach is to be consistent with the general duty of care imposed on all professionals who accept office as trustee. We consider that where a trustee has any special knowledge or experience or holds himself or herself out as having special knowledge or experience, he or she should be required to exercise the level of care, diligence, and skill that it is reasonable to expect of a person with that special knowledge or experience.
- 5.12 New legislation should address the other points listed in paragraph [5.7] above. The anti-netting rule should be expressly abolished for the avoidance of doubt. It would also be appropriate for the trustees and the courts to have regard to the same matters when setting and assessing the overall investment strategy as has been proposed. If new trusts legislation gives trustees the broad natural person powers to administer the trust and deal with trust property, which we have proposed in chapter 4 (P11(1)), then many of the specific powers currently in Part 2 are not needed. The combination of the power to invest and that new provision means that the list of specific powers currently in the Trustee Act is now unnecessary.

DISTINCTION BETWEEN CAPITAL AND INCOME

Proposal

P18 The default provisions should give trustees a power to determine what is capital and income for the purposes of distribution to allow them to invest trust assets without regard to whether the return is of an income or capital nature. Trustees would be required to act reasonably and in the best interests of the beneficiaries overall. Where there are defined classes of beneficiaries trustees should ensure a reasonable level of income is made available for the income beneficiaries. In such cases trustees would have to adopt a suitable mechanism to determine how much of the total should be distributed to the income beneficiaries.

Please give us your views on this proposal.

Current law

5.13 An important aspect of the trustees' investment obligation is the duty to be even-handed between beneficiaries. This duty, preserved by section 13F, requires trustees to act impartially between the interests of different classes of beneficiaries (where there are classes). While the duty of even-handedness retains its validity as a general principle, the way present trust law requires it to be applied is now out of keeping with the nature of the investment market and investment strategy.¹⁴⁴ The problem arises most acutely where there are beneficiaries with a life interest and others (remainder beneficiaries) with a capital interest in the trust fund. The duty can be overridden by the terms of the trust and very often is. However, if it is not, the law requires income to go to the life tenants and capital appreciation to go to the remainder beneficiaries.¹⁴⁵ The trustees must consequently ensure that the trust investment policy does not unfairly prejudice either income or capital beneficiaries. Trustees are not permitted to disregard the distinction between capital and income for the purposes of investing so cannot do what non-trustee investors do, which is invest for a maximum return. It is the duty of the trustee to achieve a mix of investments so that all classes of beneficiaries are catered for, and none are disadvantaged.¹⁴⁶

Issues

5.14 One of the key principles of modern day portfolio investment theory is that it is artificial to distinguish between capital and income when investing. Instead modern portfolio management assesses investment options based on their

144 British Columbia Law Institute, Committee on the Modernization of the Trustee Act *Total Return Investing by Trustees* (BCLI Report No 16, 2001) at 5 [*Total Return Investing by Trustees*].

145 Andrew S Butler "Investment of Trust Funds" in Andrew S Butler (ed) *Equity and Trusts in New Zealand* (2nd ed, Thomson Reuters, Wellington, 2009) 213 at 225.

146 At 225.

overall total return regardless of whether it is correctly categorised as capital or income.¹⁴⁷ However, as discussed, the default provisions in the Trustee Act do not allow trustees to disregard the distinction between capital and income when investing. This limits the ability of trustees to apply principles of modern day portfolio investment and invest for the overall maximum total return. If trustees must invest with a view to balancing the capital and income returns, both categories of beneficiaries are likely to be dissatisfied because neither will benefit from an optimal rate of return.¹⁴⁸ An important issue is therefore whether the respective interests of all beneficiaries can be better protected through an emphasis on the duties of trustees without requiring trustees to maintain what has become quite an artificial distinction between capital and income.

Options for reform

- 5.15 The options we considered were:
- retaining the status quo – a requirement that trustees select investments with regard to the legal category of the returns received; or
 - introducing a new default provision that allows trustees to follow a total return investment policy.
- 5.16 Default provisions that better supported a total return investment policy would free trustees from the requirement to select investments with regard to the legal category rather than overall return. Within the parameters of their duty of prudence, trustees would then be able to maximise the gain to the trust portfolio. The key principle here is that investment decision-making should be separated from distributional issues.
- 5.17 There are several options for how legislation could allow a total return investment policy:
- *Option A – Trustees determine what is capital and income.* Trustees would be required to make a reasonable decision as to what is capital and income for the purposes of distribution. This approach relies on trustees' duties rather than prescribing rules for trustees to follow. Trustees, guided by their duties to beneficiaries, would be required to act in the best interests of all beneficiaries. This approach would allow trustees to then make investment decisions based on total return without having to consider whether the return is income or capital appreciation. Under this option trustees might pick a fund for investment based on total overall growth and then make a reasonable determination as to what portion should be distributed as income.

147 *Total Return Investing by Trustees*, above n 144, at 5.

148 At 5.

- *Option B – Percentage trusts.* Under the percentage trust model trust assets are valued on a periodic basis and a percentage of the total value may then be distributed without regard to the distinction between capital and income. Distributions are made first from revenue and then, to the extent of any deficiency, from capital. Any revenue in excess of the percentage amount is added to capital. Overseas law reform bodies have recommended legislating for percentage trusts as an approach that permits trustees to follow a total return investment policy. The British Columbia Law Institute Committee took this approach.¹⁴⁹ It was also considered by the Law Commission for England and Wales to be the model most likely to be successful in facilitating total return investment.¹⁵⁰ If New Zealand adopted this approach, the default provisions could permit trustees to invest on a percentage trust where this is not prohibited by the trust deed.
- *Option C – Discretionary allocation trust.* This option would give statutory recognition to discretionary allocation trusts, while making provision for the percentage trust as the default. The default provisions would provide that if a trustee was directed by the deed to hold the trust property on a discretionary allocation trust, the trustee could allocate and apportion receipts between income and capital accounts without regard to their legal categorisation. Trustees could recover disbursements from either income or capital regardless of the account from which the disbursement was paid or to which it was allocated, and trustees could also deduct for depreciation from income and add an equivalent amount to capital to protect capital beneficiaries. This approach was recommended by the British Columbia Committee also because the percentage trust will not be suitable for discretionary trusts that give trustees a discretion whether to make distributions and, if so, how much.¹⁵¹

Discussion

- 5.18 Submitters overwhelmingly supported provisions that facilitate a total return investment policy. We agree that this is the appropriate approach for new legislation. Submitters commented that trustees should be required to maintain a fair balance between income and capital beneficiaries and ensure that a reasonable level of income is obtained. Against this backdrop a number said trustees should be free to decide to invest on a total return basis provided this is not prohibited by the trust deed. Submitters considered that relying on the underlying duty of trustees to be impartial and make fair and equitable distribution between all classes of beneficiaries was a better approach than retaining the capital/income distinction when investing. The view of most

149 At 5.

150 However, the Law Commission (UK) felt unable to formally recommend its adoption because of the tax implications involved; see Law Commission (UK) *Capital and Income in Trusts: Classification and Apportionment* (LAW COM No 315, 2009) at 72 [*Capital and Income in Trusts*].

151 *Total Return Investing by Trustees*, above n 144, at 14.

- submitters was that trustees could invest more effectively if they were not constrained by the obligation to provide an expected level of income for the benefit of an income beneficiary.
- 5.19 Of the three options for a total return investment approach, we favour the permissive approach of option A that relies on the important duties trustees have to beneficiaries instead of specifying any particular allocation mechanism. As discussed in chapter 3, we propose to strengthen those duties and give them greater prominence in the new Act. Option A allows trustees guided by their duties to adopt the most suitable mechanism to determine how much of the total fund should be distributed to income beneficiaries. Many recent trust deeds already permit this approach. Where the trust deed allows, trustees would have the discretion to take a percentage approach. Submitters generally favoured the broad power under option A. They considered the powers should be subject to safeguards, including the duty to be impartial and to act justly and equitably, in accordance with normal business practice, and in the best interests of the beneficiaries.
- 5.20 The few submitters who commented on the percentage trust approach (option B) considered that percentage trusts are not well understood in New Zealand and that legislation would consequently be leading the way if this approach were taken. While percentage trusts have become a feature of other jurisdictions, there has been little development or interest in the model in New Zealand so far. This is understandable because the percentage trust model is not very suitable for discretionary trusts that give trustees a discretion as to whether and how to make distributions. The New Zealand trusts landscape is distinguished by significant numbers of discretionary trusts. The percentage trust is also not particularly suitable for a trust designed primarily for capital accumulation and distribution later on.
- 5.21 Some submitters considered that the percentage trust mechanism has merit, but for it to work there would also need to be reform to tax law to allow for the appropriate treatment of income under the percentage trust. Submitters also identified other complexities, such as asset valuation periods, with the percentage trust model that would need to be addressed before it could be specified in legislation.
- 5.22 A few submitters commented on the discretionary allocation trust model (option C). They considered that trustees should still be subject to the obligation to act even-handedly towards beneficiaries. One submitter noted that provision for discretionary allocation trusts would be necessary if percentage trusts were to be provided for in legislation.
- 5.23 Where trusts have income beneficiaries the traditional capital and income allocation rules stand in the way of trustees maximising the total return on investment. If trustees are able to determine what was capital and what was income for the purposes of distribution then they will be able to invest more effectively and maximise returns. The approach in option A is a flexible alternative to the current strict capital/income distinction. Trustees would have a broad discretion but would always be required to act in accordance

with their underlying duties. Trustees would be required to maintain a fair balance between the interests of all beneficiaries. As is discussed in the next section, the apportionment of receipts and outgoings between capital and income should be undertaken in accordance with accepted business practice. We consider that the approach proposed below to apportionment, together with the trustee's general duties, should be sufficient to maintain a fair balance between the interests of different classes of beneficiaries.

APPORTIONMENT OF RECEIPTS AND OUTGOINGS BETWEEN CAPITAL AND INCOME

Proposal

P19 Apportionment clause

- (1) New legislation should provide that a trustee may:
 - (a) apportion any receipt or outgoing in respect of any period of time between the income and capital accounts, or charge any outgoing or credit any receipt exclusively to or from either income or capital as the trustee considers to be just and equitable in all the circumstances and in accordance with accepted business practice;
 - (b) transfer funds between capital and income accounts to recover or reimburse an outgoing previously charged to the account that is to receive the funds where such corrections are fair and reasonable and are undertaken in accordance with accepted business practice;
 - (c) transfer funds between capital and income accounts to recover or deduct any receipt previously credited to the account from which the funds are to be recovered where such corrections are fair and reasonable and are undertaken in accordance with accepted business practice; and
 - (d) deduct from income an amount that is fair and reasonable to meet the cost of depreciation, and add the amount to capital, in accordance with accepted business practice.
- (2) New legislation should provide that:
 - (a) if a trust deed includes a clause that attempts to exclude P19(1) then that clause is of no effect; and;
 - (b) any clause in a trust deed is invalid to the extent that it is inconsistent with P19(1).

Please give us your views on this proposal.

Current law

- 5.24 Current rules on the apportionment of receipts and expenses depend on whether a particular receipt or expense is classified as income or capital. If the trust deed is silent on apportionment, under case law the type of expense determines who bears it. Generally, expenses of an income nature are borne by income beneficiaries while expenses of a capital nature are borne

by capital beneficiaries. However, the case law rules also depend on other factors, such as for whose benefit the expense was incurred, to determine expense apportionment.¹⁵²

- 5.25 There may be uncertainty over the correct apportionment in some situations as it may be difficult to assess who benefited from a particular expense. In other situations the apportionment can cause considerable inconvenience because it requires complex calculations of very small sums of money.¹⁵³ Apportionment of income and outgoings over time where the person entitled to income changes part way through the relevant payment period can cause difficulty.
- 5.26 Many trust deeds enable trustees to exercise discretion as to how to apportion both receipts and expenses between accounts and over time. But, if the trust deed is silent on the matter, trustees must apply the complex apportionment rules.
- 5.27 In addition to the case law rules, there are a number of specific provisions in the Trustee Act that deal with apportionment in certain situations. Section 83, for example, contains special rules as to apportionment on purchase, sale or transfer of fixed income assets and shares in certain situations.

Issues

- 5.28 The current default rules on apportionment are complex and difficult to apply. Most trust deeds contract out of them and enable trustees to exercise discretion on apportionment. The question is whether the default rules governing the apportionment of outgoings between capital and income should be reformed to reflect current practice.

Options for reform

- 5.29 The options we considered are:
- (a) retaining the status quo; or
 - (b) giving trustees the power to apportion a receipt or an outgoing between income and capital accounts, or to charge an outgoing exclusively to or credit a receipt exclusively to income or capital and to apportion a receipt or outgoing in respect of any period of time, in accordance with accepted business practice where they are satisfied that it is just and equitable to do so.
- 5.30 If option (b) is favoured, then several related changes probably should also be made to allow trustees to:

152 *A Modern Trustee Act for British Columbia*, above n 143, at 53.

153 *Capital and Income in Trusts*, above n 150, at 9.

- transfer funds between capital and income accounts to recover or reimburse an outgoing previously charged to the account that is to receive the funds;
- transfer funds between capital and income accounts to recover or deduct any receipt previously credited to the account from which the funds are to be recovered; and
- deduct from income an amount that is fair and reasonable to meet the cost of depreciation and add the amount to capital.

- 5.31 We put some of these proposals forward for comment in the *Fourth Issues Paper*.¹⁵⁴ The proposals in option (b) are broadly modelled on reforms recommended by the British Columbia Committee. The British Columbia Committee proposed that trustees have the power to apportion or charge an outgoing if it is just and equitable, in accordance with sound business practice, and in the best interests of beneficiaries. The Committee also recommended trustees have the power to transfer funds between capital and income accounts to recover or reimburse an outgoing previously charged to the account that is to receive the funds. It recommended that trustees be able to deduct from income an amount that is fair and reasonable to meet the cost of depreciation and add the amount to capital.¹⁵⁵ The British Columbia Committee proposed also, although only in respect of discretionary allocation trusts, that trustees should be able to allocate receipts and outgoings to the income and capital accounts as the trustee considers just and equitable in all the circumstances.¹⁵⁶
- 5.32 It should be noted that the changes proposed in option (b) would not alter in any way the tax status or liability that attaches to any receipt or outgoing. The reforms would give trustees discretion as to how they apportion outgoings and receipts for the purposes of trust law without breaching their obligations as trustees. That would not affect the treatment of those receipts and outgoings for tax purposes.

Discussion

- 5.33 We favour option (b) over the status quo, as did most submitters who responded. The current rules on apportionment are difficult to apply and it can be hard to determine who benefits from particular expenditure or should receive a receipt. We consider it would also be confusing and unhelpful, given our proposals in the previous section, to try to retain the rules on apportionment. Many, if not most, newer trust deeds already allow trustees to exercise their discretion and apportion a receipt or an outgoing between

154 *Fourth Issues Paper*, above n 142.

155 See cl 35 of the proposed *Trustee Act in A Modern Trustee Act for British Columbia*, above n 143, at 53–54.

156 Cl 36, at 54.

- income and capital accounts or to charge an outgoing exclusively to or credit a receipt exclusively to income or capital. Trustees similarly have discretion when apportioning between accounts on the basis of time. If trustees are granted this discretion then logically they should also be permitted to change their minds subsequently or correct mistakes. The proposal also ensures that income beneficiaries are not unduly favoured due to a failure to allow for depreciation.
- 5.34 The proposed reform leaves it to trustees to allocate or apportion receipts and outgoings justly and equitably between income and capital accounts under a trust, and to disregard the traditional legal categories for income and capital accounts for that purpose. We consider that this power will assist trustees in maintaining an even hand between different classes of beneficiaries.
- 5.35 The proposed reform includes a requirement that allocation of expenses to capital or income is undertaken in accordance with accepted business practice. The New Zealand Law Society (NZLS) considered that guidance on what constitutes accepted business practice in this context could be helpful. Some submitters proposed changing the term “accepted business practice” to “generally accepted accounting practice” so that trustees would have to comply with financial reporting standards (GAAP’s) promulgated by the External Reporting Board under the Financial Reporting Act 1993. However, we are not persuaded that requiring trustees to comply with prescriptive financial reporting standards would be appropriate. We think that compliance with such standards would provide trustees with a safe harbour, but should not be necessary in all situations.
- 5.36 It is arguable that including the words “in accordance with accepted business practice” may actually be unnecessary as this will be implied by the duties on trustees, but we see value in including this broad standard to give an indication of the type of practice that will be acceptable.
- 5.37 We consider that imposing a requirement on trustees that they exercise their discretion in the best interests of all beneficiaries is likely to cause confusion and therefore be unhelpful. The NZLS noted that any requirement that the discretion be exercised in the best interests of beneficiaries might cause confusion because the interests of different classes of beneficiaries will not be consistent with each other. Life interest and remainder beneficiaries are all beneficiaries of the trust, and the decisions regarding the application of expenses to income or capital will inevitably result in an outcome that is not in the best interests of one of those categories of beneficiaries. Trustees are already subject to a duty to act in good faith and consider the respective interests of each beneficiary, so little would be added by requiring any discretion to be exercised in the best interests of all beneficiaries.
- 5.38 Most submitters supported trustees having a power to transfer funds between capital and income accounts to recover or reimburse an outgoing previously charged to the account. Some submitters agreed that the British Columbia approach provided a good model. The NZLS considered that trustees should only be able to do this if it was just and equitable and in accordance with

ordinary business practice. If trustees are granted discretion to decide whether to apply an expense to income or capital then trustees should also be permitted to change their minds subsequently.

- 5.39 Most submitters also favoured allowing trustees to deduct a reasonable cost of depreciation from income. The option enables assets to be maintained for the capital beneficiaries. Submitters considered that trustees should only be able to deduct an amount from income to provide for depreciation if satisfied that this is just and equitable and is in accordance with normal business practice. Trustees should also be permitted to reverse (in whole or part) any deduction made from income to the provision for depreciation in the event that the property is sold for more than its depreciated value.
- 5.40 The proposed reform should also replace section 83 and the other provisions of the Trustee Act that contain special rules relating to the apportionment of receipts and outgoings between income and capital. Sections 83, 84, and 85 of the Trustee Act need not be carried forward into a new statute. They are obscure, difficult to apply and can result in impractical outcomes. Instead, we propose that trustees should be able to allocate or apportion receipts and outgoings justly and equitably in these circumstances.

New approach should apply to existing trusts

- 5.41 Our proposed reforms replace the existing case law rules on apportionment by giving trustees the discretion to allocate expenses and receipts between income and capital. We are also proposing that this new approach to apportionment should apply to existing as well as new trusts and that it should apply to all trusts regardless of any provision or contrary intention expressed in any trust deed. In other words it should be a mandatory rule and express provisions in a trust deed dealing with apportionment cannot replace it. We consider that the best option is to simply replace all the existing rules with the new apportionment provision we have proposed.
- 5.42 The other option would be to make the new apportionment rules a default provision that could be modified or excluded by the terms of a trust. In our view that alternative is likely to cause significant confusion, inconsistency and unfairness. All existing trust deeds have been drafted against the background of the current case law rules on apportionment. Clauses addressing apportionment have been drafted to avoid the complexity and problems created by some of the current rules. While newer trust deeds may have given trustees the type of discretion we have proposed in our preferred approach, others will not have. Instead they will have probably only addressed specific rules, such as the rule in *Howe v Earl of Dartmouth* (which requires certain residual personal estate to be sold). If the new apportionment provision we have proposed were only a default provision, such clauses in trust deeds would probably exclude the new rule and would continue to apply instead. This would cause some confusion as such deeds would have been drafted within such a different context that they would be difficult to interpret and apply. It may also result in unfairness.

- 5.43 The Commission proposes instead that the new apportionment provision should apply to all trusts from the date that a new Act containing the provision comes into force. The new provision is flexible and will give trustees discretion to apportion as they consider just and equitable in all the circumstances and in accordance with generally accepted business practice. Clauses on apportionment included in trust deeds would only be valid to the extent that they are consistent with the new provision. Trustees would be required to consider any specific instructions on apportionment that had been included in the trust instrument.
- 5.44 The Commission is aware that it has not previously consulted on the proposal that the proposed apportionment clause should be a mandatory provision and apply to existing as well as new trusts. We have also not previously consulted on those aspects of the proposal in P19(a) and (c) that allow trustees to apportion receipts on a just and equitable basis. We therefore particularly welcome comment and feedback on these proposals.

APPOINTING INVESTMENT MANAGERS

Proposal

- P20 (1) New legislation should authorise trustees to appoint investment managers and give them authority to make investment decisions.
- (2) The appointment of investment managers should be subject to the following legislative safeguards:
- (a) trustees must act honestly and in good faith and exercise reasonable care when appointing an investment manager, and must review the investment manager's performance periodically;
 - (b) trustees must create a written policy statement that gives guidance as to how investment functions are to be exercised by an investment manager setting out the general investment objectives, and require investment managers to agree to comply with the policy statement; and
 - (c) trustees are liable for any default of the investment manager where the trustees have failed to act honestly and in good faith and exercise reasonable care when making the appointment of a manager or monitoring the investment manager's performance.

Please give us your views on this proposal.

Current law

- 5.45 Currently trustees can, and normally should, get advice on potential investments. They must, however, personally assess such advice and decide whether to accept or reject it. They can therefore act on advice but cannot appoint investment experts and authorise them to decide.

- 5.46 Many trust deeds do enable trustees to use investment managers to make investment decisions. This approach recognises that making sound investment decisions in today's world requires considerable skill and judgement. The range of potential investment products and combinations is immense. Investment techniques and methodologies are various and complex.

Issues

- 5.47 Under the current default provisions trustees are not able to appoint investment managers and give them authority to make investment decisions. This limits the ability of trustees to follow a portfolio management approach to investment fully utilising the skill and judgement of professional investment managers to make investment decisions.
- 5.48 The question is whether trustees should be able to appoint investment managers and give them authority to make decisions about investment, and, if so, what safeguards should apply.

Options for reform

- 5.49 The two broad options that were considered are:
- (a) retaining the status quo. The default provisions should not enable trustees to appoint investment managers with the authority to make investment decisions; or
 - (b) introducing new default provisions that enable trustees to appoint investment managers with authority to make investment decisions subject to suitable safeguards.
- 5.50 If option (b) is implemented, then safeguards should be applied to manage the appointment of an investment manager. The general safeguards we considered are as follows:
- requiring trustees to act honestly and in good faith when making an appointment of an investment manager (the requirement that a trustee acts honestly and in good faith is already one of a trustee's mandatory duties);
 - requiring trustees to exercise reasonable care when appointing an investment manager (the requirement to exercise reasonable care when investing is part and parcel of a trustee's obligation to exercise the care, diligence, and skill that a prudent person of business would exercise, and of the duty of care); and
 - requiring trustees to review the investment manager's performance periodically (a trustee's obligation to exercise the care, diligence, and skill that a prudent person of business would exercise when exercising investment powers would also seem to require such review and it is also likely to be required by the trustee's duty of care).

- 5.51 If option (b) is implemented, consideration must also be given to the question of whether trustees should remain liable for the actions or decisions of their appointee. The two options considered were:
- making the trustees liable for any default of the investment manager; or
 - making the trustees only liable for defaults of the investment manager where the trustees have failed to exercise reasonable care or have failed to act in good faith when making the appointment or have failed to monitor the investment manager's performance.
- 5.52 We have also now considered the option of requiring the trustees to set the trust fund's investment objectives and requiring the investment manager to act within the limits of those objectives. This option was raised by Taylor Grant Tesiram, which discussed the approach taken in the Trustee Act 2000 (UK). Under that regime trustees must prepare a policy statement in writing that sets out the objectives of the exercise of the function and enter into a written agreement whereby the delegate agrees to ensure compliance with the policy statement. KPMG suggested a similar approach in which investment policy decisions would be reserved to trustees so that the trustees could set investment strategy and policy in accordance with the terms of the trust, and only the implementation would be delegated.
- 5.53 Any provision authorising the appointment of an investment manager would be a default provision. It would therefore be possible for a settlor to exclude or alter any power of appointment or exclude or modify any of the safeguards in the trust deed, although the duty of a trustee to act honestly and in good faith in all matters is mandatory and could not be excluded.

Discussion

Allowing investment managers

- 5.54 The Commission favours a default position that permits trustees to appoint investment managers, subject to appropriate safeguards. The main argument against such a reform is that the obligation to make investment decisions is one at the heart of a trustee's role. Investment is an obligation accepted by a trustee when he or she accepts appointment and should therefore be exercised personally by the trustee. Investment managers also might not be familiar with trust matters so trustees should be actively involved in making decisions on asset allocation.
- 5.55 However, most submitters who responded on this issue favoured trustees having the power to delegate to investment managers. Our research indicates that most modern trust deeds do permit delegation of decision-making in this area. The range of potential investment products and combinations is now immense and investment has become far more complex as a result. It is not realistic to require trustees to undertake this function personally. Trustees of many private trusts take on the role of trustee without payment and do not have the time or expertise to make complex investment decisions or

monitor on a regular basis the investment performance of the fund. A suitably qualified and competent professional investment manager is likely to do a better job than many trustees. With appropriate safeguards there may be less risk in allowing for the appointment of experts than in leaving investment in the hands of trustees. Submitters commented on the complexity of the investment task, preferring that it be handled by specialised professionals as it is not reasonable to expect trustees to possess this degree of expertise or engage in complex financial analysis when highly trained specialists can undertake such tasks for a fee.

- 5.56 Further, if the default provisions in new legislation allow for the appointment of investment managers, then settlors are still able to contract out of that default if they do not want trustees to delegate investment in this way.

Safeguards

- 5.57 The main safeguard almost all submitters favoured was a requirement for trustees to act prudently in selecting investment managers and in monitoring their performance. There was general agreement that trustees must use reasonable care in choosing the investment manager and should be required to review their performance on a regular basis. One noted that trustees must be cognisant that investment fund managers might not be familiar with trust matters and trustees need to remain actively involved in decisions on asset allocation and maintaining equity between income and capital.
- 5.58 Some submitters noted that at common law a trustee has a duty of care in selecting an agent and must act prudently. The trustee's duty of prudence extends to also providing proper instructions and monitoring investments. Views on whether these obligations should be stated in new legislation differed. The Society for Trust and Estate Practitioners, New Zealand made the point in respect of monitoring that given the complexity of investment markets, it would not be realistic for the trustee to be expected to closely review or second guess the decisions of investment managers. Instead its view was that there should be an obligation for the trustee to receive and consider investment reports so that the trustee can cancel the investment mandate if the performance is clearly inadequate.
- 5.59 We agree that trustees should be explicitly required to act honestly and in good faith and to exercise reasonable care when appointing an investment manager and must review the investment manager's performance periodically. Although these obligations are part of the trustee's duty general duty of good faith and the duty to act prudently there may still be value in expressly spelling them out in this provision.¹⁵⁷
- 5.60 In addition, we consider that the default provisions should impose liability on the trustees for any defaults of the investment manager only where the trustees have failed to exercise reasonable care or act honestly and in good

¹⁵⁷ See ch 3 for a discussion on the duties of trustees.

faith when making the appointment of a manager or have failed to monitor the investment manager's performance. Submitters on this issue overwhelmingly supported this approach. Most submitters considered that there should be no liability where the trustee has acted prudently. If a trustee has exercised appropriate care and has delegated investment decision-making in good faith because the trustee does not have the necessary expertise, it would seem to be anomalous for the trustee to remain liable for what the delegate does.

- 5.61 Most submitters considered that trustees should have broad powers to define the terms of appointment of the investment manager. Most also considered that it was not appropriate for legislation to prescribe the classes of organisation or people to whom investment decision-making can be delegated. Submitters considered that the duty to act prudently will restrict the choice of investment managers in the way it currently restricts decisions on advisers. The point was also made that trustees would fail the prudence test if they acted on the advice of someone who is not a registered financial adviser.
- 5.62 We agree that it is not appropriate to prescribe in legislation the classes of organisation or people to whom investment decision-making powers can be delegated. The duty to act prudently should be sufficient. In addition the investment world changes frequently so any list of approved organisations would quickly become outdated.
- 5.63 We have been convinced that there is merit in the option, suggested by Taylor Grant Tesiram and KPMG, of having trustees set out their investment objectives. This would be an effective way of requiring the trustees to think carefully about the purpose of the trust and requiring investment strategies consistent with such purpose, rather than completely washing their hands of the investment role when an investment manager is used. It would be a practical way of emphasising the trustee's ultimate role of accounting for trust property for the benefit of the beneficiaries. We do not envisage that this would be a detailed policy, but more a basic statement of the general approach to risk and to the types of returns that are desirable. The statement would allow trustees to ensure the investment strategy takes into account the interests and needs of the beneficiaries, including potentially the individual beneficiaries' needs, depending on the number and nature of the beneficiaries of the trust.

Chapter 6

Appointment and removal of trustees

INTRODUCTION

- 6.1 This chapter addresses topics relating to the appointment and removal of trustees. The following specific issues are covered:
- acceptance or disclaimer of trusteeship;
 - who may be appointed as a trustee;
 - grounds for removal of a trustee;
 - retirement of trustees;
 - who may remove a trustee and appoint a replacement trustee when the grounds are made out;
 - whether persons removing and appointing trustees should be subject to fiduciary duties;
 - whether trustees who are removed should always be replaced and whether there should be a statutory default minimum number of trustees; and
 - the transfer of trust property when a trustee is removed.
- 6.2 We have been advised that these areas cause problems in the day to day administration of trusts due to a lack of clarity in statutory default provisions or processes, or an outdated approach that no longer meets the needs of modern trust practice. Our preferred approach is to modernise the statutory defaults for these areas of trust administration, and to provide more robust guiding principles and mechanisms for appointment and removal. Some of the statutory defaults will include mandatory aspects, such as the requirement that trustees be over the age of 18 years. We also propose the legislation give the Public Trust certain administrative roles in relation to the appointment and removal of trustees.

- 6.3 Although this chapter is separated into sections, the proposals have been designed to work together and are best read as an overall package.

ACCEPTANCE AND REJECTION OF TRUSTEESHIP

Proposal

P21 New legislation should:

- (a) clarify that if a trustee does not accept the trusteeship within three months of receiving notice of his or her appointment, he or she will be deemed to have disclaimed the trusteeship;
- (b) provide that disclaimer of trusteeship need not be in writing, but must be communicated to the appropriate person (for instance, the settlor or appointer, as the case may be under the trust deed) in clear and unambiguous terms;
- (c) provide that acceptance may be implied through conduct;
- (d) allow this default provision to be varied by the trust deed;
- (e) provide that if a trustee disclaims, the property vests in the remaining trustees, or if there are no other trustees, reverts to the settlor on the terms of the trust; and
- (f) use plain English terminology and refer to “rejecting” rather than “disclaiming” the trusteeship.

Please give us your views on this proposal.

Current law

- 6.4 Under case law, no-one can be compelled to be a trustee.¹⁵⁸ To give effect to this principle, trusteeship does not commence until the appointment is accepted. Acceptance may be express or may be implied by conduct. There are some forms of conduct which clearly constitute an implied acceptance of the role of trustee, such as dealing with the trust property.¹⁵⁹ An appointed trustee who does not want to accept the trusteeship may disclaim (reject) the office, in which case the trust property will vest in the remaining trustees, or revert to the settlor if there are no other trustees. The rejecting trustee is entitled to recover the expenses of the rejection from the trust fund and will not be subject to liability as a trustee.¹⁶⁰ After rejection, the person with the power to appoint trustees, or the court, may appoint a new trustee. There is no

158 The Trustee Act 1956 provides that the Public Trust can be compelled to be a trustee in some circumstances, but does not otherwise alter case law.

159 See *Lord Montfort v Lord Cadogan* (1816) 19 Ves 635; 34 ER 651 (Ch) and *James v Frearson* (1842) 1 Y & C Ch Cas 370.

160 *Re Tryon* (1844) 7 Beav 496.

time limit for rejection, but once the trusteeship has been accepted (including through implication) it cannot later be rejected, although it can be resigned.

- 6.5 There is case law which supports the proposition that inaction for a long period of time will be presumed to constitute rejection.¹⁶¹ However, there is also case law for the proposition that a long period of inaction will be presumed to constitute acceptance (because there has been no express rejection in this time).¹⁶² Whether there has been an implied acceptance or an implied rejection will be assessed on the facts, and the onus will be on the party alleging rejection.¹⁶³

Issues

- 6.6 It is desirable to resolve this ambiguity and clarify the rules for rejection. The law needs to clearly differentiate between circumstances which constitute an implied rejection and circumstances which constitute implied acceptance. The central question is whether a trustee should be presumed to have rejected the office unless there is a clear indication of acceptance, or vice versa.

Options for reform

- 6.7 The options we considered are:
- (a) providing that inaction is deemed to be a rejection of office;
 - (b) providing that express acceptance of office is required; and
 - (c) providing that an absence of positive steps to reject the office after sufficient notice of appointment is received will constitute acceptance.

Discussion

- 6.8 Submitters to the *Fourth Issues Paper*¹⁶⁴ had varying views on this issue. Some, including the Auckland District Law Society (ADLS) and the New Zealand Law Society (NZLS) considered that codification or restatement was not necessary. The Ministry of Social Development (MSD) submitted in favour of deemed disclaimer if no action is taken to accept the trust within six months. Greg Kelly Law and the Trustee Corporations Association (TCA) preferred the approach of presumed acceptance in the absence of express rejection within a certain time period, to protect the interests of beneficiaries. KPMG submitted in favour of requiring express acceptance.

161 *Re Clout and Frewer's Contract* [1924] 2 Ch 230; *Re Gordon* (1877) 6 Ch D 531; *Re Birchall* (1889) 40 Ch D 436.

162 See *Re Uniacke* (1844) 1 Jo & Lat 1, however the approach in this case was criticised and not followed in *Re Clout and Frewer's Contract* [1924] 2 Ch 230.

163 *Lady Nass v Westminster Bank Ltd* [1940] AC 366 (HL).

164 Law Commission *The Duties, Office and Powers of a Trustee: Review of the Law of Trusts – Fourth Issues Paper* (NZLC IP26, 2011).

- 6.9 Our preferred approach is based on the United States model code,¹⁶⁵ shown below with our proposed changes.

ACCEPTING OR ~~DECLINING~~ REJECTING TRUSTEESHIP

- (a) Except as otherwise provided in subsection (c), a person designated as trustee accepts the trusteeship:
- (1) by substantially complying with a method of acceptance provided in the terms of the trust; or
 - (2) if the terms of the trust do not provide a method or the method provided in the terms is not expressly made exclusive, by accepting delivery of the trust property, exercising powers or performing duties as trustee, or otherwise indicating acceptance of the trusteeship.
- (b) A person designated as trustee who has not yet accepted the trusteeship may reject the trusteeship. A designated trustee who does not accept the trusteeship within a ~~reasonable time after knowing of the designation~~ three months of receiving notice of the designation is deemed to have rejected the trusteeship.
- (c) A person designated as trustee, without accepting the trusteeship, may:
- (1) act to preserve the trust property if, within a reasonable time after acting, the person sends a rejection of the trusteeship to the settlor or, if the settlor is dead or lacks capacity, to a qualified beneficiary; and
 - (2) inspect or investigate trust property to determine potential liability under environmental or other law or for any other purpose.
- 6.10 This approach retains the settled position under case law that a trustee does not assume the office until the office is accepted, while clarifying that inactivity is considered to be rejection. This option continues to allow acceptance to be implied through conduct rather than requiring express acceptance. It also provides additional clarity by listing some of the circumstances in which acceptance may be implied, such as accepting delivery of trust property. This would be the default provided in new legislation, however, a trust deed could provide an alternative approach (for example that the trustee must accept the office in writing within 20 working days).
- 6.11 We consider that new legislation should stipulate a defined period of time after which inaction will be treated as rejection rather than a “reasonable time” as in the United States Model Code. This provides greater certainty for all involved, and ensures that a named trustee has clear warning of the date by which he or she must accept the office. If a flexible formulation was adopted then a trustee who did not accept promptly might be considered to have disclaimed, despite an intention on his or her part to accept before a reasonable time passes. We consider that three months provides the appointed trustee with a sufficient opportunity to accept the appointment. Three

¹⁶⁵ National Conference of Commissioners on Uniform State Laws *Uniform Trust Code* (National Conference of Commissioners on Uniform State Laws, Chicago, 2010).

months is also consistent with the period provided under section 19 of the Administration Act 1969 for the proof of a will by an executor.

- 6.12 We rejected the alternative option of requiring written acceptance of trusteeship. We consider that requiring written acceptance is not suitable as the statutory default, although it may be appropriate for some trusts. Requiring written acceptance could create practical problems, and would pose risks where an appointed trustee has assumed the office and begun dealing with trust property but without formal written acceptance.
- 6.13 Option (c) also creates risks. It could lead to liability being imposed on a person who had no intention of accepting the trusteeship.
- 6.14 There may be rare cases where an appointed trustee intends to accept but does not communicate this intention within the required time and is therefore considered to have rejected. In our view this is a less problematic and more easily remedied outcome than the risk of imposing duties on a trustee who does not intend to accept the office.

WHO MAY BE APPOINTED AS A TRUSTEE?

Proposal

- P22 (1) New legislation should restrict appointment based on capacity to be a trustee. The following categories of persons will be precluded from appointment as a trustee:
- (a) a person under 18 years of age;
 - (b) an undischarged bankrupt;
 - (c) a person who is subject to a property order made under section 31 of the Protection of Personal and Property Rights Act 1988 or a person for whom a trustee corporation is acting as manager under section 32 or 33 of that Act; and
 - (d) a corporation which is in receivership or in liquidation; and
- (2) provide that any natural person or body corporate may be a trustee unless one of the grounds above applies.

Please give us your views on this proposal.

Current law

- 6.15 Under case law, any person with legal capacity to hold property may be appointed as a trustee. This includes the settlor, and any of the beneficiaries. The only restriction is that there will not be a valid trust if the sole trustee is also the sole beneficiary, because legal and beneficial ownership will exist in the same person.¹⁶⁶

Issues

- 6.16 The issue is whether there should be any restrictions on who may be a trustee, and if so, the content of these restrictions. The *Fourth Issues Paper* invited comments as to whether there should be restrictions on appointment as a trustee for reasons such as bankruptcy or conviction of a criminal offence. It also asked whether the list of precluded appointments should mirror the grounds for removal.

Options for reform

- 6.17 In developing options, we drew a distinction between restrictions based on capacity and restrictions based on suitability. Some persons have limited capacity to deal with property or enter into contracts, for example persons under the age of 18 years, undischarged bankrupts (who because of this status cannot hold property), companies which are in liquidation, and persons subject to a property order under the Protection of Personal and Property Rights Act 1988 (PPRA). Irrespective of their suitability for office, such persons are not able to function effectively as trustees because of their limited capacity to deal with property. In contrast, other factors, such as a history of dishonesty offences, do not affect a person's capacity to deal with property, but may raise doubts about the person's suitability.
- 6.18 The options considered are:
- (a) restricting the appointment of trustees based on capacity;
 - (b) restricting the appointment of trustees based on capacity and suitability; and
 - (c) not restricting the appointment of trustees at all.

Discussion

- 6.19 Most submitters considered that there was merit in trusts legislation specifying categories of persons who could not be appointed as trustees, and that the grounds for removal from office and disqualification from appointment should reflect one another more closely. Most also considered that the categories of prohibited trustees should be strictly limited. There was general support for:

¹⁶⁶ *Re Heberley* [1971] NZLR 325 (CA) at 333 and 346; *Re Cook, Beck v Grant* [1948] 1 All ER 231 (Ch) at 232.

- including under 18 year olds as a prohibited category which could not be overridden by the trust deed; and
 - legislating for a closer match between the categories of person who cannot be appointed as trustee, and the circumstances in which trustees may be removed.
- 6.20 Our preferred approach is to impose restrictions based on capacity, but not based on suitability. Persons who lack full capacity should not be able to be appointed as trustee. Any purported appointment should be invalid. P22 should be read together with P23, which addresses grounds for removal of a trustee. Some submitters favoured a fuller list that also precluded appointments based on suitability. Some proposed a list similar to that contained in the Companies Act 1993 in relation to directors' qualifications. We have considered the argument that the office of a trustee requires the utmost good faith, good judgement, and honesty, and that this justifies restrictions to prevent persons who demonstratively lack these characteristics from being appointed. Arguments for exclusion on suitability grounds are stronger in the abstract than in application. It is difficult to draw principled grounds for excluding someone from acting as a trustee on the basis of past behaviour. For example, a category such as "dishonesty offences" includes even relatively minor instances of theft, which a settlor may not consider to be sufficiently serious to cast doubt on the responsibility of the proposed trustee and his or her ability to manage property. The inclusion of persons who are "mentally disordered" under the Mental Health (Compulsory Assessment and Treatment) Act 1992 might extend to persons who are entirely capable of managing trust property, depending on the nature of mental disorder.¹⁶⁷ A mandatory prohibition would also preclude such people from acting as trustees of trusts which they themselves settle for the benefit of their families.
- 6.21 While some trusts are commercial arrangements with a public element, many are strictly private. It is difficult to justify restrictions around suitability also because there may be valid reasons for a settlor choosing to appoint a trustee with a criminal record or previous involvement in failed companies. There is an element of subjectivity in judgements about suitability. We consider that these are best left to the settlor rather than imposed through legislation.
- 6.22 We consider that settlor autonomy is an important principle, but it does not extend to restrictions based on a lack of legal capacity. Precluding persons who do not have full capacity is a corollary of the nature of the office of a trustee and should not be viewed as a fetter on the settlor's discretion.

¹⁶⁷ The inclusion of this category in the Eden Park Trusts Amendment Bill 2009 was subject to a report by the Attorney General under s 7 of the Bill of Rights Act 1990 which held that this constituted unjustifiable discrimination on the basis of disability and was not sufficiently linked to capacity to be a trustee.

- 6.23 Corporate trustees raise their own issues. The preferred approach is to prevent a company from being appointed as a trustee if it is in liquidation or receivership. Further restrictions have been considered, including if the company is under statutory management or has entered into a compromise with creditors or does not satisfy the solvency test. There is a risk that these companies will be unable to meet financial liabilities to beneficiaries if loss is caused to the trust, and may be unable to meet liabilities to creditors of the trust. They may also be used as a means to avoid the responsibilities of trusteeship, or to avoid responsibilities to creditors. Some of these issues are addressed in more detail in chapter 8. We also propose, below, an expanded set of grounds for the removal of corporate trustees.

REMOVAL OF A TRUSTEE

Proposal

- P23 (1) New legislation should impose a duty on persons with the power to appoint and remove trustees to remove a trustee when the trustee is incapacitated and becomes subject to either an enduring power of attorney in relation to property or a property order, or has a trustee corporation appointed to act as a manager under the Protection of Personal and Property Rights Act 1988.
- (2) New legislation should provide that the court, or those with the power to appoint and remove trustees may, if it is desirable for the proper functioning of the trust, remove a trustee and appoint a replacement in the following circumstances:
- (a) the trustee refuses to act, fails to act, or wishes to be discharged from office;
 - (b) the trustee, being a corporate trustee, enters into receivership, enters into liquidation, ceases to carry out business, is dissolved, enters into a compromise with creditors under Part 14 of the Companies Act 1993, enters into voluntary administration under Part 15A of that Act, or does not satisfy the solvency test as defined in section 4 of the Companies Act;
 - (c) the trustee is no longer suitable to continue to hold office as a trustee because of circumstance or conduct, including but not limited to when the following occurs:
 - (i) the whereabouts of the trustee becomes unknown and the trustee cannot be contacted;
 - (ii) the trustee is not capable of fulfilling his or her duties by reason of sickness or injury;
 - (iii) the trustee is adjudged bankrupt;
 - (iv) the trustee is convicted of a dishonesty offence;

- (v) the trustee becomes precluded from serving as a director under the Companies Act 1993 because of a breach of that Act or the Securities Act 1978;
 - (vi) the trustee is held by the court to have misconducted himself or herself in the administration of the trust; or
 - (vii) the trustee, being a lawyer, accountant or financial adviser, is found to have materially breached the applicable ethical standards of that profession.
- (3) New legislation should retain the court's general discretion to remove trustees if expedient, in order to capture circumstances which may not be foreseen and may not be included in the grounds for removal above.

Please give us your views on this proposal.

Current law

- 6.24 Section 51 of the Trustee Act provides a list of specific circumstances in which the court may replace an existing trustee. The circumstances are where the trustee:
- (a) has been held by the court to have misconducted himself in the administration of the trust; or
 - (b) is convicted, whether summarily or on indictment, of a crime involving dishonesty as defined by section 2 of the Crimes Act 1961; or
 - (c) is a mentally disordered person within the meaning of the Mental Health (Compulsory Assessment and Treatment) Act 1992, or whose estate or any part thereof is subject to a property order made under the Protection of Personal and Property Rights Act 1988; or
 - (d) is a bankrupt; or
 - (e) is a corporation which has ceased to carry on business, or is in liquidation, or has been dissolved.
- 6.25 Section 43 states that the person nominated by the trust deed for the purpose of appointing new trustees, or the surviving or continuing trustees, or the personal representative of the last surviving or continuing trustee, may appoint a replacement trustee in limited circumstances (in addition to their powers contained in the trust deed). The circumstances are if the trustee being replaced:
- (a) is dead; or
 - (b) remains out of New Zealand for the space of 12 months during which no delegation of any trusts, powers, or discretions vested in him as such trustee remains in operation under section 31; or
 - (c) desires to be discharged from all or any of the trusts or powers reposed in or conferred on him; or

- (d) refuses to act therein; or
 - (e) is unfit to act therein; or
 - (f) is incapable of so acting; or
 - (g) being a corporation, has ceased to carry on business, is in liquidation, or is dissolved... .
- 6.26 There is some case law on the meaning of the terms “unfit to act” and “incapable of acting”. However, there remains ambiguity and these terms may not provide sufficient guidance to persons wishing to exercise a power under section 43.¹⁶⁸
- 6.27 The court has the jurisdiction to remove trustees and appoint new trustees. This is a general discretion to be exercised when the removal of an existing trustee and appointment of a new trustee is expedient (that is, desirable to ensure the proper working of the trust). This covers situations such as a conflict of interest or an irreconcilable disagreement between the trustee and the beneficiaries or any other situation where a new trustee is necessary for the proper functioning of the trust.¹⁶⁹

Issues

- 6.28 There are a number of issues with the way that sections 51 and 43 operate. These sections are neither aligned nor clearly differentiated, which causes confusion and a lack of clarity about the circumstances in which a trustee may be removed without recourse to the court. Some of the court’s specific powers of removal, for example the power to remove a bankrupted trustee, have been held to come within the broad power under section 43 to remove a trustee who is “unfit to act.”¹⁷⁰
- 6.29 The overarching questions are which circumstances warrant the removal of a trustee and whether there should be mandatory or default provisions included in the statute.

Options for reform

- 6.30 The options considered were:
- (a) including a mandatory list of grounds for removal in a new Act;
 - (b) including a discretionary list of grounds for removal in a new Act;

168 For a discussion of the case law, refer to the *Fourth Issues Paper*, above n 164, at [4.14]–[4.15].

169 *Re Roberts* (1983) 70 FLR 158; *Mendelssohn v Centrepont Community Growth Trust* [1999] 2 NZLR 88 (CA); *Kain v Hutton* CA23/01, 25 July 2002.

170 Andrew S Butler “Trustees and Beneficiaries” in Andrew S Butler (ed) *Equity and Trusts in New Zealand* (2nd ed, Thomson Reuters, Wellington, 2009) 105 at 114 [*Equity and Trusts*], citing *Re Wheeler and De Rochow* [1896] 1 Ch 315 and *In re Hopkins* (1881) 19 Ch D 61 (Ch).

- (c) not including statutory provisions on removal. The inherent court discretion to remove trustees when expedient would remain, and other removal powers could be contained in the trust deed; and
- (d) a combination of the above options.

Discussion

- 6.31 Submitters expressed widespread support for:
- retaining a default list of the grounds for removal by continuing trustees or those with the power to appoint and remove trustees under a trust deed;
 - defining “unfit” and “incapable” more precisely to provide greater guidance to persons exercising this power and to prevent these provisions from being abused;
 - amending the current grounds of removal to provide that remaining overseas should not be a default ground for removal; and
 - aligning section 43 more closely with section 51.
- 6.32 Most submitters considered that there was merit in trusts legislation specifying categories of persons who may be removed from office. However, the ADLS considered that the grounds for removal should be able to be overridden by the trust deed. Most also considered that the categories of prohibited trustees should be strictly limited. There was concern that if the list was too broad, then continuing trustees or those with the power of appointment could use the threat of removal to coerce a dissenting trustee into agreeing with a course of action they oppose. Submitters all agreed that the court should retain the discretion to remove and replace trustees in other circumstances where necessary or desirable to ensure the proper administration of the trust, such as when a trustee is not properly carrying out his or her functions.
- 6.33 We favour an approach that includes elements of the different options presented above. We propose that persons with the power to remove and replace trustees should have a duty to remove a trustee who loses capacity to deal fully with property because of a personal property order or the appointment of a property manager. The legislation would also provide a list of grounds for removal on a discretionary basis under an updated and modernised form of section 43, which should be redrafted to provide clearer guidance. Bankruptcy, liquidation, and receivership should be included among these grounds, as well as other factors that call into question the trustee’s suitability.
- 6.34 We have considered the option of mandatory removal when the grounds are made out. We consider this is not appropriate for two reasons. First, this would impose additional duties on the person with the power to remove and replace trustees. Second, there may be situations where one of the grounds is made out but it is not in the interests of the trust for the trustee to be

removed because of the particular circumstance of the trust. For instance, this may be appropriate where a trustee is incapacitated due to sickness, but is likely to recover shortly or where the trustee for property not requiring active management is bankrupted, but no suitable replacement is willing to take over the trusteeship.

- 6.35 We have also discounted the option of leaving removal provisions to the trust deed. Not all trust deeds grant someone the power of appointing and removing trustees, yet there are some circumstances where a trustee should be removed without requiring an application to the court. Section 43 is useful, as it avoids court processes and assists in the efficient removal and replacement of trustees. Most trust deeds currently in effect would have been drafted on the assumption that an express power to remove a trustee in certain circumstances exists under the legislation. Reverting to an approach which requires greater specificity in the trust deed would therefore cause complications for these trusts, while having different rules for trusts established at different dates would not simplify the legislation as we aim to do.
- 6.36 The list proposed retains a broad power of removal when a trustee is no longer suitable to hold office, but differs from the status quo by removing the vague and problematic terms “unfit” and “incapable”. Legislation would provide a list of circumstances that meet the broad criteria, to guide the exercise of discretion.¹⁷¹ In formulating this approach, we have attempted to provide robust guidance that is flexible enough to apply in unforeseen situations.
- 6.37 The expanded grounds would allow for removal of a corporate trustee that is facing financial difficulties. As with the other discretionary grounds, the trustee should be removed only if this is desirable for the proper functioning of the trust. The statutory grounds for removal would not be able to be overridden, but the trust deed will be able to include further grounds or greater detail to guide the exercise of discretion.
- 6.38 The court would retain its inherent power to remove trustees when expedient. This would be available where there is an irreconcilable breakdown between trustees, or where there is a conflict of interest or the trustees are out of sympathy with the beneficiaries, or some other situation which undermines the effective operation of the trust and requires the court to intervene.
- 6.39 The discretionary list would apply to removal by a person with the statutory power to do so, or removal by the court, for example on the application of a beneficiary. This would achieve greater alignment between sections 43 and

¹⁷¹ The power of removal would apply to established situations that currently fall under the headings “unfit” (such as dishonesty offence convictions and misconduct in trust administration), and “incapable” (trustees not capable of fulfilling their duties, for instance, because of sickness or injury).

51. The list would provide clarity on when a trustee can be removed, but would not need to be completely comprehensive, as other matters could be specified in the trust deed or used by the court.

RETIREMENT

Proposal

P24 New legislation should provide that:

- (1) if a trustee wishes to be discharged from office, he or she may be removed by deed by those with the power to do so.
- (2) if a trustee wishes to be discharged from office but those with the power to remove and appoint trustees explicitly refuse to execute the removal document, the trustee must apply to the court.
- (3) if a sole trustee wishes to be discharged from office and there is no-one with the power to remove and appoint trustees under the trust deed, the following process for retirement will apply:
 - (a) the trustee who wishes to retire will first select one or more suitable persons as a replacement trustee(s) and notify all adult vested beneficiaries (where it is reasonable to do so), or a reasonably representative sample of beneficiaries, of the person(s) selected;
 - (b) beneficiaries notified will have 20 working days in which to object to the replacement chosen;
 - (c) if no beneficiaries object, the trustee who wishes to retire will then apply to the Public Trust to confirm that beneficiaries have been given due notice of the replacement selected, and that the trust accounts are in order;
 - (d) if due notice has been given and the accounts are in order, the retiring trustee may be discharged and the replacement appointed through a deed executed jointly by the trustee being removed and the trustee being appointed;
 - (e) if the beneficiaries object to the replacement selected or if the accounts are in disarray, removal by deed will not be available and an application to the court will be necessary.
- (4) The legislation should authorise the Public Trust to set reasonable costs for the services provided.

Please give us your views on this proposal.

Current law

6.40 The Trustee Act provides four ways for a trustee to retire. Most commonly, a trustee who wishes to be discharged will be removed and replaced under section 43 by someone with the power under that section. A trustee may also retire by deed with the consent of co-trustees or those with the power to appoint trustees (section 45). If co-trustees do not consent, or if there are

no co-trustees, then a trustee may retire by “passing his accounts before the Registrar” of the High Court (section 46). The provisions under section 46 are seldom used, possibly because it is unclear what passing one’s accounts before the Registrar requires. If, in this situation, there is no-one able or willing to appoint new trustees, the retiring trustee may apply to the court for the appointment of a new trustee. This is particularly likely to be used for the retirement of sole trustees, who may not be empowered to appoint a replacement. Alternatively, a trustee could retire by applying under section 51 for the court to make a new appointment in replacement, if expedient.

Issues

6.41 There are three major concerns that reform should address:

- The current process is generally unclear, and does not operate as an effective statutory default. We have been told that many modern trust deeds do not rely on the statutory provisions and instead include a process for retirement and appointment of replacement trustees.
- In some situations, there may be valid reasons for those with a power to appoint and remove trustees not to discharge a trustee who wishes to retire, such as when the trustee seeks to retire because the trust has been poorly managed and they wish to avoid potential liability. However, there is no reasonableness requirement for withholding consent, and this may pose an obstacle to efficient removal and replacement. Conversely, a trustee could currently be discharged without consent by applying to the Registrar of the High Court, even when this is not in the best interests of the trust.
- A court application is necessary where the retiring trustee is a sole trustee and the trust deed does not grant anyone the power to remove and appoint trustees. This causes unnecessary expense and takes up the court’s time for an essentially administrative matter.

Options for reform

6.42 The options considered were:

- (a) including “that the trustee wishes to be discharged from office” as one of the possible grounds for removal;
- (b) providing a separate process for retirement that requires the consent of co-trustees and the person with the power to appoint and remove trustees; and
- (c) providing that a trustee may unilaterally retire provided that notice is given to the co-trustees and the person with the power to appoint and remove trustees, and provided that the property is transferred.

Discussion

- 6.43 Submitters expressed support for improving the process under section 46 or creating a new, less expensive process for the retirement of trustees. Many submitters also noted that there could be substantial drafting improvements to this part of the statute, and that some of the problems could be partially remedied by more accessible and clear language. We were also informed that a major issue to be addressed is the transfer of assets when a trustee retires.
- 6.44 KPMG noted that a trustee retains tax liability until the Inland Revenue is notified of the trustee's resignation. The TCA and Greg Kelly Law noted that section 45 is of limited use because of the requirement for consent, and section 46 is of limited use because of the expense of a High Court application.
- 6.45 Our preferred approach is to simplify the process for retirement and align it more closely with general provisions for removal. We therefore propose to include "wishes to be discharged from office" in the list of grounds for removal. It would not be mandatory to remove a trustee who wishes to be discharged. This would be left to the judgement of the person with the power to appoint and remove trustees. If a trustee wishes to retire but the person with the power to remove trustees refuses to discharge the trustee from office, the trustee will need to apply to the court. We consider that this is necessary to protect against a trustee abandoning a mismanaged trust without the consent of their co-trustees or the person with the power to remove and appoint trustees. When a trustee retires, the co-trustees or those with a power to appoint would wish to make sure that the trust is in order and need to carefully select a new trustee. Allowing unilateral resignation may disrupt the organisation of the trust.
- 6.46 The preferred approach is consistent with the most commonly used approach to the replacement of trustees wishing to retire, which has the advantage of familiarity. While there is a conceptual distinction between removal and voluntary discharge, we consider that the simplest option is to have one process for removal regardless of the grounds.
- 6.47 We have considered the option of allowing a trustee to retire unilaterally. This would remain available if the trust deed gives the retiring trustee the power to appoint their own replacement. However, we consider that as a statutory default, this approach may enable trustees to retire in inappropriate circumstances as an attempt to avoid liability for trust mismanagement. On the other hand, in most cases a court application would be unnecessarily complex and expensive. The preferred approach is designed to allow removal without court supervision unless there is disagreement.
- 6.48 If a sole trustee wishes to retire and there is no-one with the power to remove and appoint trustees, the sole trustee would be able to appoint their own replacement by deed provided that the accounts are in order and there is no objection from beneficiaries. Our preferred approach is to give the Public Trust a supervisory role in this process. This would be an alternative to a court application, and could only be used if the trust affairs were in order and

the retiring trustee has selected a replacement and complied with the notice provisions.

- 6.49 The role of the Public Trust would be to review the accounts of the trust and the process by which the replacement has been selected, and confirm that the beneficiaries have been given notice of the replacement chosen and have been given the opportunity to object. The Public Trust should be empowered to set a fee for this service. If the beneficiaries object to the replacement, or if the accounts are in disarray, the trustee who seeks to retire would need to apply to the court.
- 6.50 Notifying beneficiaries of the intended appointment and enabling beneficiaries to challenge a proposed new appointment would provide a safeguard to ensure that contentious cases receive court supervision. It will also prevent the unnecessary costs and delays of a court application in non-contentious cases. Consistent with P16(g) in chapter 4, a “reasonably representative sample of beneficiaries” has been proposed as the way of determining which the beneficiaries should be informed if it is not practical and reasonable to contact all adult vested beneficiaries. This provides a workable category of beneficiaries that the trustee can contact.

WHO MAY REMOVE A TRUSTEE AND APPOINT A REPLACEMENT?

Proposal

P25 New legislation should:

- (1) provide a hierarchy of persons with the power to remove and appoint trustees by deed when the grounds under the legislation are met:
 - (a) the person nominated for the purpose of appointing new trustees by the deed creating the trust; or if none, or if unavailable or unwilling to make a decision;
 - (b) the surviving or continuing trustees; or if none, or if unavailable or unwilling to make a decision;
 - (c) the personal representative of the trustee being removed;
- (2) define “personal representative of the trustee being removed” to include the following persons:
 - (a) the executor or administrator of a trustee who died while in office;
 - (b) a property manager appointed over the trustee under the Protection of Personal and Property Rights Act 1988;
 - (c) the holder of an enduring power of attorney over property of an incapacitated trustee; and
 - (d) the liquidator of a corporate trustee who enters into liquidation;
- (3) provide that if the personal representative of the trustee being removed is undertaking the removal, the following process for removal will apply:

- (a) the personal representative will select one or more suitable persons as a replacement trustee(s) and notify all adult vested beneficiaries (where it is reasonable to do so), or a reasonably representative sample of beneficiaries, of the person(s) selected;
 - (b) beneficiaries notified will have 20 working days in which to object to the replacement chosen;
 - (c) if no beneficiaries object, the personal representative will then apply to the Public Trust to confirm that beneficiaries have been given due notice of the replacement selected, and that the trust accounts are in order;
 - (d) if due notice has been given and the accounts are in order, the trustee may be discharged and the replacement appointed through a deed executed by the personal representative;
 - (e) if the beneficiaries object to the replacement selected or if the accounts are in disarray, removal by deed will not be available and the personal representative will be required to apply to the court to remove the trustee and appoint a replacement. The court will be able to make any other necessary directions about the management of the trust;
- (4) empower the Public Trust to provide the personal representative or liquidator of the trustee being removed with advice as to the process for the selection of a replacement, and enable the Public Trust to set reasonable costs for the services provided.

Please give us your views on this proposal.

Current law

- 6.51 The following persons may remove a trustee under section 43 of the Trustee Act:
- the person nominated for the purpose of appointing new trustees under the trust deed;
 - the surviving or continuing trustees; and
 - the personal representatives of the last surviving or continuing trustee.

Issues

- 6.52 In most cases, continuing trustees or someone with the power to appoint or remove trustees under the trust deed will be able to remove trustees where necessary. However, issues may arise where there is no such person, or where they are unavailable. This would be a particular problem if a sole trustee becomes subject to a property order or a corporate trustee enters into liquidation.

Options for reform

- 6.53 The options are:
- (a) empowering the holder of an enduring power of attorney or the property manager of a trustee being removed, or the liquidator of a corporate trustee, to remove a trustee if no-one else is available;
 - (b) imposing a duty on these persons to apply to the court for removal; and
 - (c) retaining the list as it currently stands.

Discussion

- 6.54 Most submitters expressed support for including liquidators of corporate trustees in the category of persons who can remove and replace a trustee. Those in support argued that this would avoid the costs of court proceedings that might otherwise be necessary. Those opposed considered that there was no basis for giving this power to the liquidator. The NZLS noted that there may be issues with a conflict of interest arising from the trustee's right of indemnity against the trust assets and that the liquidator should therefore be entitled to seek direction from the court.
- 6.55 Some submitters supported including those with an enduring power of attorney or property managers under the PPPRA in the category of persons who can remove and replace a trustee. They considered that it would be helpful as it would avoid court proceedings that might otherwise be necessary. The Ministry of Social Development (MSD) was not in favour because they considered that the role of the property manager or holder of an enduring power of attorney is to look after the incapacitated person's personal affairs. The property manager or attorney owes specific duties to the person who is unable to manage their own property; and it is not appropriate to extend the role of these personal representatives and impose duties in respect of a trust.
- 6.56 There are practical advantages in allowing a personal representative to remove a trustee in some circumstances. However, there are also risks in this approach and it is important that these are adequately addressed.
- 6.57 The removal of a sole trustee who is subject to a property order or for whom a trustee corporation has been appointed to act as a property manager is likely to raise particular issues, as these trustees may be unable to participate meaningfully in their own removal. The obvious person to remove a trustee if there is no-one else available is the personal representative of the trustee being removed, whether the holder of an enduring power of attorney or a court appointed property manager. Adding these categories would prevent the need for court proceedings to remove a trustee in non-contentious cases, and thereby reduce the costs to the trust and the risk that the trustee may continue in office despite the incapacity. We consider that these representatives would be in good position to remove the trustee and appoint a replacement because they would already be familiar with the affairs of the trustee being removed.

- 6.58 Despite the points made by the MSD, our view is that the power to remove the trustee is consistent with the existing roles of these personal representatives. The power to appoint new trustees is an extension of the role. It is consistent with the current approach of allowing the personal representative of a deceased trustee to appoint a replacement. Given that these issues only arise if there is a sole trustee in office and no-one with the power to appoint and remove trustees, the personal representative of the trustee is likely to have some level of involvement, and may be the only person aware of the situation and competent to act. If the property manager fails to remove the trustee, it will put the incapacitated trustee at risk of liability, something from which a property manager is required to protect the trustee.
- 6.59 Supervision by the Public Trust under the proposal would follow a similar process to that provided when a sole trustee retires. The Public Trust will be empowered to advise the personal representative as to the process and factors which should be considered in selecting a suitable replacement trustee. The personal representative will select a replacement and notify beneficiaries of the proposed appointment. If no beneficiaries object, the personal representative would then apply to the Public Trust to confirm that the notice provisions have been complied with and the accounts are in order. The personal representative will then execute the removal and replacement from office by deed.
- 6.60 If the Public Trust determines that the accounts are in disarray or if the beneficiaries object to the proposed appointment, the personal representative will need to apply to the court to approve the appointment. The court will also be able to make other necessary orders in respect of the trust, for example directing the newly appointed trustee to undertake an independent audit.

EXERCISE OF POWER TO APPOINT TRUSTEES

Proposal

P26 New legislation should:

- (1) impose a duty of good faith and honesty on those exercising a power to remove and appoint trustees, whether the power is exercised under statute or under the trust deed. This will apply to the decision to remove a trustee, and the selection of a replacement or the decision not to replace the trustee, as the case may be;
- (2) provide that the court may remove and replace someone with the power to appoint trustees under the trust deed if that person breached the duty of good faith, or if that person has been removed in their capacity as a trustee, or if otherwise expedient; and
- (3) provide that a person with the power to appoint trustees would be entitled to apply to the court for directions in the exercise of that power, for example if there was a perceived conflict of interest.

Please give us your views on this proposal.

Current law

- 6.61 The court has held that a person with the power to appoint trustees is subject to fiduciary duties,¹⁷² and on this basis has ordered their removal and replacement. Whether the duties will be imposed depends on the terms of the trust deed. There is no statutory provision clarifying when these duties will be imposed, and those exercising the power may not be aware of the case law. It has been argued that persons with the power to appoint and remove trustees are subject to a case law duty of good faith; however this has not been settled by the courts.¹⁷³

Issues

- 6.62 The power to appoint and remove trustees is of increasing importance. Sometimes this power is retained by the settlor to keep a final level of control over the trust.
- 6.63 There are questions regarding the appropriate bounds of this role, in particular, whether those exercising a power to appoint trustees (either under the trust deed or legislation) should be subject to any of the core fiduciary duties; and whether the court should be able to remove and appoint someone with the power to remove and appoint trustees under the trust deed.
- 6.64 Problems have arisen in relationship property claims where both parties to the relationship are trustees of a family trust, but only one party has the power to remove and appoint trustees under the trust deed.¹⁷⁴ The party with the power of appointment and removal is able to remove the other party as a trustee and acquire the full management of the trust. This would be an example of the wrongful exercise of the power, but it is unclear how much the courts are able to intervene, as duties on the person with the power of appointment and removal will depend on the wording of the trust deed.
- 6.65 There is also a lack of clarity as to whether persons exercising a statutory power to remove and appoint trustees are subject to any fiduciary duties. This is relevant to questions of liability. It is not clear for example whether a personal representative of a deceased trustee will be liable for appointing an unsuitable replacement.

172 *Carmine v Ritchie* [2012] NZHC 1514 at [66]; David Hayton, Paul Mathews and Charles Mitchell (eds) *Underhill and Hayton: Law Relating to Trusts and Trustees* (17th ed, LexisNexis Butterworths, Bath, 2006) at [73.11].

173 Andrew S Butler “Trustees and Beneficiaries” in Butler (ed) *Equity and Trusts*, above n 170, at 112–113.

174 These issues were the background to the case of *Kilkelly v Arthur Watson Savage Legal* HC Invercargill CIV-2006-425-148, 23 July 2007.

Options for reform

- 6.66 The options considered were:
- (a) imposing a specific set of duties, such as the duty of impartiality between the beneficiaries, a duty to adhere to the terms of the trust, and a duty not to profit from the office;
 - (b) imposing a general duty of good faith; or
 - (c) leaving any duties to be imposed to the trust deed.

Discussion

- 6.67 Submitters supported clarifying in legislation that the court has a supervisory jurisdiction over those with the power to appoint and remove trustees. They expressed support for enabling the court to remove and replace an appointer. Taylor Grant Tesiram suggested that the power to appoint and remove trustees should be removed automatically from a trustee who holds that power if the trustee is removed by the court on grounds of misconduct.
- 6.68 We consider that the best option would be to impose a general duty of good faith on those exercising the power to remove and appoint trustees, whether under statute or under the trust deed. We favour this option because it is flexible enough to address the broad range of circumstances that may arise, and does not impose onerous duties on personal representatives exercising the power of appointment and removal.
- 6.69 This approach is based on the principle that persons with a role of authority and power within a trust structure should be subject to duties to the trust. If there are no duties imposed on the person with the power to appoint and remove a trustee and the court has no power to remove such a person, then there is no check on the exercise of this power. This could lead to abuses of power or improper administration of the trust.¹⁷⁵
- 6.70 We considered whether further specific duties should be imposed. In our view this is not necessary. The power to appoint and remove trustees depends on the exercise of discretion. If the discretion is exercised in good faith, there is no need for a higher standard. This approach does not preclude further duties being imposed through the trust deed.

175 See for example *Re The CP Clifton Children's Trust* HC Auckland CIV-2004-404-4185, 5 November 2004, in which the general power to alter the trust deed was used to address these issues.

NUMBERS OF TRUSTEES

Proposal

P27 New legislation should:

- (1) allow trustees to be removed without being replaced provided that this is in the best interests of the trust, taking account of the suitability of remaining trustee(s), and other relevant circumstances;
- (2) leave minimum number provisions to the trust deed, rather than including a statutory default;
- (3) provide that a sole trustee may be appointed at the outset and that if a sole trustee is removed or dies in office, he or she must be replaced, and may be replaced with more than one replacement trustee unless the trust deed provides otherwise; and
- (4) prevent the circumventing of the rules on minimum numbers of trustees contained in a trust deed by providing that as a matter of interpretation, a trust deed which requires two or more trustees will be taken to mean two or more persons exercising independent judgement. For the avoidance of doubt, the legislation could provide that any two natural persons will be considered to be exercising independent judgement.

Please give us your views on this proposal.

Current law

- 6.71 The Trustee Act does not impose a minimum number of trustees. This is left to the trust deed. However, there are some provisions which combine to create ongoing minimum number requirements if more than one trustee was appointed in the initial appointment:
- a trustee must not be removed without being replaced under the statutory power of removal unless two trustees or a trustee corporation remains in office (section 43(2)(c)); and
 - a retiring trustee will not be discharged from duties unless two trustees or a trustee corporation remains in office (section 43(2)(c)).
- 6.72 In effect this means that there is a default minimum requirement of two trustees on an ongoing basis unless the initial appointment was a single trustee, or if one of the statutory trustee corporations is appointed.
- 6.73 The court does not have a specific statutory power to remove a trustee without appointing a new one, although arguably this power is within the court's inherent supervisory jurisdiction.

Issues

- 6.74 The minimum number rules are not explicit and the provisions are not well understood. We have been advised that there is a widespread misconception

that the trustee corporation exception applies to any corporate trustee, though the section only applies to a statutory trustee corporation. The issue is whether there should be a statutory default minimum number of trustees, and if so, how this should be applied. A related question is whether a trustee should be able to be removed without being replaced.

Options for reform

- 6.75 The options considered were:
- (a) imposing statutory minimum number rules and allow a trustee to be removed without being replaced provided that these requirements are met; or
 - (b) allowing a trustee to be removed without being replaced provided that any minimum number rules in the trust deed are met.

Discussion

- 6.76 The options above were not presented in the *Fourth Issues Paper*. However, submitters were invited to respond to a question on the court's power to remove trustees without replacement. Submitters expressed qualified support for allowing the court to remove a trustee without appointing a replacement, but some noted that it should be subject to the trust deed and to the court's assessment of the suitability of remaining trustees.
- 6.77 The preferred approach would allow for the removal of a trustee without replacement, provided that this is consistent with the trust deed and in the best interests of the trust. It would enable the replacement of trustees where necessary but will not require a removed trustee to be replaced in every instance. Determining whether or not to appoint a trustee in replacement should be done on a discretionary basis subject to an assessment of the suitability of remaining trustee(s) and the best interests of the trust. This decision would also be subject to the overall duty of good faith to be imposed on those exercising the powers of removal and appointment.
- 6.78 The new provision would be a statutory default and could be overridden by a contrary intention expressed in the trust deed. New legislation should not contain a statutory default minimum number rule for the initial appointment or subsequent appointments. We consider that this is unnecessary and would simply complicate existing arrangements that have only one trustee. It should continue to be possible for a settlor to appoint a sole trustee at the time that a trust is established. If a sole trustee is removed it should be possible to appoint more than one trustee in replacement.
- 6.79 We also propose clarifying that if a settlor provides in the trust deed that there should be two or more trustees on an ongoing basis, this should be interpreted as requiring two persons who are able to exercise independent judgement. Under this approach, appointing two related companies, or a natural person together with a company of which they are a director, would not comply with a requirement that there be a minimum of two trustees. We consider

that it would be useful to clarify this point, taking into account the increased prevalence of corporate trustees.

TRANSFER OF TRUST PROPERTY

6.80 The proposals on the transfer of trust property when a trustee is removed include some new elements, such as the role of the Public Trust, that were not explored in our *Fourth Issues Paper*. We are particularly interested in receiving comments on these elements.

Proposal

P28 New legislation should:

- (1) impose a duty on a departing trustee to transfer property to the continuing trustee;
- (2) provide that a trustee shall be divested of all trust property if validly removed from office (including through death or voluntary discharge), and provide that the trust property shall vest in the continuing trustee(s);
- (3) empower the Public Trust to issue a statutory certificate of vesting confirming that the deeds which remove the departing trustee and appoint the continuing trustee(s) have been validly executed, if trust property has not been otherwise transferred by the departing trustee;
- (4) provide that the statutory certificate of vesting shall be sufficient and complete proof of change of ownership of property, and:
 - (a) must be accepted as complete documentation under section 99A of the Land Transfer Act 1952; and
 - (b) must be accepted as proof of transfer of any other registered interest recorded in a register under New Zealand law;
- (5) require that after the deed of removal has been executed, 20 working days' notice must be given to the departing trustee from whom title is being transferred before the statutory certificate of vesting may be issued. If the departing trustee objects to the issuing of a certificate within the 20 day period the Public Trust will not be able to issue the vesting certificate and the continuing trustee(s) must instead apply to the court. However, a vesting certificate that has been issued will not be ineffective for failure of the notice provisions;
- (6) provide that the departing trustee must be given the documents demonstrating that the property is no longer in his or her name once transfer and registration have been completed (for example, a copy of the certificate of title);
- (7) provide that a registry that transfers property in reliance on a statutory vesting certificate is not liable for any loss caused as a result of the transfer of property;
- (8) provide that the Public Trust may refuse to grant a vesting certificate when the property arrangement is complex or it is not clear whether the trustee

was properly removed, in which case the continuing trustee(s) must apply to the court for a transfer order; and

- (9) enable the Public Trust to set reasonable costs for issuing a statutory vesting certificate.

Please give us your views on this proposal.

Current law

- 6.81 The transfer of property when a trustee is removed is addressed in sections 43, 47, 52, 57 and 59 of the Trustee Act. Section 47 provides that a deed of appointment or discharge operates to vest trust property. However, this section does not apply to many forms of property, including land under the Land Transfer Act 1952 (almost all land in New Zealand), or to any shares or stocks that are transferable only in books kept by a company or other body. This means that transfers of trust property will often be necessary, despite existing vesting provisions.
- 6.82 Under section 52, the court can make an order vesting land or an interest in land in certain circumstances, such as where the trustee has been appointed by the court or where the trustee is a corporation that has ceased to carry out business. There is a similar provision under section 59 relating to the transfer of stocks and other intangible property, such as securities. Under section 57, a vesting order takes effect as if the property had been transferred by the previous trustee. Land interests must still be registered, and a copy of the order must be provided to the Registrar and entered on the register before it will take effect in vesting or transferring the interest.

Issues

- 6.83 Based on comments in submissions, it appears that the current provisions work well for non-registered property interests, but there are issues in relation to the transfer of registered interests. The concern arises from a lack of clarity as to what documentation is required to transfer a registered interest without the involvement of the transferring owner. Registries are properly concerned to protect against wrongful transfer; however, different requirements for different registries can cause administrative problems for trusts. It can also cause difficulties for the registries in question, which would be potentially exposed to liability for a wrongfully executed transfer in the absence of a clear statutory process on which to rely.
- 6.84 A court order addresses these issues, but has its own problems due to cost, delays, and a perceived inaccessibility for lay trustees. It is also questionable whether it is appropriate to use the court's time for what is essentially an administrative matter.
- 6.85 In the ordinary course of events, the departing trustee should transfer the property to the continuing trustee(s). There are a variety of reasons why this

might not occur. For example, the departing trustee may be incapacitated or refuse to co-operate. In some cases, the departing trustee may simply have overlooked the need to transfer registered interests. Some time may pass before the continuing trustee(s) realise that they do not have legal title to the property, by which time the departing trustee may be unavailable. A process is required to transfer trust property when the departing trustee is unwilling or unable to participate; but it is also important to protect against wrongful transfer.

- 6.86 The issue is how to provide for the efficient transfer of trust property when a trustee is removed or a new trustee is appointed. This issue particularly relates to registered property interests, such as interests in real property or shares or securities.

Options for reform

- 6.87 The options we considered were:
- (a) empowering the remaining trustees to transfer property, for example by creating a temporary power of attorney over assets held by the removed trustee, which is limited to the power to sign and register the documents necessary for the transfer of those assets to the new or continuing trustees;
 - (b) providing for vesting by operation of law through a statutory provision, which would have the effect of divesting the property from the trustee who is being removed, and vesting it in the new trustee.¹⁷⁶ For registered interests, it would then be necessary to provide evidence of the vesting, such as a statutory declaration by the continuing trustee, in order to have the transfer registered. This is similar to the approach under section 47 but would apply to all property, including registered interests;
 - (c) creating a simplified court process for the transfer of trust property, possibly through Associate Judges or by giving the court the power to combine multiple proceedings into one and make a vesting order which would affect all trusts of which the trustee being removed was a trustee; or
 - (d) giving the Public Trust the power to issue a statutory vesting certificate confirming that the deeds of removal and appointment have been validly executed (not presented in the *Fourth Issues Paper*).

Discussion

- 6.88 Submitters on the *Fourth Issues Paper* all considered that the current provisions could be improved. However, doubt was expressed as to whether a statutory vesting provision could be effective in New Zealand, because of the Torrens system of land transfer and the common practice of many

¹⁷⁶ The approach suggested by the British Columbia Law Institute, Committee on the Modernization of the Trustee Act *A Modern Trustee Act for British Columbia* (BCLI Report No 33, 2004) at 46.

institutions to require proof of registered title. Submitters noted that there are often issues with banks and other institutions refusing to accept that title has changed by operation of law. The comment was that regardless of legal effect, vesting provisions in legislation may not have practical effect.

- 6.89 The preferred approach combines a statutory vesting provision with a duty on the departing trustee to transfer property, and a process for the Public Trust to issue a certificate of vesting. It would facilitate the transfer of trust property through providing an alternative to a court process for non-contentious cases.
- 6.90 We have considered the option of a statutory vesting provision either as a stand-alone response or a part of a package of reforms. As a stand-alone, we are concerned that this approach would be inconsistent with the principle of the land transfer system that the register can be relied on to accurately reflect ownership, and risks creating an unhelpful distinction between legal ownership and registered ownership. However, we consider that this proposal could be usefully included as an element of the preferred approach provided that mechanisms are in place to effectively facilitate the transfer of registered interests.
- 6.91 In most circumstances, the simplest way for trust property to be transferred will be for the departing trustee to transfer the property and register the change of ownership. Including this as an obligation in legislation might assist remaining trustees in dealing with a removed trustee who refuses to transfer ownership. However, transfer by the departing trustee is not a complete solution, as it could not be used when the trustee being removed lacked capacity or where it was discovered after removal that the property was not validly transferred.
- 6.92 The preferred approach addresses these difficulties through empowering the Public Trust to issue a certificate of vesting on application by the continuing trustees. This would not supplant the role of the courts where there is a dispute and would only be available for non-contentious transfers. If there are objections from the departing trustee, the Public Trust should not grant the vesting certificate and the continuing trustees will need to apply to the court for a transfer order. The Public Trust may also refuse to grant a vesting certificate if the property arrangement is complex or it is not clear whether the trustee was properly removed.
- 6.93 The Public Trust would check whether the deeds removing and replacing trustees have been validly executed. The continuing trustee(s) or the person with the power to appoint and remove trustees would also be required to complete a statutory declaration affirming that the former trustee was removed for a valid reason under the legislation. Notice would be provided to the former trustee, and if no challenge is received the Public Trust would issue the certificate.
- 6.94 The certificate could be lodged with Land Information New Zealand (LINZ) or with share registries or similar as evidence of change of ownership. The legislation would provide that the certificate is sufficient proof of change of

ownership (that is, registrars do not need to “look behind” the certificate), and it is not ineffective for failure of notice or any other requirements. Because the certificate would require a statutory declaration, there would be personal remedies against continuing trustees who dishonestly used a certificate of vesting to transfer property. Legislation would provide that no registry will be liable for relying on a statutory vesting certificate.

- 6.95 This option is preferred to that of giving the continuing trustees or those with the ability to appoint and remove trustees the power to unilaterally transfer assets. While this option would have the advantage of simplicity, there are risks in forgoing any form of independent supervision. Combined with the power to remove trustees, this could freeze out a dissenting trustee and facilitate breaches of trust. Provided that an alternative simple process is available, these risks are not warranted.
- 6.96 In most cases the transfer of trust property is an administrative problem and is not contentious. It is unnecessary for the court to be involved in these situations. The court’s involvement is appropriate when there is a dispute about the validity of the removal of the departing trustee. The preferred approach will retain the court’s supervision for these cases, as the continuing trustees will need to apply for a vesting order if the Public Trust refuses to issue a vesting certificate.
- 6.97 While this proposal was not presented in the *Fourth Issues Paper*, we consider that it meets the concerns raised by submitters. We have undertaken targeted consultation with the Public Trust, LINZ, and private share registries. Based on this consultation we are of the view that this approach achieves a workable solution to the problems which arise in practice when trust property comes to be transferred. We are interested in receiving public comments on this proposal.

Chapter 7

Custodian and advisory trustees

INTRODUCTION

- 7.1 This chapter addresses possible reforms to the provisions relating to advisory and custodian trusteeship, which were discussed in the *Fourth Issues Paper*.¹⁷⁷ These two mechanisms each allow for an arrangement in which there are two types of trustee with different roles and different powers.

CUSTODIAN TRUSTEES

Proposal

P29 New legislation should:

- (a) provide that the appointment of a custodian trustee must be in writing;
- (b) retain an equivalent of section 50(2)(c) providing that the role of the custodian trustee is to hold the trust property, invest funds, and dispose of the assets as the managing trustee shall direct;
- (c) provide that a custodian trustee has all the administrative powers of a trustee but none of the discretionary powers;
- (d) provide that the custodian trustee has the power to execute any documents or perform any administrative action directed by the managing trustee;
- (e) provide that the custodian trustee has a duty to act on the instructions of the managing trustee and is liable for loss caused by:
 - (i) failing to execute the instructions of the managing trustee; or
 - (ii) acting without the authority of the managing trustee;

¹⁷⁷ Law Commission *The Duties, Office and Powers of a Trustee: Review of the Law of Trusts – Fourth Issues Paper* (NZLC IP26, 2011).

- (f) provide that a custodian trustee shall not be liable for executing instructions of the managing trustee where the managing trustee is in breach of trust;
- (g) provide that a custodian trustee may apply to the court for directions if they receive instructions from the managing trustee that are suspected to be in breach of trust, but shall not be liable for a failure to do so;
- (h) provide that a custodian trustee has the benefit of the right of indemnity in respect of costs incurred by the custodian trustee;
- (i) provide that a custodian trustee may be appointed over part of the trust fund (such as, the share portfolio only); and
- (j) provide that one or more natural persons or body corporates may be appointed as a custodian trustee (or joint custodian trustees), unless the trust deed precludes this. This would bring the new legislation into line with the custodian trust provisions under Te Ture Whenua Māori Act.

Please give us your views on this proposal.

Current law

- 7.2 Custodian trusteeship is a mechanism that allows for the appointment of an ongoing bare trustee to hold assets on behalf of managing trustees.¹⁷⁸ If a custodian trustee is appointed, the custodian trustee's role is to hold and administer trust property on the instructions of the managing trustees.¹⁷⁹ The custodian trustee must accept the instructions of a majority of the managing trustees as if they were given by all the managing trustees. If the managing trustees change, there is no need to change the legal ownership of the trust assets. This mechanism allows for a separation between legal ownership, management, and beneficial interest. We understand that it is widely used in Māori land trusts, and trusts with overseas assets or an overseas managing trustee.
- 7.3 Section 50(1) of the Trustee Act provides that a corporation may be appointed as a custodian trustee in any case where a corporation could be appointed as a trustee. A specific power in the trust deed is not necessary.
- 7.4 The custodian trustee will not be liable for the default of the managing trustees or for acting on their instructions. The custodian trustee can apply to the court for directions if they consider that the instructions of the managing trustee are in breach of trust. The extent to which a custodian trustee will be liable for facilitating a breach of trust by the managing trustees is unclear.
- 7.5 The current provision does not expressly enable a custodian trustee to be appointed over part of the trust property, although this could be provided for

178 Noel C Kelly, Chris Kelly and Greg Kelly *Garrow and Kelly Law of Trusts and Trustees* (6th ed, LexisNexis, Wellington, 2005) at 445. In this context the term "bare trustee" is used to describe a trustee having minimal duties, and no role in exercising discretion to distribute trust assets.

179 Trustee Act 1956. s 50(2)(c).

in the trust deed. It is also arguably within the scope of section 50. It is unclear how commonly this occurs in practice.

- 7.6 Section 50(4) provides for the remuneration of custodian trustees, but does not address reimbursement of expenses. Arguably this comes within the provisions, enabling trustees to be reimbursed.
- 7.7 There are differences between the provisions under the Trustee Act and Te Ture Whenua Māori Act 1993 (TTWMA). Section 50 of the Trustee Act does not seem to allow for the appointment of more than one person. It also does not allow for the appointment of a natural person. Conversely, section 225 of TTWMA provides that any individual or body corporate may be appointed. Submitters have advised that custodian trustees are frequently used in Māori land trusts, and commonly the Māori Trustee is appointed as custodian trustee together with another trustee.

Issues

- 7.8 The issue is whether the provisions on custodian trusteeship can be improved in order to achieve greater clarity while retaining a convenient and flexible mechanism for separating the legal ownership and management of trust property. This section considers whether it is necessary for legislation to specify duties that apply to custodian trustees, and the circumstances in which a custodian trustee should be liable to a beneficiary. It also considers whether the detail of the statutory defaults can be improved.

Options for reform

Mandatory duties, liability, and the nature of custodian trusteeship

- 7.9 We have considered reform options in relation to the duties of custodian trustees. Some of these options could be combined. The question of liability is closely connected to the question of duties, as custodian trustees should be liable for any failure to comply with their duties.
- 7.10 The following options were considered:
- (a) imposing a specific set of duties suited to the role (such as the duty to keep records);
 - (b) imposing a general duty of good faith;
 - (c) imposing a duty to act lawfully and consistently with the trust deed;
 - (d) imposing a duty to act on the instructions of the managing trustees; and
 - (e) imposing a duty to apply to the court if unlawful instructions are received.
- 7.11 There is a possibility that imposing some of these duties may change the nature of the role. For example, if custodian trustees had a duty to act consistently with the trust deed then they would be required to second guess or supervise the substantive decisions of the managing trustees, rather than merely giving effect to these decisions. Clarifying the duties of custodian

trustees invites questions as to how the role should properly be construed. There are also questions of whether or not the duties in the statute should be mandatory.

Statutory defaults for the appointment of custodian trustees

7.12 We also considered some minor issues relating to the statutory defaults for custodian trustees. We looked at whether or not the default position should be:

- allowing natural persons to be appointed as custodian trustees;
- allowing more than one person to be appointed as a custodian trustee;
- allowing a custodian trustee to be appointed over part of the trust property;
- extending the right of indemnity to custodian trustees;
- giving custodian trustees the administrative powers of trustees.

Discussion

7.13 All submitters on this issue considered custodian trustees a useful mechanism that should be retained. Taylor Grant Tesiram submitted that the roles, duties, and liabilities of custodian trustees need to be clarified. Some submitters, including the Auckland District Law Society, considered that the mechanism is underused and that better statutory defaults could assist.

7.14 Our preferred approach is to spell out the role of custodian trusteeship in new legislation. This includes clarifying that custodian trusteeship is essentially an administrative role, and imposing duties and grounds for liability.

7.15 We do not propose to change the nature of the custodian trustee's role. The duties and liabilities to be included in new legislation are intended to be consistent with the current conception of the role. Many of the trustees' duties in chapter 3 for ordinary trustees will be inapplicable to the custodian role.

7.16 The most difficult issue is how to address a possible situation in which the custodian trustee receives unlawful instructions from the managing trustees.

7.17 The role of the custodian trustee is to act on the instructions of the managing trustee. It is not to check whether these instructions are valid. An injured beneficiary can recover from the managing trustee directly. We consider that the custodian trustee should only be liable in the following circumstances:

- the custodian trustee, on its own initiative, perpetrates a fraud against the trust;
- the custodian trustee fails to execute the instructions of the managing trustees, and thereby causes loss to the trust; and

- the custodian trustee acts independently of instructions from the managing trustees (but not fraudulently), and thereby causes loss to the trust.
- 7.18 These situations would arise only where the custodian trustee acted without the authority of the managing trustees. New legislation should provide that the custodian trustee is liable for failing to execute the instructions of the managing trustees and acting without the authority of the managing trustees. These should be mandatory provisions for which liability cannot be excluded. The legislation should also provide that the custodian trustee has the duty to act on the instructions of the managing trustee and has all the administrative powers of a trustee, although is not able to exercise discretion.
- 7.19 We propose to provide explicitly that the custodian trustee is entitled to indemnity from the trust fund, as this is necessary in order for custodian trustees to efficiently deal with property, and to provide clarity.
- 7.20 The legislation should also provide that a custodian trustee may be appointed over part of the trust property as this may be useful in some situations. This would clarify the current law and is consistent with the purpose of custodian trusteeship.
- 7.21 We propose that multiple custodian trustees and natural persons as custodian trustees should be allowed, bringing trusts legislation into line with TTTWMA. This could be useful in some circumstances, such as appointing a professional adviser as a custodian trustee. We recognise that there are some significant arguments against this approach. Part of the rationale of custodian trusteeship is to allow the assets to be held by an entity that will provide consistency through time in a way that a natural person could not. Traditionally the custodian trustee was a public trustee company that provided greater certainty that the legal personality behind the trust would not be subject to change. It could be argued that appointing natural persons or multiple persons as custodian trustees is inconsistent with this rationale, and could unhelpfully blur the distinction between custodian trusteeship, managing trusteeship, advisory trusteeship and ordinary trusteeship. It could also be argued that if the settlor wanted to allow natural persons to be custodian trustees or to allow joint custodian trusteeship this could be provided for in the trust deed, and so does not need to be included as a statutory default. Notwithstanding these arguments, in our view, if custodian trusteeship is to be enabled as a statutory default then it is desirable to allow greater flexibility so that it can be used effectively. We are not aware of any problems arising from allowing natural persons or multiple custodian trustees in Māori land trusts. The greater flexibility in the statutory defaults in this context appears to have contributed to a wider realisation of the possible administrative benefits. We consider that this should be available to other trusts as well.

ADVISORY TRUSTEES

Proposal

- P30 (1) The new legislation should continue to provide for the appointment of an advisory trustee and for a trustee to act with an advisory trustee, although the position should be renamed to remove the term “trustee”. The role of an advisory trustee should continue to be to provide advice to the trustee on any matter relating to the trust.
- (2) The new provision should clarify that the trustee is not liable for anything done or omitted by him or her by reason of following the advisory trustee’s advice or direction unless the trustee knew or ought to have known that the advice was unlawful, contrary to the terms of the trust or trustees’ duties, or was advice that no reasonable advisory trustee would have given.

Please give us your views on this proposal.

Current law

7.22 Section 49 of the Trustee Act provides for the appointment of advisory trustees by the settlor, the court, a trustee or a person with a power to appoint a trustee. An advisory trustee is not a real trustee, as he or she does not have legal ownership of the property or the powers or duties of a trustee. The advisory trustee is an adviser to the real trustee(s).¹⁸⁰ The trust property remains vested in the trustee who retains sole management and administration of the trust. The trustee may consult the advisory trustee on any matter relating to the trust or trust property. The trustee is not required to follow advisory trustees’ advice, but his or her liability is limited when they do follow it. The section provides, in proviso (c) to subsection (3), that:

where any advice or direction is tendered or given by the advisory trustee, the responsible trustee may follow the same and act thereon, and shall not be liable for anything done or omitted by him by reason of his following that advice or direction.

7.23 The trustee may apply to the court for directions if he or she thinks the advice conflicts with the trust, is contrary to law, exposes the trustee to liability, or is objectionable. The trustee may also apply to the court if the advisory trustees are not unanimous and give conflicting advice.

7.24 Trustee corporations, including the Māori Trustee, commonly use advisory trustees as they enable family members or trust advisors to be involved and oversee the administration of the trust while allowing the trustee corporation to do the day to day administration work.

¹⁸⁰ Trustee Act 1956, s 49 refers to the real trustee as the “responsible trustee”. In this chapter we will refer to this trustee as the “trustee”.

Issues

- 7.25 There appears to be a lack of clarity about the extent of the protection from liability that the section provides to a trustee relying on the advice of an advisory trustee. Section 49 was introduced to enable trustee corporations to rely on advice from a family advisor where the trustee did not have enough knowledge of the family relationships and dynamics to be able to make decisions. Proviso (c) of section 49(3) was needed as the trustee would potentially be liable for a decision where he or she had relied on the advisory trustee's advice and assumed the advisory trustee would know best.
- 7.26 It is likely that section 49(3) proviso (c) was never intended to release the trustee from liability for something he or she knew to be wrong. Proviso (d) supports this view as it provides that if a trustee is of the opinion that such advice or direction conflicts with the trusts or law, or exposes him or her to any liability, or is otherwise objectionable, the trustee may apply to the court for directions. This implies that the trustee is not entitled to rely on the advisory trustee's advice if it breaches the trust or the law. However, the wording of section 49(3) proviso (c) makes it seem as if the trustee will always be released from liability if relying on an advisory trustee's advice because it is expressed broadly. It is consequently not clear when a trustee is released from liability when relying on the advice of an advisory trustee.
- 7.27 In its 2002 report, *Some Problems in the Law of Trusts*, the Law Commission recommended amending section 49 so that a trustee must apply to the court for directions when he or she knows or ought to know that the advisory trustee's advice conflicts with the trust or any rule of law, or exposes him or her to liability. The report also recommended that in all other cases, a trustee relying on the advisory trustee's advice would not be liable for following the advice.¹⁸¹
- 7.28 The Trustee Amendment Bill 2007 included an amendment to section 49 to effect the Law Commission's recommendations, but modified the recommendation by not making it mandatory for a trustee to apply for directions if the advisory trustees are not unanimous and give conflicting advice, or are unanimous but the trustee considers the advice objectionable. The Select Committee decided to omit the mandatory requirement for obtaining court directions. It added provisions preventing the trustee from escaping liability when following the advice of an advisory trustee if the trustee would have been liable if he or she had taken that action in absence of the advice, and clarifying that a trustee is not protected from a breach of trust or failure to comply with general duties in law by following the advisory trustee's advice or direction.

181 Law Commission *Some Problems in the Law of Trusts* (NZLC R79, Wellington, 2002) at [23]–[24].

Options for reform

- 7.29 We have considered whether new legislation should require trustees to make a mandatory application to the court for directions when the advice of advisory trustees conflicts with the trust, conflicts with the law, exposes the trustee to liability, or is objectionable, or whether the trustee should have the discretion to apply to court for directions in these circumstances.
- 7.30 In relation to a trustee's liability, the options we considered were:
- (a) providing that the trustees are liable even if following the advisory trustee's advice (as recommended by the Select Committee); and
 - (b) providing that the trustees are not liable unless they knew or ought to have known that the advice was unlawful, contrary to the terms of the trust, exposes the trustee to liability, or was advice that no reasonable advisory trustee would have given.

Discussion

- 7.31 There do not appear to be any problems with the concept or role of advisory trustees, although it would be helpful to remove the word "trustee" from the name of the position to avoid confusion. They are considered useful, particularly where a trustee corporation is a trustee and needs another party to provide the personal knowledge of beneficiaries to guide decision-making. Similarly, we are not aware of any problems with who can appoint advisory trustees. The Māori Land Court commented that advisory trustees are particularly useful in Māori land trusts where there is a desire amongst owners to recognise the need for input from kaumatua and kuia who are not able to take on the full duties of responsible trustees.
- 7.32 We have proposed not making it mandatory for trustees to apply to the court for direction when the advisory trustee's advice is unlawful, objectionable or exposes the trustee to liability. Submitters were unanimously opposed to a mandatory obligation to apply to the court, stating that this would be onerous and time consuming, inefficient and not in the best interests of the beneficiaries, and could mean that advisory trustees are used less. Trustees are not required to follow the advisory trustee's advice.
- 7.33 We do consider that there is a need to clarify when a trustee can be liable when advised by an advisory trustee. Submitters appeared unclear about the extent to which the current law protected a trustee relying on an advisory trustee's advice. Most submitters were comfortable with an approach that protected the trustee from liability only where he or she has not been at fault. It would ensure that trustees can be confident in having recourse to advisory trustees for advice and direction about personal and family matters without fear of liability.

- 7.34 We suggest that the list of instances where a trustee may seek court directions (which is also the list stating when the trustee will be liable when relying on the advisory trustee's advice) should not include "exposes [the trustee] to any liability" as it currently does in proviso (d) to section 49(3). This is too broad a criterion and may not of itself be sufficiently culpable behaviour that a trustee should be liable for relying on the advisory trustee's advice.

Chapter 8

Corporate trustees and insolvent trusts

INTRODUCTION

- 8.1 In our *Fifth Issues Paper* we examined a particular type of trust used in business, the trading trust.¹⁸² By “trading trust” we were generally referring to a structure in which the trustee of a trust is a limited liability company, instead of a natural person. A particular feature of such arrangements is commonly that the corporate trustee holds few or no assets in its own right, with the assets instead held on trust for the beneficiaries.
- 8.2 This chapter will address several of the same issues raised in the *Fifth Issues Paper* discussion on trading trusts. However, as we outline below, we now consider that the issues and possible solutions apply more broadly than just to the particular structure described above.
- 8.3 This chapter considers the following areas:
- (a) the definition of a trading trust and the scope of any reforms;
 - (b) the trustee’s right to indemnity;
 - (c) disclosure of trustee status;
 - (d) the liability of directors of corporate trustees;
 - (e) appointment of liquidators or receivers for trusts; and
 - (f) insolvent corporate trustees.

182 Law Commission *Court Jurisdiction, Trading Trusts and Other Issues: Review of the Law of Trusts – Fifth Issues Paper* (NZLC IP28, 2011) at chs 6-8. Key submitters on these issues were Chapman Tripp, Perpetual, the Trustee Corporations Association, the New Zealand Law Society (NZLS), Taylor Grant Tesiram, Greg Kelly, Jeff Kenny, KPMG, the Inland Revenue, the Ministry of Social Development and Dirk Hudig.

- 8.4 There are also proposals relating to the appointment and removal of corporate trustees in chapter 6.¹⁸³

DEFINITION AND SCOPE OF REFORMS

Proposal

P31 Proposals in this chapter should apply to any corporate acting as a trustee of a trust, including the statutory trustee companies, unless expressly exempted. Legislation should not include a definition of a “trading trust”.

Please give us your views on this proposal.

Current use of trading trusts

- 8.5 We noted in the *Fifth Issues Paper* that it was difficult to ascertain empirically the incidence of trading trusts at present in New Zealand, as the status of a company acting as a trustee is not required to be disclosed or recorded. Previous Law Commission work in 2002 identified the use of trading trusts as growing but not widespread. Accordingly we asked submitters about whether they thought that trading trusts were now in widespread use and whether there were actual problems resulting from their use.
- 8.6 Submitters had divergent opinions about the popularity of trading trusts. One submitter preferred not to distinguish “trading trusts” from other trusts being used as vehicles contracting in a commercial setting. A number of submitters indicated they were uncertain, but suspected that there were relatively low numbers.¹⁸⁴ Other submitters, on the other hand, considered that there were a large number in existence and their use was widespread. Some submitters thought that their use was growing while some thought it was decreasing (or may do so with increasing use of limited partnerships).
- 8.7 The Inland Revenue provided some statistics about numbers of IR6 returns (which will include trusts with no income, trusts earning passive income, estates and trading trusts, as many trusts which do not earn income still obtain an IRD number and file). Although these figures do not provide a complete picture, they suggest that the number of income-earning trusts is increasing: from 164,800 in 2000/2001, to 237,800 in 2009/2010.¹⁸⁵

Issues

- 8.8 Particular issues arising in various areas are addressed in each section below, but one initial question is whether any reforms need to be targeted specifically at “trading trusts”, as the term is commonly used, to refer to structures

183 See [6.15]–[6.23].

184 Submissions of Perpetual, Trustee Corporation Association, the NZLS and Taylor Grant Tesiram.

185 See also < www.ird.govt.nz/aboutir/external-stats/ > .

involving an assetless corporate trustee that is engaged in business activity; and therefore whether a legislative definition of this term is required.

Options for reform

- 8.9 The options for approaching the application of any reforms are:
- (a) for any reforms to apply to corporate trustees generally (that is, to any company or other corporate that is acting as a trustee); or
 - (b) for any reforms to apply only to “trading trusts” as a defined term, such as the definition the Commission considered in 2002, with some express exclusions such as trustees of unit trusts and Kiwisaver schemes, as follows:¹⁸⁶

“trading trust” means a corporation (not being a trustee corporation or a Board incorporated under Part II of the Charitable Trusts Act 1957) which in the capacity of trustee of a trust carries on any trade or business ...

Discussion

- 8.10 Only two submitters supported the term “trading trust” being defined in new legislation: KPMG and Taylor Grant Tesiram both favoured the approach in option (b) above. The NZLS supported this definition as a starting point, if a definition was considered necessary, but considered that the prevailing notion of the concept was generally sufficiently understood. Moreover, they observed that it would be difficult to define the term helpfully, due to the different meanings it is given, including in the rural context, due to the need to accommodate and exclude certain vehicles like passive investment trusts.
- 8.11 Remaining submitters considered that “trading trusts” should not be singled out as a subset of trusts. Chapman Tripp considered that a definition was not required as the issues and risks that arise in relation to such trusts are the same as those that arise for any trust that contracts with third parties. Perpetual, the Trustee Corporations Association and Greg Kelly Law said rather than using the popular term “trading trusts”, it would be better for the legislation to state that certain provisions apply to any corporation (other than an incorporated charitable trust board or one of the trustee corporations recognised by statute) which acts as trustee.
- 8.12 We acknowledge that there would be some difficulties in formulating an appropriate definition of a trading trust, especially since the term can have several meanings, so its use could be misleading or confusing. We are also persuaded that the issues raised will often concern a company that is acting as a trustee, if it is transacting with third parties, regardless of whether it is actively “in business”. Therefore we propose that our general approach in this area should be that reforms would apply to any corporate acting as a trustee

186 Law Commission *Some Problems in the Law of Trusts* (NZLC R79, 2002) at [29] [*Some Problems in the Law of Trusts*].

of a trust. We also consider that the reforms should also generally apply to the statutory trustee corporations, unless they are expressly exempted. However, as needed, we will address the application or scope of reforms in each area as this may need to vary depending on the nature of the proposed reform and its intended object.

LIABILITY OF TRUSTEES AND RIGHT OF INDEMNITY

Proposal

- P32 New legislation should restate the following principles:
- (a) A trustee assumes personal liability unless there is an express limitation to the contrary in the contract.
 - (b) A trustee has the right to indemnity out of trust assets (in a modernised form of section 38).
 - (c) A trustee's indemnity cannot be limited or excluded by the trust deed.
 - (d) A trustee's right to indemnity is available to a former trustee in respect of actions taken by them as trustee.

Please give us your views on this proposal.

Current law

- 8.13 A trustee is personally liable for all liabilities incurred in performing the trust, including debts to third parties, unless liability has been contractually limited to the trust assets. The trustee has an indemnity against the trust assets to satisfy debts properly incurred under the trust, both in terms of reimbursement and the ability to pay trust liabilities directly out of the trust assets. Improperly incurred liabilities are not covered by the indemnity. The trustee's right to indemnity creates an equitable interest in the trust assets.
- 8.14 The primary claim for creditors is against the trustee personally. Creditors may recover from the trustee directly if the trustee has sufficient assets that are not held on trust. If, however, the trustee has few or no assets of its own, then the creditor must look to the trust property through subrogation, the process by which one person, in this case a creditor, is put in the place of another, here the trustee, so that the trustee's right of indemnity from trust assets is used to satisfy the creditor's debt. Since the creditor's subrogation is entirely derivative, if the trustee's right of indemnity is impaired, then the creditor's subrogation is likewise impaired. This can occur through a range of circumstances, for instance:
- (a) the trustee may not have properly incurred the liability in the first place, for example because it was beyond the powers of the trust deed or was in breach of duty;
 - (b) there may be cross-claims by beneficiaries; or
 - (c) the indemnity may have been excluded or limited in the trust deed itself.

- 8.15 These principles are found in the common law and are not set out in any trusts legislation at present, aside from certain aspects of the trustee's right of indemnity which are recognised in section 38(2) of the Trustee Act 1956.

Issues

- 8.16 There is a lack of clarity about the extent to which the trustee's right to indemnity can be limited or excluded entirely by the terms of the trust. One view is that the indemnity can be limited or even excluded entirely.¹⁸⁷ The alternative view is that it may not be excluded because "the right of indemnity from the assets is an incident of the office of trustee and inseparable from it".¹⁸⁸ The position has not been conclusively determined by a court in New Zealand and nor is it clear from the statute.
- 8.17 In 2002 the Law Commission considered that the right of indemnity probably could not be excluded or limited.¹⁸⁹ There is still no authority in New Zealand stating the position with certainty, but overall, as discussed in the *Fifth Issues Paper*,¹⁹⁰ the balance of commentary appears to say that it cannot be totally excluded. The question that arises is whether this position (or another) should be clarified in legislation.
- 8.18 There may also be some uncertainty and lack of understanding about the other legal principles referred to above regarding the trustee's personal liability, exercise of the indemnity, and circumstances in which creditors can be subrogated. Non-lawyer trustees and settlors in particular may not necessarily comprehend these areas well. There is a further question that requires clarification of whether the indemnity extends to acts of former trustees or whether it applies only to the current trustee's actions.

Options for reform

- 8.19 In the *Fifth Issues Paper*, we asked whether submitters thought it would be beneficial to restate in legislation the essential principles of any of the following areas of the case law (as they apply generally, not only to trading trusts):
- (a) that a trustee assumes personal liability unless there is an express contract to the contrary;

187 *RWG Management Ltd v Commissioner of Corporate Affairs* [1985] VR 385 (it should be noted that this case was decided in the context of the Trustee Act 1958 (Vic) which allows for the exclusion of indemnities); *Re German Mining Co* (1854) 43 ER 415 per Turner J; HAJ Ford and IJ Hardingham "Trading Trusts: Rights and Liabilities of Beneficiaries" in PD Finn (ed) *Equity and Commercial Relationships* (Law Book Company, Sydney, 1987) at 48.

188 BH McPherson "The Insolvent Trading Trust" in PD Finn (ed) *Essays in Equity* (Law Book Company, Sydney, 1985) at 142. See also *Kemtron Industries Pty Ltd v Commissioner of Stamp Duties (QLD)* (1984) 15 ATR 627 (QC) at 634.

189 *Some Problems in the Law of Trusts*, above n 186, at [27].

190 *Fifth Issues Paper*, above n 182, at [7.27]–[7.36].

- (b) a trustee's right to indemnity out of trust assets;
 - (c) how and subject to what, if any, conditions can a trustee's rights to indemnity be exercised;
 - (d) the circumstances in which creditors can be subrogated to a trustee's right of indemnity; and
 - (e) exclusion of the right of indemnity.
- 8.20 The alternative is to retain the status quo and not to state these principles in legislation, beyond what is specified currently in section 38.

Discussion

- 8.21 Regarding (a) to (d) in the list above, many submitters considered it would not be worthwhile to include these principles in trusts legislation. They considered that the case law in these areas is sufficiently clear and well understood as to their meaning and operation, and as such it would be unnecessary to restate them in legislation. The NZLS observed that addressing the circumstances in which a creditor will be subrogated may require an unduly complex legislative provision. However some other submitters said that these principles are not always well understood and there would be benefits in restating them in legislation. The TCA and Perpetual suggested that creditors' rights of subrogation be clarified.
- 8.22 On the other hand, most submitters responded that it would be useful for legislation to clarify the position regarding exclusion of the right of indemnity. Most agreed that the right of indemnity cannot be modified or excluded by the trust deed. Chapman Tripp's view was that the trustee's right of indemnity is a fundamental part of its role as trustee and incident of the trust relationship; without the right of indemnity the trustee would be unable to deal with the trust assets. KPMG observed that if a corporate trustee's right to indemnity was reduced the directors would be at risk of being personally liable for trading while insolvent. The NZLS considered that the current lack of an express rule was not causing problems in practice, and noted that any rule introduced would need not to cut across existing rules of indemnification which operate effectively and are well understood.
- 8.23 We concur with the majority of submitters that the right of indemnity cannot be limited or excluded by trust deed. We also agree that it would be beneficial to clarify the position in legislation to resolve any uncertainty. This would also provide some protection for creditors who do not necessarily know the terms of the trust. We consider that this is a reform that should apply to all trusts, as section 38 does, rather than trusts with corporate trustees only. A new provision could be based on the wording of Australian legislation.¹⁹¹ It would need to provide that the trustee's indemnity applied regardless of any contrary intention expressed in the trust deed. Section 38 would be retained

191 For example Trusts Act 1973 (Qld), s 65.

- in new legislation in a modernised form, so this provision could be added as a subsection in that provision.
- 8.24 The provision would need to set out the extent of the indemnity. One submitter observed that section 38(1) currently carves out wilful default but dishonesty could also be added. Our view is that any provision in this area should align with the approach proposed to be taken to exemption clauses, which would carve out dishonesty, wilful misconduct and recklessness, and a negligent breach of a mandatory duty.
- 8.25 It would also be necessary to consider how this provision would impact existing trusts, and whether it would have retrospective effect or only apply to new trusts settled after it came into force.
- 8.26 We also consider that there is value in restating in a revised section 38 some of the other fundamental and well-understood principles in this area, including a trustee's personal liability. It would be useful for this provision to clarify the application of the indemnity to former trustees, which we consider should extend to such trustees. Section 38, as it stands currently, seems to us to be incomplete and it would be preferable to have a section that covered all key aspects of the indemnity.
- 8.27 Although most submitters said that these principles were certain and well understood, we consider that it would nonetheless be helpful to lay trustees and third parties to have them spelled out simply and concisely in legislation. The provision may have an educative function for some lay trustees and the public at large about the nature of a trust and whether a trust is a separate entity. It may allay any confusion or lack of awareness regarding the personal liability of a trustee in contracts entered into. Restatement of settled common law principles is also in line with the general approach we are taking in this review. We emphasise that there is no intention to undermine or displace existing principles in this process of restatement.
- 8.28 There is a question as to whether it should be permissible for the indemnity to be substituted so that it is not provided by the trust assets but a substitute indemnity is provided through a contractual arrangement with a third party. If this approach is considered to be consistent with the principles underpinning the indemnity, legislation could make clear that such an arrangement is possible.

DISCLOSURE OF TRUSTEE STATUS

Proposal

P33 It is proposed that section 25 of the Companies Act 1993 should be amended to require a company, when acting as a trustee of a trust, to clearly describe its status as such in all communications and contracts, in the form "X Ltd acting as trustee for Y trust".

Please give us your views on this proposal.

Current law

- 8.29 At present there is no requirement for a company that is acting as a trustee to disclose this fact to prospective creditors or the public at large. As a result creditors may be unaware that they are interacting with a trust. They may deal with the trustee under a misapprehension that assets are held both legally and beneficially by the company, when in fact they are held on trust and the company itself has very limited assets.

Issues

- 8.30 The lack of disclosure means that creditors and other third parties may potentially deal with trustees on the basis of a belief – potentially mistaken – about the extent of the assets available to creditors, which may affect creditors' prospects of recovering their debt. This is a circumstance that may arise with other trusts where it is not clear that property is held on trust by the trustee, but it is more significant here because the trust may be actively involved in carrying on business and is incurring liabilities on an ongoing basis.
- 8.31 Without transparency about the fact that the company is acting as trustee, the creditor is not aware of the need to take greater precautions to protect its position, such as requiring security, guarantees, or making enquiries about the nature of the trust arrangement, the authority of the trustee to incur liabilities, the status of the trustee's right to indemnity, and the value of the company's assets owned outright. There is also an argument to be made that if there continues to be no disclosure requirement, widespread use of the assetless corporate trustee structure could impact on the integrity of the Companies Register as it would only show an incomplete picture of the company.
- 8.32 Several submitters acknowledged the problems of lack of knowledge and understanding among third parties about trustees' capacities, and how to protect oneself contractually. Most submitters agreed that lack of disclosure was a problem. However, KPMG considered that it is not difficult for creditors to identify from the Companies Register where the shares are likely held by a trust (for example a professional corporate trustee may note this status in the company name or have shareholder and directors who are lawyers or accountants using their own business addresses). KPMG thought that if anything, rather than under-reporting of trusteeships to the disadvantage of trust creditors, the problem was around over-reporting of ownership. In other words individuals who are trustees are believed to hold assets in companies when they are merely trustees for other parties, to the disadvantage of trustees' personal creditors. The NZLS considered there was not necessarily enough of a problem with non-disclosure to warrant intervention, but thought it seemed likely that there will be situations where a contracting party is unaware they are dealing with a trust.

Options for reform

- 8.33 A company could be required to disclose that it acts as a trustee for a trust in respect of which it carries on business in New Zealand. Disclosure could be effected by one of several means. The options considered were:
- (a) A company's trustee status could be indicated on the Companies Register, via the annual return.
 - (b) Companies acting as trustees could be required or have the option to join a register.¹⁹²
 - (c) A positive obligation on the director(s) of the company to inform creditors that the company is acting as a trustee.
 - (d) Disclosure that a company is acting as a trustee on company documents, and perhaps contracts entered into, in the same way that the company name must be displayed on all written communications and documents issued by or signed by the company that create a legal obligation, per section 25 of the Companies Act 1993.
 - (e) Retain the status quo of no disclosure requirements.

Discussion

- 8.34 Submitters had mixed views about whether disclosure should be required and if so, how this should be achieved, but most submitters were in favour of requiring disclosure in some form. Submitters particularly supported some sort of documentary disclosure obligation.
- 8.35 Several submitters raised concerns presented by a disclosure requirement. KPMG considered that overall, disclosure through the Companies Register would not hinder business. However, they queried whether the disclosure methods would be sufficient to provide protection to a potential creditor; the extent of the obligations; the question of requiring disclosure on an ongoing or one-off nature; compliance monitoring and penalties for breach. A number of submitters noted that disclosure alone was unlikely to give adequate warning or assist unsophisticated creditors.
- 8.36 Since the majority of submitters consider lack of disclosure about trustee status to be a problem, we consider that introducing some form of disclosure requirement would be helpful. We consider that considerations of privacy or convenience should not outweigh the need for parties to have sufficient information about the nature of the vehicle so they can decide whether and on what terms they should deal with it.
- 8.37 We acknowledge that disclosure would only be a partial measure, effective only for counterparties that understand the implication of the disclosure, and is unlikely to assist unsophisticated creditors who fail to appreciate the significance of what is being disclosed, as the *Fifth Issues Paper* and

¹⁹² See discussion on registration in ch 15 at [15.4]–[15.12].

several submitters noted. It still leaves the onus on the creditor to make any further enquiries as necessary such as the trustee's power to enter into the transaction in question. Additional options for reform aside from disclosure still need to be considered. However, our view is nonetheless that it would be a valuable starting point to allow parties to be informed, so that they are on notice and (in some cases at least) may be able to take steps to protect themselves. We acknowledge that it is important for any disclosure requirement to be brief and easy to comply with and administer.

- 8.38 Option (a) of disclosure on the Companies Register itself, through the annual return, would be likely to require an amendment to the Companies Act 1993, as well as the relevant regulations.¹⁹³ The advantages of this option are that it could draw on existing systems and so be relatively inexpensive to set up. However, potential difficulties with this option include inconsistency with existing Companies Register disclosure requirements and an adverse impact on the overall scheme of the register. It could also make the annual return form harder to complete which could result in lower compliance levels in filing, as commented by the Ministry of Economic Development. Furthermore, KPMG noted that disclosure through the annual return may be of limited effectiveness since there would be a potential period without disclosure before the filing of the return so that the information could come too late for a creditor; and at any rate in practice creditors may not use the register to check the status of the company at all; or may not review the annual returns in the register.
- 8.39 As an alternative to option (a), the Inland Revenue suggested it could ask via its forms whether a company is a trustee company at the time that an IRD number is applied for. However, since this capacity might change over time, the Inland Revenue considered that it would be more straightforward if the information formed part of a public register, such as the Companies Office, which would benefit other creditors aside from the Inland Revenue, and was updated at least annually.
- 8.40 Option (b) of registration is considered more fully in chapter 15, in particular the option of a voluntary register.¹⁹⁴ Although it is ultimately not proposed to introduce a system for mandatory registration of trusts, a voluntary register is discussed as an option that could be useful for trading trusts, and could be self-funding.
- 8.41 Little comment was received in respect of option (c) specifically.
- 8.42 Option (d), requiring disclosure of trustee status on written communications and contracts, received the most support from submitters. We agree that it is a desirable reform and should be the preferred approach. It could be effected through amendment to the Companies Act 1993, most likely section 25. It could be more effective than disclosure through the Companies Register, as

193 Companies Act 1993 Regulations 1994.

194 See [15.12].

it does not rely on the creditor to check the Register to obtain notification. Chapman Tripp has noted it is not uncommon to see this type of legal disclaimer on communications from business vehicles in England or the United States. It is accepted that there would be some expense and inconvenience involved in making changes to documentation, but this would be a relatively minor and one-off cost; there would also be some slight cost associated with the need to comply with the disclosure requirement on an ongoing basis.

- 8.43 There is a question to consider as to the extent of application of the disclosure requirement. It could be limited to those companies acting as trustees of trusts that “carry on business” and not passive trusts that happen to have a corporate trustee, as suggested in the *Fifth Issues Paper*.¹⁹⁵ Alternatively, as Chapman Tripp has suggested, it could apply to all companies that are communicating in their capacities as trustees of trusts. Chapman Tripp argued that the latter is preferred if protection of creditors or contractual third parties is the aim. We agree that this seems to be a sensible approach. We considered whether there should be an exception for bare trustees and nominees. However, we consider that since it can be difficult to draw a clear dividing line between these and other types of trustees, that it is preferable not to have an exception and for the disclosure requirement to apply to them equally.
- 8.44 It should be noted that there is no intention for this proposed amendment to have the effect of automatically limiting liability to the trust assets; the trustee would still assume personal liability unless the contract expressly provides that liability is limited.
- 8.45 As with other proposals it will be necessary to consider how the provision would impact existing trusts.
- 8.46 A further issue is what the consequences should be, if any, for failing to comply with the new disclosure requirement. Chapman Tripp and the MSD expressly supported penalties for failure to disclose (the MSD adding, even where that failure has not resulted in direct or identified loss). We agree that there should be penalties for failure to disclose, and we favour Chapman Tripp’s proposal that there be a pecuniary fine of the same level currently imposed on companies and directors in section 25(5) for failing to include the name of the company (\$5,000 for the company and \$5,000 for a director). However, we do not consider it is necessary also to extend the application of section 25(2) to this proposal, whereby failure to comply with the disclosure obligation in a document creating a legal obligation would result in the personal liability of every person who signed the document.

195 *Fifth Issues Paper*, above n 182, at [7.5].

ISSUES FOR CREDITORS

Proposals

P34 There should be an amendment to the Companies Act 1993 to provide for the liability of directors of companies acting as trustees for trust liabilities, based on section 197 of the Corporations Act 2001 (Cth), which provides:

Directors liable for debts and other obligations incurred by corporation as trustee

(1) *A person who is a director of a corporation when it incurs a liability while acting, or purporting to act, as trustee, is liable to discharge the whole or a part of the liability if the corporation:*

(a) *has not discharged, and cannot discharge, the liability or that part of it; and*

(b) *is not entitled to be fully indemnified against the liability out of trust assets solely because of one or more of the following:*

(i) *a breach of trust by the corporation;*

(ii) *the corporation's acting outside the scope of its powers as trustee;*

(iii) *a term of the trust denying, or limiting, the corporation's right to be indemnified against the liability.*

The person is liable both individually and jointly with the corporation and anyone else who is liable under this subsection.

Note: The person will not be liable under this subsection merely because there are insufficient trust assets out of which the corporation can be indemnified.

(2) *The person is not liable under subsection (1) if the person would be entitled to have been fully indemnified by one of the other directors against the liability had all the directors of the corporation been trustees when the liability was incurred.*

P35 New trusts legislation should provide for a mechanism for the appointment of a liquidator/receiver of a trust, who could manage or liquidate the trust fund. This would apply generally, not only to trusts with corporate trustees.

Please give us your views on these proposals.

Current law

8.47 Under the current law, existing trust and company law obligations apply to corporate trustees and their directors. This approach places the risks of dealing with an assetless corporate trustee mainly with the third party looking to contract with it, although the corporate trustee and its directors would still be bound by duties under the Companies Act and the Fair Trading Act 1986. Creditors have their primary claim against the trustee personally, and rely on the trustee's right of indemnity to recover their debts if the trustee has

insufficient assets. Creditors bear the risk that the indemnity is not available, possibly leaving them with no recourse to have their debt satisfied. It is potentially open to settlors to exclude the right to indemnity via the trust deed and trustees to accept the position with this limitation (although it is as yet unclear in New Zealand whether such a provision would undermine the existence of the trust).

- 8.48 The current position puts the onus on the creditor to protect their position, either by taking security if they are able to do so, or by establishing for themselves the extent of the trustee's indemnity, whether it is limited or excluded by the terms of the trust, and whether the trustee is acting within its capacity and authority in entering into the contract. Smaller and/or less sophisticated creditors may be constrained in their ability to obtain such protections, due to lack of awareness about the need for them or limited negotiating power.

Issues

- 8.49 The key problem in this area is that, as in *Levin v Ikiua*,¹⁹⁶ creditors of a corporate trustee may be left without redress. This may occur where the directors distribute the trust funds regularly so that the trustee holds few or no assets, and the beneficiaries, who receive the funds, alter their position in reliance on the validity of such distributions. Several submitters referred to this problem in their comments.
- 8.50 There is also a potential problem for creditors if, for any of a number of reasons,¹⁹⁷ the trustee loses its right to indemnity, and consequently the creditor cannot recover through subrogation. It seems unfair or inappropriate that a creditor acting in good faith can be left out of pocket due to the unrelated acts of a trustee, and this can result in a windfall for the beneficiaries of the trust, as noted in the *Fifth Issues Paper* and by some submitters. A more serious aspect of this would be corporate trustees incurring liabilities with no intention of meeting those obligations, perhaps in reliance on creditors being unable to have recourse to the trust assets, whether directly or indirectly.
- 8.51 There is a question over whether this is an issue exclusive to “trading trusts” or companies acting as trustees. Several submitters hold the view that it is not a special problem in dealing with trading trusts, but merely the same type of common problem faced by creditors dealing with companies and other third parties generally (such as solvency, effective contractual enforcement, and debt recovery). The NZLS considered that although a creditor's right of recourse against a trading trust with a corporate trustee was more difficult than, say, a company, actual problems of this nature do not really arise in

196 *Levin v Ikiua* [2010] 1 NZLR 400 (HC).

197 For example, because the trustee lacks the requisite capacity or authority, because of cross-claims, or the trustee is in breach of their duty.

practice, in light of helpful judicial authorities and creditors' willingness to seek recourse from directors.

Options for reform

8.52 Two of the options considered in the *Fifth Issues Paper* are discussed above: disclosure of trustee status (option 1) and preventing exclusion of the trustee's right to indemnity (option 2). The remaining options, set out in more detail in chapter 7 of the *Fifth Issues Paper*, are:¹⁹⁸

- Option 3: Strengthening the creditor's access to the right to indemnity, for instance providing that the creditor can still rely on indemnity from the trust fund irrespective of whether the trustee acted in breach of trust in incurring the liability or was otherwise indebted to the trust fund.
- Option 4: Giving trustees the power to grant charges for creditors over trust assets.
- Option 5: Providing creditors with direct recourse to trust assets in some situations, without needing to rely on the trustee's right of indemnity.
- Option 6: Providing for liability of directors of companies acting as trustees for trust liabilities in some situations, based on section 197 of the Corporations Act 2001 (Cth).
- Option 7: Retaining the status quo, so that existing trust and company law obligations would continue to apply to corporate trustees and their directors.

8.53 In addition, in submissions to the *Fifth Issues Paper* the NZLS and the Inland Revenue have both proposed the introduction of the ability to appoint a liquidator/receiver of a trust (referred to below as Option 8).

Discussion

8.54 There was not a clear consensus among submitters in respect of the options proposed in the *Fifth Issues Paper*. There was a measure of support for retaining the status quo, with a number of submitters saying that there is not enough evidence of a defined problem to intervene in this area (a position which may be strengthened in light of the preferred approaches involving disclosure requirements and addressing the exclusion of indemnity).

8.55 However, marginally more submitters favoured some kind of reform than supported retaining the status quo, even if there were differences of opinion as to the appropriate approach to be taken. We have considered the various possible options for reform. We have come to the view that, of the options considered, there are two key proposals that should be carried forward:

198 For more detailed discussion of the options, see *Fifth Issues Paper*, above n 182, at [7.37]–[7.84].

- Option 6: providing for liability of directors of companies acting as trustees for trust liabilities in certain circumstances; and
 - Option 8: providing a mechanism for a liquidator/receiver of a trust (not included in the *Fifth Issues Paper*).
- 8.56 Option 6 (liability of directors of companies acting as trustees) was supported by a number of submitters. Chapman Tripp and KPMG both noted the existing laws that impose obligations on directors of companies. KPMG considered that due to existing obligations already on directors there is no real difficulty in this area, but section 197 would be acceptable if clarity were required; KPMG thought any rule changes should apply to all trusts and trustees.
- 8.57 Option 8 (the ability to appoint a liquidator/receiver) was not traversed in the *Fifth Issues Paper* in relation to this issue. However, the NZLS and the Inland Revenue have both indicated that they would favour a clear procedure to be able to liquidate a trust using an independent liquidator/administrator. The Inland Revenue was concerned that there is no legislative mechanism enabling a creditor to have a trust “wound up” or terminated if it is not paying its debts or is insolvent. In a submission to the *Second Issues Paper*¹⁹⁹ the MED stated that it would favour a cost-effective mechanism for creditors to recover trust debts from trustees without having to file for bankruptcy or have the trustee replaced, such as having the Public Trustee or Official Assignee appointed as administrator or receiver.
- 8.58 Submitters’ comments on the other options are set out below.
- 8.59 *Option 3: Strengthening creditors’ access to the right to indemnity:* This option was supported in one form or another by a number of submitters. KPMG noted that ultra vires defence to a transaction under company law has effectively been removed, so trusts should not be treated any differently; Chapman Tripp considered that it should remain up to the creditor to address the risk of the trustee’s power and capacity to enter into the contract (no indoor management-type rule) but did support the approach that when a trustee who is indebted to the trust for reasons unconnected with a contract with a particular creditor, that indebtedness should not prevent the creditor from being indemnified out of the trust fund, although it would reduce the right of indemnity to the extent of the indebtedness. Greg Kelly Law, the TCA and Perpetual thought that creditors’ rights should not be affected by breach of the terms of the trust of which the creditor was not aware or did not appreciate the significance. Jeff Kenny made a particular proposal related to this option, of modernising and expanding section 22 of the Trustee Act to protect persons, such as secured and unsecured creditors, dealing with trustees in good faith for proper value.

199 Law Commission *Some Issues with the Use of Trusts in New Zealand: Review of the Law of Trusts – Second Issues Paper* (NZLC IP20, 2010).

- 8.60 *Option 4: Giving trustees the power to grant charges for creditors over trust assets:* This option was not generally favoured by submitters. Chapman Tripp in particular argued that there was no justification for new legislation in this area; most modern trust deeds contain such a power in any case. However KPMG thought that to protect unsuspecting creditors who have obtained void security, it should be a rebuttable presumption that the security is valid unless the creditor knew the trustee was acting outside their powers.
- 8.61 *Option 5: Providing creditors with direct recourse to trust assets:* This was the preferred option of some submitters, and was also supported by others. The MSD wanted to give access to creditors and any other parties (such as spouses, government agencies) when they have suffered a loss caused by the trust or associated entity, or where there is a debt owing. The Inland Revenue noted that the risk of having a misbehaving trustee should fall on the beneficiary/trust estate and not on a creditor, particularly an involuntary creditor; this reform would be an incentive to appoint directors or trustees of straw. Greg Kelly Law thought there was some merit in direct access but not the complete reversal of our present law suggested in paragraphs [7.54] to [7.58] of the *Fifth Issues Paper*. This option was supported by Taylor Grant Tesiram, but as a default position, one capable of being modified through contract. If a creditor misses out on direct recourse because for example the trustee has distributed all of the trust assets, the creditor may still pursue remedies against the trustee personally. Taylor Grant Tesiram noted a number of exceptions to permitting creditors to have direct access to trust assets that would be required. This option was expressly not supported by Chapman Tripp.
- 8.62 *Option 7: Retaining the status quo:* the NZLS preferred to maintain the status quo, saying the difficulties faced by creditors caused by trading trusts are not sufficiently serious, widespread or identifiable to warrant legislative or other intervention. Chapman Tripp and the TCA also considered there are already methods of preventing or remedying the problem (such as seeking undertakings from the trustee that it will not distribute to beneficiaries if it reduces the trust assets to below a certain level, akin to a reserve fund; seeking indemnities or guarantees from key beneficiaries; contracting on the basis that liability is limited to the assets of the trust; seeking a floating charge; sections 344 to 350 of the Property Law Act 2007; sections 135 and 136 of the Companies Act). KPMG said there was arguably no need for reform, but if the law is being redrafted anyway, it would be appropriate to include stronger remedies for creditors, if only for deterrent effect, due to the impact of financial exposure on businesses and the fact that it can be costly to take steps such as obtaining security, investigating the indemnity and so on.

Providing for liability of directors

- 8.63 Our preferred approach is for an amendment to the Companies Act based on an adaptation of the Australian section 197 of the Corporations Act 2001 (Cth) to ensure that directors of corporate trustees are liable to discharge a

liability incurred by the company acting in its capacity as trustee. Section 197 provides:

Directors liable for debts and other obligations incurred by corporation as trustee

- (1) A person who is a director of a corporation when it incurs a liability while acting, or purporting to act, as trustee, is liable to discharge the whole or a part of the liability if the corporation:
 - (a) has not discharged, and cannot discharge, the liability or that part of it; and
 - (b) is not entitled to be fully indemnified against the liability out of trust assets solely because of one or more of the following:
 - (i) a breach of trust by the corporation;
 - (ii) the corporation's acting outside the scope of its powers as trustee;
 - (iii) a term of the trust denying, or limiting, the corporation's right to be indemnified against the liability.

The person is liable both individually and jointly with the corporation and anyone else who is liable under this subsection.

Note: The person will not be liable under this subsection merely because there are insufficient trust assets out of which the corporation can be indemnified.

- (2) The person is not liable under subsection (1) if the person would be entitled to have been fully indemnified by 1 of the other directors against the liability had all the directors of the corporation been trustees when the liability was incurred. ...

8.64 In the *Fifth Issues Paper* we discussed this provision and noted that its basis for introduction was that it is reasonable to encourage all directors of companies acting as trustees to ensure that the company does not enter into trust deeds which deny creditors access to trust assets to meet liabilities incurred by the company. Its purpose was to ameliorate the consequences for creditors where there is no access to trust funds to meet liabilities incurred by a corporate trustee.²⁰⁰

8.65 We consider that it would be worthwhile to introduce such a provision, even though we are proposing elsewhere not to permit exclusion or limitation of the trustee's right to indemnity in the trust deed. It would give creditors an avenue of protection in the event of a breach of trust or ultra vires conduct by the trustee. It would also be useful for our law to align with that of Australia in this area, where this provision has been in operation for several decades. Further, while this option still requires steps to be taken to enforce a claim against the directors, it is hoped it would deter directors from allowing a situation to arise where the company is unable to meet its liability and is not entitled to be indemnified from the trust assets.

8.66 We acknowledge that such a proposal would not provide a full guarantee for repayment of creditors, as it would depend on the available asset base of the directors. We also recognise the potential for such a proposal to discourage

200 See *Fifth Issues Paper*, above n 182, at [7.63]–[7.81], especially [7.72].

persons from acting as directors of trustees, due to expanded personal liability and the possible effect on indemnity insurance; however we do not consider that directors will be significantly discouraged.

- 8.67 In drafting a version of this provision for New Zealand the following points will require further consideration:
- (a) whether to list the circumstances of extinguishment or limitation of the right of indemnity, as section 197 does in subsection (1)(b)(i) to (iii), define these circumstances more widely or narrowly, or to leave this aspect open to be determined by the courts – our preliminary view is that this should either be left open or should at least contain a general catch-all provision;
 - (b) whether any protections or defences to liability under the provision should be available to directors under the section, or a discretion so that the court can only impose liability if it is just and equitable to do so; and
 - (c) how to address the issue of directors ensuring that the trust has insufficient funds to fulfil the right of indemnity, for example by requiring the directors to discharge all company debts and out of pocket expenses before proceeding to distribute the balance of trust funds to the beneficiaries, and whether this situation should be brought within the ambit of the section.
- 8.68 We are interested in submitters' views about how this provision would operate in practice.

Providing for the appointment of a trust liquidator/receiver

- 8.69 As outlined above, this was an option raised in discussion with the NZLS²⁰¹ and was supported by the Inland Revenue. We consider this has the potential to be a very useful process; the receiver can take charge of the fund, deal with and if necessary realise some assets, conduct a managed distribution, and if appropriate, hand back the fund to the trustees.
- 8.70 We note that in law there is already the ability for the court to appoint a receiver in respect of trust property under its inherent jurisdiction, so this is not a new process; while receivers are more commonly thought of in connection with companies, the jurisdiction of the court to appoint one is not limited to companies.²⁰² An example of the exercise of the jurisdiction in respect of trusts in New Zealand is the case of *Molloy v Molloy*.²⁰³ It has also been employed overseas.²⁰⁴ However, it appears this jurisdiction is rarely

201 Meeting between the NZLS Property Law Section and Law Commission (March 2012).

202 Noel C Kelly, Chris Kelly and Greg Kelly *Garrow and Kelly Law of Trusts and Trustees* (6th ed, LexisNexis, Wellington, 2005) at [17.9.1].

203 *Molloy v Molloy* HC Auckland CP106/99, 22 June 2001.

204 See for example *Tasarruf Mevduati Sigorta Fonu v Merrill Lynch Bank and Trust Company (Cayman) Ltd & Ors (Cayman Islands)* [2011] UKPC 17 (receiver appointed over power to vary).

used; this may in part stem from a lack of awareness or understanding that this option is available. In addition, at the moment there is no mechanism to liquidate a trust (aside from winding up). And although it is possible to liquidate a company acting as a trustee, there is nothing to prevent serial appointments of new trustees, which would in turn require new proceedings to liquidate.

- 8.71 We consider that it would be beneficial, therefore, to clarify in trusts legislation that the court can appoint a receiver to deal with a trust and the trust fund, and to provide that a liquidator is also an option. However, we would emphasise that this proposal should not be taken as limiting the existing receivership jurisdiction of the court in any way. It should also be noted that we consider this proposal should apply not only to trusts that have corporate trustees, but to trusts more broadly, as is the position in equity at present.
- 8.72 Certain features of the process would need to be determined and set out in legislation, such as:
- (a) who is able to make an application for the appointment of a receiver/liquidator (the NZLS favoured the process being available at the behest of a creditor, but this could be open to other parties as well);
 - (b) the test for when it is necessary for there to be such an appointment (the NZLS proposed the grounds for appointing a liquidator/receiver could be on the basis that it was just and equitable to do so; this would be at the discretion of the court);
 - (c) whether this proposal would apply to all trusts or only to trusts with corporate trustees – as indicated above, at this point we consider that there is not a reason to confine the proposal only to trusts with corporate trustees;
 - (d) where such applications would be heard – we anticipate that this process would have to take place in the same place as company liquidations, namely the High Court;
 - (e) whether to spell out some of the powers of the receiver or liquidator, which would need to be flexible, and would not limit the existing receivership jurisdiction. The powers listed could include realising assets or terminating a trust under the supervision of a court;
 - (f) priorities of those involved – otherwise the question of priorities could be left to be determined under general principles or set out separately in company/insolvency legislation; and
 - (g) payment of fees of the liquidator/receiver: clarification is needed as to whether these fees can be claimed from the trust assets – we consider that it is appropriate that this be the case in these circumstances.

ISSUES FOR BENEFICIARIES

Proposal

P36 It is proposed that legislation should require that directors (or equivalent) of a corporate acting as a trustee have the same obligations to the beneficiaries of the trust as they would have had if they and not the company had been the trustees.

Please give us your views on this proposal.

Current law

- 8.73 The position of a beneficiary of a corporate trustee is the same as it is in any other trustee-beneficiary relationship. In the event of a breach of trust, the beneficiaries may have a claim against the company, assuming liability has not been excluded by the trust deed.²⁰⁵ However, if the company has insufficient assets of its own with which to compensate the beneficiaries, pursuing remedies against the company will be pointless.²⁰⁶ The beneficiaries may therefore need to try to claim against the individuals responsible for causing the company to breach the trust, generally the directors of the company.
- 8.74 Claiming against the directors can be more difficult than bringing a claim against the corporate trustee, because there is no direct fiduciary relationship between the directors of corporate trustees and the beneficiaries of the trust for which the company is a corporate trustee.²⁰⁷ Trustees owe a direct fiduciary duty to beneficiaries, and directors owe a duty to the company. But directors are not automatically liable to beneficiaries for the actions of a corporate trustee, including breaches of trust committed by the company.²⁰⁸
- 8.75 However, directors may be liable to beneficiaries based on other claims.²⁰⁹ Where the corporate trustee has committed a breach of trust, a director may be liable for providing dishonest assistance in that breach of trust. Beneficiaries may have other possible claims in knowing receipt; as a *trustee de son tort*; or a “dog-leg” claim attributing liability to directors indirectly through their duty of care to the company. However, most of these heads of

205 For a full discussion of trustee exemption clauses, see Law Commission *The Duties, Office and Powers of a Trustee: Review of the Law of Trusts Fourth Issues Paper* (NZLC IP26, 2011) at ch 3.

206 Ford and Hardingham, above n 187, at 58.

207 Jeff Kenny and Jared Ormsby “Trading Trusts” in Andrew S Butler (ed) *Equity and Trusts in New Zealand* (2nd ed, Thomson Reuters, Wellington, 2009) 415 at 422.

208 At 421; *Bath v Standard Land Company Ltd* [1911] 1 Ch 618.

209 See *Fifth Issues Paper*, above n 182, at [8.1]–[8.9]. For further discussion of the liability of directors, including other heads of liability not covered here, see Chris Kelly and Greg Kelly “So you want to be trustee” (paper presented to New Zealand Law Society Trusts Conference, 2009) at 52–54.

liability are relatively uncertain, being untested in New Zealand, and unlikely to succeed except in limited circumstances.

Issues

- 8.76 A potential problem in respect of beneficiaries of a corporate trustee is that if the business fails, the beneficiaries' only recourse is against a trustee who may be assetless. Therefore in an action against a corporate trustee, for example if it commits a breach of trust, the beneficiaries will be unable to recover funds (in the absence of insurance cover). Beneficiaries do not have any special protection in these circumstances, and may be vulnerable. However the key question in this area is whether the law adequately protects beneficiaries already through the existing heads of liability referred to above.
- 8.77 The NZLS and Chapman Tripp did not consider there were any problems or disadvantages relating to beneficiaries that were sufficiently serious to warrant intervention. They considered that the cases in which a beneficiary suffers loss are likely to be rare and that there are already sufficient legal remedies available. Taylor Grant Tesiram noted that beneficiaries are unlikely to have the same prospects of a recovery against the trustee as beneficiaries of a trust with individual trustees, which is arguably unfair, but beneficiaries are generally volunteers, and settlor choice is important. The remaining submitters who commented on this perceived that lack of protection for beneficiaries was a problem that needed to be addressed.

Options for reform

- 8.78 The options are:
- (a) a "direct look-through" extending the liability of directors of a trust company, to impose on the directors the same obligations to beneficiaries to which they would have been subject if they personally had been the trustees (also proposed by the Commission in its 2002 review);²¹⁰
 - (b) a requirement for a professional trustee to disclose to the client settlor the implications of the choice of a corporate trustee and to advise on what trustee insurance the trustee has in place (as proposed by Taylor Grant Tesiram);
 - (c) a provision similar to section 27 of the Unit Trusts Act 1960, under which the directors of a trustee of a trust can be found liable as delinquent directors on the application to the court by the trustee, a liquidator of the trustee or a unit holder (as proposed by KPMG);
 - (d) to retain the status quo, with no reforms targeted at beneficiaries.

210 Law Commission *Some Problems in the Law of Trusts*, above n 186, at [29].

Discussion

- 8.79 Many but not all submitters favoured reform in this area to protect beneficiaries. Some submitters argued that the position of beneficiaries of a trading trust is even less secure than that of creditors; the beneficiaries' right to sue for breach of trust is not useful if the trustee is a company that can easily be liquidated, as occurred for example in the case of *CIR v Chester Trustee Services*.²¹¹ The TCA noted that trustees will usually be exempted from liability to the beneficiaries except for dishonesty or wilful breach of trust, so beneficiaries' possible claims are likely to be limited.
- 8.80 In terms of reform options, several submitters supported making directors personally liable if the corporate trustee cannot pay. The NZLS considered the proposal to be sensible, but of a lower priority than other trust reforms. KPMG favoured a provision based on section 27 of the Unit Trusts Act, and Taylor Grant Tesiram favoured requiring disclosure to the settlor client by the professional trustee about the implications of appointing such a trustee, as set out in [8.78] above.
- 8.81 KPMG raised a further question as to the ranking of the beneficiaries' claim against a corporate trustee for breach of duty: it was considered unclear whether the claim should be in priority to other unsecured creditors, rank *pari passu*, or be deferred to other creditors (with the latter being KPMG's preferred option).
- 8.82 Based on the response from submitters, it appears that this issue is finely balanced in terms of the necessity of reforms in relation to beneficiaries. Submitters were divided about the adequacy of current measures and about the existence and extent of a problem in this area.
- 8.83 Although there are several existing routes by which directors could be held liable to beneficiaries, there have been few such claims in New Zealand. As such these possible avenues are uncertain, and it is difficult to assess whether they are in practice sufficient, but it is likely they would involve high thresholds to succeed. The lack of claims cannot necessarily be taken to indicate that there is no problem in this area.
- 8.84 We have considered the advantages and disadvantages that direct liability on directors would bring. Several submitters argued that imposing a direct relationship between directors of corporate trustees and beneficiaries would provide accountability and an incentive to directors to ensure that trading trusts are run properly. It is effectively the case that the directors of the company are to all intents and purposes the trustees, and so should be treated as such. It would seem sensible for the law to recognise the practical reality of the arrangement, notwithstanding the conventional protection of the corporate veil – and one submitter noted that the corporate veil ought to be for the protection of investors rather than directors.

211 *Commissioner of Inland Revenue v Chester Trustee Services Ltd* [2003] 1 NZLR 395.

- 8.85 On the other hand, there are various disadvantages to the proposal. Extending liability of directors in this way could discourage third parties from acting as directors of corporate trustee companies. One submitter commented that a law that imposed a direct relationship could be considered to cut across and complicate fundamental aspects of company and trust law; such an intervention would be difficult to design and could create problems in the interaction between the two areas of law. A submitter commented that the corporate veil should not be pierced and directors should continue to be protected from liability, provided that they have acted in accordance with their duties.
- 8.86 On balance, we have concluded that it is preferable to introduce a direct look-through with directors of companies acting as trustees being directly accountable to beneficiaries. We are concerned about the precarious position of beneficiaries and the difficulties involved in attempting to hold a corporate trustee to account through the indirect mechanisms that are currently available. We consider that there is potential for the corporate trustee structure to be used as a means to avoid liability to beneficiaries, and that direct liability on directors is the most straightforward and effective means of addressing this. We believe there is some merit in KPMG's suggestion involving section 27 of the Unit Trusts Act and a provision in new trusts legislation could in part draw on this provision. An alternative formulation is found in clauses 130 to 132 of the Financial Markets Conduct Bill, which will repeal the Unit Trusts Act. Clause 130 provides that the manager of a registered scheme established under a trust deed has the same duties and liability in the performance of its functions as manager as it would if it performed those functions as a trustee, within the context of the wider civil liability scheme of the bill.
- 8.87 Since we are elsewhere proposing liability to creditors for directors of corporate trustees, it is also desirable to have consistency in the approach taken. We acknowledge that there may be some issues arising over interaction with the company law scheme. We are interested in submitters' views about how this proposal would operate in practice. We particularly invite comment on whether the proposal is suitable for all corporates and how it would impact on different types of corporate.

- 8.88 The proposal by Taylor Grant Tesiram may warrant further consideration, as in addition to the preferred approach set out above, or as an alternative. This proposal was to require professional trustees to disclose to the client settlor the implications of the choice of a corporate trustee, and advise as to what trustee insurance is in place. They also suggested minimum requirements as to trustee insurance cover may be appropriate. We discuss a comparable option in relation to informing clients about exemption clauses in chapter 3,²¹² and similar considerations apply here: administrative and cost burdens on those settling trusts; questions about effectiveness; evidential difficulties in establishing compliance; and an issue about the consequences attaching to a failure to inform the client as required. However, we note that the settlor is usually the director in these cases, and so this proposal does not directly address the problem of the risk to beneficiaries. We prefer that it remain as a possible alternative position if the preferred approach does not proceed.

INSOLVENT CORPORATE TRUSTEES

Proposal

- P37 It is proposed that the Ministry of Business, Innovation and Employment should review and clarify the following areas in insolvency legislation:
- (a) whether an insolvent corporate trustee should be liquidated;
 - (b) whether liquidators are entitled to claim fees and expenses from trust assets;
 - (c) the distribution of assets and priority of creditors on liquidation.

Please give us your views on this proposal.

Issues

- 8.89 The *Fifth Issues Paper* considered three areas of uncertainty regarding trusts in the context of insolvency: whether an insolvent corporate trustee should be liquidated; whether liquidators are entitled to claim fees and expenses from trust assets; and the distribution of assets and priority of creditors on liquidation.²¹³
- 8.90 After submissions closed on the *Fifth Issues Paper*, the Court of Appeal released its decision in *CIR v Newmarket Trustees Ltd*.²¹⁴ This allowed the appeal by the Commissioner against the High Court's decision not to order the liquidation of the respondent, Newmarket Trustees Ltd, an insolvent trustee company which was established and operated by a law firm. It was the trustee

212 See [3.64]–[3.68].

213 *Fifth Issues Paper*, above n 182, at [8.10]–[8.31]. The Ministry of Business, Innovation and Employment, which includes the Government department that was formerly the Ministry of Economic Development, has responsibility for the administration of the Insolvency Act 2006.

214 *Commissioner of Inland Revenue v Newmarket Trustees Ltd* [2012] NZCA 351.

of over 100 trusts. Notably the Court of Appeal commented that the Associate Judge should not have taken into account, in his decision not to liquidate the company, the propriety of lawyers providing trustee services through trustee companies, and the practical consequences of having to replace the trustee for the other trusts affected.²¹⁵ As the Court noted, the NZLS is responsible for whether and, if so, how such trustee companies should be able to operate, and there is some legislation in place already around this.²¹⁶

Discussion

- 8.91 Submitters to the *Fifth Issues Paper* told us that the problems referred to were correctly identified, and most agreed that these areas required legislative clarification or reform, however there was little comment on the preferred direction or nature of the reform required.²¹⁷ The view of the NZLS was that all the issues identified by the Commission in the paper in respect of insolvent trading trusts are ones that in practice may cause problems in the future, although to what degree and in how many situations is unclear. The NZLS supported some narrow, targeted amendments in the problem areas identified by the Commission. Taylor Grant Tesiram argued that whilst these issues have not been significant in New Zealand litigation so far, they are likely to increasingly emerge; this area of law is too fundamental to have so much uncertainty. It considered that issues apply to any insolvent trust, not just trading trusts.
- 8.92 Particular areas that submitters mentioned as requiring statutory clarification or amendment were:
- priority between trust creditors and general creditors of an insolvent trustee, as well as priorities between trust creditors;
 - whether and how trust creditors have a claim over general assets (if trust assets will not satisfy the debts);
 - the application of the insolvent transaction regime to trust creditors;
 - whether trust assets are available to meet the expenses of winding up; and
 - a more flexible, discretionary rule that allows, at a judge's discretion, for the non-liquidation of a corporate trustee in circumstances of the type described in *Newmarket Trustees* where the circumstances leading to the particular debt default were not the fault of anyone involved with the corporate trustee (though taking care not to encourage softer stewardship).

215 At [60].

216 At [60]. Lawyers and Conveyancers Act 2006 ss 65, 67, 94 and 95; Lawyers and Conveyancers Act (Trust Account) Regulations 2008 and Lawyers and Conveyancers Act (Lawyers: Nominee Company) Rules 2008.

217 Comments on this topic were received from Greg Kelly Law, Perpetual, Taylor Grant Tesiram, KPMG, Chapman Tripp and Perpetual.

- 8.93 We agree with submitters that it would be desirable to provide greater certainty in these areas, through clarification in legislation. However, these amendments are likely to involve issues of interaction with existing company and insolvency law regimes, which would involve going beyond the scope of the Commission's trusts review. It may be an inquiry with some complexities which could delay other parts of this package of proposals. For these reasons we consider that it is preferable that the review in these areas be carried out by the government department responsible for the company and insolvency legislation, and we recommend accordingly.
- 8.94 The *Newmarket* case has provided some further guidance on the appropriate factors to consider when deciding whether an insolvent corporate trustee should be liquidated. However, it has highlighted the problem that can occur when there is a professional corporate trustee administering multiple trusts, and an issue with one trust causes the company to become insolvent, so that it is unfit to be a trustee and requires removal, creating numerous practical difficulties for the remaining trusts. The risk of this predicament arising can be reduced by proper administration or avoided by using a structure of a single corporate trustee for a single trust, as the Auckland District Law Society has noted previously.²¹⁸
- 8.95 This issue is one that may need consideration by the NZLS and the Auckland District Law Society, as to what responses are appropriate in light of the Court of Appeal's decision. It is also an area that the Commission may examine more closely in the context of stage three of the review of trust law on the trustee companies legislation.

218 Public Issues Committee, Auckland District Law Society Inc *Independent Trustees, Corporate Trustee Companies and the Need for Good Governance – the Newmarket Trustees Lesson* (Public Issues Paper, 1 August 2011).

Part 3
**COURT POWERS
AND
JURISDICTION**



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Chapter 9

Revocation and variation of trusts

INTRODUCTION

- 9.1 The general rule is that trusts, once established, cannot be varied. One of a trustee's core duties – his or her “very plainest duty” – is to adhere to the terms of the trust.²¹⁹ However, changes in law, taxation rules and family circumstances can mean that trust deeds need to be modified to enable the trust property to be dealt with or the trust administered in a way that was not provided for at the outset. The law has therefore long recognised that there are circumstances where, notwithstanding the general rule, trusts should be able to be varied, brought to an end (revoked) or even resettled onto new trusts. This topic was discussed in the *Third Issues Paper*.²²⁰
- 9.2 In this chapter we put forward proposals for reform relating to the revocation and variation of trusts. The specific topics examined are:
- revocation and variation by beneficiaries;
 - revocation and variation by the High Court on behalf of beneficiaries (section 64A of the Trustee Act 1956);
 - extension of the trustee's powers by the High Court (section 64 of the Trustee Act); and
 - variation pursuant to a power in a trust deed.

219 Augustine Birrell *The Duties and Liabilities of Trustees* (1896) at 22, quoted in Noel C Kelly, Chris Kelly and Greg Kelly *Garrow and Kelly Law of Trusts and Trustees* (6th ed, LexisNexis, Wellington, 2005) at [20.3.1] [*Garrow and Kelly*].

220 Law Commission *Perpetuities and the Revocation and Variation of Trusts: Review of the Law of Trusts – Third Issues Paper* (NZLC IP22, 2011).

REVOCAION AND VARIATION BY BENEFICIARIES

Proposal

P38 New legislation should:

- (a) state the common law rule (known as the rule in *Saunders v Vautier*) which provides that where they are in agreement, consenting, legally capable adult beneficiaries may act together to revoke a trust;
- (b) clarify that where they are in agreement, and with the agreement of the trustees, legally capable adult beneficiaries may act together to confer new powers upon trustees or deviate from, or vary, the terms of the trust; and
- (c) clarify that legally capable adult beneficiaries may consent to a resettlement of a trust, as well as a variation or revocation.

Please give us your views on this proposal.

Current law

- 9.3 Where all the beneficiaries of a trust are adults with full legal competence and are in agreement, they can act together to require the trustees to terminate the trust and transfer the trust property to them to distribute as they see fit. This is the rule in *Saunders v Vautier*.²²¹ The case law rule recognises that while the title and management of the trust property resides with the trustees, the right to beneficial ownership lies with the beneficiaries. It is for them to decide how they will enjoy the property.²²²
- 9.4 The scope of the rule has been widened by the courts. In New Zealand the High Court has allowed beneficiaries to use the rule to confer new powers upon trustees or deviate from, or vary, the terms of the trust where the trustees are in agreement. In *Re Philips New Zealand Ltd*, Justice Baragwanath stated the position in the following terms:²²³

The rule in *Saunders v Vautier* ... points the way: while all beneficiaries *sui juris* cannot direct trustees who bona fide oppose a particular course of action – *Re Brockbank* [1948] 1 Ch 206 – their power to put an end to the trust is the ultimate exercise of unanimous consent. Since they can together use their possession of the total bundle of proprietary rights to terminate the trust it is difficult to see why they cannot use the same rights to permit the trustees to modify it.

221 *Saunders v Vautier* (1841) Cr & Ph 240; 41 ER 482.

222 DWM Waters, MR Gillen and LD Smith *Waters' Law of Trusts in Canada* (3rd ed, Thomson Carswell, Toronto, 2005) at 1175.

223 *Re Philips New Zealand Ltd* [1997] 1 NZLR 93 at 101. See also *Neville v Wilson* [1996] 3 All ER 171 (CA).

- 9.5 This is also the position in the United Kingdom.²²⁴ This extension is consistent with the policy behind the rule in *Saunders v Vautier*. Those with the right of enjoyment in the property should be able to dictate the manner of enjoyment. It is likely that the rule would also be applied to allow beneficiaries to consent to a resettlement of a trust as this would be consistent with policy that those with the beneficial interest in property should be able to determine what happens to that property. The agreement of the trustees would be needed in any such situation where the original trusts were not simply being revoked.
- 9.6 The application of the rule in *Saunders v Vautier* is not straightforward in relation to contingent and discretionary beneficiaries. The rule does not apply if a beneficiary's interest is not indefeasible and absolute.²²⁵ A beneficiary cannot request the revocation of a trust where their interest is contingent unless all beneficiaries agree (including those who would benefit if the contingency were not met). Also, where trustees have the discretion to apply the whole or part of the trust fund to a beneficiary, the beneficiary cannot revoke the trust under the rule as he or she does not have a vested interest in the whole of the trust fund. However, where the trustees do not have discretion as to the amount of the trust fund to be given to the beneficiary, but only as to the method in which the fund shall be applied for the beneficiary, the beneficiary may revoke the trust. In the case of a fixed discretionary trust with several beneficiaries, where the trustees have a discretion regarding how much (if anything) each beneficiary receives, but the whole of the trust fund must be divided somehow for those beneficiaries, the rule can apply, if all the beneficiaries are legally capable adults and consent to the revocation or variation.²²⁶ This is because between them they have the right to beneficial ownership. However, in practice the rule often cannot be used to vary discretionary trusts because it is not always possible to identify all the beneficiaries or to obtain agreement from each of them.
- 9.7 Finally, the rule in *Saunders v Vautier* may also be used to transfer to an adult, legally capable beneficiary of a fixed share of the trust property his or her share.²²⁷ The limitation on this is that the trust property must be of a form that allows the beneficiary's share to be transferred to him or her. It is more difficult where the property includes land or shares in a private company. The beneficiary may have to wait until property can be sold so that it can be divided.²²⁸

224 *IRC v Holmden* [1968] AC 685 (HL) at 713, *Goulden v James* [1997] 2 All ER 239 (CA) at 247 and *Wyndham v Egremont* [2009] EWHC 2076.

225 *Burns v Steel* [2006] 1 NZLR 559 at [36].

226 *Re Smith: Public Trustee v Aspinal* (1928) Ch 915 at 918.

227 Andrew S Butler "Trustees and Beneficiaries" in Andrew S Butler (ed) *Equity and Trusts in New Zealand* (2nd ed, Thomson Reuters, Wellington, 2009) 105 at 147; *Quinton v Proctor* [1998] 4 VR 469.

228 *Stephenson v Barclays Bank Co Ltd* [1975] 1 All ER 625 (Ch) at 637.

Issues

- 9.8 The Trustee Act does not address the circumstances under which beneficiaries should be able to revoke, vary or resettlement a trust by agreement. Currently the rules that apply are a matter for case law as developed by the courts. While the case law rules are reasonably clear in most respects, they are not necessarily known or understood by lay people involved with trusts. Many people would be surprised to learn that the current law allows beneficiaries to vary or revoke a trust, in certain circumstances, without the involvement of the court.

Options for reform

- 9.9 The options are:
- (a) stating and clarifying the extended common law rule in *Saunders v Vautier* in legislation; or
 - (b) retaining the status quo and leave the matter to case law.

Discussion

- 9.10 Stating the rule in legislation would make the law more accessible for non-lawyers. It would be clear on the face of the statute that consenting, legally capable beneficiaries can vary, revoke and resettlement a trust without the oversight of the court. The agreement of the trustees should continue to be needed in situations where the trust is not simply being revoked.
- 9.11 We suggested in the *Third Issues Paper*²²⁹ that codification of the extended *Saunders v Vautier* rule could be included in a revised version of section 64A of the Trustee Act. Under this approach, the provision would cater for court-approved variations, revocations and resettlements of trusts and also enshrine the principle that adult, capable beneficiaries acting together can also affect each of these actions, without court oversight. Codifying the case law rule in legislation in this way could help to place the court's powers to vary trusts into context.
- 9.12 Submitters were almost evenly divided on the issue of codifying the rules applying to revocation and variation by beneficiaries in legislation. A slight majority (including the New Zealand Law Society (NZLS)) favoured codifying the rule in legislation on the basis it would make the law more accessible for lay people and that it would also help place the court's powers to approve variations into context. Those that rejected codification of the law in this area (including the Auckland District Law Society) expressed the view that the rule is already sufficiently clear and appropriately applied by the common law. They suggest that there is some risk that any legislative formation of the rule will not have the flexibility of the common law to

229 *Third Issues Paper*, above n 220, at [4.23].

address new circumstances. Setting the rule out in legislation may also give rise to unintended and undesirable effects.

- 9.13 We consider that a clear statement of the law in this area would have significant educative value. The concerns expressed by those who favour leaving the matter to case law can be adequately addressed by careful drafting that summarises case law, and retains sufficient flexibility to address new circumstances. Overall our assessment is that there are sufficient benefits in stating case law rules that specify the circumstances under which competent adult beneficiaries can agree to revoke, vary, or resettle the terms a trust in legislation and clarifying where the agreement of trustees is needed.

REVOCAION AND VARIATION BY THE HIGH COURT

Proposal

P39 New legislation should:

- (1) provide the court with discretionary powers to:
 - (a) approve any revocation, variation or resettlement of a trust or any change to the scope or nature of the powers of the trustees to manage or administer the trusts on behalf of the following:
 - (i) minors (currently section 64A(1)(a));
 - (ii) incapacitated persons (currently section 64A(1)(a));
 - (iii) persons who may become entitled at a future date or on the happening of a future event or once they become a member of a certain class (currently section 64A(1)(b));
 - (iv) unborn persons (currently section 64A(1)(c)); and
 - (v) beneficiaries under protective trusts (currently section 64A(1)(d));
 - (b) waive the requirement for the consent of any other person and approve any revocation, variation or resettlement of a trust or any change to the scope or nature of the powers of the trustees to manage or administer the trusts;
- (2) set out the following factors for the court to have regard to when exercising its discretion under P39(1)(a) or (b) of the provision:
 - (a) the nature of any person's interest and the effect any proposed varying arrangement may have on that interest;
 - (b) the benefit or detriment to any person that may result from the court approving any proposed varying arrangement;
 - (c) the benefit or detriment to any person that may result from the court declining to approve any proposed varying arrangement; and
 - (d) the intentions of the settlor to the extent these can be ascertained;
- (3) remove the current requirement that any varying arrangement must not be to the detriment of those beneficiaries on behalf of whom the court provides consent under P39(1)(a). The court should instead be required to

consider the broader range of factors set out in P39(2) when deciding whether to approve a varying arrangement;

- (4) provide that the court must not use its discretionary power under P39(1)(a) or (b) of the proposed provision to reduce or remove any vested interest or any other property rights held by a beneficiary.

Please give us your views on this proposal.

Current law

- 9.14 The High Court can under its inherent jurisdiction authorise variations of trusts on behalf of beneficiaries in some circumstances. The House of Lords ruled in *Chapman v Chapman*²³⁰ that the courts can consent to variations on behalf of incapable beneficiaries in the following limited circumstances:²³¹
- (a) changing the nature of an infant's property;
 - (b) providing maintenance for an infant and, rarely, for an adult beneficiary;
 - (c) sanctioning unauthorised transactions for the purpose of salvage of the estate; and
 - (d) sanctioning a compromise on behalf of an infant.
- 9.15 Section 64A, modelled on section 1 of the Variation of Trusts Act 1958 (UK), was enacted largely to address the limitations identified in *Chapman*. Under section 64A the court has a discretionary power to approve on behalf of a minor, and certain incapacitated or unascertained beneficiaries, any arrangement that varies or revokes a trust or enlarges the powers of the trustees in respect of property subject to a trust.²³² The court may only approve an arrangement if it is not to the "detriment" of the beneficiary on whose behalf it is consenting.

Range of varying arrangements the courts should be able to approve

- 9.16 Two types of "arrangement" can be approved by the court under section 64A:
- (a) those that vary or revoke all or any of the trusts; and
 - (b) those that enlarge the trustees' powers to manage or administer the trust property.

230 *Chapman v Chapman* [1954] AC 429 (HL). See also *Re Gray (deceased)* [1956] NZLR 764 and *Re Ebbett (deceased)* [1974] 1 NZLR 392.

231 As summarised by the New Zealand High Court in *Re Ebbett* [1974] 1 NZLR 392 at 396.

232 *Re Clifford (deceased)* HC Christchurch A30/82, 22 July 1993 at 11.

- 9.17 Although the term is not used, the New Zealand courts have interpreted section 64A as permitting resettlements. The courts have accepted that a revocation can encompass both the termination of existing trusts and substitution by new trusts.²³³
- 9.18 One issue that is not fully settled is whether a variation must leave the substratum or fundamental purpose of the trust intact. If a proposed variation changes the fundamental purpose of a trust, then it may be argued that conceptually it cannot be regarded as “varying” that trust. In contrast, an arrangement (even if it involves a resettlement) that gives effect to the purpose of the original trust by other means, leaves the substratum intact, so may be regarded as merely varying the original trust.
- 9.19 The concept of substratum is an elusive one. There has been something of a shift away from it operating as a limit on the court’s jurisdiction. In *Greenwood* Tipping J disagreed with the proposition that a variation or revocation cannot be approved by the court if it conflicts with the primary or predominant intention of the settlor. His view was that the intention of the testator (or settlor) was relevant as one of the considerations in deciding whether approval shall be given but did not limit the court’s ability to approve arrangements that conflicted with the testator’s (or settlor’s) primary intention.²³⁴ He said the purpose of section 64A is to put the court in the shoes of a beneficiary who is, by reason of infancy or other incapacity, incapable of assenting to the variation or revocation proposed.²³⁵
- 9.20 On its face, the wording used in section 64A(1), “enlarging the powers of the trustees of managing or administering”, suggests that only arrangements that broaden a trustee’s existing powers and not those that remove existing powers can be approved. Whether “enlarging the powers” includes adding new powers is also open to interpretation.
- 9.21 Other law reform bodies have proposed extending the scope in this way and allowing arrangements “enlarging, adding to or restricting the powers of the trustees of managing or administering any of the property subject to the trusts”.²³⁶

233 *Re Greenwood* [1988] 1 NZLR 197 (HC) at 211 and *Clucas v Trustees of T E Clucas Family Trust* HC Christchurch M1/95, 5 May 1998.

234 *Re Greenwood* [1988] 1 NZLR 197 (HC) at 211.

235 At 211.

236 Law Reform Commission of Ireland *The Variation of Trusts* (LRC 63-2000) at [3.21]; British Columbia Law Institute, Committee on the Modernization of the Trustee Act *A Modern Trustee Act for British Columbia* (BCLI Report No 33, 2004) at 76.

Classes of persons on behalf of whom the court can give consent

- 9.22 Under section 64A the court can by order only approve an arrangement on behalf of:
- (a) any person who does not have full legal capacity (such as a minor or a person who otherwise lacks legal capacity);
 - (b) any person who has a future interest in trust property or an entitlement which is conditional on some future event;
 - (c) any person not yet born or who is unknown; and
 - (d) any person who could benefit from a protective trust (under section 42) once the interest of the principal beneficiary has come to an end.
- 9.23 The interpretation of paragraph (b) has caused some difficulty for the courts. It covers beneficiaries with a more remote interest than those with vested interests, but it can be difficult to determine exactly what types of beneficiaries fit within this category. The word “unknown” in paragraph (c), taken in context, has been read by the courts as an enlargement of “unborn persons” rather than a new category.²³⁷ Paragraph (c) therefore encompasses persons who if born would have an entitlement, where it was not known whether any such persons had been born or not. Paragraph (c) does not include absent beneficiaries who are known to be born, but whose whereabouts are unknown.
- 9.24 Paragraph (d) relates specifically to discretionary beneficiaries under protective trusts, as defined in section 42 of the Trustee Act.²³⁸ There are some protective trusts in existence in New Zealand, although the mechanism is now seldom used. It is probably no longer necessary to distinguish beneficiaries under protective trusts from others for the purposes of the court giving consent.

237 *Re Campbell (deceased)* [1991] 3 NZLR 363 at 367.

238 Andrew S Butler “Introduction to the Law of Trusts” in Butler (ed) *Equity and Trusts*, above n 227, 41 at 62.

The requirement for no detriment

9.25 The court's power to approve an arrangement under section 64A is discretionary. The only express guidance given when considering whether or not to do so is the requirement that the arrangement must not be to the "detriment" of those beneficiaries on behalf of whom the court provides consent. The court does not need to find a positive benefit to the beneficiary in question; it is sufficient that the arrangement does not leave him or her any worse off. In determining whether an arrangement is to the detriment of any person the court has regard to all benefits which may accrue to him or her directly or indirectly in consequence of the arrangement, including the welfare and honour of the family to which he or she belongs.²³⁹ Where there is a real possibility of detriment to a beneficiary for whom the court has been asked to approve a variation, the problem has sometimes been addressed by covenants to make good any losses that may occur.²⁴⁰

Issues

9.26 The High Court has a limited jurisdiction under section 64A to approve variations or revocations of trusts on behalf of minors and incapacitated or unascertained beneficiaries. It also has limited power to consent to variations on behalf of incapable beneficiaries under its inherent jurisdiction.

9.27 The main problems with the current provision are:

- There is uncertainty over the range of varying arrangements the courts can approve on behalf of beneficiaries.
- The classes of beneficiaries for whom the court can approve varying arrangements are somewhat unclear and are very limited. It is questionable whether the provision adequately caters for the range of situations where the consent of beneficiaries cannot be reasonably obtained.
- The requirement that any varying arrangement must not be to the "detriment" of those beneficiaries on behalf of whom the court provides consent may be too restrictive.
- The court should have greater discretion to consider the consequences of any proposed variation for all affected beneficiaries.

239 See *Re Clifford (deceased)* HC Christchurch A30/82, 22 July 1993 at 11. See also *Van Gruisen's Will Trusts, Bagger v Dean* [1964] All ER 843 and *Re Bryant* [1964] NZLR 846.

240 See *Re Aitken's Trusts* [1964] NZLR 838 (SC) and *Re Smith (deceased)* [1975] 1 NZLR 495.

Options for reform

- 9.28 In terms of the range of varying arrangements the courts should be able to approve on behalf of beneficiaries, the options considered were:
- (a) giving the courts the power to approve any revocation, variation or resettlement of a trust or any change to the scope or nature of the powers of the trustees to manage or administer the trusts; or
 - (b) limiting the courts' powers to approving arrangements that leave the "substratum" or purpose of the trust intact, and/or those that expand the ambit of the trustees' powers to manage or administer the trust property. Under this option new powers would not be able to be added and existing powers could not be removed.
- 9.29 On the issue of the classes of beneficiaries for whom the court should be able to approve varying arrangements we considered the options of retaining the status quo or adding all or some of the following classes:
- (a) persons who have an interest, but whom it is impracticable to contact;
 - (b) persons who have an interest but cannot be traced despite reasonable efforts to do so;
 - (c) persons with an interest in the trust property that is very remote or conditional;
 - (d) persons with an interest in the trust property that is of negligible value;
 - (e) any person who would not be detrimentally affected by the proposed revocation, variation, or resettlement, but who had refused or failed to consent to it.
- 9.30 An alternative approach, suggested by law firm Taylor Grant Tesiram, is to give the court discretion to waive the requirement for consent of persons not currently in the classes covered by section 64A.
- 9.31 We also considered whether the requirement that the court must not approve an arrangement on behalf of any person that is to that person's detriment should be retained. The alternatives considered included requiring the court to consider a broader range of factors when deciding whether to approve a varying arrangement. The relevant factors might include: (i) the nature and significance of the various beneficiaries' interests; (ii) any detriment that the various beneficiaries might suffer as a result of the varying arrangement being approved or not approved; and (iii) the intentions of the settlor. We also considered the option of allowing the court a completely unfettered discretion to determine whether or not to approve any varying arrangement.

Discussion

Range of varying arrangements the courts should be able to approve

- 9.32 We consider that the court should have jurisdiction to agree to any revocation, variation or resettlement of a trust or any change to the scope or nature of the powers of the trustees to manage or administer the trust.
- 9.33 Our assessment is that this approach is the most consistent with the extended rule in *Saunders v Vautier* that allows legally capable adult beneficiaries, by agreement, to vary the terms of any trust or modify the powers conferred upon trustees. We also consider the concept of the “substratum” of a trust or its primary purpose is too elusive and problematic to provide a useful basis for limiting the court’s jurisdiction in respect of variations. Instead we favour the type of approach taken in *Re Greenwood* where the intention of the settlor and the primary purpose of the trust is considered to be one of a number of relevant considerations that the court weights when deciding whether approval should be given.²⁴¹ This does not limit the court’s ability to approve varying arrangements that conflicted with the settlor’s primary intention or the trust’s substratum. We suggest that this approach balances respect for the settlor’s intentions and the possible need for adjustments to be made over time as the needs and interests of the beneficiaries change.
- 9.34 Almost all submitters favoured a specific reference to resettlement in legislation, although one expressed some concern over the court being able to approve a resettlement when the liability for any resultant tax consequences would be borne by trustees. Responses from submitters on whether variations should be limited to those that were consistent with the substratum of the trust were more divided. A number considered that the substratum concept was vague and problematic and should be avoided. The focus of a trust changes over time as the needs and interests of the beneficiaries change. Limiting variations to some supposed original underlying intention or substratum may not be in the best interests of the beneficiaries. However, some submitters thought that the concept of the substratum remained an appropriate restriction on variations. They considered that the intention of the settlor should be respected and the principle that the settlor determines the scope of the trustee powers and the nature of the trusts should not be departed from lightly.
- 9.35 We consider that the better interpretation of “enlarging the powers” of trustees would be that the court may approve any variations to trustees’ powers including those that add new powers or remove existing powers. This is consistent with the rationale that the court ought to be able to agree to any variation that an adult beneficiary might agree to under the extended rule in *Saunders v Vautier*.

241 *Re Greenwood* [1988] 1 NZLR 197 (HC) at 211.

Classes of person for whom the court should be able to approve variations

- 9.36 The classes of person for whom the court can currently approve an arrangement under section 64A are quite limited. It is questionable whether the provision adequately caters for the range of situations where consent cannot reasonably be obtained.
- 9.37 We considered a number of different possible extensions to the classes of persons for whom the court should be able to approve an arrangement. To prevent desirable variations being thwarted there would seem to be a need to provide for situations where one or more ascertainable beneficiary cannot be traced or contacted despite reasonable efforts. Reform might also provide for the court to give approval in situations where persons have only a remote or conditional interest in trust property, or have a notional interest of negligible value. Where there are numerous beneficiaries with a remote or negligible interest in a trust it is impractical and costly to require the personal consent of all of them. It is also unreasonable to allow people with interests that are remote, conditional, or negligible to have a power of veto over variations that are desired by beneficiaries with a more significant interest. Most submitters favoured expanding the classes of person in respect of whom the court could agree to a varying arrangement.
- 9.38 There was concern and less unanimity on the position of the recalcitrant adult beneficiary who has either failed or refused to consent to a variation. The *United States Uniform Code* allows the court to approve a varying arrangement on behalf of a competent adult beneficiary who has declined to consent if he or she would suffer no detriment as a result of the variation. However, law reform bodies in other jurisdictions have not recommended going this far. They have expressed concern that overriding recalcitrant adult beneficiaries could be regarded as expropriation of their property.
- 9.39 The point was made in a number of submissions that there are widely different circumstances in which a beneficiary refuses to consent to a variation that would not be detrimental to their interests. The NZLS said that it might be considered reasonable for the court to overrule a person's refusal where they are one of 3,500 potential beneficiaries with a minor or remote interest. However, it would not be considered so reasonable to override their view if they were one of only a handful of beneficiaries with a more significant interest. We agree that a more nuanced approach is needed. Overriding the views of a beneficiary in the latter type of situation is also not consistent with the underlying principle in *Saunders v Vautier* that those with the right of enjoyment in the property should be able to dictate the manner of enjoyment.

The requirement for detriment

- 9.40 Some concern was raised by submitters over the current requirement that the court could not approve any varying arrangement on behalf of a beneficiary if it was to the beneficiary's detriment. When determining whether an arrangement is to the detriment of any person the court is able to consider

all benefits, including non-financial ones like the welfare and honour of the person's family. However, the court often has to work around the provision to balance what can be relatively technical detriments to one person against the significant consequences that could result for others in not varying the trust. Devices such as covenants to make good any losses are resorted to as a way of getting around the problem of detriment.

Discretion of the court to waive the requirement for consent

- 9.41 In its submission Taylor Grant Tesiram made the important point that as a general rule a power of the court to give substituted consent on behalf of persons (such as the one currently in section 64A) should be restricted to persons who are, because of some disability or other impediment, unable to determine the matter and consent for themselves. It proposed instead an approach that gave the court a discretion to waive the requirement for consent in respect of other people (such as those who could not be traced or those with remote or negligible interests).
- 9.42 We agree that conceptually this is a better approach. It provides a mechanism for dealing with situations where it is impractical to obtain consent or where there are numerous beneficiaries with remote interests and so on, but does not stretch the concept of substituted consent beyond its natural ambit. It is also now clear to us that the type of approach set out in the *Third Issues Paper*²⁴² that lists additional classes of person for whom the court is able to approve an arrangement will not adequately address the various concerns that have been raised. It also does not adequately grapple with the reality of our modern trust landscape.
- 9.43 Many recently established trusts in New Zealand are fully discretionary family trusts. Constructing additional rigid classes based on whether interests are remote, conditional or discretionary is therefore going to be problematic. If the classes are broadly constructed, and include contingent and discretionary beneficiaries, they are likely to capture almost all beneficiaries under modern discretionary trusts. However, if the classes are narrowly constructed they will not adequately cater for the full range of situations that may arise. The court would still need to have a residual discretion to address circumstances that might not have been anticipated.
- 9.44 Our preferred approach takes account of all these points. As well as the current power to give substituted consent on behalf of persons who are, because of some disability or other impediment, incapable of determining the matter for themselves and giving their consent, the court should have a discretionary power to waive the requirement for consent in respect of any other interested person and approve any varying arrangement. When exercising its discretion under this provision the court should take into account the nature of the interests of everyone affected by the proposed arrangement, and the benefits or detriments to those affected if the court

242 *Third Issues Paper*, above n 220, at [5.69].

approved that arrangement or if the court declined to approve the arrangement. The court should also be required to consider the intentions of the settlor to the extent that these can be ascertained.

- 9.45 The concern that overriding the views of recalcitrant adult beneficiaries would in some situations be regarded as expropriation of their property rights needs to be addressed. This could be done by including a proviso that the court may not use its discretionary powers under the proposed provision to reduce or remove any vested interest or other property rights. The provision could not be used to reduce or remove the interests of *sui juris* beneficiaries who have refused their consent. If it were to do so that would amount to expropriation of the person's property.

EXTENSION OF TRUSTEES' POWERS BY THE HIGH COURT

Proposal

P40 The court should have the power to make amendments to the non-distributive administrative provisions of any trust deed where necessary to enable the trustees to efficiently manage trust property. The court should be able to amend a trust deed to enlarge on an ongoing basis the scope of the powers available to the trustees' for administering or managing trust property. The court should not, however, be able to alter the beneficial interests under the trust under this provision.

Please give us your views on this proposal.

Current law

- 9.46 Section 64 of the Trustee Act is essentially administrative in nature, empowering the court to sanction specific transactions where they would be in the best interests of beneficiaries and there would otherwise be difficulties in effecting those transactions. The types of transactions listed in the section are sale, lease, mortgage, surrender, release, other disposition, purchase, investment, acquisition, retention or expenditure. These are all transactions concerned with the non-distributive administration of the trust property. The provision does not permit the court to make changes to the beneficial interests under the trust.
- 9.47 Before any transaction can be approved under section 64 the court must be satisfied that it would be inexpedient, difficult or impractical to undertake the transaction without the court's assistance. The court must also be satisfied that the transaction in question is expedient for the trust as a whole, rather than just expedient for one or more of its beneficiaries. The cases are clear that the court should not sanction a transaction, however expedient it may be for one beneficiary, if it is inexpedient from the point of view of the others.
- 9.48 Section 64 provides that the court may "by order confer upon the trustee, either generally or in any particular instance, the necessary power for the

purpose” of undertaking and completing the transaction. On a narrow interpretation, section 64 does not expressly authorise actual variations to the trust deed. However, the courts have used the provision to approve changes to trust deeds. The phrase “by order confer upon the trustee, either generally or in any particular instance, the necessary power” has been interpreted broadly as implying a power to amend the trust deed.

- 9.49 The court’s power to sanction transactions under the section is “subject to any contrary intention expressed in the instrument ... creating the trust”. The words contrary intention do not mean unless expressly forbidden. Rather, consideration needs to be given to whether, on a fair reading of the trust deed as a whole, the proposed power would be inconsistent with the purpose of the trust deed. The intent of the settlor cannot be overruled by the court.
- 9.50 The court is able, under section 64, to make an order even where there is objection on the part of anyone who is or may be interested as a beneficiary. There is no requirement that the beneficiaries consent to the variation. The High Court has also used its inherent jurisdiction to effect modifications of an administrative nature, rather than changes to beneficial interests.

Issues

- 9.51 Section 64 makes an unnecessary distinction between the court conferring on the trustees the necessary powers to undertake a class of transaction and simply amending the administrative provisions of a trust deed. The threshold for court intervention is also set high. The court must be satisfied that it would be inexpedient, difficult or impractical to effect the transaction in question without the court’s assistance.
- 9.52 The question is whether the legislation should give the court a more direct power to modify the trustees’ administrative powers under a trust deed to allow them to more effectively manage and administer the trust and its assets, and, if so, whether the threshold for intervention should be lower.

Options for reform

- 9.53 New legislation should more clearly state what types of modifications can be made by the court to the terms of a trust without the agreement of the beneficiaries.
- 9.54 We considered the option of giving the court the power to make amendments to the non-distributive administrative provisions of the trust deed where necessary to enable the trustees to efficiently manage trust property. The court would be able to amend the trust deed to enlarge the scope of the powers available to the trustees for administering or managing trust property but would not be able to alter the beneficial interests under the trust. The option of allowing the court to also amend those trustees’ powers that altered the beneficial interests under the trust was not considered here because powers to approve varying arrangements that affect beneficial interests have already been addressed in the previous section of this chapter.

- 9.55 The alternative of retaining the current approach and confining the court's power to sanctioning transactions concerned with the non-distributive administration of the trust property was also considered. If the status quo was retained the court's power would not extend to amending the provisions in the trust deed.

Discussion

- 9.56 Traditionally section 64 has mainly been applied to authorise dealings with trust assets in a way that has not been contemplated or authorised by the trust deed. It can be distinguished from the type of intervention undertaken under section 64A (which allows more substantive amendments to trusts including changes to provisions about beneficiaries). We consider this type of distinction should be retained. However some broadening of the provision to allow the court to make amendments to the non-distributive administrative provisions of the trust deed where this is necessary to enable the trustees to efficiently manage trust property seems appropriate.
- 9.57 In our view the criteria for the court's intervention should also be modified. The requirement that any proposed change be in the interests of the beneficiaries as a whole should be retained but it seems unnecessary to require the trustees to demonstrate that it is too difficult, impractical, or inexpedient to effect the proposed changes any other way. The provisions in question are the non-distributive administrative provisions of the trust deed. Trustees should simply be required to show that the change is necessary for the efficient management of the trust and its assets.
- 9.58 Submitters favoured an approach that restricted any replacement section 64 to amendments that are for the administration and management of the trust assets rather than more substantive changes. Some thought section 64 should be restricted to individual transactions that the court could approve if it was satisfied that they were expedient for the trust as a whole. A further concern was that the court should continue to be precluded from agreeing to any change, where on a fair reading of the trust deed as a whole, the change would be inconsistent with the trust deed.
- 9.59 These concerns reflect the basic principle that the settlor gives the trust property to the trustees, subject to whatever conditions and restrictions the settlor believes are important and that the law should not lightly override a settlor's decision to restrict the trustees' powers and modify the trust deed. If the court is required to sanction specific transactions then a judgement is made on the facts of the specific case that the proposed action is appropriate. It can be argued that this is preferable to changing the trustees' powers because it ensures greater scrutiny of each individual instance where the trustees' exercise the power.
- 9.60 However, the counter argument is that it is impractical and costly to require trustees to go to court on every individual transaction that falls outside their administrative powers. It is more efficient to have the court modify the trust deed rather than deal with specific transactions. The current section 64

already allows the court to more generally sanction transactions outside the scope of the trustees' powers. As a matter of practical reality a general order authorising a type of dealing with trust property that is not authorised by the trust deed effectively amends the trustees' powers. It would therefore be clearer and simpler for the court to amend the trust deed. The law would also be more transparent if it did this.

- 9.61 Our preferred approach seeks to strike an appropriate balance between administrative expediency and respecting the settlor's intentions.

VARIATION PURSUANT TO A TRUST DEED

Proposal

P41 New legislation should continue the status quo and have no statutory provision regarding variation clauses under a trust deed.

Please give us your views on this proposal.

Current law

- 9.62 Variation and resettlement powers are commonly included in trust deeds. Variation powers usually lie with the trustees, but may be reserved to the settlor or some other person. It is also possible to include a revocation power in a trust deed, although such provisions are uncommon these days.
- 9.63 The extent of any such power will depend on the interpretation of the clause and deed itself. The principles applying to the interpretation of contracts are also applied to the interpretation of trusts. As *Garrow and Kelly* illustrates, the nature of a trust, for example, whether it is a family trust, a superannuation trust, debenture trust, or energy trust, also influence how its provisions are interpreted.²⁴³ It is therefore difficult to identify definitive rules from the case law that could guide the use of variation clauses. Clauses need to be construed in the context of the type of trust involved and the particular wording employed.
- 9.64 Generally speaking, it seems that "clear words" giving a power of variation are required and the court is to "construe each provision according to its natural meaning, and in such a way to give it its most ample operation".²⁴⁴ A general broad power giving the trustees the fullest possible powers or the powers of a natural person cannot be used by trustees to change or add to their own powers and duties created by the trust deed. These types of general powers are normally interpreted as supplementing the other specific powers given by the deed, but not as intending to convey a power of variation. There appears to be a rebuttable presumption that a variation power cannot be

²⁴³ *Garrow and Kelly*, above n 219, at ch 11.

²⁴⁴ *Kearns v Hill* (1990) 21 NSWLR 107 (SC) at 109.

used to extend its own scope or amend its own terms.²⁴⁵ Trustees cannot use variation powers to remove a specific restriction to which they were subject from the very foundation of the trust.²⁴⁶

- 9.65 In a number of cases the courts have held that a power of variation cannot be used by the trustees to change the fundamental purpose of the trust (the substratum).²⁴⁷ The rationale is that the variation clause needs to be interpreted consistently with the settlor's intention and purpose in establishing the trust. However, it is not clear whether this approach of preserving the substratum would hold up where a variation clause explicitly authorised the trustees to make fundamental changes to the terms of a trust.

Issues

- 9.66 We have considered whether the common law should be stated in legislation and whether legislation should impose limits on how far a trust deed can allow a trust to be varied.

Options for reform

- 9.67 The options are:
- (a) maintaining the status quo and not using legislation to limit the scope of variation powers in trust deeds. Variation clauses would continue to be construed on a case by case basis according to the existing common law principles of interpretation.
 - (b) enacting a provision stating the common law position that deed trusts may include variation powers, and that such clauses should be construed on a case by case basis according to the common law principles of interpretation.
 - (c) enacting statutory guidance for interpreting variation clauses. Guidance might, for example, include the rebuttable presumptions that a variation power cannot be used to extend its own scope or amend its own terms and that a variation power may not be used by the trustees to change the fundamental purpose of the trust.

245 David Hayton, Paul Matthews and Charles Mitchell (eds) *Underhill and Hayton: Law Relating to Trusts and Trustees* (17th ed, LexisNexis Butterworths, London, 2007) at [47.19].

246 *Re UEB Pension Plan* [1992] 1 NZLR 294 at 301.

247 *Garrow and Kelly*, above n 219, at [26.4].

Discussion

- 9.68 Given the need for a contextual approach to be taken to the interpretation of variation and resettlement powers, we indicated in the *Third Issues Paper*²⁴⁸ that we thought little could be gained from enshrining guidance in legislation. However, while unnecessary from a remedial perspective, enacted guidance could have some educative and explanatory benefit. People may find it confusing or misleading for other aspects of the law on variations to be in legislation but not the law on variation clauses in trust deeds.
- 9.69 In our view variation clauses should continue to be construed on a case by case basis according to the existing principles of interpretation. The existing principles of interpretation are well understood and flexible and that enacting statutory guidance in this area risks stifling further development of the principles of interpretation. There is merit in allowing a consistent approach to the interpretation of legal documents to be developed by the courts in all areas of law.
- 9.70 There would therefore seem to be little value in restating the common law in legislation as this is not an area where the status quo is causing any problems. There are also risks that unintended legal consequences could arise from the enactment statutory guidance in this area.

248 *Third Issues Paper*, above n 220, at [5.56]–[5.60].

Chapter 10

Reviewing the exercise of trustee discretion

INTRODUCTION

- 10.1 This chapter considered whether the statutory review procedure under section 68 of the Trustee Act 1956 for reviewing the exercise of a trustee's discretion should be retained and, if so, what reforms should be made to that procedure.

STATUTORY REVIEW OF TRUSTEES

Proposal

- P42 (1) A new mandatory (non-excludable) statutory review procedure should replace section 68. Under the new provision there would be a two stage process:
- (a) an applicant would be required to put forward evidence that raises an issue as to whether or not a trustee has exercised a power lawfully or that shows reasonable grounds to anticipate an issue as to whether or not a trustee would exercise a power lawfully (first stage);
 - (b) the court would then review the exercise of the trustee's power, with the onus on the trustee to substantiate and uphold the grounds of the act, omission or decision that is being reviewed (second stage).
- (2) The ground on which the court may review a trustee's act, omission or decision under the provision would be whether it was one that was not reasonably open to the trustee in the circumstances.
- (3) In the second stage of the procedure, the trustee can be required to appear before the court to substantiate his or her decision.
- (4) A trustee's act, omission or decision under a power either in the new Act or the trust deed would be subject to review.
- (5) An "applicant" would include:

- (a) any beneficiary, including anyone who might potentially, at some time, benefit under the terms of a trust or anyone who is the object of a power of appointment;
 - (b) any personal representative of a beneficiary who lacks capacity (such as a parent or guardian of a minor beneficiary, and a property manager or holder of an enduring power of attorney for an incapacitated beneficiary); and
 - (c) a settlor.
- (6) Where the court finds the trustee's act, omission or decision was one that was not reasonably open to the trustee, the court may make any orders it considers necessary in the circumstances, except that the court may not disturb any distribution of trust property that has been made without a breach of trust before the trustee was aware of the application to the court. The court may not affect any right acquired by a person in good faith and for value.

Please give us your views on this proposal.

Current law

- 10.2 Section 68 permits a beneficiary aggrieved by an act, omission or decision of a trustee to apply to the High Court to review that act, omission or decision. A beneficiary may also apply if he or she has reasonable grounds to anticipate that an act, omission or decision of a trustee will aggrieve the beneficiary. The court may require the trustee to appear before it and substantiate the trustee's decision. The court may make any orders as are necessary in the circumstances except that the court may not disturb any distribution of trust property that has been made without a breach of trust before the trustee was aware of the application to the court. The court also may not affect any right acquired by any person in good faith and for value.
- 10.3 The statutory jurisdiction under section 68 can only be invoked by a person who is beneficially interested in the trust property. In addition, it is limited to acts, omissions or decisions of a trustee in the exercise of a power conferred by the Act. Trustees' powers conferred by trust deed or by another statute fall beyond the jurisdiction of section 68, as do powers conferred by court order.²⁴⁹
- 10.4 Section 68 is silent about whether it gives the court a greater ability to interfere with a trustee's decision than under the court's inherent jurisdiction to supervise the exercise of discretionary powers by trustees.

²⁴⁹ *Jaspers v Greenwood* [2012] NZHC 2433 at [19].

10.5 In relation to the courts' inherent jurisdiction to supervise trustees, Jeff Kenny has noted that there are difficulties framing and interpreting the grounds on which the court will intervene in the exercise of discretionary powers. He says that the courts have employed a wide range of terms in different cases when describing conduct by trustees and this has not assisted in developing a clear test for intervention.²⁵⁰ The courts have, for example used the terms "arbitrarily or unreasonably", "capriciously", "improperly or unreasonably", "mischievously or ruinously", and "wantonly and capriciously" in different cases.²⁵¹ On occasion attempts have been made to set out in a more comprehensive way the grounds for intervention. In *Dundee General Hospitals Board of Management v Walker* Lord Reid said:²⁵²

If it can be shown that the trustees considered the wrong question, or that, although they purported to consider the right question they did not really apply their minds to it or perversely shut their eyes to the facts or that they did not act honestly or in good faith, then there is no true decision and the court will intervene.

10.6 In New Zealand the most comprehensive outline of the grounds for intervention is in the decision of Fisher J in *Wrightson Ltd v Fletcher Challenge Nominees Ltd*. In summary court will set aside the trustee's decision only where the trustee has:²⁵³

- acted in bad faith or for an improper motive;
- failed to exercise the discretion by considering the wrong question or misinterpreting the trust deed;
- considered irrelevant considerations;
- failed to consider relevant considerations; or
- reached a decision that is perverse or capricious.

10.7 A further ground for intervention that has been discussed in some cases is that the trustee must not have acted unreasonably in the exercise of the power or discretion.²⁵⁴ The rationale, here being that the donor of the power has given trustees their powers on the implicit basis that they will exercise them reasonably.²⁵⁵ In *Wrightson Ltd v Fletcher Challenge Nominees Ltd* Fisher J said that "unreasonableness is a notoriously vague concept in any context". He agreed with the obiter comments of Tipping J in *Craddock v Crowhen* that in this context a trustee's decision would not be regarded as unreasonable unless

250 Jeff Kenny "Trustees Powers" in Andrew S Butler (ed) *Equity and Trusts in New Zealand* (2nd ed, Thomson Reuters, Wellington, 2009) 155 at 158–161.

251 At 159.

252 *Dundee General Hospitals Board of Management v Walker* [1952] 1 All ER 896 (HL) at 905.

253 *Wrightson Ltd v Fletcher Challenge Nominees Ltd* (1998) 1 NZSC 40,388 at 40,413.

254 At 40,413; *Craddock v Crowhen* 1 NZSC 40,331; *Gailey v Gordon* [2003] 2 NZLR 192 (HC) at [89].

255 *Wrightson Ltd v Fletcher Challenge Nominees Ltd* (1998) 1 NZSC 40,388 at 40,413.

it was one which “no reasonable trustee could rationally have made in all the circumstances”.²⁵⁶ Later in *Gailey v Gordon* O’Regan J declined to further develop any grounds for intervention around unreasonableness saying that “the potential for the Court to intervene in the exercise of discretion by trustees where the discretion has been exercised unreasonably involves some extension of the Court’s supervisory role”. He considered that the question should be left for a superior court.²⁵⁷

- 10.8 The question of whether the court can only interfere under section 68 with a decision of a trustee if one of the established grounds for intervention can be shown has not been fully resolved. The Supreme Court of Western Australia in *Wendt v Orr*, when considering the Western Australian equivalent of section 68, was not prepared to limit itself in that way. It considered that while the established grounds for intervention would allow the court to intervene, there may be other grounds as well.²⁵⁸ In one of the very few cases on the provision, *Rossiter v Wrigley & Alves*, the High Court quoting from *Garrow and Kelly Law of Trusts and Trustees* seemed to consider that section 68 “would seem to give the Court a wide power to interpose its guiding, or restraining, hand on the exercise by trustees of their powers and discretions ... where the power is one conferred by the Trustee Act 1956”.²⁵⁹
- 10.9 However, given the paucity of case law on section 68, this matter remains unresolved. There is a compelling argument that the settlor has given the discretion to the trustees and not the court, so the court should be as reluctant under section 68 to interfere with the trustee’s decision as it is under its general equitable jurisdiction. The role of the court should be a supervisory one ensuring that discretions and powers entrusted to trustees are properly exercised by them.²⁶⁰

256 This comment of Tipping J’s in *Craddock v Crowhen* 1 NZSC 40,331 was cited with approval in *Wrightson Ltd v Fletcher Challenge Nominees Ltd* (1998) 1 NZSC 40,388 at 40,413.

257 *Gailey v Gordon* [2003] 2 NZLR 192 (HC) at [89].

258 *Wendt v Orr* [2004] WASC 28 at [56].

259 N C Kelly *Garrow and Kelly Law of Trusts and Trustees* (5th ed, Butterworths, Wellington, 1984) at 404 quoted in *Rossiter v Wrigley* HC Hamilton A105/80, 3 July 1989 at 6.

260 Where trustees are exercising a discretion as to some matter under the trust deed the traditional position is that the court will not interfere with the exercise of that power or discretion unless the trustees have acted in bad faith or beyond the scope of their discretion; see Noel C Kelly, Chris Kelly and Greg Kelly *Garrow and Kelly Law of Trusts and Trustees* (6th ed, LexisNexis, Wellington, 2005) at [19.3.1] [*Garrow and Kelly*].

- 10.10 Section 68 allows a beneficiary to apply to the court to have the trustee appear before the court and substantiate the grounds for a decision. The court may then require trustees to disclose their reasons to the court. In *Rossiter v Wrigley & Alves* the court required the applicant to do no more than satisfy the standing requirement before requiring the trustee to show that he had not breached a duty or standard.²⁶¹ In the recent case of *Jaspers v Greenwood*, the court considered that *Rossiter* was not authority generally for the proposition that, on a section 68 application, the onus lies on the defendant trustees to justify his or her actions as prior orders to that effect had been made in *Rossiter*. The court in *Jaspers* disagreed with *Rossiter* in finding that section 68 does not alter the ordinary incidence of the onus lying on the applicant for review under section 68.²⁶²
- 10.11 In Queensland, where there have been a number of cases under a similarly worded provision,²⁶³ the courts have placed more onus on the applicant beneficiary to show that the trustee has breached the appropriate standard of conduct required of trustees before they have required a trustee to appear to defend his or her actions.²⁶⁴

Need for a statutory review procedure

- 10.12 We considered whether or not a statutory review procedure should be retained. We agree with submitters who considered that it would be confusing to repeal section 68 and leave review to the courts' inherent jurisdiction. We propose including a provision in new legislation to replace section 68. The discussions below address the questions raised on the scope and nature of a new provision in the *Fifth Issues Paper*.²⁶⁵

WHAT SHOULD AN APPLICANT BE REQUIRED TO PROVE?

Options for reform

- 10.13 The options regarding what an applicant should be required to prove in order for the court to review a trustee's decision are:
- (a) requiring an applicant merely to apply and satisfy the court that he or she has standing to bring the application. The onus would then shift to the trustees to substantiate their decision;

261 *Rossiter v Wrigley* HC Hamilton A105/80, 3 July 1989.

262 *Jaspers v Greenwood* [2012] NZHC 2433 at [23] (comments in obiter).

263 Trustee Act 1956 (Qld), s 8.

264 See the discussion on the Queensland cases in CEF Rickett "Reviewing a Trustee's Act, Omission or Decision under Section 68 of the Trustee Act 1956" [1990] NZ Recent Law Review 69 at 80.

265 Law Commission *Court Jurisdiction, Trading Trusts and Other Issues: Review of the Law of Trusts – Fifth Issues Paper* (NZLC IP28, 2011).

- (b) requiring an applicant to put forward evidence that raises an issue about the trustees' exercise of their power. The onus would then shift to the trustees to substantiate their decision; or
 - (c) requiring an applicant to show on the balance of probabilities that the trustees breached the appropriate standard of conduct required of trustees. Only then could the trustees be required to substantiate their decision.
- 10.14 Option (a) is essentially the approach taken in *Rossiter v Wrigley & Alves*, while option (c) is more akin to the approach taken by the courts under the Queensland provision.²⁶⁶ Option (c) is also, of course, the standard more normally applied by the courts under their general equitable jurisdiction to supervise trustees' decision-making and was the approach recently taken by the High Court in *Jaspers*.²⁶⁷ Option (b) is something of a compromise. It is based on a proposal for reform presented by Jeff Kenny in *Equity and Trusts in New Zealand*.²⁶⁸

Discussion

- 10.15 The risk with option (a) is that the bar is set too low and that trustees may end up having to respond to frivolous time and resource wasting applications. All submitters considered that there should be some obligation on an applicant to raise at least a tenable issue. Most also expressed concern that trustees could be subject to nuisance claims by beneficiaries who merely disliked their decision or had a general sense of grievance.
- 10.16 Under option (c) an applicant would have to produce evidence about the trustees' reasons in order to prove that the trustee had not lawfully exercised his or her discretion. However, the applicant is not entitled to disclosure of those reasons unless the applicant can show that the trustee has not lawfully exercised the discretion. There was support for option (c) from five of the seven submitters that commented on this issue. They considered that the applicant should bear the onus of demonstrating that a trustee's decision or action should be interfered with by the court. They favoured the approach taken in Queensland and argued that the presumption should be that a trustee has appropriately exercised his or her discretion unless it is proven, on the balance of probabilities, that this is not the case.
- 10.17 Our concern with option (c) is that it sets too high a threshold for beneficiaries to overcome given the information asymmetry between trustees and beneficiaries. A trustee is not required to give reasons for the exercise of his or her discretions. Without knowing the reasons, it may be difficult for a beneficiary to challenge the exercise of a trustee's discretion as improper.

266 See the discussion contrasting the two approaches in *Rickett*, above n 264, at 78.

267 *Jaspers v Greenwood* [2012] NZHC 2433 at [23] (comments in obiter).

268 Kenny, above n 250, at 192.

This rather defeats the purpose of a review provision – which is to provide a mechanism to allow beneficiaries to hold trustees to account. This concern was shared by the other two submitters and led them to suggest a different approach. The New Zealand Law Society (NZLS) said option (c) risks becoming a “haven for trustees”. It proposed that where an applicant produced evidence that a trustee may not have exercised a power lawfully, the trustee’s reasons should be disclosed to the court. The court could then review that decision to determine whether it complied with the law.

- 10.18 Law firm Taylor Grant Tesiram submitted that it could be too difficult for a beneficiary to challenge the exercise of a trustee’s discretion if the onus is on him or her to prove a breach. Its suggestion that an applicant should instead have to raise a tenable issue and then the onus would rest on the trustees to satisfy the court that their discretion was properly exercised on the balance of probabilities was similar to option (b).
- 10.19 We favour option (b) because it will prevent trustees being subject to nuisance claims by beneficiaries who merely dislike a decision reached by a trustee or beneficiaries who are perpetually aggrieved. The proposed provision broadens the ability to have trustees’ decisions reviewed, although this is subject to a clear threshold of evidence that is needed before an application is considered by the courts. We consider that this reform is beneficial for beneficiaries in that it provides a clear and workable mechanism for holding trustees to account.

APPLICATION TO TRUSTEES’ POWERS UNDER TRUST DEEDS

Options for reform

- 10.20 The options considered were:
- (a) a new provision to allow for trustee decisions under either the new Act or the trust deed to be reviewed, for instance, based on section 8 of the Trusts Act 1973 (Qld) which provides that an application can be made in respect of:
 - any act, omission, or decision of a trustee or other person in the exercise of any power conferred by the Act or by law or by the instrument (if any) creating the trust.
 - (b) retaining the status quo which would allow only trustee decisions under the new Act to be reviewed.

Discussion

- 10.21 We consider that a new provision should allow for the review of all powers regardless of whether they are sourced from the new Act or the trust deed. This has the advantage of introducing a consistent standard across all such actions. It also addresses any uncertainty over whether review is available where powers contained in the statute are reproduced in the trust deed. Most submitters were in favour of this approach. They argued that it is something

of an anomaly to allow the court to review when trustees exercise statutory powers but not when they exercise powers set out in the trust deed. It is confusing and leads to inconsistencies in the law. The NZLS noted that in Queensland the wider scope for review has not resulted in the courts more readily interfering with trustee decisions.

- 10.22 If the provision is extended to cover trustee decisions under trust deeds as well as under the Act, then careful consideration also needs to be given to the question of what limits should be placed on the grounds for intervention by the courts. Currently, if a power is given to trustees by the trust document the courts are reluctant to interfere, as long as the power is exercised in good faith and not ultra vires. Most of the concern over extending review under section 68 to powers under trust deeds arises due to concern that the grounds for intervention will be expanded too broadly. Greg Kelly Law said in its submission that a new review provision should apply to all powers and discretions given to trustees whether under the statute or the trust deed, however this support was contingent on limits being placed on the grounds for intervention by the courts. Taylor Grant Tesiram submitted that a power to review should not extend to the exercise of dispositive discretions, such as the power to distribute income or capital.

WHO SHOULD HAVE STANDING TO APPLY FOR A REVIEW?

- 10.23 This issue particularly addresses the question of which types of beneficiaries should be able to apply under the section. The court has jurisdiction to review a decision of a trustee under section 68 only where an applicant has a beneficial interest in the trust fund. The specific wording in the section is “any person who is beneficially interested in any trust property”. Some commentators and judges have suggested that it is arguable that discretionary beneficiaries cannot apply under the section,²⁶⁹ while others have considered that it is likely that a person with contingent or vested interests, whether indefeasible or subject to divestment, would be considered “beneficially interested”.²⁷⁰

Options for reform

- 10.24 The options we considered were:
- (a) defining beneficiary broadly, so that anyone who might potentially, at some time, benefit under the terms of the trust or anyone who is the

269 Professor Rickett says that it is arguable that discretionary beneficiaries cannot apply under the section; see Rickett, above n 264, at 80; accepted in obiter by Kós J in *Jaspers v Greenwood* [2012] NZHC 2433 at [21]–[24].

270 The authors of *Garrow and Kelly* express this view and cite *Johns v Johns* [2004] 3 NZLR 202 (CA) at [49] in support of their view of what beneficially interested might include; see *Garrow and Kelly*, above n 260, at 743.

object of a power of appointment may apply for review under the provision; or

- (b) defining beneficiary more narrowly for the purposes of the section to exclude discretionary beneficiaries or those who are merely objects of a power of appointment.

Discussion

- 10.25 We agree with the handful of submitters who commented on this issue that the broadest possible definition of beneficiary is appropriate given the very different types of discretionary and other trusts in common use in New Zealand that should be caught by this provision. The NZLS submitted that the new provision should not distinguish between beneficiaries of a trust and the objects of a power of appointment, and that both should be entitled to make an application. Additionally, the fact that trust deeds often contain a mixture of trusts, trust powers and mere powers, which the NZLS also points out, support this option. Distinctions will always remain between trusts, trust powers, and mere powers. The court is able to consider the beneficiary's entitlements under the terms of the trust in determining whether the trustee should be required to appear and disclose their reasons.
- 10.26 In the *Introductory Issues Paper*²⁷¹ we discussed the problems that have arisen in some cases in distinguishing between a discretionary trust (where a trustee has a duty to select which beneficiaries shall actually benefit and to distribute to those selected beneficiaries) and a bare power of appointment (where the donee of a power generally has no such duty but just a discretion to distribute).²⁷² Traditionally the classification as either a trust or a power has affected the duties and rights of the parties involved. The objects of a bare power of appointment cannot ask the court to enforce the power, whereas the court can intervene in a discretionary trust. The general tenor of submissions on that issue has been that the law of trusts ought to apply to powers of appointment within a trust where the donee of the power is also a trustee. We share that view and it has underpinned the development of the preferred approach across all policy areas. We see no reason to now draw a distinction in respect of applications for review.
- 10.27 Our proposed approach is to define beneficiaries broadly, so that anyone who might potentially, at some time, benefit under the terms of the trust or anyone who is the object of a power of appointment may apply for review under the provision. We consider that it would be appropriate to allow the guardians of minor beneficiaries and representatives of incapacitated beneficiaries to apply under the section. This is consistent with the definition of beneficiary proposed in chapter 2.

271 Law Commission *Review of Trust Law in New Zealand: Introductory Issues Paper* (NZLC IP19, 2010).

272 At [3.16]–[3.23].

- 10.28 We also consider that settlors should be able to apply under this provision as they are an interested party in how the trustees are carrying out the trust. The evidential threshold we propose as the first stage of the process for having the exercise of a trustee's power reviewed will ensure that settlors must have a legitimate issue with the trustee's conduct before the court will properly consider an application.

GROUNDS FOR COURT INTERVENTION

- 10.29 Section 68 does not prescribe the circumstance in which the court may interfere with a trustee's decision or action. This may give the court a wide power to interpose its guiding, or restraining, hand on the exercise by trustees of their powers and discretions. In *Rossiter v Wrigley* the Court seemed to consider that the standard for review was whether the trustees acted reasonably or not in the steps that they took.²⁷³ In obiter comments in the recent case of *Jaspers v Greenwood* Kós J said that:²⁷⁴

the relevant beneficiary grievance must involve the exercise (or intended exercise) of a trustee power in a manner that is ultra vires, vitiable on the basis of relevance of considerations or bad faith, or unreasonable in a *Wednesbury* sense. In other words, the ordinary means of review of the exercise of a statutory power.

In *Wendt v Orr* the Supreme Court of Western Australia considered that while the established grounds for intervention allow the court to intervene, there may be other grounds as well.²⁷⁵ There is therefore some uncertainty as to the ground on which the court may currently intervene under section 68.

- 10.30 This raises an important issue. We have already proposed expanding the scope of any new section 68 so it applies to the exercise of any power by a trustee whether that power is conferred by the Act, or by law, or by the trust deed. If the ambit of the review provision is expanded in this way there is scope for far greater use to be made of such review, and the question of what is the most appropriate standard for the courts to apply when reviewing a trustees' actions becomes more important. If the courts take the broader approach that seemed to be taken in *Rossiter v Wrigley* the standard is whether the trustee acted reasonably or not.²⁷⁶ This sets a low threshold for intervention and also imposes a high standard of obligation on trustees. Trustees are effectively required to act reasonably when exercising any of their powers.

273 *Rossiter v Wrigley* HC Hamilton A105/80, 3 July 1989.

274 *Jaspers v Greenwood* [2012] NZHC 2433 at [22] (comments in obiter).

275 *Wendt v Orr* [2004] WASC 28 ; see also the discussion in Kenny, above n 250, at 190.

276 *Rossiter v Wrigley* HC Hamilton A105/80, 3 July 1989.

Options for reform

- 10.31 The options we considered for the grounds for review were:
- (a) restricting the grounds to those already developed by the court under its supervisory equitable jurisdiction, namely that the trustees:
 - acted in bad faith or for an improper motive;
 - failed to exercise the discretion by considering the wrong question or misinterpreting the trust deed;
 - considered irrelevant considerations;
 - failed to consider relevant considerations; or
 - reached a decision that is perverse or capricious;
 - (b) whether the court considers that the act, omission or decision of the trustee was one that was not reasonably open to the trustee in the circumstances;
 - (c) whether the court considers that the trustee acted reasonably; or
 - (d) allow the court to determine the grounds for review.

Discussion

- 10.32 We consider that on balance a new provision should specify the standard against which the court will review trustees' decisions. If the new provision is silent there will be continued uncertainty about the standard expected of trustees when exercising their powers. As discussed, there is currently some uncertainty as to whether trustees are required to exercise powers sourced from the Trustee Act reasonably or risk review under section 68. To make the position clear, and to alleviate concern that extending the range of powers that may be reviewed under the provision to include those in the trust deed as well may result in excessive intervention by the courts with trustees' decision-making, the new provision should specify the standard against which trustees are to be reviewed. We are concerned that simply leaving it to the courts to develop the grounds for intervention without any legislative guidance would be unhelpful.
- 10.33 Some submitters argued that review under the provision should be limited to reflect the grounds developed by the court under its supervisory equitable jurisdiction which are that the trustees acted *ultra vires* or in bad faith. This reflects the court's role as a corrector of fundamentally flawed decisions and not a *de facto* trustee. There was favour from some submitters for new legislation clarifying that trustees' decisions cannot be overturned on the grounds of unreasonableness. Other submitters favoured the standard in option (b).
- 10.34 The NZLS argued against option (c) as it considered the word "reasonably" to be imprecise and various forms of noncompliance by a trustee can fall

within the meaning of “unreasonable”. It can also give the impression that the merits of a trustee’s decision can be examined for reasonableness. The NZLS considered that the term “irrational” (in the sense that no reasonable trustee could make the decision) was more precise and should be used instead. However, it favoured the grounds on which the court may interfere with a trustee’s decision being left open for the courts to continue to develop. They argued that many of the grounds for intervention overlap and that trying to specify the grounds in legislation would be too complex and that there is also potential for unintended outcomes.

- 10.35 The authors of *Garrow and Kelly* have argued that caution should be exercised before importing administrative law concepts such as unreasonableness into trust law.²⁷⁷ Requiring trustees of a typical trust to meet standards of reasonableness may set the standard too high. Trustees are selected by a settlor because they are trusted to give effect to the settlors’ interests. Chris Kelly has suggested that excessive judicial intervention with trustees’ decision-making may encourage unnecessarily defensive attitudes by trustees.²⁷⁸ Trustees need to be able to administer the trust fund without being second guessed by the courts. Striking a balance between these considerations and the need for beneficiaries to be able to hold trustees to account is not an easy task.
- 10.36 We consider that the standard of whether the action or decision of the trustee was one that was not reasonably open to the trustee in the circumstances strikes an appropriate balance between these considerations. Option (b) is preferred to a less precise test of whether the decision is unreasonable.
- 10.37 We also consider that the court’s inherent jurisdiction to supervise and review the action of trustees’ should be unaffected by any new provision. A number of submitters agreed. Thus it would be possible to apply to the court either under the replacement for section 68 or the inherent jurisdiction or both. The preservation of the case law would enable New Zealand courts to benefit from decisions in other common law countries as the law develops.

277 *Garrow and Kelly*, above n 260, at 521.

278 Chris Kelly “Supervision of Trustees: Enforcement or Problem Solving” (LLM Thesis, Victoria University of Wellington, 2009) at 47.

Chapter 11

Other powers of the court under the Trustee Act

INTRODUCTION

- 11.1 A wide variety of unrelated powers are conferred on the court by different sections of the Trustee Act 1956. This chapter deals with the issues raised by these remaining provisions.²⁷⁹ The provisions of the Trustee Act considered here are:
- section 66 – applying to court for directions;
 - section 72 – authorising payment of commission;
 - section 74 – a power to make a beneficiary indemnify for breach of trust;
 - section 75 – barring claims and future claims;
 - sections 77 to 79 – payment of trust money to the Crown;
 - section 76 – distribution of shares of missing beneficiaries; and
 - section 35 – protection against creditors by means of advertising.
- 11.2 The chapter makes a number of proposals for reforming these provisions.

²⁷⁹ These sections were all discussed in Law Commission *Court Jurisdiction, Trading Trusts and Other Issues: Review of the Law of Trusts – Fifth Issues Paper* (NZLC IP28, 2011), except s 66, which was discussed in Law Commission *The Duties, Office and Powers of a Trustee: Review of the Law of Trusts – Fourth Issues Paper* (NZLC IP26, 2011).

SECTION 66 – POWER OF COURT TO GIVE DIRECTIONS

Proposal

P43 New legislation should:

- (a) retain the power to apply to the court for directions;
- (b) codify the case law principle that as far as possible trustees should present a proposed course of action regarding the matter on which they seek directions;
- (c) provide that the power to apply for directions can only be exercised by current trustees of the trust;
- (d) provide that for the avoidance of doubt, the statutory power to apply to the court for directions does not restrict the ability of the trustee to apply to the court for a declaration as to the interpretation of the trust deed.

Please give us your views on this proposal.

Current law

- 11.3 Section 66 of the Trustees Act provides that a trustee may apply to the court for directions concerning the trust property, the management or administration of trust property or the exercise of a power of discretion of the trustee.
- 11.4 Case law has established more detailed parameters as to when this section should be used than appear on the face of the provision. The section is intended to assist trustees facing a choice between two or more courses of action, either of which might expose the trust to risk. For example, a decision to proceed with litigation against a third party leaves the trust fund open to costs if the litigation is unsuccessful, while not proceeding with litigation means that the trustees will not recover the loss incurred. Further, section 66 should only be used in the following circumstances: when the facts are clear, agreed upon and fully disclosed to the court; when no breach of trust is alleged or questions of law or interpretation at issue; and when the issue cannot be simply resolved through legal advice or the independent exercise of discretion.²⁸⁰ It is also established that the court should not go further than answering the questions posed.
- 11.5 Examples of when an application under section 66 will be appropriate include for providing directions as to whether a trust should pursue litigation against a third party, a proposed sale of property at a loss or undervalue, and the final distribution of trust assets.

²⁸⁰ Noel C Kelly, Chris Kelly and Greg Kelly *Garrow and Kelly Law of Trusts and Trustees* (6th ed, LexisNexis, Wellington, 2005) at 711–715; Andrew S Butler “Trustees and Beneficiaries” in Andrew S Butler (ed) *Equity and Trusts in New Zealand* (2nd ed, Thomson Reuters, Wellington, 2009) 105 at 144.

Issues

- 11.6 The restrictions in the types of applications for directions that can be made under section 66 are not clear from the words of the provision, although they are relatively clear from case law. Because of this, the section may not be well understood by lay trustees. There is some case law that suggests beneficiaries can apply for directions under section 66, and some case law which holds that section 66 cannot be construed to extend to beneficiaries. It is unsatisfactory for this to remain ambiguous. At times there has also been confusion about applications that hinge on the interpretation of the trust deed. The court has an inherent jurisdiction to provide directions on the interpretation of a trust deed. The legislation may need to make it clear that questions of interpretation should not be addressed under section 66.

Options for reform

- 11.7 The options for reforming section 66 are:
- (a) incorporating some or all of the settled case law principles into an updated section 66;
 - (b) clarifying that the section applies to an application for directions by trustees only, and that beneficiaries cannot apply under this section; and
 - (c) codifying the court's inherent jurisdiction to provide directions on the interpretation of a trust deed.
- 11.8 These options are not alternatives as they address separate issues with section 66. An alternative to each of these options is to maintain the status quo.

Discussion

- 11.9 The wording of section 66 is broad, seemingly allowing trustees to apply for court directions in a wide variety of circumstances. Case law has provided restrictions on when section 66 is available to trustees that are not apparent from the words of the section. The intention of the courts is to prevent section 66 being used by overly-cautious trustees who should be exercising their discretion or seeking legal advice, or where alternative proceedings, such as breach of trust, would be more appropriate. The revised section needs to balance these concerns.
- 11.10 Submitters who commented on section 66 generally considered that it would be beneficial to incorporate common law principles into legislation. Greg Kelly Law warned that the legislation should not be too prescriptive, but that examples might be useful. The Trustee Corporations Association considered that the scope of the section is clear, but that the legislation should clarify ambiguous areas of case law and should provide that trustees who have acted unreasonably in seeking directions should be personally required to meet the costs of the proceedings.

- 11.11 In the interests of ensuring the section's meaning is clear on its face, we consider that it should include more detail about the types of circumstances for which directions may be sought and clarification about the availability of alternative proceedings. This would be consistent with the approach of restating settled case law principles to make legislation more accessible. We consider that the revised section 66 should not go as far as detailing all of the case law principles because it is desirable to have a relatively broad power of direction and to retain some discretion of the court as to whether section 66 applies in the circumstances. The legislation should continue to use language that specifies that only trustees can apply, and should make it clear that this is only current trustees. We consider that this is unmistakably the intention of the section as it stands, and the revised version should make sure this remains so. It would be helpful for the section to signal that the court has inherent jurisdiction to make a declaration on the interpretation of a trust deed and that the court may refuse to provide directions if alternative proceedings would be better.
- 11.12 The updated section 66 would differ from the current section in the following ways (indicative drafting only):

66 Right of trustee to apply to Court for directions:

- (1) Any trustee may apply to the Court for directions concerning any property subject to a trust, or respecting the management or administration of any such property, or respecting the exercise of any power of discretion vested in the trustee.
- (2) As far as possible, a trustee should present a proposed course of action or possible course of action regarding the matter on which he or she seeks directions.
- (3) Every such application shall be served upon, and the hearing may be attended by, all persons interested in the application or such of them as the Court thinks expedient.
- (4) For the avoidance of doubt:
 - (a) a court may refuse to provide directions if it would be more expedient for the issues to be addressed through a different form of proceedings;
 - (b) an application for directions under this section can only be made by a trustee for the time being of the trust in question; and
 - (c) the power under subsection (1) does not restrict the ability of the trustee to apply to the Court for a declaration as to the interpretation of the trust instrument.

SECTION 72 – PAYMENT OF A COMMISSION TO A TRUSTEE

Proposal

- P44 (1) New legislation should retain the provision in section 72 of the Trustee Act 1956 under which the court may authorise payment of a reasonable fee or remuneration to a trustee out of trust property.
- (2) New legislation should retain the list of factors for determining what, if any, payment would be just and reasonable, with the factor in section 72(1A)(g) being amended so that it allows consideration of whether any payment that might otherwise have been allowed should be refused or reduced due to the conduct of the trustee in the administration of the trust.
- (3) Payment under this provision is one of the exceptions to a trustee’s duty to act gratuitously and the court should only authorise payment under the provision where the trustee has provided services above and beyond what would normally be expected from a trustee.

Please give us your views on this proposal.

Current law

11.13 Under section 72 the court may authorise payment out of trust property of a “commission or percentage” to a trustee of an amount for the trustee’s services before, during, or on termination of the administration of the trust. When determining what payment would be just and reasonable the court must consider:²⁸¹

- (a) the total amount that has already been paid to any trustee of the trust, whether pursuant to the trust instrument or to any earlier order of the court or to any agreement or otherwise;
- (b) the amount and difficulty of the services rendered by the trustee;
- (c) the liabilities to which the trustee is or has been exposed, and the responsibilities imposed on him;
- (d) the skill and success of the trustee in administering the trust;
- (e) the value of the trust property;
- (f) the time and services reasonably required of the trustee;
- (g) whether any commission or percentage that might otherwise have been allowed should be refused or reduced by reason of delays in the administration of the trust that were occasioned, or that could reasonably have been prevented, by the trustee; and
- (h) all other circumstances that the court considers relevant.

281 Trustee Act 1956, s 72(1A).

- 11.14 Payment of commission on the authority of the court under the section is one of the few exceptions to a trustee's duty to act gratuitously and not profit from trusteeship.

Options for reform

- 11.15 The courts clearly need a power to approve the payment of remuneration to trustees. However, the terminology of "commission or percentage" used in section 72 is now out of date. A replacement provision in new trusts legislation should use contemporary terminology and enable the court to approve the payment of a reasonable fee or remuneration to any trustee.
- 11.16 The main issue that has been considered in respect of section 72 is whether the list of guiding factors should be retained.²⁸² The options are:
- (a) retaining the current list of relevant factors;
 - (b) amending the list of factors; or
 - (c) removing the list of relevant factors entirely.

Discussion

- 11.17 The few submitters who addressed this particular issue all agreed that retention of an updated provision for the court to approve remuneration is desirable. They also all favoured retaining the type of non-exhaustive list of factors that should be taken into account by the court when determining whether to authorise payment to a trustee and the level of such remuneration. Although most acknowledge that the list largely states the obvious, it was thought to provide useful guidance for trustees seeking payments as well as for the court.
- 11.18 The New Zealand Law Society (NZLS) suggested some minor changes to the list of factors. First, that (c) above should refer to the "trustee's responsibilities" rather than those "imposed" on the trustee. Secondly, that (g) (which is aimed at reductions in remuneration) should be broadened to include factors other than delay that might warrant a reduction in the trustee's fee. The provision should encompass a range of less than optimal conduct by a trustee, not just delay. For example, a trustee may have been negligent in dealing with part of the trust fund resulting in losses.
- 11.19 We consider that the list of guiding factors should be retained in a replacement provision. We also consider that the minor modifications suggested by the NZLS should be made. The replacement provision for section 72 should be drafted in a manner that makes it clear that payment is an exception to the trustee's duty to act gratuitously and that the courts will authorise payment under the provision only where the trustee has provided services above and beyond what would normally be expected from a trustee.

²⁸² *Fifth Issues Paper*, above n 279, at [2.10].

SECTION 74 – BENEFICIARY INDEMNITY FOR BREACH OF TRUST

Proposal

- P45 (1) New legislation should retain without substantive amendment the beneficiary indemnity for breach of trust contained in section 74 of the Trustees Act 1956.
- (2) The proviso concerning "married women restrained from anticipation" should be repealed.

Please give us your views on this proposal.

Current law

- 11.20 If a trustee commits a breach of trust at the instigation, request or with the written consent of a beneficiary, the court may indemnify the trustee. All of the beneficiary's entitlements may be confiscated or impounded by the court in order to make good the loss and indemnify the trustee. The right to confiscate a beneficiary's interest is subject to the discretion of the court.
- 11.21 In practice the provision enables trustees to give effect to compromises and settlements reached by beneficiaries. The most common use made of it is where a Family Protection Act 1955 or similar claim is settled. In such cases a compromise arrangement may require the trustees to depart quite substantially from the terms of the trust stated in a will. Where the beneficiaries have agreed to such an arrangement and the trustee acts on this at their behest, it seems only right that the beneficiaries should accept responsibility for any departure from the terms of the trust. Although mainly applicable to trusts under a will, interests under lifetime trusts may also be compromised by agreement with the beneficiaries.
- 11.22 In cases where beneficiaries simply consent to a breach of trust, but do not do this in writing, section 74 is not available and beneficiaries cannot be made to indemnify trustees. However, at equity they cannot sue the trustees for any loss they suffer as a result of any breach to which they consented. In such circumstances the beneficiaries are also liable to account to the trust for any profit they may have made from the breach of trust.
- 11.23 Finally, the section, as currently drafted, contains a very antiquated proviso stating that the court may make an order impounding the property "notwithstanding that the beneficiary may be a married woman restrained from anticipation". This proviso predates legislative changes giving married women full and equal status under law and is now unnecessary.

Options for reform

11.24 The options are:

- (a) retaining the current beneficiary indemnity provision (with no change to its scope);
- (b) broadening the provision to cover consents to a breach of trust that are not in writing; or
- (c) repealing the provision.

Discussion

- 11.25 The few submitters who commented on this issue favour retention of the current provision with no change to its scope. Submitters consider retention of this type of provision necessary to deal with the types of compromise situations discussed above. All submitters also agreed that the proviso, which many point out was already obsolete in 1956, should be removed.
- 11.26 Submitters expressed no interest in the possibility of extending the scope of a replacement provision to cover situations where beneficiaries give verbal but not written consent to a breach. We consider that there would be evidential as well as other practical difficulties in doing this anyway. In our view the better option is to retain the current requirement for written consent. It is reasonable to expect prudent trustees to obtain written consent from beneficiaries if they wish to be indemnified against a departure from the terms of the trust. Our preferred approach is therefore to retain the current beneficiary indemnity provision with no change to its scope.

SECTION 75 – BARRING CLAIMS AND FUTURE CLAIMS

Proposal

- P46 (1) New legislation should retain the provision in section 75 of the Trustee Act 1956 under which a trustee may give notice to any claimant or potential claimant requiring him or her to take legal proceedings (within three months from the date of service) or to enforce his or her claim through court proceedings. Where a potential claimant on whom notice has been served fails to take proceedings, or fails to enforce his or her claim through the courts, the trustee would be able to apply to the court to have the claim barred.
- (2) Where the value of a potential claim is \$15,000 or less, and the trustee has given the potential claimant notice, and no proceedings have been commenced by the potential claimant at the expiry of the notice period, the trustee should be able to apply to the Public Trust under a new provision for a certificate barring the bringing of the claim.

Please give us your views on this proposal.

Current law

- 11.27 Section 75 confers powers on a trustee for the dual purposes of facilitating the prompt distribution of an estate and also for managing claims that the trustee considers ill-founded. Where a trustee has received a claim but is not prepared to pay it or agree to a compromise with the claimant he or she can utilise section 75. Also, where the trustee anticipates a claim that has not been made yet he or she can use section 75 to give notice to the prospective claimant.
- 11.28 Under section 75 the trustee may serve upon any claimant or potential claimant a notice requiring him or her to take legal proceedings (within three months from the date of service) to enforce and prosecute his or her claim through court proceedings. At the expiry of the notice period the trustee may apply to the court for an order barring the person's claim. The claimant or prospective claimant must be served with the application seeking to bar his or her claim. The court may make an order barring the claim or allowing the trust property to be dealt with without regard to the claim.
- 11.29 For the purposes of section 75, a claim or potential claim means any claim in respect of any estate or trust property or against the trustee personally where the trustee is entitled to be reimbursed out of the trust fund. The section can be used whether the claim is made under the Law Reform (Testamentary Promises) Act 1949 or as a creditor, or next of kin, or beneficiary under the trust. Section 75 expressly does not apply to any claim under the Family Protection Act 1955.
- 11.30 Relevant here also is the power of the Public Trust to bar small claims (under \$10,000) against itself under section 127 of the Public Trust Act 2001. If the Public Trust rejects any claim or potential claim covered by section 127 it may serve notice calling on the person bringing the claim to take legal proceedings within three months to establish or enforce the claim. If proceedings are not commenced by the person within the three month period the claim is barred on the expiry of the three month period and the Public Trust may proceed to administer and distribute the estate disregarding the claim.
- 11.31 The power of the Public Trust under section 127 can be contrasted to the power of trustees under section 75 of the Trustee Act 1956. Under section 75, trustees are required to apply to the court at the expiry of the notice period for an order barring a claim, even where proceedings have not been commenced by the prospective claimant. The prospective claimant must then be served with the application seeking to bar his or her claim. Under section 75, an application to the court is required regardless of whether the claim is pursued and regardless of the value of the claim.

Options for reform

- 11.32 Two options were considered:
- (a) retaining the provision (section 75) with no substantive change; and
 - (b) including an additional provision, modelled on section 127 of the Public Trust Act 2001, which provides a simplified procedure involving an application to the Public Trust where a claim is under \$15,000 and proceedings have not been commenced to establish or enforce the claim.
- 11.33 Under option (b) a trustee would still be required to give three months' notice to prospective claimants. However, if proceedings are not commenced by a prospective claimant by the expiry of that period, the trustee could apply to the Public Trust for a certificate barring the claim. The Public Trust's role here would be an administrative rather than adjudicative. It would ensure that proper notice had been given by the trustee to the potential claimant and that the trustee had complied with the obligations under the provision. If satisfied that the necessary steps had been taken, the Public Trust would issue a certificate confirming this. The claim would be barred from the date of the certificate and any money claimed would be unrecoverable. The trustee would then be free to deal with the trust property disregarding the claim.
- 11.34 The certificate process proposed here would only be available where the potential claim was a small claim (under \$15,000) and proceedings have not been commenced. If proceedings have been commenced (irrespective of the value of the claim) the trustee would be required to apply to the court under section 75.
- 11.35 A trustee would also be free under option (b) to choose to make application to the court in respect of any small claim if he or she considered this a better alternative to seeking a certificate from the Public Trust.
- 11.36 An alternative to option (b), which we did not develop, would be to simply bar any small claim where notice has been given by the trustee to the potential claimant and where the claimant has failed to commence proceedings within the three month notice period. We dismissed this option because of the potential for abuse by trustees. We consider that the oversight of a public authority like the Public Trust is an essential safeguard for potential claimants.

Discussion

- 11.37 Only a handful of submitters commented on section 75. All supported the retention of this provision. Submitters considered the section to be useful where there are doubtful claims by supposed creditors. In practice it is used mostly in relation to estates, but on rare occasions in relation to lifetime trusts as well.

- 11.38 Some submitters said that it seemed inconsistent that the section extended to claims under the testamentary promises legislation but not to Family Protection Act claims. It was suggested that section 75 should be extended to cover Family Protection Act claims also. After considering this suggestion, we have decided not to proceed with it. The Family Protection Act seems to be a different type of legislation from the Testamentary Promises Act. It has more of a social welfare intent rather than the semi-contractual nature of claims under the Testamentary Promises Act, and people cannot contract out of it, meaning there is less of a case for allowing the barring of claims.
- 11.39 The issue of whether a simplified procedure involving an application to the Public Trust for small claims was not included as an option in the *Fifth Issues Paper* so has not generally been consulted on. However, the Commission has undertaken consultation with the Public Trust on this and the other proposals that relate to possible functions new legislation might give to the Public Trust. The Public Trust's view is that it is well suited to undertaking this type of function under a new Trusts Act.
- 11.40 We have decided to use this paper to "test the waters" further on option (b). Some alternative process is needed for barring small value claims. The expense and time involved in applying to the court means that it is not worthwhile for trustees to apply to bar small claims at present. However, such outstanding claims can impede a final distribution of the trust assets. We consider that an alternative is needed. We have therefore proposed the simplified procedure involving an application to the Public Trust. The upper limit of \$15,000 has been proposed because this is the upper limit of the Dispute Tribunal's jurisdiction. It would therefore seem an appropriate figure to use to define a small claim.

SECTIONS 77 TO 79 – PAYMENTS TO THE CROWN

Proposal

- P47 New legislation should retain with the following changes the provisions in sections 77–79 of the Trustee Act 1956 under which trustees may pay unclaimed monies over to the Crown where they are unable to find beneficiaries and distribute it:
- (a) The requirement for trustees to file an affidavit should be abolished and trustees should be required to give the Secretary to the Treasury information about the trust and beneficiaries (such as a copy of the trust deed and a statement of accounts).
 - (b) The Secretary to the Treasury should have a power to refuse to accept money where he or she is not given the required information about the trust and its beneficiaries.
 - (c) The obligation on the Secretary to the Treasury to publish a statement of all money held annually in the *Gazette* should be replaced by a more general requirement that he or she make that information publicly available in a

manner that is likely to bring it to the attention of potential claimants. The obligation could in practice be fulfilled by putting the information into an online directory of unclaimed funds on a website.

- (d) There should be no requirement on the Crown to pay any interest to claimants on any of the funds held under the provisions.
- (e) The Crown should have a power to deduct any reasonable costs and expenses before making payment to any claimant.

Please give us your views on this proposal.

Current law

- 11.41 Where beneficiaries cannot be located, trustees may be relieved of their responsibilities as trustees by paying trust money or securities over to the Crown. Under section 77 trustees (or a majority of them) may:
- (a) file an affidavit in the nearest High Court registry giving particulars of the trust and beneficiaries; and
 - (b) serve a copy of the affidavit on the Secretary to the Treasury; and
 - (c) pay the money or transfer the securities to the Crown.
- 11.42 Where the majority of trustees wish to make use of the provision but other trustees do not agree, the court can make an order under the section requiring payment or transfer to the Crown. A receipt from the Treasury discharges the trustees and the money and securities are then administered by the Treasury.
- 11.43 Where money has been paid to the Crown under section 77, an *ex parte* application can later be made under section 79 by any person claiming an interest in it for the recovery of that money or securities held by the Crown. The court may make such orders as it thinks fit.
- 11.44 The Treasury advises that each year a number of trustees pay money or transfer securities to the Crown under section 77. The Treasury will not accept a transfer of funds under the provision unless trustees are able, in their affidavit, to provide sufficient evidence that they have taken all reasonable steps to locate beneficiaries and pay out the funds. Most of that money is paid over by the trustees of unit trusts or superannuation trusts when the trustees want to wind those trusts up. The Treasury receives some money from solicitors firm trust accounts. It seems the mechanism is not, however, currently used by the trustees of private trusts. This is likely to be because there are other options available when trustees wish to pay out such funds and beneficiaries cannot be found.

- 11.45 The Treasury holds monies paid under section 77 in trust for six years. The Treasury must publish a statement of all money and securities held by the Crown under section 78 in the *Gazette* at the end of each financial year.²⁸³ The Treasury's practice is to list the name of individual beneficiaries, where these are known, as well as the names of the funds and the amount being held. Where someone is able to establish a claim, the Treasury may pay the money held to that person. The reasonable costs and expenses of the Crown may be deducted before payment is made.
- 11.46 Money that is not claimed and paid out during the six years that it is held in a trust account by the Treasury is then transferred to the Crown bank account as unclaimed money. The Treasury currently holds approximately two million dollars (\$2,672,638.81) on trust. Approximately \$250,000 was transferred from the trust account to the Crown bank account on 1 July 2011 as it had, at that date, been held for 6 years. On 1 July 2012, \$115,000 was transferred to the Crown bank account. The Treasury estimates that approximately three per cent of the trust money and securities paid to the Crown under these provisions are subsequently claimed and paid out to claimants. The remaining 97% ends up in the Crown Account and is never claimed.

Options for reform

- 11.47 Some final backstop procedure of this kind is necessary. Trustees need to have access to a legislative mechanism under which they can pay unclaimed monies over to the Crown where they are unable to find beneficiaries and distribute it.
- 11.48 The options for reform that were considered are:
- (a) abolishing the requirement for trustees to file an affidavit and simplifying the procedure for paying unclaimed money to the Treasury. Instead trustees would give the Treasury information about the trust and beneficiaries;
 - (b) giving the Treasury a power to refuse to accept money where it is not given the required information about the trust and its beneficiaries;
 - (c) replacing the obligation on the Treasury to publish a statement of all money held annually in the *Gazette* with a requirement to make that information publicly available in a manner that is likely to bring it to the attention of potential claimants, for instance by putting the information into an online directory of unclaimed funds on a website;
 - (d) not requiring the Crown to pay interest to claimants on the funds held; and
 - (e) giving the Crown a power to deduct any reasonable costs and expenses before making payment to any claimant.

²⁸³ Trustee Act 1956, s 78.

Discussion

- 11.49 Only a few submitters commented on these provisions. All submitters agreed that these long provisions (spanning over four pages of dense text) should be simplified and all unnecessary procedural requirements removed. Submitters considered that the requirement to file an affidavit unnecessarily added to the cost of using the provisions. They considered that trustees should only need to give the Treasury copies of statements of account and of the relevant trust documents (such as deeds and wills). A requirement to provide information about the trust and its beneficiaries would be sufficient.
- 11.50 All submitters also considered that the requirement that the Treasury advertises in the *Gazette* was no longer appropriate. Very few people are likely to ever see these advertisements so it would make more sense for the Treasury to place the material on a website so that information about missing beneficiaries would be available to anyone who wished to search for it.
- 11.51 The NZLS agreed that a simplified and cheaper process for paying small amounts to the Crown should be included in a new Act. It thought the current section was unclear as to whether the Treasury can refuse to accept money where the required information is not given and that this should be clarified.
- 11.52 Two submitters suggested that there is an informal understanding that the Treasury does not in practice charge for the work involved in administering funds under the provisions because this is offset by any interest it earns on the money and is not required to pay to claimants. These two submitters suggested that this was a fair trade off that should be set out in the legislation.
- 11.53 We accept all but the last point made by submitters. Although the Crown may earn sufficient interest on unclaimed money to cover the costs of administering the scheme, that is not necessarily the case. We consider that the Crown should therefore retain a power to deduct any reasonable costs and expenses before making payment to any claimant.
- 11.54 Sections 77 to 79 could be simplified and all unnecessary procedural requirements and detail removed. In particular the current requirement that trustees file an affidavit seems unnecessarily onerous, particularly when small sums of money are involved. A simpler less expensive process would seem more appropriate for dealing with unclaimed money.
- 11.55 At present a significant amount of money is never claimed from the Treasury and ultimately is absorbed into the Crown Account. This suggests that notification in the *Gazette* is insufficient to bring the existence of funds to the notice of unaware beneficiaries. These days an obligation to make information publicly available is likely to be more effective than giving notice in the *Gazette*. Publication of a directory of unclaimed funds on a website should be more effective.
- 11.56 Treasury officials have advised us that they are happy with the changes to the provision proposed in this chapter.

11.57 In addition, at some future date, consideration could be given to amalgamating all the different provisions and arrangements the Crown has for dealing with unclaimed money into one regime. At present the Unclaimed Money Act 1971 covers unclaimed money from deposits in banks, financial institutions, some money in solicitors trust accounts, unclaimed proceeds of life insurance policies, and unpaid wages and employee benefits. Money is paid to the Commissioner of Inland Revenue under that Act. However, under some Acts other unclaimed money and assets are to be paid to the Public Trust, and under others to the Māori Trustee. In addition unclaimed awards from court cases, reparations to victims of crime are held by the Ministry of Justice and unclaimed prisoners' allowances are held by the Department of Corrections. The number of different arrangements involving different arms of the Crown suggests that at some stage a review of this whole area may be desirable.

SECTION 76 – DISTRIBUTION OF SHARES OF MISSING BENEFICIARIES

Proposal

- P48 (1) New legislation should retain the provision in section 76 of the Trustee Act 1956 under which the court has broad powers to approve distributions by trustees where beneficiaries cannot be traced.
- (2) The following changes should be made to the requirements concerning advertising for potential beneficiaries:
- (a) Trustees should be required to give notice advertising for potential beneficiaries in a manner that is likely to bring the notice to the attention of potential beneficiaries.
 - (b) Trustees may seek advice from the Public Trust and rely on that advice where there is doubt as to what notice advertising for potential beneficiaries is appropriate.
 - (c) Trustees may seek directions from the court, as an alternative to seeking advice from the Public Trust, where the trustee is uncertain about what notice advertising for potential beneficiaries is necessary.

Please give us your views on this proposal.

Current law

11.58 Section 76 provides the machinery for ascertaining the existence or whereabouts of unknown or missing claimants. It is a long and impenetrable provision that essentially sets out a process for trustees to follow where beneficiaries cannot be ascertained. Under it the court may give directions where a trustee is uncertain about what advertisements to place to notify potential beneficiaries.

- 11.59 The court also has broad powers under the section to approve distribution where beneficiaries cannot be traced. The process has been used in a few cases involving pension funds that have largely been distributed, but where a handful of outstanding beneficiaries cannot be located despite extensive efforts on the part of trustees. Where the trustees obtain and comply with such directions they are protected against personal liability.

Options for reform

- 11.60 The court needs to retain its broad powers to approve distributions where beneficiaries cannot be traced. However, quite a fundamental rethink of the mechanism for ascertaining the existence or whereabouts of unknown or missing claimants is necessary. Rather than requiring trustees to apply to the High Court for directions about what advertisements the trustee needs to place to notify potential beneficiaries, trustees could be given the option of seeking advice from the Public Trust. The Public Trust could advise trustees on when and how often they should advertise when trying to locate missing beneficiaries. This would not have the status of a court ruling but would at least protect the trustees who act in reliance on it.
- 11.61 More generally the provisions on advertising under section 76 (and also section 35 discussed below) need to be modernised. Advertisements in newspapers are expensive and are also unlikely to be brought to the attention of the beneficiaries or creditors towards whom the advertisement is directed.
- 11.62 The options for reform in respect of advertising are that:
- (a) trustees should be required to give notice advertising for potential beneficiaries in a manner that is likely to bring the notice to the attention of potential beneficiaries;
 - (b) trustees may seek advice from the Public Trust where there is doubt as to what notice advertising for potential beneficiaries is appropriate. The provision could allow trustees to rely on the Public Trust's advice; or
 - (c) trustees could seek directions from the court, as an alternative to seeking advice from the Public Trust, where the trustee was uncertain about what notice advertising for potential beneficiaries was necessary.
- 11.63 Under option (b) the Public Trust would need to be able to charge a fee for its work. It would also need to be free to decline to provide advice where it considered that directions from the court should be obtained.

Discussion

- 11.64 Only a few submitters commented on this section. Most submitters considered the current section to be unnecessarily detailed and long. However, all agreed that there is a need for some means to deal with missing beneficiaries. A few said that trustee corporations have had experience in locating missing beneficiaries. In particular, the Public Trust deals with a number of intestate estates and has processes in place to deal with the identification of widely dispersed families. Submitters suggested that

applications to the High Court for directions as to advertising for missing beneficiaries could largely be avoided if trustees and their lawyers were encouraged to seek advice from the Public Trust, other trustee corporations or lawyers with experience in this type of work. We agree that it would be useful to include a mechanism for trustees to seek advice from the Public Trust as an alternative to the court.

- 11.65 Submitters also suggested that the provisions relating to advertising need to be future-proofed so that the new Act continues to be relevant over the next 50 to 60 years. Rather than specifying where and how trustees should advertise, the section should simply require trustees to make such enquiries and give notification (whether in a newspaper or a website or any other way) as the trustee considers necessary to bring the matter to the attention of any potential beneficiary. Provided a trustee has made a conscientious effort to bring the matter to the attention of potential beneficiaries and, where appropriate, has taken proper advice, whether from a trustee corporation or any other similarly experienced person, the trustee should be released from liability if the trustee distributes funds on the basis of the information known.
- 11.66 As already noted in paragraph [11.39], we consulted representatives from the Public Trust. The Public Trust view is that an advisory role in respect of advertising would be a suitable function for the Public Trust.
- 11.67 The court needs to retain its broad powers under section 76 to approve distributions where beneficiaries cannot be traced.

SECTION 35 – PROTECTION AGAINST CREDITORS BY MEANS OF ADVERTISING

Proposal

- P49 New legislation should retain the provision in section 35 of the Trustee Act 1956 that protects trustees from liability where they advertise and give notice to potential creditors before distributing property under a trust. The following changes should be made to the advertising requirements in the provision:
- (a) Trustees should be required to give notice advertising for claims in a manner that is likely to bring the notice to the attention of potential claimants.
 - (b) Trustees may seek advice from the Public Trust and rely on that advice where there is doubt as to what notice advertising for claims is appropriate.
 - (c) Trustees may seek directions from the court, as an alternative to seeking advice from the Public Trust, where they are uncertain about what notice advertising for claims is necessary.

Please give us your views on this proposal.

- 11.68 The court has a power to give directions under section 35(4) where there is doubt as to what advertisements should be published by a trustee giving notice advertising for claims before distributing property under a trust. Where the trustees obtain and comply with such directions they are protected against personal liability.
- 11.69 The options for modernising the approach to advertising and giving notice that were considered in relation to section 76 were also considered in relation to section 35. The points made by submitters on the issue of advertising in paragraphs [11.64] to [11.65] apply equally here. We consider that the same approach as has already been proposed for modernising the advertising requirements in section 76 should be taken here also.

Chapter 12

Jurisdiction of the courts

INTRODUCTION

- 12.1 This chapter considers whether the District Court should have concurrent jurisdiction with the High Court to exercise some or all of the powers under new trusts legislation.²⁸⁴ It also considers whether the Family Court should have jurisdiction to exercise any powers under new trusts legislation where matters involving trusts are otherwise before that court.
- 12.2 In its 2004 report, *Delivering Justice for All*, the Law Commission recommended that the High Court retain exclusive or predominant jurisdiction in relation to trusts.²⁸⁵ Having now revisited that issue eight years later, we propose a different approach. This issue was discussed in the *Fifth Issues Paper*.²⁸⁶

SHOULD THE DISTRICT COURT HAVE JURISDICTION?

Proposal

- P50 (1) The High Court should have jurisdiction to hear any matter and make any order under new trusts legislation. It should retain exclusive jurisdiction to determine any proceeding under new trusts legislation where the amount claimed or the value of the property claimed or in issue is more than [\$500,000].

284 In this paper we will refer to the District Court and the Family Court in the singular, although there are in fact 63 District Courts and Family Courts located throughout New Zealand. Each District Court is separately constituted under the District Courts Act 1947. Each Family Court was established as a division of each District Court by the Family Courts Act 1980.

285 Law Commission *Delivering Justice for All* (NZLC R85, 2004) at 262.

286 Law Commission *Court Jurisdiction, Trading Trusts and Other Issues: Review of the Law of Trusts – Fifth Issues Paper* (NZLC IP28, 2011).

- (2) The District Court should have jurisdiction under new trusts legislation to determine any proceeding where the amount claimed or the value of the property claimed or in issue is [\$500,000] or less.
- (3) The District Court should also have jurisdiction to determine any proceedings or applications (such as those to appoint or remove a trustee) not involving claims for money or property.
- (4) Section 43 of the District Courts Act 1947 (dealing with the rights of defendant to object to proceedings being tried in the District Court) should apply to proceedings involving any claim for money or any claim or issue over property. Where proceedings commenced in a District Court do not involve any claim for money or property any party to those proceedings should be able to give notice objecting to the proceeding being determined in that court and should have the right to have the proceeding transferred to the High Court.

Please give us your views on this proposal.

Current law

- 12.3 The District Court is granted by section 34(1)(a) of the District Courts Act 1947 “the same equitable jurisdiction as the High Court”, so long as “the amount claimed or the value of the property claimed or in issue” is no more than \$200,000. Specific qualifications are imposed on the District Court’s equitable jurisdiction by section 34(2). Where an Act (other than section 16 of the Judicature Act 1908 – the provision conferring general jurisdiction on the High Court) has conferred equitable jurisdiction on the High Court (or any other court) over a proceeding or class of proceeding then the District Court has no jurisdiction over such proceeding.
- 12.4 The Trustee Act 1956 is one of the Acts that confers exclusive jurisdiction on the High Court.

Issues

- 12.5 The District Court has jurisdiction to determine breach of trust claims within their monetary limits but they cannot exercise any powers under the Trustee Act. Some inconvenience and difficulty is caused by this restriction. It might even be argued that the District Court’s jurisdiction in respect of trusts is rendered ineffective because it is not able to make orders under the Act. For example, the District Court does not have jurisdiction to appoint new trustees, remove or replace trustees, hear applications for variations to the terms of a trust, or grant relief to a trustee under section 73.
- 12.6 The problem is well illustrated by the Court of Appeal decision in *Morris v Templeton*.²⁸⁷ In this case beneficiaries brought proceedings against a trustee

287 *Morris v Templeton* (2000) 14 PRNZ 397 (CA).

in the District Court alleging that the trustee had breached his trust by investing funds in unauthorised securities. The District Court Judge found for the applicants that the trustee had breached his trust, but then purported to exercise the discretion given to the High Court under section 73 of the Trustee Act and excuse the trustee from personal liability for losses suffered as a result of the breach. The beneficiaries appealed. Eventually the case reached the Court of Appeal, which held that “[t]he Legislature specifically reserved the power to grant relief under s 73 to the High Court”.²⁸⁸ The District Court can hear claims for breach of trust under their equitable jurisdiction as provided for in section 34(1) of the District Courts Act but the Trustee Act reserves jurisdiction to grant relief under section 73 to the High Court so by virtue of section 34(2) the District Court has no jurisdiction.²⁸⁹

- 12.7 Where the District Court makes an order against a trustee for breach of trust the trustee needs to apply to the High Court for relief if the trustee wishes to invoke section 73 of the Trustee Act and avoid personal liability. It seems an unsatisfactory situation to have two separate courts consider the same salient facts and make determinations. In addition the District Court cannot make an order under section 51 to remove and replace a trustee where the court finds that the trustee has breached his or her trust and mismanaged the administration of the trust. Again it seems unsatisfactory that a further application would have to be made to the High Court to have the offending trustee removed and replaced. To avoid such multiplicity of proceedings low value breach of trust cases may be effectively forced into the High Court notwithstanding the modest sums involved.²⁹⁰
- 12.8 The equitable jurisdiction of the District Court has expanded significantly since the Trustee Act was enacted.²⁹¹ The District Court is now a court of general jurisdiction. As a result it could be considered something of an anomaly that the District Court was given full equitable jurisdiction in 1992 but cannot exercise statutory powers in respect of trusts within its monetary jurisdiction.
- 12.9 There are also issues in respect of access to justice. The District Court has become the primary court of first instance in many areas of law. They are intended to be the “people’s courts”; to be local, readily accessible, and able to provide justice speedily with a minimum of formality and expense. Yet at present beneficiaries who are dissatisfied with the performance of a trustee’s duties must take their proceedings in the High Court if they wish to enforce

288 At [9].

289 At [9].

290 Andrew S Butler “Historical Introduction” in Andrew S Butler (ed) *Equity and Trusts in New Zealand* (2nd ed, Thomson Reuters, Wellington, 2009) 1 at 10.

291 Before the enactment of the current s 34 of the District Courts Act in 1992 a list of specific matters previously defined the District Courts’ equitable jurisdiction. The 1992 amendment reversed the approach giving the District Court the same broad equitable jurisdiction as the High Court with specific exceptions.

the trust. Where trustees seek noncontroversial administrative changes to the terms of a trust or directions on some matter they must also take proceedings in the High Court. The question here is whether the District Court might provide a less costly and more accessible option for beneficiaries and trustees in some situations.

- 12.10 Whether the District Court should have jurisdiction under new legislation replacing the Trustee Act is a significant issue for this review.

Options for reform

- 12.11 The two broad options we considered are:
- (a) retaining the status quo – the High Court should continue to have exclusive jurisdiction to exercise some, or all, court powers under new trusts legislation; or
 - (b) giving the District Court concurrent jurisdiction within specified monetary limits to exercise some, or all, court powers under new trusts legislation.
- 12.12 As has been noted, section 34(1)(a) of the District Courts Act gives the District Court “the same equitable jurisdiction as the High Court”, so long as “the amount claimed or the value of the property claimed or at issue” is no more than \$200,000. Where proceedings do not involve a claim or dispute over money or property the District Court would seem to have jurisdiction because section 34(1)(a) only limits the District Court’s equitable jurisdiction to \$200,000 in respect of money and property claims.²⁹²
- 12.13 If the District Court is given concurrent jurisdiction, as proposed by option (b), similar limits could be applied to proceeding under a new trust Act. The District Court could have jurisdiction, concurrent with the High Court, to make orders under the new Act where the amount claimed or the value of the property claimed or at issue was under a specified limit. In addition, applications under the new Act not involving money and property claims might also be made in the District Court for any relevant order or directions. For example, an application seeking the appointment of a new trustee, or an application seeking an order directing a trustee to supply information could then be brought in the District Court rather than the High Court under option (b).

Discussion

- 12.14 Submitters were almost evenly split with half favouring preserving the status quo and the other half supported the District Court having concurrent jurisdiction within its monetary limits.

292 As already discussed s 34(2) imposes specific limitations as well.

Arguments for the High Court retaining exclusive jurisdiction

- 12.15 Most submitters who argued in favour of the status quo favour greater judicial specialisation. It was generally argued that trust law should be approached as a specialism involving issues of both legal and factual complexity. Consequently they argued that considerable expertise at both the judicial and representational level is required and that this is more readily available in the High Court. Concentrating trust cases in the one court improves both the quality of decision-making and case management. Judges with greater familiarity and expertise with the subject matter comprehend the evidence and issues more readily. Ultimately this leads to better case management and decision-making which reduces court time and cost. The New Zealand Law Society (NZLS) took the position that greater judicial specialisation in New Zealand would be desirable and that giving the District Court jurisdiction in trust matters would not achieve that end. It did not elaborate on why it considered specialisation was not an option within the District Court.
- 12.16 A further argument that is put forward is that the case management systems and processes in the High Court are better suited to dealing with complex trust matters. Some practitioners have argued that the High Court's originating application process is suitable for much trust work and makes the High Court relatively cost-effective. Although the fee structure is higher in the High Court than the District Court, the difference in the cost of legal representation may not be significant. These practitioners considered that the District Court's processes are unsuitable for trust litigation. The NZLS reported that there is widespread dissatisfaction among its members with the District Court's processes under the new District Courts Rules.

Arguments for the District Court having concurrent jurisdiction

- 12.17 Most submitters who argued in favour of the District Court having concurrent jurisdiction did so on the basis that this would improve access to the courts, particularly for lower value disputes. The District Court is now the primary court of first instance.
- 12.18 Since the Trustee Act came into force in 1956 the jurisdiction of the District Court has expanded, in equity, as well as in other areas. As the monetary jurisdiction of the District Court has increased, amendments have also broadened the scope of its jurisdiction under section 34. Subsection (2A) was, for example, inserted in 1996 giving the District Court the power to make orders under section 49 of the Administration Act 1969. The current section 34 replaced a list of specific matters that previously defined the Court's equitable jurisdiction in 1992. Given the general expansion of the Court's equitable jurisdiction during the years since the Trustee Act was enacted, it is argued that it is an anomaly that the District Court cannot exercise statutory powers in respect of trusts.
- 12.19 The District Court, like the High Court, is now a court of general jurisdiction. It has a broad civil and equitable jurisdiction. New Zealand's general civil jurisdiction is divided between the High Court and District Court primarily

on the basis of the monetary value of the matter in dispute, rather than principles around different functions. A strong argument can therefore be made in favour of extending the District Court's jurisdiction based on the current division of functions between the courts. Although, in other areas of law, for example company law, statutes do reserve exclusive jurisdiction to the High Court.

- 12.20 It was also argued that the case for specialisation and the complexity of trust law has been overstated. Many matters that need to go to court under the Trustee Act (such as approving the replacement of a retiring trustee or issuing a vesting order) are straightforward in nature and are unlikely to involve difficult questions of law. It is not necessary to reserve such powers to the High Court. Another flaw in the specialisation argument is that the District Court is already involved with trust law. Actions for breach of trust can be taken in the District Court under its general equitable jurisdiction provided the amount in dispute falls within the specified monetary limits set by section 34(1)(a). The logical extension of the argument for specialisation and a single court dealing with trust law would be to remove the District Court's existing jurisdiction as it relates to trusts. One submitter also made the point that there could be a panel of specific judges with trust law experience assigned to hear trust cases in the District Court. It should not be assumed that the District Court means generalist judges.
- 12.21 It is also argued that the District Court could provide a less costly and generally more accessible option for beneficiaries seeking to hold trustees to account in lower value disputes.²⁹³ In some situations where trustees need to apply to the High Court for directions or orders, the cost of such applications might be reduced if they could be made to the local District Court. At present, for example, even a comparatively straightforward application to remove a trustee on grounds of incompetence or criminal fraud requires a High Court application.
- 12.22 Litigating in the High Court is expensive. The fee structure for the High Court's civil jurisdiction is premised on it primarily hearing high value cases or those that raise complex issues of law. The filing fee for an application is presently \$1,329.20 although a concession rate proceeding fee of \$483.40 is available for some applications under the Trustee Act.²⁹⁴ Hearing fees for the High Court are \$1,570.90 for each half day of court time.²⁹⁵ In contrast, an application fee in the District Court is \$169.20 and hearing fees are set at \$906.30 for each half day.²⁹⁶ It would cost the parties less if straightforward

293 Chris Kelly "Supervision of Trustees: Enforcement or Problem Solving" (LLM Thesis, Victoria University of Wellington, 2009) at 107.

294 However, the Commission has been advised by practitioners that practices vary between different registries as to when this lower rate is applied.

295 High Court Fees Regulations 2001, sch.

296 District Courts Fees Regulations 2009, sch.

applications dealing with matters such as uncontested appointments of new trustee could be filed in the local court.

- 12.23 The cost of legal representation between the two courts would seem to differ less. We have not found any useful statistical information on the comparative costs here. In any event comparing average costs may not be very helpful. It has been suggested to the Commission by a number of practitioners that the cost of representation will be similar regardless of whether cases are heard in the High Court or District Court. This is because, as already noted, some proceedings can be undertaken using the less costly originating application process. This process is not available in the District Court so overall the cost of representation may remain similar, even where practitioners' charging rates are lower in the District Court.
- 12.24 Another argument sometimes made is that a local District Court would resolve applications more quickly. This point is also very difficult to assess. In the *Fifth Issues Paper* we discussed the dearth of research into this question and recent attempts to address this. As noted in that paper, the picture from that preliminary research is mixed. We are not able to comment further on whether matters could be more quickly resolved by the District Court.²⁹⁷ Some submitters argued also that court processes, and the respective speed and efficiency of turnaround in each court change will inevitable change over time. They suggested that it would be unwise to decide this issue on the basis of current processes.
- 12.25 Finally, the point was made by a few submitters that the current upper jurisdictional limit for the amount claimed or the value of the property at issue of \$200,000 should be raised as many claims in respect of trust would exceed this.

Assessment

- 12.26 After weighing the competing arguments our preferred approach is for the District Court to have concurrent jurisdiction under new trusts legislation (option (b)). We acknowledge that our proposal differs somewhat from the position taken by the Commission in 2004 when it recommended that the High Court retain its predominant jurisdiction in relation to trusts. There are a number of important reasons for now favouring a greater concurrent jurisdiction in respect of trusts.
- 12.27 The District Court has a broad civil and equitable jurisdiction. The current jurisdictional division between the High and District Courts is based generally on the monetary value of the matters in dispute. As a result the equitable jurisdiction of the District Court is of a general nature and it does seem to be an anomaly that the District Court cannot exercise statutory powers in

²⁹⁷ See the discussion in *Fifth Issues Paper*, above n 286, at [3.28]–[3.29] and also Rachel Laing, Saskia Righarts and Mark Henaghan *A Preliminary Study on Civil Case Progression Times in New Zealand* (University of Otago Legal Issues Centre, Faculty of Law, 15 April 2011).

respect of trusts. Our proposal for concurrent jurisdiction is consistent with the District Court's jurisdiction in other areas and their overall development as the primary court of first instance.

- 12.28 We consider that the case for specialisation based on the complexity of trust law can be overstated. Many matters that need to go to court, such as approving the replacement of a retiring trustee or issuing a vesting order, are straightforward in nature. They are unlikely to involve difficult questions of law and it is just not necessary to reserve such powers to the High Court. The District Court already has a general equitable jurisdiction. Our proposal will give them the necessary tools to exercise their jurisdiction more effectively.
- 12.29 In formulating our proposals we have been mindful of the concerns expressed by some submitters (for instance that the District Court process is not particularly suitable for complex trusts claims). However, amendments have recently been made to the District Court Rules are intended to better deal with those cases where early access to a process aimed at adjudication might be in the best interests of the parties.²⁹⁸ The amendments allow litigants to seek summary judgment much earlier in the process (within 20 working days of filing the Notice of Claim). These changes may also go some way to addressing the procedural points raised by litigators in their submissions
- 12.30 Whether trust work within the District Court is best allocated to specific judges or whether it is dealt with more generally does need some thought. The development of civil judges within the District Court is likely to continue and there is no reason why specific judges could not be assigned to hear trust cases within that court.
- 12.31 We consider that expanding the District Court's jurisdiction in the way we have proposed may improve access to justice because it gives potential parties a greater range of litigation options. For appropriate cases the District Court could provide a lower level dispute resolution option. There are significant differences between the civil process used in the District and High Courts. Our proposal for concurrent jurisdiction allows advantage to be taken of both of these. It does not preclude a litigant from filing their claim in the High Court if they consider that the better option, even if the amount in dispute is below the upper monetary limit for the District Court. As discussed further below, our proposed approach will include a degree of transfer to the High Court as of right where a party objects to the matter being determined in the District Court.

The proposed jurisdiction for the District Court

- 12.32 As has been already discussed, the amount claimed or the value of the property at issue in any breach of trust claim or filed in the District Court cannot currently exceed \$200,000. Where proceedings do not involve a claim

298 The District Courts (General) Amendment Rules 2012 came into force on 14 June 2012.

- or dispute over money or property the District Court has been given by section 34(1)(a) the same equitable jurisdiction as the High Court.
- 12.33 If the District Court is to have jurisdiction under new trusts legislation, as we are proposing, then consideration needs to be given to the question of what limits should be placed on that jurisdiction. The most logical and consistent approach would be to broadly replicate the position already taken in section 34(1)(a) of the District Courts Act in respect of the District Court's equitable jurisdiction. Taking this approach, the upper limit for money claims would be capped at the threshold set in that Act, which is currently \$200,000, but there would otherwise be no restrictions on the District Court's jurisdiction to grant any other orders or make any other directions under the new Act.
- 12.34 Another approach which we have also considered is whether to limit the District Court's jurisdiction under new legislation in some way by reference to the value of assets held under the terms of the trust. This type of approach is taken by section 31 of the District Courts Act to proceedings for the recovery of land. Under that provision the court has jurisdiction where the value of the land in question does not exceed \$500,000. Similarly, section 34(1)(b) of the District Courts Act also determines the District Court's jurisdiction to dissolve or wind up partnerships by reference to the total value of the partnership assets. However, unlike these examples, there is not the close nexus between the value of the assets of the trust and the court's function. In the case of trusts the value of assets in the trust will not always be relevant to the matter before the court in the way it must always be in the case of a dispute over the ownership of land.
- 12.35 There are many applications that could come before the courts under a new Act, which are relatively straight forward or are not contested. Two good examples are (a) approving the replacement of a retiring trustee; (b) issuing vesting orders transferring property from a retiring trustee to another trustee. Irrespective of the overall value of the assets in trust, the District Court could readily exercise such functions. It could also readily determine many other routine matters.
- 12.36 In the *Fifth Issues Paper* we also discussed the option of giving the District Court jurisdiction under some specific provisions in a new trusts statute and not others.²⁹⁹ We have also rejected this approach because of the potential that aspects of a trust case before that court could raise issues that fall beyond the court's jurisdiction. Submitters who commented on this matter also favoured the District Court being able to exercise all powers under new legislation rather than a limited subset.
- 12.37 Instead of taking either of these approaches we have opted for the District Court having jurisdiction, concurrent with the High Court, to hear and determine proceedings and make any order under new trusts legislation where the amount claimed or the value of the property claimed or in issue

299 *Fifth Issues Paper*, above n 286, at [3.31]–[3.36].

does not exceed a specified upper threshold. The District Court would also have jurisdiction, concurrent with the High Court, to determine any proceedings (such as those to appoint or remove a trustee) that do not involve any claim for money or any claim or issue over property. This means that irrespective of the value of the assets in the trust, that court could determine any proceeding or application under the new Act that does not involve any claim for money or property.

- 12.38 Where proceedings are commenced in the District Court and do not involve any claim for money or property we propose that any party to those proceedings should be able to give notice objecting to the proceeding being determined in that court. The proceedings should then as of right be transferred to the High Court. Under section 47 of the District Courts Act 1947 a defendant has the right to have a proceeding transferred to the High Court if the sum sought, or the value of the property or relief claimed, exceeds \$50,000. Where the amount involved in the claim is less than \$50,000 the defendant may object but the transfer will be at the discretion of the Court. The Court may only order that such proceedings be transferred if it is satisfied that some important question of law or fact is likely to arise. In our view, concurrent jurisdiction and providing the parties with rights of objection and transfer are sufficient to address any concern that proceedings raising complex issues of trust law will be inappropriately determined in the District Court.
- 12.39 A final issue here is the appropriate upper threshold for the District Court's monetary jurisdiction under the Act. A number of submitters have commented that in practice the current upper limit for money claims of \$200,000 is likely to preclude much trust litigation being undertaken in the District Court. We acknowledge this problem. Many modest family trusts, containing no more than the family home, have assets well in excess of that amount.³⁰⁰
- 12.40 The Law Commission is currently considering whether the upper limit of the District Court's civil jurisdiction should be raised as part of its reference to review the Judicature Act 1908 and consolidate courts legislation. Although that report has not yet been released, the Commission intends to recommend that the upper limit be increased significantly from \$200,000. The reasons for those increases will be fully canvassed in that report when released. However, in anticipation of that recommendation we have proposed here that the upper limit for proceedings brought under new trusts legislation should be capped at \$500,000.

300 For example, the national average sale price for a residential property in three months ending 1 August 2012 was \$423,569; while the average for Wellington city was \$502,319 and for Auckland city was \$659,639; figures taken from Quotable Value New Zealand Limited published sales data < www.qv.co.nz > .

SHOULD THE FAMILY COURT HAVE JURISDICTION?

Proposal

P51 In addition to P50 it is proposed that:

- (1) The Family Court should have jurisdiction to make any orders and give any directions under new trusts legislation where this is necessary to give effect to any determination of other proceedings that are properly before the Family Court.
- (2) The Family Court's jurisdiction should not be subject to the upper threshold of [\$500,000] that has been set in P50 for proceeding in the District Court. Instead, regardless of the value of the claim, the Family Court should have jurisdiction to exercise powers under new trusts legislation where the proceedings (such as proceedings under the Family Protection Act or Property (Relationships) Act) in which such orders will be made are within its jurisdiction.

Please give us your views on this proposal.

Current law

- 12.41 Family Courts were established as divisions of the District Court by the Family Courts Act 1980. Section 11 of that Act gives the Family Court jurisdiction for a wide variety of matters affecting couples, families and children.
- 12.42 The Family Court has concurrent jurisdiction with the High Court under the Family Protection Act 1955. It also has jurisdiction under the Property (Relationships) Act 1976. As a result, the Family Court is sometimes required to consider aspects of trust law where they arise in proceedings properly within its jurisdiction.
- 12.43 However, the Family Court does not have the substantive equitable jurisdiction of the District Court. Section 11(1) of the Family Courts Act 1980 confers jurisdiction on the Family Court. Section 16 of that Act then applies the District Courts Act with any necessary modifications, to the Family Court and Family Court judges. A line of High Court cases has confirmed that these provisions do not confer the District Court's substantive equitable jurisdiction under section 34 onto the Family Court.³⁰¹ In the most recent decision the High Court stated that "further words are required to confer on the Family Court the civil jurisdiction of the District Court. Those further words are absent".³⁰² The Family Court has, under section 16 of the Family Courts Act, the ancillary jurisdiction of a District Court under section 41

301 *Singh v Kaur* [2000] 1 NZLR 755 (HC); *Perry v West* HC Auckland M1331-SD00, 8 September 2000; *F v W* HC Wellington CIV-2009-485-531, 3 August 2009; *Yeoman v Public Trust Ltd* [2011] NZFLR 753 (HC).

302 *Yeoman v Public Trust Ltd* [2011] NZFLR 753 (HC) at [28].

of the District Courts Act so is able to give equitable relief where a matter is within its jurisdiction, but does not have jurisdiction to hear a cause of action founded in equity.³⁰³ The Family Court also has no jurisdiction to make orders under the Trustee Act, although it may make ancillary orders when this is necessary in any relationship property matter varying the terms of any trust or settlement, other than a trust under a will or other testamentary disposition.³⁰⁴

Issue

- 12.44 The main issue is whether the Family Court (which is a division of the District Court) should also have jurisdiction to make orders and give directions under new trusts legislation.
- 12.45 Some relationship property matters and also other family proceedings that come before the Family Court involve components of trust law. In some situations this means that the parties need to make subsequent applications to the High Court to address the related trust matters. Given the proposals we have made in respect of the District Court, the question is whether there is any reason why the Family Court should not have the same powers under new trusts legislation to better deal with matters properly before it and reduce the need for subsequent proceedings in the High Court.

Options for reform

- 12.46 The options considered were:
- (a) retaining the status quo – an application should be made to the High Court (or the District Court) for any order available under new trusts legislation; or
 - (b) giving the Family Court jurisdiction to make any orders and give any directions under new trusts legislation as may be necessary to give effect to any determination of Family Court proceedings that are properly before those courts.
- 12.47 The Chief Justice proposed, in her submission to the Ministry of Justice Review of the Family Court that the High Court's previous concurrent jurisdiction in relationship property proceedings should be reinstated. Under this option relationship property proceedings could be commenced in either court and both the High Court and the Family Court would have powers to transfer proceedings as necessary. An applicant would then file their relationship property claim in the High Court, rather than the Family Court, where they anticipated orders would be needed under new trusts legislation.

303 At [27] and [29].

304 Under s 33(3)(m) of the Property (Relationships) Act 1976 the Family Court may make an ancillary order varying the terms of any trust or settlement, other than a trust under a will or other testamentary disposition.

- 12.48 In addition, one of the recommendations of the *Reference Group Report to the Ministry of Justice on Family Court Review* released earlier this year is that the concurrent jurisdiction of the High Court which applied pre-2002 should be reintroduced in relationship property proceedings. The Reference Group's report also suggested that it would be beneficial to extend the jurisdiction of the Family Court to deal with trust issues which arise in relationship property cases so there is no necessity for separate proceedings in the High Court where overlapping trust issues arise. To that end the Reference Group recommended that the Family Court should be given greater powers to deal with trust issues in relationship property cases.³⁰⁵ We have also considered these options.

Discussion

- 12.49 The *Fifth Issues Paper* asked for feedback on the two options for reform. It did not include the proposal of reinstating the High Court's previous concurrent jurisdiction under the relationship property regime.
- 12.50 Submitters were evenly divided with half favouring preserving the status quo and the other half supporting the option of giving the Family Court some jurisdiction under new legislation.

Option (a) – Maintain the status quo

- 12.51 Submitters who did not favour expanding jurisdiction of the Family Court in respect of trusts essentially argued that the High Court should retain exclusive jurisdiction under new legislation. Their main point is that trust law should be approached as a specialism involving issues of both legal and factual complexity and therefore belonged in the High Court.
- 12.52 As already noted, the submission made by the Chief Justice to the Ministry of Justice Review of the Family Court, which we were invited to consider, opposed the trust jurisdiction of the High Court being devolved to the Family Court in relationship property claims. The Chief Justice commented that the High Court has inherent jurisdiction as well as its specific statutory powers under the Trustee Act and can deal comprehensively with all issues relating to trusts.
- 12.53 The Chief Justice's submission proposed that:
- the simplest solution to the jurisdictional issue raised in both the Review of the Family Court and in our law of trusts review, is to reinstate concurrent jurisdiction in relationship property proceedings. The High Court would have power on application or own motion, to transfer the proceedings to the Family Court as part of the proposal.
- 12.54 One other submitter went further and argued that the High Court, and not the Family Court, should have originating jurisdiction over any matters concerning personal or relationship property where trusts are also involved.

305 *Reference Group Report to the Ministry of Justice on Family Court Review* (27 April 2012) at 50.

Option (b) – Family Court jurisdiction

- 12.55 Approximately half of submitters thought the Family Court should have jurisdiction where trusts related to issues arising in the course of proceedings otherwise within the court's jurisdiction. Submitters suggested that quite commonly relationship property proceedings raise incidental questions relating to family trusts and that it would therefore be sensible for the court to have the tools to deal with such matters as they arise. Most submitted that the Family Court should be able to exercise any powers under a new Trusts Act, irrespective of the value of the claim, if the court considered this necessary to resolve any proceedings properly brought before the court under legislation listed in section 16A of the Family Courts Act.
- 12.56 The NZLS's submission did not favour giving the Family Court general jurisdiction in relation to trusts but thought there might be a case for the Family Court being able to exercise certain powers where these are ancillary to its core jurisdiction. To avoid the procedural inefficiencies that can arise where relationship property disputes are related to trust disputes the NZLS has suggested that new legislation should provide:
- a caveat procedure under which an appointer can be prevented from exercising his or her powers to appoint or remove trustees where parties separate, in the exercise of the powers approved by the Family Court;
 - a limited jurisdiction for the Family Court to remove and appoint trustees where parties to a relationship separate and there is a serious deadlock or hostility between some or all of the trustees that results or may result in the trust or the beneficiaries being at risk; and
 - a limited jurisdiction for the Family Court to remove and appoint an appointer or suspend or supervise an appointer's power to appoint or remove trustees in the same circumstances.

Assessment

- 12.57 If the District Court has the jurisdiction under new trusts legislation that we have already proposed, then it is difficult to argue that the Family Court, which is a division of District Court, should not also have those powers. We propose that the Family Court should only be able to exercise the powers and make orders under new trusts legislation as an ancillary jurisdiction to provide a remedy where a matter is within its jurisdiction. The Family Court already has the ancillary jurisdiction of the District Court under section 41 of the District Courts Act to give equitable relief where a matter is within its jurisdiction, but not jurisdiction to hear a cause of action founded in equity.

- 12.58 In proceedings under the Property (Relationships) Act the Family Court may already make some ancillary orders under section 33(3) in respect of trusts to give effect to decisions under that Act. The Court of Appeal has said that “s 33(3) enables the court to adopt one or more of a number of means of dividing the property so as to give effect to its conclusion as to entitlement”.³⁰⁶ Section 33(3)(m) empowers the Family Court to vary the terms of an inter vivos trust, but not a testamentary trust.
- 12.59 Relationship property settled on a trust by one of the partners to the relationship will be beyond the Court’s jurisdiction, unless the disposition to the trust is caught by section 44 and can be set aside, or one or both of the partners has a vested or contingent interest in the trust.³⁰⁷ In such cases, the Court can make orders dealing with the trust assets, including orders varying the terms of the trust under 33(3)(m).³⁰⁸ For example, the Court may vary the terms of the trust to confer on a spouse or partner a vested interest or remove a contingency, or it could vary the final distribution date to the date of judgment.³⁰⁹
- 12.60 These ancillary powers go some way, but we consider that it would be desirable for the Court to also be able to make as an ancillary order, other orders or directions under new trusts legislation. Where the partners to a relationship have separated and one or both of them has an interest in a trust, or a claim is to be brought by one partner under section 44, the Court should have jurisdiction to make any orders necessary under the new Act. For example, orders removing or appointing trustees, suspending distributions from the trust, or requiring trustees to provide information might be appropriate to manage a serious deadlock or hostility between trustees, or to preserve the assets of the trust until the property claims of the parties to the relationship can be resolved. The Court should be able to make orders at any stage of proceedings, or in situations where proceedings under the new Act are pending.
- 12.61 Where the spouse or partner’s interest in the trust is merely a discretionary interest, the Court could not ultimately make any substantive orders in relation to the trust assets, unless it first determined that there have been dispositions of property to the trust to which section 44 applies. This is because a partner with a discretionary interest does not have any beneficial ownership in the assets in trust but only a hope or expectation. However,

306 *Coxhead v Coxhead* [1993] 2 NZLR 397 at 408; (1993) 10 FRNZ 46 (CA) at 58.

307 Substantive orders cannot be made in respect of trust assets, unless s 44 applies, if a spouse’s or partner’s interest in the trust is merely a discretionary interest because the spouse or partner has no beneficial ownership in the assets in trust. He or she merely has a hope or expectation until the trustees exercise their discretion in the beneficiary’s favour: See *Nation v Nation* [2005] 3 NZLR 46; (2004) 23 FRNZ 783 (CA) and the discussion in Nicola Peart (ed) *Brookers Family Law — Family Property* (online looseleaf ed, Brookers) at [RP33.12].

308 Peart, above n 307, at [RP33.12].

309 At [RP33.12].

we consider that the Court should be able to make interim orders until determination about the nature of any interest in the trust or the application of section 44 is resolved.

- 12.62 We consider that the Family Court should be able to exercise any powers and make any orders under new trusts legislation to provide a remedy where a matter is within its jurisdiction. There are significant difficulties with trying to identify the correct subset of powers that the Family Court could need to effectively address all possible circumstance that may arise in cases before it. The suggestions put forward by the NZLS are obvious ones, but are not necessarily sufficient to address the full range of circumstances that may arise. If the Court is only able to access a limited list of powers then aspects of a case may raise issues the Court has no jurisdiction to address. In such cases further proceedings would still need to be filed in the High Court and an application for transfer made.

The option of reinstating the High Court's concurrent jurisdiction

- 12.63 At present the Family Court is the primary court of originating jurisdiction for all proceedings under the Property (Relationships) Act.³¹⁰ That has been the position since 2001 when the High Court's concurrent jurisdiction under that Act was removed.
- 12.64 From the perspective of the Commission's review of trust law, reinstating the High Court's concurrent jurisdiction in respect of relationship property, as has recently been proposed, goes further than is necessary to address the problems that arise in cases at the interface between relationship property and trust law. Such a proposal has implications for all proceedings brought under that Act and not just those raising trust law issues. We consider that this type of proposal may well have merit but it falls beyond the scope of our review of trust law.
- 12.65 To deal with the specific issues that arise in cases at the interface between relationship property and trust law, our preferred approach is for the Family Court to have jurisdiction under new trusts legislation to make any orders and give any directions available under that legislation where this is necessary to give effect to any determination of relationship property proceedings or any other proceedings that are properly before the Family Court. As already noted, the *Reference Group Report to the Ministry of Justice on Family Court Review* also recommended extending the jurisdiction of the Family Court to deal with trust issues which arise in relationship property cases.
- 12.66 In August 2012 the Minister of Justice announced a package of reforms to the Family Court resulting from the recent Review of the Family Court. One of the reforms proposed is to lower the current threshold and make it easier to transfer relationship property cases from the Family Court to the High Court. The proposal is that the current requirement for "complexity" would

310 Property (Relationships) Act 1976, s 22.

be removed so a case must be transferred from the Family Court where it would be more appropriately dealt with in the High Court.

- 12.67 This is likely to mean that relationship property cases with trust issues can more readily be consolidated with other proceedings in the High Court. However, it does not necessarily reduce the need for parties to file two sets of proceedings and the additional costs associated with that. For some cases also, notwithstanding some trust issues, the Family Court is still the most appropriate forum. While we welcome the proposed change, we consider it is still necessary to extend the Family Court's jurisdiction to deal with trust issues in the way we have proposed here.

Chapter 13

Resolving disputes outside of the courts

INTRODUCTION

- 13.1 This chapter discusses the options for providing methods for resolving disputes in trusts outside of a court. It looks at the following:
- introducing a new mechanism for dispute resolution and decision-making;
 - a role for the Public Trust; and
 - taking measures to enable the use of alternative dispute resolution (ADR) techniques.

ALTERNATIVE MECHANISMS FOR DISPUTE RESOLUTION

Proposal

P52 New legislation should not introduce a new mechanism for dispute resolution.

Please give us your views on this proposal.

Current law

- 13.2 There is currently no decision-maker or supervisory body for trusts outside of the courts.

Issues

- 13.3 The *Fifth Issues Paper*³¹¹ discussed the option of introducing a new mechanism for trusts dispute resolution and decision-making. This idea had been posited

311 Law Commission *Court Jurisdiction, Trading Trusts and Other Issues: Review of the Law of Trusts – Fifth Issues Paper* (NZLC IP28, 2011).

by some commentators and the media. The options looked at were an ombudsman, a tribunal and a commission. The issues that the options for an alternative mechanism for trusts were intended to address are the practical difficulties and disadvantages that can arise for beneficiaries in trying to hold trustees to account, such as cost, complexity, time and the adversarial nature of a court proceeding. The *Fifth Issues Paper* conceded that in the current fiscal environment the government is unlikely to introduce any of these mechanisms raised as options. Consequently, the purpose of this consideration is more to present the advantages and disadvantages of the different options rather than to recommend one for inclusion in our package of reforms.

Options for reform

13.4 The options considered were to introduce:

- *an ombudsman* – an individual with authority to make non-binding recommendations on certain disputes, including helping to resolve them through mediation and advice, and educating the public by reporting annually and providing case notes;
- *a tribunal* – a binding decision-making authority with jurisdiction on certain trust issues where \$200,000 or less is at issue; or
- *a commission* – a body with the role of overseeing trusts by providing guidelines, supervising providers of trust services and providing a mediation service.

Discussion

Ombudsman

13.5 Introducing a trusts ombudsman would provide an informal procedure for addressing trust disputes that is less adversarial than the courts. The investigation and resolution of complaints by the ombudsman would be cheaper and quicker than having these matters determined by a court. The ombudsman would become an expert in trust law, which would mean the ombudsman's guidance and recommendations would carry considerable weight. An ombudsman could provide guidance to trustees to help them carry out their role better and improve the management of trusts.

13.6 There is a risk that if a trusts ombudsman were introduced that it would not provide sufficient resolution for disputes because its recommendations would be non-binding and would not prevent parties from going to court. Because trust law is complex and not fully settled in some areas, the ombudsman may be required to effectively develop the law, something that is likely best left to a court.

Tribunal

- 13.7 A tribunal would have binding decision-making authority, so could provide more conclusive decisions than an ombudsman. Like the ombudsman, it would have a more informal and less adversarial procedure than the courts. It is likely that a tribunal would provide speedier access to decision-making than the courts also. The tribunal would focus solely on trust law so would become an expert in this complex area of law.

Commission

- 13.8 A commission would be a body with responsibility for supervising the use of trusts. It would provide guidance which would assist trustees in being aware of their duties and the management requirements for trusts. For effective supervision of trusts by a commission, a trusts register would probably be needed, something that is unlikely because of the significant costs it would entail with few benefits.

General arguments

- 13.9 Introducing a trusts-specific mechanism for dispute resolution can be seen as singling trusts out unnecessarily. Trusts are one of many different ways of structuring property. Other structures or entities, such as companies or incorporated societies, do not have their own decision-making or dispute resolution bodies.
- 13.10 The biggest barrier to introducing one of these mechanisms is the cost. There would be considerable expense in establishing any of the three options and funding one would require some or all of the government, complainants or all trusts to bear the costs, which markedly decreases their desirability.

Assessment

- 13.11 Most submitters were not in favour of introducing a new dispute resolution mechanism for trusts for pragmatic, cost-related reasons. The New Zealand Law Society (NZLS) considered that with the current fiscal realities this type of reform is unlikely to be a government priority. Its view was also that a registration system would need to operate for a supervisory mechanism to be effective. The Trustee Corporations Association has noted the merit of these ideas in the past but does not consider them viable at present. Its view is that the ombudsman and commission would have questionable utility, and the cost of the tribunal is unlikely to be justified by the benefits. Greg Kelly Law's view was that it is unwise to recommend these options when government expenditure is under pressure. Taylor Grant Tesiram's view is that dispute resolution should remain solely with the High Court as the other options are not viable. They consider that as trusts are private, the state should not subsidise their administration or dispute resolution.
- 13.12 The New Zealand Trustees' Association (NZTA) and KPMG were in favour of the introduction of a new mechanism. The NZTA preferred an

ombudsman, while KPMG felt that the public element to trusts justifies an ombudsman or commission and a tribunal.

- 13.13 While the options all have some merit, we have not found that there are such strong factors in their favour or such a strong need for an alternative mechanism to the courts that the serious concerns about their cost and value can be overcome. There is not really a case for a special mechanism for trusts when none is provided in other areas of civil law. Furthermore, if the proposals we made in chapter 12 for expanding the District Courts' jurisdiction under trusts legislation are introduced, the concern about the cost and accessibility of a court proceeding may be somewhat alleviated. We therefore consider that new legislation should not include an ombudsman, tribunal or commission for trusts.

A ROLE FOR THE PUBLIC TRUST

- 13.14 During the consultation phase of the project the option of providing for the Public Trust to have a greater role under new legislation was suggested as an alternative to having an ombudsman, tribunal or commission. While this option would be significantly narrower than what was envisaged for an alternative mechanism for dispute resolution, the Public Trust does present an attractive alternative for carrying out relatively straightforward administrative processes and the provision of advice. Currently only the High Court has the power to issue certificates and approvals, which could conceivably be carried out by a different independent body with reduced cost and delay.
- 13.15 Under the Public Trust Act 2001, the Public Trust is established as a statutory corporation that is a Crown entity. It has functions relating to the business of providing estate management and administration services, under that Act, the Trustee Act 1956, and a number of other Acts. Under various statutes the Public Trust is given responsibility for managing public money, administering estates, filing certificates, holding securities, advancing and borrowing money on others' behalf, executing instruments to discharge a mortgage and overseeing property managers' property statements.³¹²
- 13.16 Following consultation with the Public Trust, we propose that it should be able to carry out a number of administrative functions under trusts legislation. While it is not suited to resolving disputes between parties, the Public Trust is comfortable with gaining additional functions under a new trusts statute if the functions are of a similar nature to those it has currently. The court's jurisdiction should remain in place, but where a matter is straightforward and there is no dispute among parties, the Public Trust can

312 For instance, Insolvency Act 2006, ss 273, 283–289, 385 and 387; Protection of Personal and Property Rights Act 1988, ss 37, 39, 46, 91 and sch 2; Property Law Act 2007, ss 109 and 112; Public Works Act 1981, ss 81 and 96–98; Life Insurance Act 1908, s 69; Administration Act 1969, s 19.

provide orders, certificates and advice on specific matters. The proposed roles for the Public Trust include:

- advising trustees on when and how often they should advertise, for instance when trying to locate missing beneficiaries (see paragraphs [11.58] to [11.67]);
- advising trustees on the release of specific trust information or documents when requested by beneficiaries (see paragraphs [3.81] to [3.82]);
- providing a vesting certificate to confirm that assets are vested in named new trustee (see paragraphs [6.81] to [6.97]);
- removal and/or replacement of a trustee on the ground of incapacity or similar where there is no-one else with authority to do this apart from the court (this could be limited to relatively small trusts and estates) (see paragraphs [6.51] to [6.60]);
- overseeing the retirement and replacement of a sole trustee when there is no-one else with the power to appoint a new trustee under the trust deed (see paragraphs [6.40] to [6.50]);
- appointing a mediator or arbitrator to settle a trust dispute where the parties wish to settle the dispute out of court (see below);
- the power to bar small claims (see paragraphs [11.27] to [11.40]);
- the power to make decisions on behalf of trustee where the trustee is unavailable and cannot be contacted for any reason and no delegation is in place (see [4.36] to [4.44]); and
- a role in relation to unclaimed moneys (see paragraphs [11.41] to [11.57]).

13.17 Most of these proposals are discussed in more detail in the relevant chapters. Overall the primary argument in favour of conferring additional administrative functions on the Public Trust is that it will be more efficient and cost-effective for the administration of trusts. It addresses the concern raised by many submitters that requiring court processes for administrative matters is time consuming and expensive, and adds unnecessary complication. The main argument in opposition is that the court should retain supervision of trusts. However, the proposed functions above would still be subject to court supervision, but would provide a mechanism for lower level supervision of administrative matters. The Public Trust would be able to refuse to exercise the powers in the list above if it considered that court supervision was appropriate in the context. The Public Trust would be able to charge a fee for carrying out these functions in order to cover their costs.

THE USE OF ALTERNATIVE DISPUTE RESOLUTION

Proposal

P53 New legislation should:

- (a) give trustees a power to use alternative dispute resolution (ADR) to settle an internal dispute (between trustees and beneficiaries) or an external dispute (between trustees and third parties), where none is given by a trust deed;
- (b) give trustees a specific power to give future assurances of action that have been agreed to as a part of an ADR settlement;
- (c) provide that trustees will not be liable to other parties to an ADR settlement for agreeing to the settlement if they acted honestly and in good faith while doing so;
- (d) provide that a beneficiary can make a request to the court that mediation be used to resolve a dispute rather than continuing with court proceedings and that the court can require mediation to be used. It should be open to the court to allow the costs of the mediation to be paid from the trust assets;
- (e) provide that the court can appoint representatives of unascertained and incapacitated beneficiaries, who may be other beneficiaries, who can agree to an ADR settlement on behalf of the unascertained and incapacitated beneficiaries, subject to the court's approval of the settlement; and
- (f) provide that parties to a dispute can request that the Public Trust appoint a mediator or arbitrator. The Public Trust would be able to charge a fee to cover reasonable costs for carrying out this service.

Please give us your views on this proposal.

Current law

- 13.18 ADR techniques, such as mediation, conciliation and arbitration, are used in trust disputes. Some trust deeds, particularly more modern ones, explicitly allow the use of ADR. Where a trust deed does not provide for the use of ADR, it may be possible to vary the trust deed to provide this power or for parties to agree to the use of ADR. Where all parties, including beneficiaries, are capable of consenting, parties can agree to a mediation settlement. Where there are some unascertained or incapacitated beneficiaries, the court can appoint a person to represent the interests of these beneficiaries. In this case, any settlement must be consented to by the court.
- 13.19 There is nothing in the Trustee Act that makes ADR generally available. However, section 20(g) does provide a trustee with the power to:
- compromise, compound, abandon, submit to arbitration, or otherwise settle any debt, account, claim, or thing whatever relating to the trust or to the trust property ...
 - and for any of those purposes [to] enter into, give, execute, and do such agreements, instruments of composition or arrangement, releases, and other things as to him seem

expedient, without being responsible for any loss occasioned by any act or things so done by him in good faith.

- 13.20 This power is limited to settling a debt, account or claim, and appears generally to apply to external disputes, rather than disputes between beneficiaries and other beneficiaries or beneficiaries and trustees, but in these circumstances could cover an agreed settlement by ADR.

Issues

- 13.21 The benefits of using ADR to resolve disputes are well accepted and well documented. When compared with a court hearing, these include cheaper costs, quicker resolution, achieving finality, maintaining confidentiality and privacy, and being less adversarial. However, ADR may not be available in some trusts because trustees do not have the appropriate powers under the trust deed. Even where ADR is available, the nature of trusts can prevent the use of ADR because there can be unascertained and incapacitated beneficiaries who are not able to give consent to the use of ADR or to any agreement reached under ADR. While it is likely that the courts do have considerable inherent powers to order or approve the use of ADR and to appoint representatives on behalf of unascertained and incapacitated beneficiaries, there is certainly room for legislation to make this clearer and to further facilitate the use of ADR.

Options for reform

- 13.22 The options considered were:
- (a) retaining the status quo of the limited default power to compromise and agree under section 20(g). The legislation could make it clear that this includes ADR.
 - (b) introducing a statutory power for trustees to use ADR to settle an internal or external dispute, where no power is given by a trust deed. This option would make ADR available even where not expressly allowed under a trust deed, and would make it available for all types of trust dispute, rather than just those currently covered by section 20(g). Parties would need to agree to use ADR and to agree to the settlement.
 - (c) introducing a provision based on the Hawaiian legislation allowing a beneficiary to request that the court require mediation to be used to resolve a dispute instead of court proceedings. Unlike the Hawaiian rules which require the parties to bear the cost of the mediation it would be open to the court to allow the costs of the mediation to be paid from the trust assets.
 - (d) providing that the court can appoint representatives of unascertained and incapacitated beneficiaries, who may be other beneficiaries, to agree to an ADR settlement on their behalf. Any agreed settlement would then have to be approved by the court. This would explicitly state in legislation the law as it currently stands.

- (e) allowing trust deeds to provide for “virtual representatives” who could be appointed to represent the interests of unascertained and incapacitated beneficiaries and agree to binding settlements on their behalf, without need for the court’s involvement, either to appoint the representatives or to approve the settlement.

Discussion

Including provisions on ADR

- 13.23 ADR is an effective and efficient way of resolving trust disputes. While ADR does not provide the independent supervision of trusts that the courts have, in many cases an agreed settlement will be an appropriate way of resolving a dispute. The use of ADR should be encouraged and facilitated where it is the best option. A legislative provision enabling the use of ADR in all trusts would help to achieve this. Although ADR may sometimes be an option under section 20(g) of the Trustee Act and is provided for in many trust deeds, providing trustees with a legislative power to settle disputes using ADR would make it clearer that these options are available in all trusts and would be particularly useful in the case of older trust deeds which are less likely to explicitly provide for the use of ADR. The proposed provision would apply to all trusts, including existing trusts. Submitters on the *Fifth Issues Paper* were fairly evenly divided on this question of whether a statutory provision facilitating the use of ADR should be introduced. Taylor Grant Tesiram’s view was that legislation should facilitate but not compel the use of ADR, and that the best option was extending section 20(g) to make it clear that it extends to all disputes involving trustees. Their view is that arbitration is not suitable for beneficiary-trustee disputes and its use should be prohibited under the legislation, but that it could be suitable for trustee-third party disputes. Susan Robson considered that ADR should be available even where it is not allowed under a trust deed.
- 13.24 The NZLS, the Trustee Corporations Association and Perpetual agreed that ADR was useful in trust disputes, but considered that no legislative reforms were necessary because it is available under modern trust deeds or by consent of the parties. We recognise that there is no evidence of a large problem with access to ADR in trust disputes at present. However, we consider that the advantages of using ADR over going to court are such that legislation should make it clear that ADR can be used in all trust disputes where it is appropriate.
- 13.25 The use of ADR may raise a few problems for trustees, however. If an ADR settlement requires trustees to commit to a future course of action, they are effectively fettering their decision-making, which may breach the duty to be active. Reaching an agreed settlement in a dispute is often going to be the best option for trustees. Legislation can alleviate this issue by providing trustees with a specific power to give future assurances of action that have been agreed to as a part of an ADR settlement. Trustees may also be hampered in a decision to settle a dispute using ADR by the risk of liability if other parties

to the settlement are unhappy with the settlement later on. We favour the approach of providing in statute that trustees will not be liable for agreeing to an ADR settlement if they acted honestly and in good faith.

Beneficiaries requesting ADR to be used

- 13.26 We see merit in the option of introducing a provision which allows a beneficiary to apply to the court for an order that mediation be used to resolve a dispute rather than court proceedings. This would give beneficiaries increased power to select how disputes are settled, something that seems appropriate given that they are to be most affected by the outcome of a dispute. The court will exercise judgement as to whether ADR is appropriate in the circumstances of the dispute. The Hawaiian provision, upon which the proposal is based, requires the costs of the ADR to be borne by the parties to the dispute. We agree with Greg Kelly Law and the Trustee Corporations Association that the provision should allow for the court or parties to decide that dispute resolution costs should be paid out of the trust fund.

Unascertained and incapacitated beneficiaries

- 13.27 We have considered the option of proposing legislation that allows the appointment of virtual representatives for unascertained and incapacitated beneficiaries who can bind those beneficiaries to a settlement without the court having to approve the settlement. However, we are concerned that this would not adequately protect the interest of beneficiaries who cannot represent themselves. Although it does add to costs, the court as an independent decision-maker is in the best position to decide how the interests of unascertained and incapacitated beneficiaries can best be safeguarded.
- 13.28 Most submitters did not support introducing virtual representatives. Taylor Grant Tesiram stated that in no other circumstances could incapacitated or unascertained beneficiaries be bound without court appointed representation. Its view is that even with court appointed representatives, mediation settlements can be relatively low cost. Greg Kelly Law and the Trustee Corporations Association were concerned that it would be difficult to ensure virtual representatives acted fairly rather than doing the bidding of the party that appointed them. They considered that the protection and supervision of the court is beneficial. KPMG considered that the idea had some merit but that it would be difficult to make agreements with virtual representatives binding and that third parties would find non-binding compromises too uncertain.
- 13.29 We propose instead that the legislation should provide that the court can appoint representatives of unascertained and incapacitated beneficiaries. This is for the purpose of clarifying that this option is available to the court, as the court does have the power to do this currently.

Appointment of an independent mediator or arbitrator

- 13.30 Where parties are willing to settle a dispute by ADR but want an independently appointed mediator or arbitrator, we consider that there should be a way of having an independent appointment made without having to go to the court. We propose that this could be one of the new functions for the Public Trust in its expanded role under the new legislation.

Part 4

GENERAL TRUST ISSUES



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Chapter 14

Remoteness of vesting and the duration of trusts

INTRODUCTION

- 14.1 The courts of the common law and equity have devised several interconnected ways of encouraging the free alienability of property (the ability for property to be sold or transferred). The rule against perpetuities, which should more accurately be called the rule against remoteness of vesting,³¹³ is one of these rules. The rule provides that a future interest in property is only valid if it is to take effect within 21 years of the death of someone who was alive at the time the interest was created (the “perpetuity period”). This rule has ramifications for structuring trusts, and limits their duration. It also applies more broadly to other property arrangements.
- 14.2 In this chapter we put forward proposals for reform of the rule against perpetuities. The topics examined in the chapter are:
- the rule against perpetuities / remoteness of vesting;
 - the duration of trusts;
 - the rule against accumulations; and
 - exceptions to allow perpetual trusts in expanded circumstances.

313 As has been noted by many prominent authors of trust textbooks, see for example J Morris and W Leach *The Rule Against Perpetuities* (2nd ed, Sweet & Maxwell, London, 1962) at 1–2.

REFORMING THE RULE AGAINST PERPETUITIES

Proposal

P54 New legislation should:

- (a) repeal the Perpetuities Act 1964 and provide that the common law rule against perpetuities / remoteness of vesting is of no application in New Zealand;
- (b) provide a default duration of 150 years for all trusts (a shorter period may be specified in the trust deed);
- (c) provide that at the expiry of 150 years from the date of the establishment of a trust, all trust property is to be vested in accordance with the provisions contained in the trust deed, or if the trust deed is silent, is to be vested in all surviving beneficiaries in equal shares;
- (d) provide that trusts which include a mechanism to calculate the vesting date rather than specifying a duration shall continue until the earlier of the date resulting from the calculation, or 150 years from the establishment of the trust;
- (e) provide that, notwithstanding these reforms, distributions which were valid under the Perpetuities Act 1964 at the date they occurred remain valid;
- (f) update section 59 of the Property Law Act 2007 to reflect the abolition of the rule against perpetuities / remoteness of vesting;
- (g) update the rule against accumulations to reflect the abolition of the rule against perpetuities / remoteness of vesting and provide a fixed accumulations period;
- (h) carry over the existing exceptions allowing certain trusts to continue indefinitely despite the rule against perpetuities and apply these exceptions to the rule limiting the duration of trusts;
- (i) establish a new exception to allow unit trusts to continue indefinitely (existing trusts will need to apply to the court for an extension);
- (j) establish a new exception to allow energy consumer trusts to continue indefinitely (existing trusts will need to apply to the court for an extension).

Please give us your views on this proposal.

Current law

- 14.3 The Perpetuities Act 1964 modifies the rule against perpetuities, but does not define the rule and does not replace it with a statutory code. Familiarity with the common law rule is therefore necessary to understand the effect of the Perpetuities Act and the current law.
- 14.4 The rule against perpetuities is one of a collection of rules and restrictions developed by the courts to promote unfettered ownership and free transfer of property. The classic statement of the rule is this: no interest is good unless it must vest, if at all, not later than 21 years after some life in being at the creation of the interest.³¹⁴ This technical rule is underpinned by a more fundamental and abstract principle of land law, that the “freehold must not be in abeyance.”³¹⁵
- 14.5 The Property Law Act 2007 and its predecessors have reformed or restated many common law rules relating to property. The modern statement of the law regarding future interests is contained in section 59:

59 Future estates and interests

- (1) Future estates and interests in property may be created that take effect at a future time;
 - (2) Subsection (1) applies subject to the rule against perpetuities and the Perpetuities Act 1964.
- 14.6 In complying with the rule against perpetuities, trusts must establish a date for the vesting of trust property. This provides a de facto maximum duration, as the trust will not continue after the final distribution of trust property.³¹⁶ The date may either be fixed, or calculated with reference to someone’s life (or the lives of more than one person). Under the common law a fixed date could not exceed 21 years from the date of settlement.³¹⁷ This has been extended to 80 years under the Perpetuities Act.

314 JC Gray *The Rule against Perpetuities* (4th ed, Little Brown & Co, Boston, 1942) at 201.

315 See *Freeman d Vernon v West* (1763) 2 Wils KB 165. For the prohibition on inalienable estates see *Washborn v Downs* (1671) 1 Ch Ca 213. The principle that the freehold must not be in abeyance also informed another rule prominent in the 18th century, known as the “rule against double possibilities”. This rule provided that an interest was void if it depended upon more than one successive contingency. In New Zealand, the rule against double possibilities was repealed by the Property Law Act 1908. This increased the importance of the rule against perpetuities as the primary means of voiding remote dispositions. The primacy of the rule against perpetuities was confirmed in s 18 of the Perpetuities Act 1964, which provided that the rule against perpetuities applies to a possibility of reverter on the determination of a determinable fee simple, or the possibility of resulting trust on the determination of other determinable interests.

316 For a more complete discussion of the rule against perpetuities and implications for the duration of trusts, see Law Commission *Perpetuities and the Revocation and Variation of Trusts: Review of the Law of Trusts – Third Issues Paper* (NZLC IP22, 2011) at Part 1.

317 See *Cadell v Palmer* (1833) 1 Cl & F 372, 6 ER 956.

- 14.7 The rule against perpetuities is a creation of the common law governing property. However, the courts of equity also developed a distinct rule precluding perpetual trusts.³¹⁸ This distinction does not come through clearly in the Perpetuities Act 1964 and subsequent legislation, where the phrase “rule against perpetuities” is used to refer to both the rule against remoteness of vesting, and the rule against perpetual trusts, depending on the context.³¹⁹ Indeed, some modern commentators consider that the rule against remoteness of vesting and the rule against a perpetual trust are two elements of the same rule, that is, the rule against perpetuities.³²⁰ However, the two rules are conceptually distinct. For example, a future interest created to take effect beyond the perpetuity period will not be valid by reason of being created to benefit a charity, even though a charitable trust may exist “in perpetuity.”³²¹
- 14.8 A related rule with ramifications for trusts is the rule against excessive accumulations. This provides that a direction to accumulate funds is void if it extends beyond the perpetuity period. This is of little relevance in private trusts, but is significant in relation to charitable trusts and other trusts that are able to exist in perpetuity. The Perpetuities Act reformulated the common law rule by providing that a direction to accumulate and dispose of funds will be valid if the disposition is valid, and will be invalid if the disposition is invalid.³²²

318 Also known at times as the rule against indestructibility of trusts or the rule against inalienability. This rule had its most common application in relation to non-charitable purpose trusts. See David Hayton, Paul Mathews and Charles Mitchell (eds) *Underhill and Hayton: Law Relating to Trusts and Trustees* (17th ed, LexisNexis Butterworths, Bath, 2006) at 254–255. For an example of the general rule limiting the duration of trusts as applied to an allowable purpose trust, see *Re Dean* (1889) 41 Ch D557.

319 For example, most treaty settlement legislation includes a provision to the effect that neither the rule against perpetuities nor the Perpetuities Act 1964 will prescribe or restrict the period during which a trust created under that legislation may exist. In contrast, the Perpetuities Act 1964 itself appears concerned mainly with the implications of the rule for remoteness of vesting. Te Ture Whenua Māori Act 1993 contains perhaps the clearest example of a mixed reference:

235 Trusts not subject to rule against perpetuities:

No trust constituted under this Part of this Act shall be subject to any enactment or rule of law restricting the period for which a trust may run.

320 See H Ford and W Lee *Principles of the Law of Trusts* (Law Book Company, Sydney, 1983) at [740].

321 *Attorney General v Webster* (1875) LR 20 Eq 483.

322 It is arguable that the common law rule was never in effect in New Zealand due to its amendment by the Accumulations Act 1800 (UK), which was held to apply in New Zealand in *The Trustees, Executors, and Agency Company (Limited) v Bush and Anor* (1908) 28 NZLR 117. The provision in s 21 of the Perpetuities Act 1964 can therefore be seen as reverting to the common law rule and departing from the statutory variation passed by the Parliament of the United Kingdom.

- 14.9 The Perpetuities Act made a number of modifications to the common law position on remoteness of vesting. The two most significant are the ability to specify a perpetuity period of 80 years or less as an alternative to the perpetuity period of a life in being plus 21 years; and the “wait and see” approach to interests which may or may not vest within the perpetuity period. Such interests are valid if they do vest within the perpetuity period, and may be modified in some circumstances to enable this to occur.³²³ Under the rule in *Saunders v Vautier*³²⁴ a trust can also be varied by the agreement of all beneficiaries, to provide for an earlier distribution.³²⁵ This means that since the Perpetuities Act commenced, most dispositions which would otherwise have been invalidated under the rule against perpetuities are able to be rescued through modification.

Issues

- 14.10 Even with the amendments under the Perpetuities Act, the rule against perpetuities is complex and causes considerable problems in practice.³²⁶ Most obviously, it causes uncertainty and there is a risk it may invalidate legitimate dispositions. It is not well understood, and so trust deeds may inadvertently fall foul of its requirements. The rule is also difficult to reconcile conceptually with the modern discretionary trust. The pertinent question is not whether the rule should be reformed, but how. In more abstract terms, we are considering how the law should approach the possibility of perpetual trusts and the issue of contingent or unvested interests.

Options for reform

- 14.11 The following options have been considered:
- (a) reforming the current rule and retain some limit on remoteness of vesting;
 - (b) abolishing the current rule but retain some limit on the duration of trusts; or
 - (c) abolishing the current rule completely to allow perpetual trusts and indeterminately remote vesting of future interests.

323 This is known as *cy pres* modification. See Perpetuities Act 1964, ss 9–12.

324 *Saunders v Vautier* (1841) Cr & Ph 240; 41 ER 482.

325 If any of the beneficiaries are minors or otherwise incapacitated, the court may approve a variation. See the *Third Issues Paper*, above n 316, at Part 2 and at ch 9 of this paper.

326 In California the Supreme Court has famously gone so far as to hold that a solicitor is not liable for negligence to beneficiaries when drafting a disposition that is intended to, but does not, comply with the rule against perpetuities: *Lucas v Hamm* (1961) 56 Cal 2d 583; 364 P 2d 685; 15 Cal Rptr 821.

Discussion

- 14.12 Submitters to the *Third Issues Paper* considered that the current rule is complex, poorly understood, and causes significant problems in practice. All advocated reform, and nearly all supported retrospective reform to create a single rule applying whenever a trust was created. It was submitted that unless the reform is retrospective, the situation will become more complicated to apply, rather than simpler and easier to understand. However, it was also noted that the reform should not retrospectively validate trusts previously held invalid, or affect previous distributions. Submitters also noted conceptual difficulties with the rule, as it hinges on the concept of remoteness of vesting in relation to a life or lives in being, which is not well understood.
- 14.13 Many submitters considered that the original policy rationales are no longer persuasive in the modern context and that the rule should be abolished entirely. However, the New Zealand Law Society expressed the view in its submission that if wide consultations were carried out, the New Zealand public would be likely to share the concerns that lead to the retention of the rule in the United Kingdom – that is, concern about “dead hand” control and wealthy individuals locking up assets in trusts indefinitely.
- 14.14 Those submitters who advocated abolition stated that if this approach was not adopted, their preference would be an alternative rule which limited the duration of the trust to a specified maximum period of 100 to 150 years (to take account of increased life expectancies), and that this rule should apply only to private trusts.
- 14.15 The Ministry of Social Development considered that there were strong policy reasons for the rule, but that it was complex and should be simplified. Its preferred reform was a new rule which would limit the duration of a trust to a maximum of 80 years.
- 14.16 Over time the conceptual distinction between the rule against remoteness of vesting and the rule against perpetual trusts has been eroded. However, trust practice has continued to evolve over the past century, and the distinction may once again be useful.³²⁷ This is particularly so in the modern discretionary trust that is intended to facilitate a managed but flexible transfer of wealth between generations, possibly for particular purposes such as education of the settlor’s descendants or the retention of a family farm. For many settlors, the intention is that the trust will continue until its funds are exhausted or its property is distributed to beneficiaries on their initiative. The question of remoteness of vesting is therefore less apposite than the question of the duration of the trust.

327 It has been said that: “The common law rule against perpetuities was directed at the problem of the vesting of future interests and bears little relationship to the problem of inefficient use of resources due to unforeseen changes in circumstances. The problem of changed conditions relates to the duration of fragmented interests.” (Gregory Alexander “The Dead Hand and the Law of Trusts in the Nineteenth Century” (1985) 37 *Stan L Rev* 1189).

- 14.17 Our proposal would repeal the outdated rule against remoteness of vesting, and create a statutory maximum duration for trusts of 150 years. This would address the practical concerns expressed by those who favoured reform or complete abolition, through providing a bright-line rule that is easy to understand and promotes certainty in trust dealings. It would prevent perpetual trusts, while allowing a high degree of flexibility for settlors to dispose of property as they choose.
- 14.18 The new rule will apply to all trusts currently in existence, regardless of when the trust was created. However, it would not validate trusts previously held invalid and will not affect prior distributions. The rule will therefore “rescue” existing trusts that fail to comply with the current rule, without requiring modification of the trust deeds.
- 14.19 We have considered the alternative time period of 125 years, which has recently been adopted as a maximum perpetuity period in the United Kingdom. However, given increasing life expectancies, we prefer an upper limit of 150 years. This will allow most trusts established for the duration of a life in being plus 21 years to continue until their natural end.
- 14.20 The court currently has powers to vary the vesting date of a trust, and some trust deeds also allow the vesting date to be varied by trustees. The variation provisions in new legislation will be broad enough to allow trustees to apply to the court to extend the duration of the trust in light of the new statutory maximum. This will allow extension where appropriate without creating complex transitional provisions for existing trusts.
- 14.21 In our view, there are strong policy reasons to retain some form of limit on the duration of private trusts. There is an important difference between trusts that continue for two or three generations and trusts that continue indefinitely. We consider that allowing perpetual trusts could potentially create problems for trust administration and undermine the interests of the current generation of beneficiaries. It will be difficult for trustees to discharge their duties in a perpetual trust because the interests of successive generations of unborn beneficiaries would need to be considered. An ever-increasing class of beneficiaries would eventually make a trust administratively unwieldy, or invalid because of a lack of certainty of objects. The greater the number of beneficiaries, the more difficult it would be to vary the trust. There is also a risk that settlors may inadvertently create perpetual trusts, preventing the more immediate beneficiaries from enjoying property. For example, a disposition “to my children and their descendants” would create a perpetual trust though the settlor’s intention may be only to benefit the next few generations.

- 14.22 As part of the preferred proposal, it would also be necessary to update section 59 of the Property Law Act, which currently allows future interests to be created subject to the rule against perpetuities. Reforms to this section could require all future interests to take effect within 150 years of their creation, or alternatively could provide that future interests may be created to take effect at any future date. The first option would be closer to the status quo and would retain a modified form of the rule against remoteness of vesting. The second option is closer to a full repeal of the rule.
- 14.23 This reform will have implications for property transactions which involve deferred or contingent interests, such as an option to purchase.³²⁸ This is an area where the traditional rationales of the rule against remoteness of vesting conflict with modern commercial practice. For example, in commercial subdivisions it may be desirable to create indefinite options to purchase, as a concomitant to an easement or covenant. In addition, because the rule is concerned with the date interests take effect and not their duration, it can cause confusion as to what is included and what is excluded. For example, it is generally said that the rule applies to options, but not to easements. However, the grant of an easement to take effect when a property is sold or subdivided would fall foul of the rule, as the interest may never take effect. This is not well understood, and causes confusion as well as potentially altering the burdens and benefits in property arrangements through voiding some elements of the arrangement (such as an indefinite option to purchase), but not other elements (such as a covenant). For these reasons we prefer the second option presented and suggest repealing section 59(2) of the Property Law Act.
- 14.24 It is proposed that the rule against accumulations be retained but updated for consistency with other reforms. The new rule would clarify that trustees may accumulate income, provided the trust deed so allows and provided the accumulated income is distributed upon the termination of the trust. The proposed approach will also clarify the position in relation to charities and other allowable perpetual trusts. The position at common law is that a direction requiring a charitable trust to accumulate income beyond the perpetuity period is a fetter on the use of the fund for charitable purposes and is therefore void.³²⁹ The case of *Re Armstrong*³³⁰ establishes that this position continues in New Zealand notwithstanding the Perpetuities Act. It is

328 The common law rules relating to options to purchase have been modified by s 17 of the Perpetuities Act 1964.

329 *Martin v Margham* (1844) 14 Sim 230, followed in *The Trustees, Executors, and Agency Company (Limited) v Bush and Anor* (1908) 28 NZLR 117 at 119–120: “where there is a trust for charitable purposes and a direction to accumulate the income or a portion of it indefinitely, or for any period in excess of that allowed by the rule against perpetuities, such direction is not a trust in favour of the charity, but is a fetter on the charitable trusts and prevents the use of the property for charitable purposes during the period for which the accumulation is directed.”

330 *Re Armstrong* [2006] 1 NZLR 282 (HC) (also cited as *Perpetual Trust Ltd v Roman Catholic Bishop of the Diocese of Christchurch*).

proposed that legislation will restate this principle and extend it to other non-charitable perpetual trusts, through providing that a direction to accumulate income is void if it extends for longer than the accumulation period. However, a rule which allows accumulations for 150 years rather than 80 years is a significant change. There may be an argument that the accumulations period for charitable trusts should be reduced, based on the idea that a binding direction to accumulate is a fetter on the charitable use of the fund. We invite comments on this issue.

- 14.25 There is a widespread view that commercial trust arrangements should be allowed to continue indefinitely. Trusts provide a useful way of creating commercial structures run for the benefit of a class of people, such as energy trusts, superannuation schemes, insurance schemes, or unit trust investment structures. It is argued that there is no reason to limit the duration of these sorts of arrangements and any rule that does so creates unnecessary complexity. For some commercial activities, such as insurance, an alternative to a trust structure is a co-operative company, and these can continue indefinitely. Superannuation schemes are currently exempt from the rule,³³¹ which does not appear to have created any problems, suggesting that the rule can be abolished for similar trusts without adverse effects. Notwithstanding these arguments, there are real difficulties in defining “commercial trusts structures” to exclude these from a general rule. Many submitters suggested that the rule should only apply to private trusts; however it is also unclear how “private trusts” should be defined.
- 14.26 In our view it would be simpler to have a default rule for all trusts, and list specific additional exceptions, such as unit trusts and energy trusts. If the maximum duration is of a sufficient length, such as 150 years, then this will ameliorate the current problems with remoteness of vesting and allow for commercial certainty in developing trust structures.
- 14.27 In recent years, many jurisdictions have moved further away from the rule against perpetuities.³³² The United Kingdom is notable for not following this path, and reforming rather than removing the rule through the Perpetuities and Accumulations Act 2009. Some submitters expressed a view that New Zealand should follow the global trend and allow perpetual trusts. Those who favour this option acknowledge that trusts of long duration may create problems, such as a growth in the number of beneficiaries and the fragmentation of interests in real property, or the risk that the purpose for which the trust was established will cease to be relevant as times change. However, it is argued that these issues could be addressed through giving the courts broader variation powers or the power to wind up a trust at

331 Perpetuities Act 1964, s 19.

332 The rule has now been abolished in six Canadian states and 21 states within the United States of America, as well as Ireland and South Australia. The Law Reform Commission of Nova Scotia has also recommended abolition: Law Reform Commission of Nova Scotia *The Rule Against Perpetuities* (Final Report, 2010).

some point in time after it was established (for example, 80 years, as in South Australia). We consider that this proposal would not be best suited to New Zealand's circumstances, particularly because of the popularity and prevalence of discretionary family trusts. There are advantages in a clear rule that provides certainty at the outset of the creation of the trust. We also note that if New Zealand were to abolish the rule against perpetuities, rather than reform it, we would be the only country to do so in the context of a tax system that does not otherwise discourage trusts of long duration.³³³ We consider that this would be too radical a reform, and would open the door to perpetual trusts and extremely long term trusts. We therefore propose the more modest proposal of a statutory limitation on the duration of trusts.

333 For example, the report by the Irish Law Commission recommended abolishing limits on the duration of trusts on the basis that the tax system provided sufficient disincentives for trusts of long duration, including through an annual tax on the capital held in trust. This argument for abolition does not apply in New Zealand. See Law Reform Commission of Ireland *Report on the Rule against Perpetuities and Cognate Rules* (LRC 62-2000).

Chapter 15

Regulation

INTRODUCTION

- 15.1 We have considered whether a register of trusts should be introduced to keep an official record of trust relationships. Several types of register were discussed in the *Fifth Issues Paper*.³³⁴
- 15.2 The Commission also considered whether there is a need for additional regulation of individuals and companies that provide services to settlors establishing trusts or to trustees administering and managing trusts. Most people providing professional services to support trusts, such as lawyers, financial advisers and accountants, are regulated, but others are not. If additional regulation of this type is necessary, then a further issue is whether individuals and companies who act as professional paid trustees should also be covered by such regulation.
- 15.3 We have concluded that neither a register of trusts nor regulation of trust service providers is necessary. However, we consider that it is still appropriate to briefly canvass the issues and the options for regulation.

REGISTRATION OF TRUSTS

Proposal

P55 A system of registration for trusts should not be introduced.

Please give us your views on this proposal.

Current law

- 15.4 At present there is little registration of trusts in New Zealand. Incorporated charitable trusts are required to be registered. Charities can register under

³³⁴ Law Commission *Court Jurisdiction, Trading Trusts and Other Issues: Review of the Law of Trusts – Fifth Issues Paper* (NZLC IP28, 2011).

the Charities Act 2005. Foreign trusts must be registered with the Inland Revenue regardless of whether they derive taxable income or not.³³⁵ However, there is no register for standard inter vivos or testamentary trusts. In respect of incorporated charitable trust boards, registration is the process that establishes such a trust board as a corporate body. As trusts otherwise do not have legal personality, there is not the same necessity for a registration system to establish legal personality.

- 15.5 There are also no external reporting requirements for trusts other than the requirement for income earning trusts to submit a tax return to the Inland Revenue. Up until 1 October 2011, those making gifts of in excess of \$12,000, including settlors gifting to private trusts, had to submit an annual gifting return to the Inland Revenue indicating how much had been given in order to be assessed for gift duty. This included settlors that were gradually gifting to the trust the value of the settlement of trust property at a rate that was under the threshold for gift duty. This created a de facto reporting requirement for a number of trusts. Gift duty has now been abolished. New legislation provides some requirements for trust service providers to obtain, verify and retain records of the beneficial ownership and control of trusts.

Issues

- 15.6 In the *Fifth Issues Paper* we raised the option of requiring trusts to be registered.³³⁶ This has been suggested to us as a way of attempting to make more information about general trust use and about individual trusts available. Because trusts are private there are few official requirements that alert the government or the public to the existence of the trust. The government has limited information about the use of trusts generally in New Zealand and about features of individual trusts that may be relevant to applications for government assistance. It can sometimes be difficult for third parties to determine that they are actually contracting with a trustee rather than a beneficial owner. The requirements for the administration of trusts are obligations owed only to the beneficiaries. There is no official body that has the responsibility and access to information to ensure that trusts are being properly administered. A register of trusts had been suggested by members of the public and media, as a way of officialising trusts and making them more transparent. Compared with the registration and reporting requirements for companies, the absence of a register for trusts means it is comparatively easy for trusts to be established, administered and altered, and for property ownership in trusts to be flexible.

335 Resident trustees of a foreign trust must disclose the name or other identifying particular (such as the date of settlement of the trust), the name and contact details of resident foreign trustees, and details of membership of trustees in approved professional organisations.

336 *Fifth Issues Paper*, above n 334, at ch 9.

Options for reform

- 15.7 The options regarding registration we considered were:
- (a) retaining the status quo of no statutory registration or reporting requirements for trusts (other than existing requirements for income earning trusts, charitable trusts and foreign trusts); or
 - (b) introducing a register for trusts. Various forms of register were suggested, such as a closed register, a searchable public register and a register for trading trusts only.
- 15.8 The Inland Revenue has suggested the option of a voluntary register for trading trusts or trusts operating a business. This option would tie in to a requirement for the trustees of these trusts to disclose that they are managing the trust in the capacity of trustee. Registration on this register could be considered sufficient disclosure, whereas trustees that did not register would be required to prove that the trust existed and that they had met more onerous disclosure obligations to creditors.

Discussion

- 15.9 It is possible that a register of trusts could have some advantages, the nature of which would be dependent on the amount of information that must be submitted and who is able to access this information once it is registered. By incorporating a regulatory element into the process for establishing a trust, there could be greater opportunity to provide information to trustees to ensure that they understand their obligations. A register could mean more information is available about the number of trusts in existence and how they are being used. Government agencies, beneficiaries and potential creditors would all be likely to gain benefit from having information available about trust relationships. Registration and reporting requirements may be an additional tool to ensure that trustees retain the information they are required to in order to meet their duties as trustees.
- 15.10 However, a register would significantly alter the nature of trusts by giving them a publicly registered status. We consider that the potential benefits are not sufficient to warrant such a change. It is also questionable whether the potential problems are valid and whether a register is the best way of addressing these problems. Furthermore, there are considerable disadvantages to the option of introducing a register. The costs of establishing and maintaining a register are likely to be large. It would be difficult to enforce the regulation of the hundreds of thousands of existing trusts. The reduced privacy, confidentiality and anonymity of trusts could make trusts less attractive and shift demand to alternative private structures to meet this need. The comparison with companies does indicate that trusts are comparatively less regulated as companies must be registered, have the names and addresses of directors and shareholders recorded, and make company constitutions and other documents available on a publicly searchable register. Several submitters noted that the nature of companies is that public

registration is required in order to establish their legal personality, however, something that is not applicable to trusts.

- 15.11 Most submitters were opposed to the introduction of a register. Ernst & Young considered that a register would result in increased compliance costs, particularly because it would require regular updating, and departure from overseas and historical norms with little advantage to be gained. It suggested that if there is a problem with ownership as trustee not being noted on share registries or the land transfer registry then these should be required to show where someone owns as trustee rather than changing trust requirements. The Trustee Corporations Association and Greg Kelly Law made the point that foreign trusts may not be settled in New Zealand if trusts become less private, something which may not be in the country's interests. Taylor Grant Tesiram's view was that concerns about the administration of trusts should be addressed by beneficiaries directly by taking court proceedings against a trustee. The New Zealand Law Society's (NZLS) view was that trusts are private matters and it is up to parties contracting with them to enquire into what relationships are in place. The Inland Revenue was favourable towards the introduction of a register. It considered that the value of privacy in trusts must be balanced against the rights of creditors to know who they are dealing with in a commercial world. Its view was that in an open market economy like New Zealand's the default position should be transparency in relation to business or asset holding entities unless there is a good reason why this should not be the case. It considered that compliance costs could be reduced by utilising an existing register, such as the Companies Register.
- 15.12 We have considered the option of a voluntary register as a part of a group of measures to address trusts that have a corporate as a trustee in order to encourage disclosure of status as a trustee. Such a register would not apply to most trusts but could increase the transparency of some business or estate holding entities where this would be useful. We are keen to avoid adding a regulatory requirement to the long-established general requirements for creating a trust as trusts have traditionally been able to be created privately and flexibly. A voluntary register would only be effective if there were incentives for trustees to register information about the trust. If corporate trustees were required to disclose their status as trustees in some way, a voluntary register could provide a straightforward method for them to disclose. An incentive suggested by Inland Revenue was that registration could be deemed to provide evidence of the existence of a trust and the onus would not be on the trustees to prove its existence, the date it was settled, the parties and the assets held. However, in chapter 8 we propose an alternative method for corporate trustees to disclose their status as trustees (see P33), along with other proposals to address the issues that arise with these types of trusts. We do not consider it necessary to proceed further with consideration of a voluntary register at this stage.

REGULATION OF TRUST SERVICE PROVIDERS

Proposal

P56 Further regulation of individuals and companies providing services to settlors establishing trusts, or to trustees administering and managing trusts, should not be introduced at this stage.

Please give us your views on this proposal.

Current position

15.13 Regulatory regimes apply to lawyers, chartered accountants, financial advisers and trustee companies.³³⁷ The Securities Trustees and Statutory Supervisors Act 2011 introduced a licensing regime for trustees and statutory supervisors of unit trusts and retirement villages.³³⁸ However, these regimes do not cover everyone who is providing administrative and advisory services to settlors and trustees.

337 Lawyers are regulated under the Lawyers and Conveyancers Act 2006 and the Lawyers and Conveyancers Act (Lawyers: Conduct and Client Care) Rules 2008. Chartered accountants are a self-regulated professional group. They must be members of the New Zealand Institute of Chartered Accountants and are subject to its regulatory standards, mandatory professional development, code of ethics and professional standards. Financial advisers and financial service providers are regulated by the Financial Advisers Act 2008 and the Financial Service Providers (Registration and Dispute Resolution) Act 2008. Trustee companies listed in s 2 of the Trustee Companies Act 1967 are regulated by that Act, the Trustee Companies Management Act 1975, and the Trustee Companies Management Amendment Act 1978.

338 The Securities Act 1978 requires all public issuers of debt and equity securities to appoint a trustee and the issues of other participatory securities to appoint statutory supervisors. The Unit Trusts Act 1960 similarly requires that a trustee be appointed in respect of a unit trust, and the Retirement Villages Act 2003 requires retirement villages to appoint a statutory supervisor. Note that the Financial Markets Conduct Bill currently before Parliament will repeal the Securities Act and the Unit Trusts Act and also amend and rename the Securities Trustees and Statutory Supervisors Act 2011.

- 15.14 From 30 June 2013 the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 will impose anti-money laundering reporting requirements on trust service providers and trustee companies and corporations.³³⁹ Most of the companies and individuals that currently fall outside other regulatory regimes will be covered by this Act. Under this new regime providers of trust-related services will be required to comply with anti-money laundering reporting requirements from 2013.³⁴⁰
- 15.15 General consumer protection regulation is also relevant. The Consumer Guarantees Act 1993 applies to all trade and professional services of a personal or domestic nature. This Act guarantees that such services will be carried out with reasonable skill and care and that they will be fit for any particular purpose that the consumer made known to the provider. It also guarantees that services will be completed within a reasonable time and at a reasonable cost. Where a service provider fails to meet these standards consumers are able to cancel services, refuse payment (or part payment) or claim compensation. The Fair Trading Act 1986 prohibits traders from making false or misleading representations about their services. Remedies are also available under that Act where service providers breach that obligation.

Issues

- 15.16 There is currently a small regulatory “gap”. It is, however, confined to occupational regulation. Although trust service providers are covered by consumer protection legislation and anti-money laundering legislation they are not under any occupational obligations. They are not required to be registered or required to comply with standards of professional competence in the way lawyers and financial advisers are.
- 15.17 The extent and significance of the regulatory gap is a little unclear. The number of service providers that operate in this unregulated gap and the nature and quality of the services they provide is not monitored. Without registration requirements it is also difficult to assess the size of any problem. However, the then Ministry of Economic Development has indicated that it considers that this gap in occupational regulation is very small.³⁴¹

339 From 30 June 2013 trust service providers and trust companies will be required to maintain records and report against anti-money laundering measures contained in the Anti-Money Laundering and Countering Financing of Terrorism Act 2009. That Act applies to all “reporting entities”. A reporting entity is partially defined in the Act but also includes a person or class of persons declared by regulations to be a reporting entity; see Anti-Money Laundering and Countering Financing of Terrorism Act 2009, s 5.

340 Anti-Money Laundering and Countering Financing of Terrorism (Definitions) Regulations 2011.

341 Ministry of Economic Development “Comment on External Paper” (21 November 2011). The Ministry of Economic Development is now a part of the Ministry of Business, Innovation and Employment.

- 15.18 Unregulated advisers provide their services as an alternative and in competition with trustee corporations and regulated professional advisers. Given they are claiming similar specialist skills and expertise, we have considered whether they should be similarly regulated to ensure their services meet a certain standard to better protect the consumers of such services.
- 15.19 If regulation is appropriate, a further issue is whether individuals and companies who act as professional paid trustees should also be covered. Trusteeship carries with it specific duties and liabilities. Where trustees claim to have specialist skills and expertise and act as trustees in the course of business for reward they hold themselves out as having special skills and expertise. They are also in a position to obtain indemnity insurance. In chapter 3 we have proposed that the duty of care applying to professional trustees should take into account any special knowledge or experience that it is reasonable to expect of a person in that role. In the *Fifth Issues Paper* the option of regulating professional trustees under any new regime applying to those providing trust-related services was also raised.³⁴²

Options for reform

- 15.20 The following options for reform were considered:
- *Option 1* – retain the status quo by not introducing further regulation; leave it to the market and to general consumer protection legislation to moderate the standard of services that fall outside these regimes.
 - *Option 2* – regulate and require providers of trust-related services to be registered and meet certain statutory standards of conduct set by a regulatory authority. This option could either include a professional body or association as regulator, or a state authority, which could undertake the task of registration, monitoring and enforcement. Within the legislative framework the regulator would set competence and good practice standards and would enforce these. The regime would also need to contain a mechanism for resolving complaints about service providers.
 - *Option 3* – extend the type of regulation proposed in option 2 to any paid or professional trustees.

342 *Fifth Issues Paper*, above n 334, at [10.37]–[10.38].

- 15.21 A further option, which we do not consider viable, is to simply prohibit anyone who is not a lawyer, chartered accountant, financial adviser, or trustee company from providing trust-related services. We rejected this option because a blanket restriction of this type is very heavy-handed. It is also inconsistent with the current approach to professional regulation, which minimises the areas of work that are reserved for particular professions.³⁴³
- 15.22 If option 2 or 3 is favoured, then one approach to consider is to extend the coverage of an existing occupational regime, such as the financial advisers' regime, which could be extended to cover all individuals and companies providing trustee services.
- 15.23 In the *Fifth Issues Paper* we discussed the ways that these issues have been addressed in other jurisdictions. While many have regulated those providing trust advisory services, we noted variations in the scope and coverage of their regimes. Some only regulate specialist trust companies, while others regulate a broader group of professional service providers.³⁴⁴

Discussion

- 15.24 A handful of submitters commented on this topic. Two-thirds favoured a light-handed approach to regulation, with an obligation for those providing trust-related services to be registered and to retain basic trust documents and information. Others including the Ministry of Economic Development and the NZLS were not in favour of an additional layer of regulation.
- 15.25 There are a number of points in favour of regulation. The practices of unregistered and unregulated service providers, and the quality of services they are providing, are difficult to gauge while services are not monitored. Light-handed regulation that required service providers to register would give a clearer picture. Some submitters expressed concerns that some of those operating in the market are probably not meeting appropriate quality standards, and that the numbers providing unregulated services would likely continue to grow. Regulation would either force these service providers to improve or exit the market.
- 15.26 There is also some interest in developing New Zealand's foreign trust jurisdiction. A couple of submitters suggested that given the increased interest in New Zealand providing foreign trust services, regulation was appropriate

343 For instance, under the Lawyers and Conveyancers Act 2006 the only areas of work reserved solely for lawyers are advising on the direction and management of court proceedings and providing representation in the courts, and giving legal advice or carrying out other action that is required to be carried out by a lawyer under any enactment (ss 6 and 24). Non-lawyers are not prohibited from entering the legal service market and giving advice on legal and equitable rights or obligations, although, they must not call themselves "lawyer", "law practitioner", "barrister", "solicitor", "counsel" or "an attorney-at-law" (s 21).

344 Society of Trust and Estate Practitioners (STEP) "STEP Policy Briefing January 2010 – Trust Reporting Systems – An International Comparison" (2010) Society of Trust and Estate Practitioners at 2 < www.step.org > .

to help develop and promote New Zealand as a jurisdiction of choice. They thought that regulation would force those who did not meet the quality standards to either improve or leave the market and that it would improve public confidence and ensure that providers had an appropriate level of financial stability. Regulation of service providers is a significant feature of off-shore trust jurisdictions so could assist with such development.

- 15.27 Extending regulation to paid or professional trustees might improve the quality of services provided by some trustees. Regulation may also address existing concerns about the poor administration of some trusts.
- 15.28 Submitters provided views about the type of regulation that could be introduced. Some favoured a regime that applied to all companies or individuals who charge for advice about trust establishment or administration, or who prepared documents for these purposes, or anyone who is paid to act as a trustee. Some considered that it should not cover all paid trustees but only organisations and individuals that are in the business of providing professional trustee services to multiple clients. The suggestion was made that statutory trustee corporations, persons who act as trustees gratuitously and persons who act as trustees for a limited number of trusts (for example up to five) should be exempt.
- 15.29 The Financial Markets Authority (FMA) and the supervisory bodies under the Anti-Money Laundering and Countering Financing of Terrorism Act, which will be the Department of Internal Affairs for trustee service providers and the FMA for trustee companies, were suggested as possible regulatory authorities.
- 15.30 However, in our view the arguments against regulation are more compelling. Although some submitters favoured light-handed regulation, no-one has identified any significant regulatory gap or any serious problem with the quality of services available. As the Ministry of Economic Development's submission notes, settlors and trustees are able to obtain a full range of trust services from regulated professional service providers. The Ministry saw no obvious need to protect consumers who choose to obtain services from unregulated persons. It seems unnecessary to regulate further, particularly when regulation would increase compliance costs and the administrative burden already imposed on trusts. There would be costs involved in establishing a register and resourcing a regulator. In our view the size of the regulatory gap here simply does not justify the additional cost.
- 15.31 After weighing the arguments, we consider that additional regulation is unnecessary because the occupational regulatory gap is very small. The financial advisers' regime, current professional regulation and the anti-money laundering legislation together cover most of those providing services in this market. We propose that it should be left to the market and to general consumer protection legislation to moderate the standard of services that fall outside these occupational regimes.

- 15.32 However, it would be appropriate for the Ministry of Business, Innovation and Employment to continue to monitor the situation for developments. It will take time before the impact of recent amendments to the financial advisers' regime, and the Anti-Money Laundering and Countering Financing of Terrorism Act can properly be assessed. These changes are likely to address many of the problems of unqualified advisers working in the trust sector.
- 15.33 Finally, we consider that it is unnecessary to impose additional regulatory requirement on paid trustees. We have proposed in chapter 3 that new trusts legislation strengthen trustee duties. Trustees are under duties which are enforceable by beneficiaries through the courts. We agree with the NZLS that these remedies against trustees should be adequate to address situations where trustees fail to meet appropriate standards.

Chapter 16

Interaction of trusts with other policy areas

INTRODUCTION

- 16.1 In the *Second Issues Paper* the Commission acknowledged the wider public perception that trusts are being used in certain situations in ways that are considered by some to be inappropriate and potentially unfair.³⁴⁵ This includes settlors or beneficiaries of trusts avoiding obligations to creditors and the government, and individuals being able to access government benefits or subsidies, by artificially minimising personal assets or income. The policy and legislative mechanisms outlined in the *Second Issues Paper* were considered in this context.
- 16.2 The *Second Issues Paper* discussed a range of legislative responses to the use of trusts, which allow trust assets to continue to be treated as the settlor's assets or to continue to be subject to the claims of third parties. It considered the adequacy of current legislative provisions and noted that each of the statutory regimes takes a different approach to how trust property and income is treated. The paper outlined several options to address the inconsistency in approaches to trusts across the different legislative provisions.
- 16.3 This chapter discusses submitters' views on whether the current legislative provisions are adequate, and if they are considered inadequate, whether the solution is to strengthen the current provisions or whether a stronger, more uniform solution is called for. We conclude that it is more appropriate that the approach to trusts is addressed separately in the individual regimes rather than as a part of these reforms.

345 Law Commission *Some Issues with the Use of Trusts in New Zealand: Review of the Law of Trusts – Second Issues Paper* (NZLC IP20, 2010) at ch 2.

Proposal

P57 It is proposed that trusts should continue to be addressed in individual legislative schemes, rather than in a uniform “look-through” provision in trusts legislation.

Please give us your views on this proposal.

ADEQUACY OF EXISTING LEGISLATIVE MECHANISMS

16.4 The *Second Issues Paper* reviewed the legislation for the protection of creditors, the Property Law Act 2007 and the Insolvency Act 2006, and sections of the Property (Relationships) Act 1976 and the Family Proceedings Act 1980. It also examined provisions relating to government assistance and obligations to government under the Income Tax Act 2007, the Social Security Act 1964, and the Legal Services Regulations 2006.³⁴⁶

Submissions comment

16.5 Submitters were asked whether the existing legislative mechanisms for addressing the impact of trusts were adequate, and if not, whether they could be made more effective and how that could be done.

16.6 The majority of submitters considered that existing legislative mechanisms to address trusts were adequate.³⁴⁷ Several submitters noted that laws around creditor protection, particularly the Property Law Act and Insolvency Act, have been reviewed recently and now provide greater protection for creditors than had been the case. Likewise, KPMG considered that with recent changes to the “associated persons” definitions, the Inland Revenue now has wider scope to link trusts to other taxpayers. The view expressed was that there are also currently wide measures of relief available through the Companies Act 1993, insolvency laws and civil actions, so there is not necessarily any need to address concerns at the trust law level.

16.7 Some submitters considered existing mechanisms to be inadequate in one or more respects. Tobias Barkley argued that existing legislative mechanisms are inadequate because they are not designed to remedy situations involving discretionary trusts, especially where the settlor is able to benefit from the trust assets and continue to exercise control, so the circumstances of alienation of the property are irrelevant.

16.8 Several submitters considered that existing statutes concerned with creditor protection, relationship property, tax avoidance and social welfare eligibility could be strengthened and made more explicit. Several submitters commented

346 At ch 3.

347 This included the New Zealand Law Society (NZLS), KPMG, the Trustee Corporations Association (TCA), and Ayres Legal.

that there was a need for effective enforcement of current legislative provisions.

Property Law Act 2007

- 16.9 The New Zealand Law Society (NZLS) considered that the provisions of the Property Law Act are not inadequate or in need of strengthening.³⁴⁸ Law firm Taylor Grant Tesiram observed that the Property Law Act 2007 and the Insolvency Act 2006 have been reviewed recently and are likely to be subject to further review from time to time, and there was not a strong argument for a significant change in creditor legislation or remedies.

Insolvency Act 2006

- 16.10 The NZLS observed that more focus will fall on the provisions of the Insolvency Act following the abolition of gift duty, and in particular the onus of proving that the donor of a gift (the settlor) remained solvent when the gift was made. The NZLS did not consider the provisions of the Insolvency Act were inadequate or ought to be amended in relation to gifts or transactions between settlors and trustees. However, it did believe that the provisions needed examining in relation to insolvency of trusts. It also considered that remedial legislation is desirable to strengthen the Official Assignee's standing to make claims as assignee of a bankrupt settlor.³⁴⁹
- 16.11 Peter Kellaway recommended that the Official Assignee be able to set aside the form of a transaction and claim the assets as part of the bankrupt estate. He considered that it may be necessary to amend the definition of the bankrupt's property or provide a specific provision regarding the setting aside of trusts where the substance of the transaction is to defeat the bankrupt's unsecured creditors. He thought there might be a need to provide for the same powers in the Trustee Act, but leaving it to the court's discretion to set aside the trust.

Income Tax Act 2007

- 16.12 The NZLS and Taylor Grant Tesiram considered that there are sufficient powers within existing tax statutes and other commercial laws to address trusts; there is a broad range of remedies available, and the present rules are working well. KPMG considered that the application of tax laws to trusts can be significantly onerous and a trust structure can be disadvantageous in certain circumstances. The NZLS and Taylor Grant Tesiram observed that tax legislation is constantly updated and reviewed, and considered that there was no particular issue of concern in respect of tax laws as they relate to trusts. WHK considered that recent changes to income tax rates may have addressed concerns about people using trusts improperly.

348 This view was shared by Taylor Grant Tesiram and Harris Tate.

349 This issue is addressed separately below. See [16.39]–[16.47].

Property (Relationships) Act 1976

- 16.13 Although submitters considered the current legislative mechanisms in other areas to be largely adequate, those who commented specifically on the Property (Relationships) Act identified the look-through mechanisms in this Act as problematic. Submissions generally considered that the current provisions should be strengthened because the court's ability to make orders in respect of property transferred to trusts in property relationship cases was too limited.
- 16.14 However, these submitters were cautious about proposing specific amendments to the Act. The Auckland District Law Society (ADLS) argued that significant statutory reform should only be considered following a careful review of case law in specific areas. Chapman Tripp commented that the solution was not to try and formulate a "simple fix" for trusts. Reform needed to focus on the objectives of the statute, which applied to a range of entities and persons and not just trusts. Taylor Grant Tesiram favoured a separate review for the possible shortcomings in the Property (Relationships) Act and related legislation rather than addressing these in a review of trust law.
- 16.15 The NZLS submitted that the problems around the Property (Relationships) Act arise because the objectives of trust law and relationship property law differ. Relationship property law is aimed at ensuring a fair distribution of the assets produced or enhanced by a qualifying relationship. It said that:
- A clear decision needs to be made about whether the equal sharing concept should be paramount. If it is to be paramount, the legislation should clearly say so and contain wider discretions giving the courts freedom to make appropriate orders in relation to trust assets that would otherwise have been relationship property or separate property subject to a court order. Such legislation would also require the courts to have regard to the other beneficiaries of the trust when making orders.
- 16.16 Views on how best to address the issues arising here varied.

Section 182 of the Family Proceedings Act 1980

- 16.17 The NZLS commented on section 182 of the Family Proceedings Act, under which the courts can vary the terms of a trust where it is an ante- or post-nuptial settlement. Whilst acknowledging the historical reasons for the separate regime for modifying trusts in section 182, the NZLS considered that the interrelationship between section 182 and the Property (Relationships) Act needed to be reviewed. It commented on the inconsistency of the Property (Relationships) Act applying to de facto couples, but section 182 not doing so, and of the equal sharing principle, which is paramount in the relationship property area, not applying to ante- or post-nuptial trusts that hold assets that would otherwise have been relationship or separate property.
- 16.18 The NZLS suggested that there ought to be a single set of provisions dealing with trusts contained in the Property (Relationships) Act and that this should replace the current provisions in both Acts.

Eligibility for government assistance under the Social Security Act 1964 and other entitlements

- 16.19 The NZLS considered that there was room for improvement and some harmonisation of approach between the provisions relating to the residential care subsidy and the Legal Aid Services Regulations 2006, although each did have a different focus and therefore required a different approach to assessment and criteria. It considered that the residential care subsidy regulations should have more focus on the “interest” of the beneficiary under the trust and the likelihood of the beneficiary receiving a benefit. If deprivation of property remained part of the test for residential care subsidy purposes, a purpose or intention test with a rebuttable presumption operating for a specified “look-back” period was suggested.
- 16.20 Jennifer Dalziel considered reform was required to prevent people obtaining access to the residential care subsidy, the Community Services Card and the student allowance through the use of trusts.

Other statutes

- 16.21 The TCA commented that succession laws (such as the Family Protection Act 1955 and Law Reform (Testamentary Promises) Act 1949) needed to be looked at as trusts can be used to sidestep a will-maker’s obligations under these Acts. John McIlwaine suggested that the use of trusts to hide assets from the reach of the Family Protection Act be considered. There are no mechanisms in these statutes to look through or recover assets from trusts.

Discussion

- 16.22 We understand from submissions that, except in the relationship property area, there is no strong evidence of significant overall problems in the operation of individual statutes that address the impact of trusts, as opposed to more minor issues. In contrast, more significant issues were raised by submitters and through informal feedback during the course of the project over the adequacy of the look-through mechanisms in the Property (Relationships) Act. In the next chapter we discuss the specific issues with these look-through mechanisms.
- 16.23 While some submitters did raise specific issues with other statutes, there was no clear consensus as to problems. Key statutes, such as the Property Law Act, Insolvency Act and Income Tax Act, have been updated recently and were considered satisfactory. A specific problem with the insolvency of trusts and the Official Assignee’s standing to make claims as assignee of a bankrupt settlor is addressed at the end of this chapter.
- 16.24 The enforcement of existing provisions could be improved and there may also be a case for approaches in individual statutes to be strengthened and made more explicit, as suggested by some submitters. The Ministry of Social Development may wish to consider reviewing the Social Security (Long-Term Residential Care) Regulations in light of the comments put forward

by the NZLS regarding the potential harmonisation of the regulations with those relating to legal aid. The broader question of the suitability of existing mechanisms for discretionary trusts with some ongoing settlor involvement, for example as a trustee, a beneficiary, or an appointer, as is common in New Zealand, is also worthy of attention.

- 16.25 However, we acknowledge the point raised in submissions that any review and amendment of provisions in legislation needs to take into account the impact on the entire legislative and policy scheme in that area. Accordingly it is preferable that these matters be considered in the context of those individual regimes rather than as part of this set of reforms.

REFORM OPTIONS CONSIDERED

- 16.26 Each of the statutory regimes outlined in the *Second Issues Paper* takes a different approach to trusts. The *Second Issues Paper* set out a number of possible options for reform to harmonise the approach to how trust property and income is treated across the different legislative provisions. These options included:

- (a) central look-through provision in new legislation replacing the Trustee Act that sets out factors that would be considered in assessing whether a disposition of property to a trust can be disregarded in assessing a person's obligations to another person or the Government, or in assessing eligibility for government assistance,³⁵⁰ and
- (a) leaving it to individual statutes to address dispositions of property or income to trusts (the status quo).³⁵¹

- 16.27 Further options of a provision in new legislation containing principles about the uses to which trusts can be put, and administrative guidelines for agencies when considering the implications of trusts in particular policy contexts were also discussed.³⁵²

Submission comment

- 16.28 Submitters were asked whether the solution was to strengthen the current provisions or whether a stronger, more uniform solution was called for. They were asked, if they thought there should be a single provision in trusts legislation, what factors should be included in this provision.

Single uniform provision in trusts legislation

- 16.29 The majority of submitters did not favour having a uniform provision in trusts legislation, and preferred that trusts continue to be addressed in the

350 *Second Issues Paper*, above n 345, at [5.18]–[5.20].

351 At [5.21].

352 At [5.22] and [5.23].

individual statutes governing each area.³⁵³ Comments made by submitters against a uniform provision in trusts legislation included the following:

- (a) Trust law is mainly aimed at protecting beneficiaries, while other bodies of law seek to achieve different aims, so a provision of general application would not be viable. Having a consistency of approach across various areas is not necessarily an appropriate policy objective.
- (b) A uniform provision is unlikely to operate effectively in practice, and could result in confusion, uncertainty and potential dispute, for example in the tax area. It could complicate trust law and undermine the integrity of trusts. Such a provision may also involve some increased compliance costs; wholesale reforms could impose significant costs with little benefit. The consequences of looking through or disregarding trusts in any given area would also need to be considered fully, and the same outcome may not be appropriate in all areas.
- (c) Issues with the use of trusts are not trust-specific; other legal arrangements can be used for the same purpose and achieve the same outcomes. A uniform trusts provision would encourage the use of alternative legal arrangements instead of trusts.

16.30 A few submitters supported having a uniform provision in trusts legislation. This included the MSD and KPMG, with some conditions. The ADLS reserved its view on the issue but acknowledged that a new statutory regime could provide increased certainty and less cost associated with litigation. KPMG considered there was some merit in model rules which can be switched on or off by legislation in specific circumstances, to allow third parties to “look through” a trust or claim priority. KPMG’s preference is that such model rules would not affect the validity of a trust. A specific rule was preferred over a general one, due to the uncertainty and problems in application of a general rule.

16.31 The MSD favoured a consistent approach to be applied in trusts legislation, enabling the existence of the trust to be ignored, and the assets and income to be treated as those of the settlor, if the trust has a purpose or effect that is unlawful or inconsistent with specified public policy objectives (including income and asset testing for access to state assistance).

Leaving trusts to be addressed by individual statutes

16.32 This was the preferred approach of most submitters.³⁵⁴ Submitters considered that it is preferable to allow individual statutes to address the impact of trusts, and concerns about the use of trusts, in those particular legislative contexts.

353 Submitters against a uniform legislative provision included the NZLS, Ernst & Young, Chapman Tripp, Lawler & Co, Jack Riddet Tripe, and the Ministry of Economic Development, the TCA, Taylor Grant Tesiram, and Ayres Legal.

354 This included the NZLS, Ernst & Young, KPMG, Chapman Tripp, the TCA and Taylor Grant Tesiram.

Submitters considered that any possible review and amendment should occur in the context of specific legislation, rather than via an overall trust law rule.

- 16.33 Several submitters, including the NZLS and Chapman Tripp, noted that many of the existing provisions that can be relevant to trusts are of general application; that is, they apply to a range of persons and entities and not just to trusts. The TCA preferred the use of provisions that were “entity-neutral” and targeted transactions instead of trusts, such as the provisions found in the Insolvency Act.

Discussion

- 16.34 Regarding the overall approach to be taken in legislation, we agree with the majority of submitters that it is preferable to continue to address the impact of trusts in each individual legislative scheme. The overall view of submitters is that the different approaches taken to trusts in the different statutory and policy areas are appropriate. Individual policy areas, such as tax and insolvency, require different approaches to the use of trusts because they involve different problems, objectives and priorities which necessitate their own criteria and responses. On this basis, increasing consistency across the various areas was not considered a desirable aim.
- 16.35 We considered whether it would be desirable to have a uniform look-through provision in trusts legislation, to bring consistency in how trusts are regarded in different policy areas. There was only limited support for this position. Generally a coordinated, uniform approach was favoured by government agencies, while members of the legal and accounting profession, professional and industry organisations did not favour such an approach.
- 16.36 The strong view of the majority of the submitters is that a uniform provision would not be helpful or effective in practice, as there would be great difficulty in formulating a provision that would be suitable to apply across a range of policy areas. We acknowledge submitters’ concerns that imposing a uniform arrangement in trusts legislation would cut across the tailored responses currently available in each area, and could create new difficulties in the interface with other legislative schemes. On the whole, submitters’ perceptions of a uniform provision were that it would complicate trust law and create uncertainty rather than increase clarity and certainty. In this respect, a uniform provision does not align well with the objectives of this review and the preferred approaches.
- 16.37 There may be broader conceptual reasons as to why trust interface issues should be dealt with in each individual area, rather than in trusts legislation. Some aspects of the use of trusts only present difficulties when they interact with other policy areas, and do not necessarily in themselves contravene trust law principles or undermine the trust concept; for example settlor control can be legitimate (as long as the trustee is accountable to beneficiaries).³⁵⁵

355 Jessica Palmer “Controlling the Trust” (2011) 12 Otago LR 473 at 493.

Furthermore, a general look-through provision does not seem to be appropriate in trusts legislation because it undermines the law of trusts, which is about establishing and managing this property holding mechanism. A look-through provision too easily allows a trust to be unwound and trust law overridden. It would also lead to the question of why there should be a look-through provision for trusts and not for other forms of property holdings.

- 16.38 We also considered variations on a look-through provision, including a provision in new legislation containing principles about the uses to which trusts can be put, and administrative guidelines for agencies when considering the implications of trusts in particular policy contexts.³⁵⁶ However, there was limited interest in them among submitters, who generally considered these approaches were too general to work effectively across different areas of the law, although the principles provision was the Ministry of Economic Development's (MED) preferred option because it would give the courts flexibility to make judgments taking into consideration the facts of each case. We do not see benefit in pursuing either of these since they suffer from the same difficulties as a look-through provision in legislation; it would be too difficult to develop a set of principles or guidelines that would be suitable for working across a range of policy areas while still providing useful guidance.

STANDING OF THE OFFICIAL ASSIGNEE

Proposal

- P58 Legislation should provide that the Official Assignee has standing to challenge a trust regardless of whether the bankrupt could have done so prior to the bankruptcy.

Please give us your views on this proposal.

Current law

- 16.39 Prior to the Court of Appeal's decision in *Official Assignee v Wilson*,³⁵⁷ the position, as commonly understood, was that the Official Assignee was able to allege sham structures, whether or not the bankrupt could have done so. However in *Wilson* the Court held that the Official Assignee could not challenge a trust structure if the bankrupt himself could not have challenged it. The Official Assignee was standing in the shoes of the bankrupt, who was the settlor of the trust (but not a trustee or beneficiary). Since the bankrupt himself could not have challenged the trust (because he was settlor and

356 *Second Issues Paper*, above n 345, at [5.22] and [5.23].

357 *Official Assignee v Wilson* [2008] NZCA 122.

therefore challenging the existence of the trust would have been for his own benefit and would have concerned transactions to which he was an active party), the Official Assignee could not challenge the trust either.³⁵⁸

Issues

- 16.40 The issue is whether legislative amendment is required to override the decision of the Court of Appeal in *Wilson* that the Official Assignee is unable to challenge a trust when the settlor is the bankrupt.
- 16.41 The Court's decision has been criticised by New Zealand and international commentators as incorrect.³⁵⁹ For example, Guest (who acted for the Official Assignee in the case) has argued that the position of the Official Assignee is not to be equated with the position of the bankrupt for all purposes, because there is no broad statutory declaration that this is the case or any case law comment.³⁶⁰ Further, the *Wilson* case was not about property that vested in the Official Assignee, but rather was about the Official Assignee's allegation that property held by third parties in reality was held by them on trust for the bankrupt to the point of the adjudication.³⁶¹ He argued that it ought to be open to the Official Assignee to claim that third parties hold property on trust for the bankrupt estate, and the result of such claim ought not to depend on whether the bankrupt could have pursued such a claim prior to the bankruptcy.³⁶²

Options for reform

- 16.42 The options are for legislative reform to override the Court's decision in *Wilson* and provide that the Official Assignee does have standing; or to retain the status quo and have no reform in this area. If legislative reform is favoured, there is a further question as to what form this would take.

358 *Official Assignee v Wilson* [2008] NZCA 122 at [18]–[25]. This issue was touched upon in *Official Assignee v Sanctuary Propvest Ltd* HC Auckland CIV-2009-404-852, 11 June 2009 in the context of an application by the Official Assignee that a caveat not lapse. There the Court held that the Official Assignee did have a reasonable argument that he had an interest in the property and could challenge the trust as a sham, since the bankrupt person in question was a beneficiary (unlike the bankrupt in *Wilson*).

359 J Guest “Is the trust fortress strong enough? ... Or ‘one door shuts and another door opens’” (paper presented to the New Zealand Law Society Trusts Conference, June 2009) at 98. See Anthony Grant “New Zealand’s sham trusts – facing international criticism” *NZLawyer* (online ed, 19 September 2009) referring to comments by Justice David Hayton at the 2009 Transcontinental Trusts Conference in Geneva, that on the facts in *Wilson* the Assignee should have been able to make the trust property available to the creditors, and that a more objective test should be used for establishing a sham: see < <http://nzlawyer magazine.co.nz/Archives/Issue121/121N5/tabid/1971/Default.aspx> > .

360 Guest, above n 359, at 100.

361 At 100.

362 At 101.

Discussion

- 16.43 The *Second Issues Paper* did not address this issue directly, and submitters were not directly asked to comment on it. Despite this, two submitters (the NZLS and the MED) raised the point, and both considered that the Court of Appeal's decision was incorrect in this respect and legislative change was required to correct it.³⁶³
- 16.44 The NZLS noted that the Court of Appeal in *Wilson* did not receive the benefit of proper argument on this issue, and the Court did not consider section 412 of the Insolvency Act 2006, which allows the court to look at the “real nature of the transaction”. It considered that the Official Assignee should not be constrained from doing something that a creditor could do, this being consistent with broader principles of insolvency law. The Official Assignee is likely to be the plaintiff in many cases where a trust structure is being used as a shield against the payment of debts. The NZLS considered that *Wilson* confuses the principle that the Official Assignee takes property subject to equities, with the notion that the Official Assignee generally stands in the shoes of the bankrupt. The MED agreed that the Official Assignee must have standing where the settlor is the bankrupt, and legislative recognition of that is required.
- 16.45 Our preferred approach is to amend the position through legislation to provide that the Official Assignee has standing to challenge a trust regardless of whether the bankrupt could have done so prior to the bankruptcy. The provision could potentially involve a leave application for the Official Assignee to obtain standing. The provision could be effected as part of trusts legislation, or as a separate amendment to the Insolvency Act.
- 16.46 Such a provision would clarify and provide more certainty about the position of the Official Assignee, in light of the criticism both in New Zealand and overseas about the decision in *Wilson* and the need for a legislative response. This issue is still somewhat uncertain given that there was only limited argument heard on this issue in the Court of Appeal, and the decision was not appealed to the Supreme Court.
- 16.47 We agree with the NZLS that a clear benefit of altering the position through a legislative provision would be the protection of creditors, since the Official Assignee is their main representative in proceedings and is likely to be the plaintiff in many cases alleging a sham trust. It would also be consistent with principles of insolvency law that the Official Assignee not be constrained from doing something that a creditor could do.

363 The NZLS emphasised this point in its submissions on both the *Introductory Issues Paper* and the *Second Issues Paper*.

CONCLUSIONS

16.48 We have reached the following conclusions:

- (a) Trusts should continue to be addressed in individual legislative schemes, rather than in a central look-through provision in trusts legislation.
- (b) It may be appropriate for some other policy areas to have stronger powers to disregard dispositions to trusts or consider assets to be available to a person when they have beneficial interests, or effective control. Those developing or reviewing provisions may want to consider how they view dispositions to a trust, beneficial interests or expectations, and effective control.
- (c) While not recommending a general look-through provision in trust law, other aspects of existing trust law, which it is proposed to set out in trusts legislation, may be relevant. These aspects include the validity of the trust in question (courts can find no trust if it does not meet the three certainties) or the failure of the trustee to meet their obligations (for example, not considering all the beneficiaries, or allowing themselves to be directed by a third party such as the settlor).
- (d) There is a case for a specific reform to be made to provide that the Official Assignee has standing to challenge a trust regardless of whether the bankrupt could have done so prior to the bankruptcy.

Chapter 17

Relationship property and trusts

INTRODUCTION

- 17.1 In the previous chapter we noted that the *Second Issues Paper*³⁶⁴ discussed a variety of legislative provisions that have been enacted to “look through” the trust, so that trust assets can be considered to be the settlor’s or beneficiaries’ own assets for certain purposes, or trust assets can be accessed in order to meet certain claims. The legislative provisions considered in the *Second Issues Paper* included sections 44 and 44C of the Property (Relationships) Act 1976 (PRA) and section 182 of the Family Proceedings Act 1980 (FPA). These provisions apply to give relief to a disadvantaged spouse or partner on the breakdown of a relationship where property has been transferred to a trust. However, many dispositions of property to trusts fall beyond the reach of these provisions.
- 17.2 As was discussed in the previous chapter, the Commission asked submitters whether they considered existing legislative provisions adequate for addressing the impact of trusts in this and other areas. The overall response from most submitters was that the provisions in the relationship property area are inadequate and not as effective as legislative provisions addressing trusts in other policy areas, such as insolvency. Some submitters said that the current provisions do not produce a just division of assets produced or enhanced by a relationship. Some also argued that the courts should be able to intervene in dispositions of property to trusts in a broader set of circumstances.
- 17.3 We have included a separate chapter on relationship property because submitters identified the look-through provisions in the PRA as those most in need of review and reform. This chapter discusses the issues that have been

364 Law Commission *Some Issues with the Use of Trusts in New Zealand: Review of the Law of Trusts – Second Issues Paper* (NZLC IP20, 2010).

raised around the effectiveness and reach of the current provisions. The two main issues that are considered are:

- whether there are circumstances (not currently addressed by the PRA) where dispositions to trusts should be set aside to better give effect to the equal sharing regime in that Act; and
- whether the reach of section 182 of the FPA should be extended to also apply to de facto relationships.

- 17.4 After canvassing the issues that have been raised over the effectiveness of the current look-through provisions in the PRA, our conclusion is that a review of the PRA may be needed to properly address these matters. As has been discussed in the previous chapter and also in the introductory chapter to this paper, the overall approach the Commission has taken to this review of the law of trusts is to address matters of core trust law rather than problems that arise solely at the point where trust law interacts with other policy areas. In the previous chapter we proposed that any problems arising at the point where trust law interacts with other policy areas are best addressed by the legislative schemes governing those policy areas and not by provisions in trusts legislation.
- 17.5 With these points in mind we are cautious about proposing changes to provisions in the PRA and FPA. It is beyond the scope of this review of trust law to fully analyse problems and issues arising over the use of trusts in the relationship property area. However, despite these concerns we have identified two possible amendments that might reasonably be advanced as part of our review to address some of the issues identified by submitters.
- 17.6 Firstly, we propose amending section 182 of the FPA to address the disparity in treatment between de facto couples and other couples. Although our proposal affects all nuptial property settlements, including any that are not trusts, we consider the proposed amendment to be relatively straightforward and to address what has now become an unfair anomaly.
- 17.7 Secondly, we put forward for comment the option of amending section 44C(2)(c) of the PRA to give the court broader powers to require the trustees of a trust to which relationship assets have been transferred to compensate the spouse or partner whose claim or right has been defeated by the disposition to the trust. We consider that this option has merit and that it would address a number of the issues with the current provision. We are therefore seeking submissions on whether it would be desirable to pursue this reform, or whether a fuller review of the PRA should instead be recommended to the Government.

DISPOSITIONS TO TRUSTS AND RELATIONSHIP PROPERTY

Proposal

P59 It is proposed that section 182 of the Family Proceedings Act 1980 (under which the courts may vary the terms of ante- and post-nuptial settlements, including trusts, when a marriage or civil union is dissolved) be amended to also cover de facto relationships. The following changes should be made to the jurisdictional requirements of section 182:

- (a) the terms de facto partner and de facto relationship should have the same meaning as these terms have in sections 2C and 2D of the Property (Relationships) Act 1976;
- (b) the triggering event that allows an application to be made to the court, or the court to make an order varying any qualifying settlement, should be changed from when a marriage or civil union is dissolved to when the parties to a relationship separate; and
- (c) an application to the court should be able to be made in respect of relationship settlements rather than nuptial settlements. The term relationship settlement may need to be defined.

Options for Comment

Which, if either, of the following options do you favour for the Property Relationship Act 1976, and why?

Option (1)

Amend section 44C(2)(c) of the Property (Relationships) Act 1976 to give the court a broader power to require the trustees of a trust to which relationship assets have been transferred to compensate the spouse or partner whose claim or right has been defeated by the disposition to that trust. Section 44C(2)(c) should be amended as follows:

- (c) *an order requiring the trustees of the trust to pay to one spouse or partner ~~the whole or part of the income of the trust, either for a specified period or until a specified amount has been paid~~ any specified amount or to transfer any property of the trust.*

Section 44C should otherwise remain unchanged.

OR

Option (2)

A review of the Property (Relationships) Act 1976 should be undertaken to determine whether there are circumstances (not currently addressed by the provisions of the PRA) where dispositions to trusts should be set aside, to better give effect to the equal sharing regime in that Act.

Please give us your views on these proposals and options.

Current law

- 17.8 Sections 44 and 44C of the PRA are the provisions of the PRA that are most relevant to the law of trusts.³⁶⁵ Section 182 of the FPA is also relevant.

Property (Relationships) Act 1976 – section 44

- 17.9 Under section 44 of the PRA the court can set aside dispositions of property (including those to a trust) that are made “in order to defeat the claim or rights of any person” under the Act. Initially the courts interpreted section 44 narrowly. In *Coles v Coles*,³⁶⁶ the Court of Appeal held that the words “in order to defeat” meant that the partner who entered the transaction had to have done so:³⁶⁷

because of a conscious desire to remove some item or items of matrimonial property from the reach of the Courts. It must be shown that such was the aim or object of the transaction; the end which the transaction was intended to achieve.

- 17.10 However, the more recent Supreme Court decision in *Regal Castings*³⁶⁸ has clarified that a defeating purpose or motive is not required in this type of test. Instead, if the person has knowledge that a consequence of the disposition will be to defeat the other person’s rights, then he or she is considered to have intended that consequence, even if it was not actually his or her wish to cause that loss. The reasoning in *Regal Castings* was applied to section 44 in *Ryan v Unkovich*.³⁶⁹ In that case Justice French said:³⁷⁰

I accept the principles enunciated in *Regal Castings* are sufficiently general to apply to s 44. In particular, I accept that in so far as the *Coles* formula fails to distinguish between intention and motive, it is contrary to the reasoning of the Supreme Court and should not be followed. Knowledge of a consequence can be equated with an intention to bring it about.

365 Also relevant are Property (Relationships) Act 1976, ss 33(3)(m) (Ancillary order varying the terms of a trust or settlement), 43 (Dispositions may be restrained), 44A (Application of ss 44B and 44C) and 44B (Court may require party to disclose information about dispositions of property to trust).

366 *Coles v Coles* (1987) 3 FRNZ 101.

367 At 105.

368 *Regal Castings Ltd v Lightbody* [2009] 2 NZLR 433 (SC).

369 *Ryan v Unkovich* [2010] 1 NZLR 434.

370 At [33].

- 17.11 Relief is not available under section 44 where the person from whom relief is sought received the property or interest in good faith and has altered his or her position in reliance on having an indefeasible interest in the property or interest.³⁷¹ The court may also determine that it is inequitable to grant relief in other circumstances.³⁷²

Property (Relationships) Act 1976 – section 44C

- 17.12 Section 44 is supplemented by section 44C, which enables the court to make an order compensating a spouse or partner whose claim or rights have been defeated by a disposition to a trust. Under section 44C there is no need to prove intention to defeat the other party's rights.
- 17.13 Section 44C only applies where the court is satisfied that section 44 does not apply to the disposition before moving to consider section 44C.³⁷³ Section 44 may not apply because the required intention cannot be proved or because relief cannot be ordered under section 44 because the recipient trustees received the property in good faith and for valuable consideration. In such circumstances a claim under section 44C can be pursued. Orders can be made by the court under section 44C:³⁷⁴
- requiring payment of a sum of money or transfer of property, whether out of relationship property or separate property; or
 - requiring the trustees of the trust to pay the whole or part of the income (but not the capital) of the trust.
- 17.14 An order diverting income from a trust may only be made if the first source is not sufficient to compensate the spouse or partner. The court may not make an order against the trustees if it would prejudice beneficiaries of the trust who have altered their position in the bona fide belief that they could rely on the ability of the trustees to distribute the income from the trust. The court has no power to distribute capital or to withdraw assets from the trust.
- 17.15 Section 44C was added by the Property (Relationships) Amendment Act 2001, on the recommendation of the Ministerial Working Group on Matrimonial Property and Family Protection, to redress the detrimental effect trusts were having on property rights.³⁷⁵ The difficulty of proving the required intention under section 44 and the increasing use of trusts had placed large amounts of relationship property beyond the reach of the courts, often to the detriment of one of the spouses or partners. The objective of section 44C was

371 Property (Relationships) Act 1976, s 44(4).

372 Property (Relationships) Act 1976, s 44(4).

373 *Babylon v Babylon* HC AK CIV-2006-404-3217, 12 October 2007.

374 Property (Relationships) Act 1976, s 44C(2).

375 See Department of Justice *Report of the Working Group on Matrimonial Property and Family Protection* (October 1988) at 28–31[*Matrimonial Property and Family Protection*].

to strengthen the Property (Relationships) Act where dispositions to trusts had the effect of defeating one of the party's rights, but where intention to defeat a party's rights could not be shown.

- 17.16 The scope of section 44C is limited and is easily circumvented. In *Equity and Trusts in New Zealand*, Professor Peart summaries the problems:³⁷⁶

...its ability to achieve a just division of assets produced or enhanced by the relationship is limited both by the section's requirements and by the remedies. ... it is easy to avoid being caught by s 44C. The section cannot be invoked if the trustees acquired the assets directly from third parties, rather than from either of the partners to the relationship. Nor does it apply to trusts that affect both parties equally or that were settled by third parties ... Even if the disposition does come within s 44C, the constraints on the compensation powers prevent applicants from achieving an equal share of the fruits of their efforts.

Family Proceedings Act 1980 – section 182

- 17.17 Section 182 of the FPA is also relevant to this discussion. Under section 182 the court may vary the terms of ante- and post-nuptial settlements – including trusts – when the marriage or civil union of the parties comes to an end.
- 17.18 Section 182 jurisdiction is separate from the PRA rules and the concept of equal sharing is not directly relevant to a determination under section 182. What is relevant is that, whereas a trust structure might have served the interests of a couple while they were harmoniously together, the tying up of their property in such a structure upon break up is unlikely to be able to serve them both in the way envisaged. The Supreme Court in *Ward v Ward*³⁷⁷ made it clear that there is no entitlement to a 50/50 or any other fractional division of the trust property under section 182. What is relevant, however, is that the nuptial settlement was premised on the continuation of the marriage.³⁷⁸ Under section 182, the court must assess whether an order is necessary and, if so, in what terms, to reflect the fact that that fundamental premise (the continuation of the marriage) no longer applies.³⁷⁹

376 Nicola Peart "Equity in Family Law" in Andrew S Butler (ed) *Equity and Trusts in New Zealand* (2 ed, Thomson Reuters, Wellington, 2009) 1161 at 1190–1191.

377 *Ward v Ward* [2010] 2 NZLR 31 (SC).

378 At [15].

379 At [62], in concurring with the Family Court judge's decision in the case, the Supreme Court said: "The Judge was entitled, indeed obliged, to bear in mind the interests of the children and, to a lesser extent, the interests of the remoter beneficiaries. On that premise, his decision to maintain the trust structure as far as possible, rather than order any absolute payment out of the Trust, was a principled and entirely justified one. Having reached that point, the subdivision of the original Trust into two, with the two new trusts being for the benefit of each of the parties and the children and other beneficiaries, to the exclusion of the other party, was within a properly exercised discretion. ... This equality of division, but on the premise of continuing but separate trusts on both sides, was a logical and fair way of giving effect to Mrs Ward's original expectation of the Trust in the changed circumstances. Equal division of the Trust represented the application of appropriate s 182 principles. It should not be seen as based on relationship property principles."

- 17.19 Under section 182, a “post-nuptial settlement” clearly captures a trust established after a marriage if the trust is intended to provide for the couple (and their children). To qualify as an “ante-nuptial settlement”, a trust must:³⁸⁰ (1) be on one or both of the parties; (2) be with reference to their married state; and (3) possess a “nuptial characteristic”. The inquiry is into whether there is the necessary degree of connection or proximity between the settlement (not the settled property) and the particular marriage.
- 17.20 If, in light of all the circumstances, there is good reason to intervene, then the court is able to remove capital or assets from the trust, vary the terms of the trust, or resettle the trust for the benefit of one or both parties to the marriage or civil union. The court may also make orders in regard to administration and management of the trust.
- 17.21 Section 182 of the FPA does not apply to de facto relationships so currently provides a remedy for some couples, but not for others. This inconsistency in the treatment of de facto and other couples must now be considered an anomaly.

Issues

- 17.22 In broad terms the issue is whether the current look-through provisions in the PRA are adequate to produce a just division of the assets produced or enhanced by the relationship. The use made of trusts by one or both partners to a relationship together with the limited scope of sections 44 and 44C may be undermining the broader policy objectives of the relationship property regime. In addition, the perceived unfairness of some divisions produced by the application of the PRA has contributed to unhelpful distortions and developments in the law of trusts as judges have attempted to find other ways to do justice between spouses or partners under the PRA.³⁸¹ A second issue is whether section 182 of the FPA should continue to apply to marriages and civil unions but not to de facto relationships.
- 17.23 A summary of the more specific issues and problems that have been identified with the current provisions are as follows:
- section 44 has broad application in the sense that it applies to any disposition of property to a trust, not just dispositions of relationship property, however, the cases indicate that applicants have had difficulty showing that a disposition has been made to defeat their or others rights. This issue may now have been addressed by the decision in *Regal Castings*.

380 *Kidd v van den Brink* HC AK CIV-2009-404-4694, 21 December 2009 at [18].

381 See the discussion in the *Second Issues Paper*, above n 364, at [4.33]–[4.43].

- the scope of section 44C is limited and is also easily circumvented.³⁸² It applies only to dispositions of relationship property to a trust by one or other partner. The provision is not available where:³⁸³
 - a disposition to a trust is made before the qualifying relationship begun;
 - the property in question was not relationship property at the time of the disposition;
 - the trustees acquire the trust assets directly from a third party rather than from one of the parties to the relationship; or
 - both parties to the relationship are equally affected by the disposition. This is because the disposition must have the effect of defeating the claim or rights of only one of the spouses or partners.
 - the range of remedies available under section 44C is limited. The court may only make an order under section 44C requiring trustees to pay the income (but not capital) of the trust to the defeated partner where there is insufficient relationship or separate property from which to compensate him or her for the disposition. As has already been noted, the court has no power to require trustees to distribute capital or to withdraw assets from the trust.
 - section 182 of the FPA provides an alternative, and arguably more flexible, option where the settlement of property on a trust is an ante- or post-nuptial settlement. However, as already noted it does not apply to de facto relationships. Rather unfairly it currently provides a remedy for some couples and not for others.
- 17.24 Two further issues, which are also likely to undermine the effectiveness of section 44C, should be mentioned. First, gift duty was repealed in 2011. It has been suggested that this is likely to make the circumventing of section 44C even easier because the repeal has largely removed the need for dispositions to trusts to be coupled with a debt back to the settlor and a staggered debt forgiveness gifting programme. If there is no debt back, from which compensation might be sourced by the court, it will be far easier for one party to put relationship property beyond the reach of the court under section 44C.
- 17.25 Secondly, the Commission has proposed in chapter 5 of this paper that the distinction between capital and income for the purposes of investment and distribution of trust funds should be removed (see paragraphs [5.13] to

382 Nicola Peart “Intervention to Prevent the Abuse of Trust Structures” in [2010] NZ Law Review 567 at 599.

383 Nicola Peart “Relationship Property and Trusts” (paper presented at the New Zealand Law Society Seminar “Relationship Property Intensive – Your Big (Legal) Day Out!”, August 2010) at 14.

[5.23]). Under that proposed reform trustees will determine what is to be treated as capital and income for the purposes of distribution. This approach is also likely to make section 44C, which only permits the court to direct the trustees to pay income, less effective.

Options for reform

- 17.26 When considering possible reform we must also consider the extent to which reform of the PRA can legitimately be proposed by the Commission as part of our review of the law of trusts. Evaluating the effectiveness of the PRA at ensuring a just division of all assets produced or enhanced by a qualifying relationship is beyond the scope of our project. We consider that proposing substantive changes to the PRA is also beyond the scope of the project.
- 17.27 There are a number of options for reform that attempt to address the issues that arise at the point where trust law interacts with the PRA, however most would require substantial change to the PRA so fall outside the bounds of our review. For completeness we briefly outline different options that have been mooted.

Option 1 – Amend section 44C of the PRA

- 17.28 The first option is to amend section 44C and give the court broader powers to require the trustees of a trust, to which relationship assets have been transferred, to compensate the spouse or partner whose claim or rights have been defeated by the disposition of relationship property to that trust.
- 17.29 This option would involve relatively modest drafting changes to the PRA. While it would not alter the range of circumstances to which section 44C could be applied, it would expand the pool of assets from which the court could order compensation. Where the respondent's share of relationship property or separate property proved insufficient to adequately compensate the spouse or partner whose claim or rights have been defeated by a disposition to a trust, the court could, under this option, order the trustees to pay any specified amount from the trust or transfer any trust property to the defeated partner as compensation. The current restriction that the court should not make an order against the trustees where it would prejudice beneficiaries who had altered their position in reliance on distribution from the trust would be retained.
- 17.30 This option would essentially implement the original recommendation made by the Working Group on Matrimonial Property and Family Protection in their 1988 report.³⁸⁴ The Working Group recommended that compensation payments be sourced in the first instance from the respondent's share of the relationship property or separate property. If they were insufficient, the Working Group thought, the court should have the power to not only divert

384 See *Matrimonial Property and Family Protection*, above n 375, at 28–31.

income from the trust, but distribute capital from the trust and, as a last resort, to withdraw assets from the trust.³⁸⁵

Option 2 – Amend section 44 of the PRA

- 17.31 The second option is to amend section 44 to remove the requirement for any disposition to be made with the intention of defeating a claim. The court would then be able to set aside any disposition made by party A, whether for value or not, where the effect of the disposition was to defeat the claim or rights of party B. This would significantly broaden the scope of the provision because, as has already been noted, section 44 applies to any disposition of property and not just dispositions of relationship property. This option would allow the court to set aside a disposition of property made by a third party at the direction of party A.
- 17.32 However, the court would still not be able to order the recipient of property under a defeating disposition, or any person who took an interest from that person, to transfer the property (or interest) or to pay market consideration if the recipient had received the property (or his or her interest in it) in good faith and had subsequently altered his or her position in reliance.
- 17.33 Section 44 is a general provision addressing all dispositions of property to third parties, so this option would change the circumstances in which the court could set aside any disposition of property and not just dispositions to trusts.

Option 3 – A new provision empowering the court to vary or resettle a trust

- 17.34 Another option is a new provision that gives the court a power to vary or resettle any trust that holds assets that would otherwise be relationship assets for the benefit of a former spouse or partner. Some commentators have discussed a provision drafted with the same flexibility as section 182 of the FPA.³⁸⁶
- 17.35 As with section 182, the court would consider whether the trust arrangements that had been entered into still served the interests of the parties in the way envisaged now their relationship has broken down. The court's task would be to assess how best in the changed circumstances to now give effect to the reasonable expectations the parties had of those arrangements. Like section 182 of the FPA this type of provision would be premised on the parties' expectations of the trust. Professor Peart has suggested in a discussion on this type of approach that the power to vary or resettle the terms of the trust might only be exercised as a last resort if there is no other property from which a just division can be ordered.³⁸⁷

385 At 30.

386 Peart "Intervention to Prevent the Abuse of Trust Structures", above n 382, at 599.

387 At 599.

Option 4 – Impose a requirement for independent advice before settling a trust

- 17.36 Another option that has been mooted³⁸⁸ would be to recognise the establishment of a trust during a relationship as akin to contracting out of the PRA and impose a requirement to obtain independent advice similar to that applying to section 21 agreements under the Act. When assets are transferred into a trust they cease to be relationship property so are not subject to the equal sharing regime. Independent legal advice could make the parties aware of the effects and implications of having their assets in trust.
- 17.37 A failure to obtain independent advice could, as with section 21 agreements, invalidate the settlement. Similarly, it might also be appropriate, under this option, to give the court the power to set the settlement aside if the trust causes serious injustice on similar grounds to those that apply to section 21 agreements.³⁸⁹
- 17.38 However, the analogy with section 21 agreements breaks down at this point. Invalidating a trust adversely affects the interests of its beneficiaries. Unlike a section 21 agreement, which involves the interests of the parties, the settlement of a trust creates a broader set of relationships. Further, such a provision would impose what are arguably unnecessary upfront costs on all parties to all relationships who wish to create trusts. Many trusts are likely to be created during the course of relationships for legitimate reasons and in circumstances where the disposition of assets to a trust will not have the effect of defeating a future claim by one of the spouses or partners. Is it therefore appropriate to impose a blanket requirement across all settlements to address a problem that sometimes occurs and only in some relationships when they break down?
- 17.39 Again, there may be merit in this type of reform, but it involves substantive alteration to the PRA so falls well beyond our scope.

Option 5 – Extend section 182 of the FPA to de facto partners

- 17.40 A final reform option we examined is amending section 182 of the FPA so it applies also to ante- and post-relationship trusts (and other settlements) established to benefit de facto partners as well as married and civil union partners. Under section 182 the court is currently able to vary the terms of or resettle a qualifying trust when the marriage or civil union contract is dissolved. The reform option considered here would allow the court to vary the terms of any relevant ante- and post-relationship settlement – including any trust – when a qualifying relationship between de facto partners as well as married or civil union partners end.
- 17.41 It should be noted that section 182 applies to all ante- and post-nuptial settlements, so this option has implications for all such settlements and not

388 At 599.

389 Property (Relationships) Act 1976, s 21J.

just for trusts. However, the rationale for reform here in addressing the section is addressing an outdated anomaly that treats de facto relationships differently than marriages and civil unions.

Discussion

- 17.42 Options 2, 3, and 4 all involve considerable change to the PRA, and so fall beyond the scope of our review. If significant changes to the PRA need to be considered, then a separate review of the PRA should be undertaken to determine how that regime should be modified. These are not matters we can address in passing as an adjunct to our review of trust law.
- 17.43 The reforms proposed in options 1 and 5 are, however, more constrained in nature. In our view they do not seek to alter the PRA and FPA in such a significant way.

Option 1 – Amending section 44C of the PRA

- 17.44 There are some difficulties with option 1. A considerable amount of uncertainty would be introduced into the operation of trusts if all of the assets of a trust were potentially available to be clawed back to compensate one partner to the relationship under section 44C. Any disposition of property to a trust and all assets held in any trust to which qualifying dispositions are made would potentially be available as compensation. Compensation could potentially be sourced from any trust asset and not just dispositions of relationship property made by the other partner to the trust. This arguably prioritises the relationship partner's interests over those of the trust's beneficiaries and others such as creditors. However, the point should not be overstated because compensation from the trust could not exceed the value of the dispositions of relationship property (valued at the date of hearing) that had been made to the trust. The court would also be required to consider changes to other circumstances and could not make an order where any third party has acted in good faith and altered their position in reliance and it would be unjust to make an order.
- 17.45 In 1988 the legislature rejected this option and confined section 44C to allowing distributions of income. This was done on the grounds that trusts were created for legitimate reasons and should be permitted to fulfil that purpose where there is no intention to defeat a relationship property claim at the time the trust was established.³⁹⁰ This is still an important point to consider. Trusts take such a variety of forms and affect spouses and partners in a different ways. Many trusts are settled for legitimate reasons with property from a variety of sources for a range of purposes. Amending section 44C so as to require trustees to withdraw assets from the trust to compensate a partner whose rights have been defeated by a disposition to the trust addresses one problem, but does so at the risk of creating others. It is not clear that the claim of a defeated spouse or partner for compensation should be

390 Government Administration Committee *Report on Matrimonial Property Amendment Bill* (1999).

prioritised over others (including the trust's beneficiaries) who are essentially required to fund that compensation under this option.

- 17.46 Option 1 does not address all of the problematic issues that have arisen at the interface between trusts and the PRA. However, it does arguably address one of the most glaring problems identified; namely, that the court may be satisfied that relationship assets have been disposed of to a trust during the relationship with the result that one partner's rights to those assets are defeated but the court is unable to do anything to fairly compensate him or her for the loss because there is not enough other relationship and separate property. As we have already discussed, the repeal of gift duty and the Commission's proposal that trustees determine what should reasonably be treated as capital and income for the purposes of distribution are likely to make it far easier for one party to successfully put relationship property beyond the reach of the court under the current section 44C.
- 17.47 Despite the limitations and concerns, option 1 has merit and we believe it should be considered further. We have therefore included it as an option for feedback and invite comment on the advantages and disadvantages of amending section 44C in the way proposed. The alternative option we have included is that the Commission should recommend that the Government undertake a separate review of the PRA. This option also has merit. It would allow full and careful consideration to be given to other options for reform, including those we briefly outlined earlier. Also, in not attempting to directly address the issues arising over the use of trusts, it accords better with the general focus of our review.

Option 5 – Amending section 182 FPA

- 17.48 The Commission proposes that section 182 of the FPA be extended to cover de facto relationships. This is again a relatively constrained proposal. It does not alter the fundamentals of the provision or the test applied by the courts, but just expands the class of potential applicants. Our primary concern here is that the current differing treatment of de facto relationships from married and civil union couples cannot be justified. It is something of an anomaly that this section of the FPA continues to discriminate against some relationships when other family law legislation does not. It would seem to us a relatively non-controversial change for that Act to be amended so it provides the same remedies for qualifying de facto couples as it does married and civil union couples in the same circumstances. Unlike the options for reform of the PRA, this proposal relates to a jurisdiction that is limited to settlements made for the benefit of the parties to the relationship. Any variation to the settlement would therefore not unduly interfere with the rights of others. Further, the basis on which the jurisdiction is exercised, as carried out in *Ward v Ward*,³⁹¹ seeks to perpetuate the objects of the settlement. This means that there is no departure from core trust principles.

391 *Ward v Ward* [2009] SCNZ 125 at [62].

- 17.49 Some consequential changes to the mechanics of section 182 are obviously needed to put de facto relationships, marriages and civil unions on an equal footing. For the reasons discussed we propose that the triggering event should change from dissolution to separation and applications should be allowed to be made in respect of relationship settlements rather than nuptial settlements. These changes are necessary to make the provision work. There is no equivalent to a “dissolution” at the end of a de facto relationship, nor is there the equivalent of a “nuptial” at the commencement. Separation, rather than dissolution, is widely seen as the end of a marriage or civil union, so the amendment would ensure that section 182 applications are not unduly delayed for all relationships. The approach taken in the PRA to defining of a qualifying de facto relationship and to determining when separation occurs should also apply.
- 17.50 We are mindful that this is our first opportunity to publicly consult on this proposal and we welcome feedback on it.

Appendix

List of submitters

INTRODUCTORY ISSUES PAPER

Auckland Energy Consumer Trust
Ayers Legal
Tobias Barkley
Chapman Tripp
Justice John Fogarty and Geeti Faramarzi
Gorden Goodall
Guardian Trust
Grace Haden, Verisure Investigations Ltd
Hutt Valley Community Law Centre
KPMG
Ministry of Economic Development
New Zealand Law Society
New Zealand Trustee Services
Stace Hammond
Taylor Grant Tesiram
Jill Thompson
Trustee Corporations Association
Trustee Executors Ltd

SECOND ISSUES PAPER

Auckland District Law Society
Ayers Legal
Tobias Barkley
Cash Flow Doctors Ltd
Chapman Tripp
Jennifer Dalziel, Chartered Accountant
Ernst & Young
Peter Kellaway, Kellaways Lawyers
KPMG
Lawler & Co
John McIlwaine

Ministry of Economic Development
Ministry of Social Development
Grant Nelson, The Gama Foundation
New Zealand Law Society
Martin Riley, Stirling Tax Services
Alan Tate, Harris Tate
Taylor Grant Tesiram
Gary Thomas, Ryan Thomas and Co
John Tripe, Jack Riddet Tripe
Trustee Corporations Association
Ivan Turk
Veda Advantage
Julie Walker
WHK

THIRD ISSUES PAPER

Auckland District Law Society
Auckland Energy Consumer Trust
Ayers Legal
Capital Trust Management
Chapman Tripp
Chris Kelly, Greg Kelly Law
Ministry of Social Development
New Zealand Law Society
Perpetual Trust
Russell McVeagh
Tauranga Energy Consumer Trust
Taylor Grant Tesiram
Trustee Corporations Association

FOURTH ISSUES PAPER

Anchor Trustees
Auckland District Law Society
Auckland Energy Consumer Trust
Phillip Bartlett, Bartlett Partners
Chapman Tripp
Charities Commission
Samuel Chatwin
Cone Marshall Ltd
Grace Haden, Verisure Investigations Ltd
Chris Kelly, Greg Kelly Law
KPMG
Garth Lucas, Lucas and Lucas Ltd
Māori Land Court
Liam McNeely

Ministry of Social Development
National Council of Women
New Zealand Law Society
Simon Scannell, SJ Scannell and Co
Society of Trust and Estate Practitioners New Zealand
Taylor Grant Tesiram
Tripe Matthews and Feist
Trustee Corporations Association

FIFTH ISSUES PAPER

Auckland Energy Consumer Trust
Chapman Tripp
Energy Trusts of New Zealand
Ernst & Young
Justice John Fogarty
Greg Kelly Law
Dirk Hudig
Inland Revenue
Jeff Kenny
KPMG
Ministry of Economic Development
Ministry of Social Development
New Zealand Law Society
New Zealand Trustees Association
Perpetual Trust
Susan Robson
Taylor Grant Tesiram
Trustee Corporations Association
and one submitter who wishes to remain anonymous

