LAW·COMMISSION
TE·AKA·MATUA·O·TE·TURE

Preliminary Paper 48

SOME PROBLEMS IN THE LAW OF TRUSTS

A discussion paper

The Law Commission welcomes your comments on this paper and seeks your response to the questions raised.

These should be forwarded to the Law Commission
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Preface

THIS PAPER IS BASED on the discussions of a working party made up of KR Ayers, Helmore Ayers, Solicitors, Christchurch; Professor JK Maxton, School of Law, University of Auckland; WM Patterson, Minter Ellison Rudd Watts, Lawyers, Auckland, and Commissioners Dugdale and Heath. The Law Commission is grateful to the three first named for making available their time and expertise. It is of course the Law Commission that takes responsibility for the paper in its published form.

The matters discussed in this paper are important. The Law Commission would be assisted by expressions of opinion on the various points raised. Closing date for submissions is 15 March 2002.

The Commissioner having the carriage of this project is DF Dugdale.

Some problems in the law of trusts

INTRODUCTION

1 IN AN ADDRESS in May 2001 opening a conference on Trust Law convened by the New Zealand Law Society, Justice Blanchard, a judge of the Court of Appeal and sometime Law Commissioner, advocated "a quiet review" of trustee law "to see what improvements can be made". In his view "The trouble with quiet reviews, of course, is that they do not generate headlines and therefore can come to be as neglected as their subject matters". The rueful tone of this observation no doubt reflects the fact that it was Commissioner Blanchard who was responsible for the Law Commission's 1994 report *A New Property Law Act*.[1] The universal acclaim with which that report was greeted has been insufficient at any time in the intervening seven years to convince successive governments of the need to find sufficient parliamentary resources to turn its proposals into law.

2 This is not an exclusively New Zealand phenomenon. Summing up the English scene Professor Clarke has recently observed:

> A Parliament with members who are subject to re-election every few years prefers to spend time and energy on legislation that is attractive to a significant section of the electorate. In a democracy such as ours, lawyers' law lacks political "sex appeal". … Statutory reform in England today is likely to be limited to what has been called legislative microsurgery: statutes to correct particular defects.[2]

3 The purpose of this perhaps over-elaborate *apologia* is to explain the Law Commission's approach to the current project. There is much to be said for the view that the Trustee Act 1956 is, in important respects, confused and confusing and in need of a complete overhaul. It has, however, seemed to us better to confine our attention to the specific issues with which this discussion paper deals. We believe them to be the principal points of current difficulty. If we are reproached for patching a tyre that ought to be replaced our answer must be that this seems a lesser evil than leaving the tyre in its present state of hazardous deflation. Although the subjects with which we deal may seem to be diverse there is a common underlying theme. It is simply that trusts are today used, and some would say at times misused, for purposes some of which were undreamt of when the current rules were settled, and that in this as in so many other contexts the time is well overdue for the law to catch up with what is actually happening in the world.

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1 New Zealand Law Commission *A New Property Law Act: NZLC R 29* (Wellington, 1994).

2 Malcolm Clarke *Doubts from the Dark Side – The Case Against Codes* [2001] JBL 605, 613.

TRUSTEE'S POWERS OF DELEGATION

4 The general rule is that trustees may delegate to others 'ministerial functions' (meaning, roughly, the carrying out of decisions) but unless authorised by the trust instrument may not delegate the power to decide on the distribution of trust property or the exercise of fiduciary discretions relating to the investment of trust property. The Trustee Act 1956 section 29 empowers trustees to employ agents (including trust corporations) to perform various commercial functions, but such power to delegate falls short of authorising the delegation of the trustees' fundamental decision-making powers.

5 It is generally accepted that the present law is defective in two respects in particular. First, the line between ministerial and other functions is less than hard-edged. Secondly, and more importantly, "[t]rusteeship is an increasingly specialised task that often requires professional skills that trustees may not have".[3] So the prohibition of the delegation of fiduciary discretions can inhibit rather than promote the conscientious discharge of the obligations of trusteeship. In New Zealand of course this is particularly so as a consequence of the more sophisticated investment regime resulting from the 1988 enactment of a new Part II of the Trustee Act 1956.

6 To deal with this problem the English and Scottish Law Commissions in a joint report[4] recommended that trustees should have power to delegate to agents their powers to administer the trust including powers of investment and management but excluding powers to appoint and replace trustees or to decide how the income or capital of the trust is to be distributed. This recommendation was adopted by the Trustee Act 2000 (UK) section 11. That section differentiates between charitable and non-charitable trusts in a way that, because the relevant statutory provisions do not have a New Zealand counterpart, does not fit the New Zealand statute. We invite comment on the proposal that section 29 of the Trustee Act 1956 be replaced by the following provision (which reproduces sections 11(1) and (2) of the United Kingdom statute minus the reference to charitable trusts but plus the words following "distributed" in the proposed section 29(2)(a)).

> **29.**(1) Subject to the provisions of this Part, the trustees of a trust may authorise any person to exercise any or all of their delegable functions as their agent.
>
> (2) The trustees' delegable functions consist of any function other than–
>
> (a) any function relating to whether or in what way any assets of the trust should be distributed, used, possessed or otherwise beneficially enjoyed.
>
> (b) any power to decide whether any fees or other payment due to be made out of the trust funds should be made out of income or capital,
>
> (c) any power to appoint a person to be a trustee of the trust, or
>
> (d) any power conferred by any other enactment or the trust instrument which permits the trustees to delegate any of their functions or to appoint a person to act as a nominee or custodian.

EXCULPATING TRUSTEES

7 It is common for trust deeds to include clauses protecting trustees from liability for breaches of trust. It is clear that if the trustee has prepared the document,

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[3] The Law Commission and the Scottish Law Commission *Trustees' Powers and Duties* (Law Com No 260, Scot Law Com No 170, 172) (London, The Stationary Office, 1999), para 4.6.

[4] The Law Commission and the Scottish Law Commission, above n 3, Part IV.

as will in practice often be the case where there is a commercial or professional trustee, any ambiguity will be construed against the trustee, and that such a trustee may be under a fiduciary obligation (breach of which will preclude reliance on the exculpating clause) to draw the clause to the attention of the settlor and explain its effect.[5]

8 It is equally clear that a trustee has certain basic obligations that are so essential to the very concept of a trust that any attempt to relieve the trustee from the consequences of breaching such obligations is of no effect. There are academic statements (relying on a series of Scottish cases decided by the House of Lords) that one of these basic obligations is not to be guilty of gross negligence, liability for which cannot therefore be excluded.[6] In *Armitage v Nurse*[7] the English Court of Appeal rejected the view that the Scottish cases laid down any such general rule. It held that they did no more than construe particular clauses. Millett LJ for the Court of Appeal said this:

> I accept the submission made on behalf of [the beneficiary seeking a remedy for breaches of trust] that there is an irreducible core of obligations owed by the trustees to the beneficiaries and enforceable by them which is fundamental to the concept of a trust. If the beneficiaries have no rights enforceable against the trustees there are no trusts. But I do not accept the further submission that these core obligations include the duties of skill and care, prudence and diligence. The duty of the trustees to perform the trusts honestly and in good faith for the benefit of the beneficiaries is the minimum necessary to give substance to the trusts, but in my opinion it is sufficient.[8]

9 Assuming this to be the law, does it call for reform? Millett LJ went on to say:

> At the same time, it must be acknowledged that the view is widely held that these clauses have gone too far, and that trustees who charge for their services and who, as professional men, would not dream of excluding liability for ordinary professional negligence should not be able to rely on a trustee exemption clause excluding liability for gross negligence.[9]

The Ontario Law Reform Commission has observed in relation to trustee negligence that "a professional trustee should be carrying insurance, and a non-professional trustee who is sufficiently unsure of his competence to require such safeguards should not accept the office".[10] That Commission recommended that an exculpatory provision should be invalid to the extent that it purported to exonerate trustees from failure to exercise the degree of care, diligence and skill that a person of ordinary prudence would exercise in dealing with the property

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5 The matter is expressed in the Restatement in these terms:

> To the extent to which a provision relieving the trustee of liability for breaches of trust is inserted in the trust instrument as the result of an abuse by the trustee of a fiduciary or confidential relationship to the settlor such provision is ineffective. (American Law Institute 2 *Restatement of the Law Trusts 2D* St Paul, Minnesota, 1959, para 222(3).)

And see AW Scott and WF Fratcher *III The Law of Trusts* (Little Brown and Company, Boston, 4th ed, 1988), para 222.4.

6 Paul Matthews "The Efficacy of Trustee Exemption Clauses in English Law" [1989] Conv 42. The decision of the Alberta Surrogate Court in *Re Poche* (1984) 6 DLR (4th) 40 is to the same effect. In the one New Zealand case on the topic the Court of Appeal avoided this trap (*Robertson v Howden* (1892) 10 NZLR 609).

7 *Armitage v Nurse* [1998] Ch 241.

8 *Armitage v Nurse*, above n 7, 253–254.

9 *Armitage v Nurse*, above n 7, 256.

10 Ontario Law Reform Commission *Report on the Law of Trusts* (Ontario 1984), 40.

of another person.[11] The British Columbia Law Institute's Committee on the Modernisation of the Trustee Act has expressed the provisional view that exculpating clauses should be deprived of effect, but that the Court's powers to excuse a trustee under the equivalent of our Trustee Act 1956 section 73 should be strengthened.[12]

10 The two areas in respect of which trustees are most likely to seek exculpation are in relation to:

- investment; and
- liability for the acts or omissions of fellow trustees.

It may be noted in relation to the first of these matters that the Trustee Act 1956 section 13D accepts the possibility of exculpatory provisions.[13] That section (and sections 13B and 13C to which it refers) are in the following terms:

> **13B Duty of trustee to invest prudently**
> Subject to sections 13C and 13D of this Act, a trustee exercising any power of investment shall exercise the care, diligence, and skill that a prudent person of business would exercise in managing the affairs of others.
>
> **13C Duty of certain persons to exercise special skill**
> Subject to section 13D of this Act, where a trustee's profession, employment, or business is or includes acting as a trustee or investing money on behalf of others, the trustee, in exercising any power of investment, shall exercise the care, diligence, and skill that a prudent person engaged in that profession, employment, or business would exercise in managing the affairs of others.
>
> **13D Provisions in trust instrument relating to duty of investing trustees**
> (1) The duty imposed on a trustee by section 13B or section 13C of this Act shall apply to a trustee if and so far only as a contrary intention is not expressed in the instrument, if any, creating the trust or any Act, and shall have effect subject to the terms of that instrument or Act.
>
> (2) Any rules and principles of law relating to any provision in an instrument that purports to exempt or limit the liability of a trustee in respect of any breach of trust, or to indemnify a trustee in respect of any breach of trust, shall remain in force and apply in respect of any provision in a trust instrument that expresses a contrary intention for the purposes of subsection (1) of this section.

These provisions will require attention if exculpation is to be limited.

11 An obvious drafting device to limit the effectiveness of a statutory provision striking down a clause relieving a trustee from liability would be to achieve the same result by drafting the provision not in exculpatory terms, but as a limitation of the duties of the trustee.[14] If exculpatory provisions are to be struck down the draftsman will need to ensure that the proposed statutory provision embraces both methods of expression. It would be necessary to take care not to alter accidentally the position of advisory and custodian trustees (specifically taken

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[11] Ontario Law Reform Commission, above n 10, 41–42.

[12] British Columbia Law Institute *Consultation Paper on Exculpation Clauses in Trust Instruments* (Vancouver 2000), 13.

[13] And note the concluding words of s 13F.

[14] It seems that such a limitation will be given effect to (*Wilkins v Hogg* (1861) 3 Giff 115, 66 ER 346; *Hayim v Citibank* [1987] AC 730 (PC)), provided that it falls short of being repugnant to any trust relationship. We will need to return to this question when later in this paper we come to consider protectors.

care of by the provisions of the Trustee Act 1956 sections 49 and 50 respectively).

12 So we invite submissions as to whether and, if so, what legislative intervention to restrict provisions exculpating trustees is appropriate. The issues would seem to include:

- In the light in particular of the proposed new powers of delegation, should there be a statutory limitation to the effectiveness of provisions in trust deeds exculpating trustees from liability for obligations (other than basic obligations)?
- If there is to be such a limitation should it be confined to professional trustees (who can be expected to insure) or apply to all trustees?
- If there is to be such a limitation should it apply not only to direct exculpation but also to provisions limiting the duties of trustees?
- What would be an appropriate transitional provision in the case of trustees who, before any new provision comes into force, have accepted appointment as trustees where the trust instrument confers a protection stuck down by the new statute?

THE REMUNERATION OF TRUSTEES

13 The historical position was that a trustee undertook his duties in a spirit of noblesse or altruism without any expectation of, or entitlement to, remuneration or reward. But this approach is inconsistent both with the complex demands of modern trusteeship, and (a cynic would add) contemporary rationalisations of self-seeking and greed. In New Zealand today a trustee is entitled to remuneration:

- If the relevant trust instrument so provides. In the case of a will such a provision is classified as a legacy, with implications in relation to attestation and abatement.
- With the leave of the Court pursuant to its inherent jurisdiction or to the Trustee Act 1956 section 72.
- Pursuant to the Trustee Companies Act 1967 section 18 or the Public Trust Office Act 1957 section 100.

14 The Trustee Act 2000 (UK) section 29 entitles a trustee to reasonable remuneration for professional services with the written consent of all his co-trustees if there is no charging provision in the relevant instrument, and if he is not a sole trustee. The reason for excluding sole trustees is that the scheme envisages co-trustees monitoring the reasonableness of remuneration.[15] The remuneration is available for acts performed in a professional capacity, whether or not a lay trustee might have performed them.[16] Section 28, dealing with the position of trustees where there is a charging provision, contains the following useful subsection (4):

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[15] The phrase used by the Law Commissions recommending the reform was "the safeguard of collective scrutiny", The Law Commission and the Scottish Law Commission *Trustees' Powers and Duties* Law Com No 260, Scot Law Com No 172 (London, The Stationary Office, 1999), para 7.11).

[16] Trustee Act 2000 (UK), ss 29(2) and (4).

(4) Any payments to which the trustee is entitled in respect of services are to be treated as remuneration for services (and not as a gift) for the purposes of–
  (a) section 15 of the Wills Act 1837 (gifts to an attesting witness to be void), and
  (b) section 34(3) of the Administration of Estates Act 1925 (order in which estate to be paid out).

In New Zealand the appropriate reference in (b) would be to section 37 of the Administration Act 1969 (abatement of specific bequests where estate primarily liable is insufficient). Section 28(5) defines when a trustee acts in a professional capacity in these terms:

(5) For the purposes of this Part, a trustee acts in a professional capacity if he acts in the course of a profession or business which consists of or includes the provision of services in connection with–
  (a) the management or administration of trusts generally or a particular kind of trust, or
  (b) any particular aspect of the management or administration of trusts generally or a particular kind of trust,
and the services he provides to or on behalf of the trust fall within that description.

We invite consideration of whether comparable provision should be enacted in New Zealand and in particular whether it is necessary if there is such a liberalisation to exclude sole trustees from its benefits.

15 There are provisions now to be found in Part XII of the Te Ture Whenua Maori Act 1993 for five classes of trust. They are putea trusts for very small interests grouped together for Māori community purposes, whanau trusts, which hold assets for the benefit of descendants of a single tipuna (ancestor), ahu whenua trusts designed to facilitate the use and administration of land, whenua topu trusts used to hold land for community purposes of an iwi or hapu and kai tiaki trusts to hold property for beneficiaries under a disability. Trustees are appointed by the Māori Land Court. Unless the trustee is the Māori Trustee,[17] trustees are entitled to remuneration only to the extent that it is authorised by the Māori Land Court, which in relation to such trusts, has the same powers as the High Court.[18]

16 We would be grateful for submissions as to whether and, if so, in what respect the provisions of Te Ture Whenua Maori Act 1993 should be amended to accommodate a reform comparable with the one discussed in this part.

PROTECTORS

17 The term 'protector' is not a legal term of art. It is commonly used today to describe a person (including a group of persons or a corporation) who is not a trustee or beneficiary and on whom the trust instrument by its terms confers determinative powers that, but for such terms, would be trustee powers. Some description other than 'protector' may be employed. Although trust instruments have, under different descriptions, made provision for protectors for some hundreds of years, there has been a recent substantial increase in provision for protectors, beginning with off-shore trusts and spreading to trusts with no off-

[17] In which event there is an entitlement to remuneration under the Maori Trustee Act 1953 s 48 and the Maori Trust Office Regulations 1954 (SR 1954/46).

[18] Te Ture Whenua Maori Act 1993 s 237.

shore element.[19] Commonly such provisions empower protectors to direct or veto the exercise by the trustees of their powers, or to choose or veto the trustees' choice of beneficiaries of the trust. They may confer other powers.

18 The Law Commission's concerns in considering this topic are that the promotion to centre-stage of a player who is neither trustee nor beneficiary necessarily creates uncertainty as to the precise obligations and liabilities of a protector and as to the effect of the protector's role on the obligations and liabilities of the trustee. Because there is not much litigation on this topic it is sensibly arguable that in the interests of certainty there should be statutory intervention.

19 The tentative view of the Commission (and comment is sought) is that the existing law is sufficiently robust to solve most but not all of the obvious problems.

- Our hearts, it is suggested, need not bleed unduly if there are occasions when, as a result of the appointment of a protector, a purported trust is denied that classification. Being too clever by half always carries its risks.
- Where the provision under consideration in effect confers on the protector a *dispositive* power, a mandate to dispose of property not his own, it seems sufficiently probable that a court would treat the protector as the donee of a power of appointment to make legislative interference unnecessary.
- Where, on the other hand, the provision under consideration confers on the protector a *managerial* as distinct from a *dispositive* power, it seems reasonably clear that a court would, despite the terminology of the instrument, classify the protector as a trustee or at least subject to fiduciary obligations sufficient for the protection of the beneficiaries.

20 The Trustee Act 1956 already provides in section 49 for the role of 'advisory trustee'. The difference between an advisory trustee and a protector, in the sense that we have been using that term, is that a trustee *may elect* to consult an advisory trustee but *is obliged* to act on the direction of a protector. Section 49(3)(d) empowers the responsible trustee to challenge the advice of an advisory trustee but makes it clear that he is under no obligation to do so:

> (d) In any case where the responsible trustee is of opinion that such advice or direction conflicts with the trusts or any rule of law, or exposes him to any liability, or is otherwise objectionable, he may apply to the Court for directions in the matter, and the decision and order therein shall be final and shall bind the responsible trustee and the advisory trustee, and the Court may make such order as to costs as appears proper:
>
> Provided that nothing in this paragraph shall make it necessary for the responsible trustee to apply to the Court for any such directions.

We invite consideration of:

- an application of section 49(3)(d) of the Trustee Act 1956 to the binding directions of protectors;

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[19] Professor Walters, whose essay "The Protector: New Wine in Old Bottles" in AJ Oakley (ed) *Trends in Contemporary Trust Law* (Clarendon Press, Oxford, 1996), 63 discusses the topic at length, points out that protectors received no mention in the fourteenth edition of *Underhill and Hayton* published in 1987 and appeared for the first time in the fifteenth edition in 1995.

- a variation of the provision in the case of an objectionable direction by a protector to make an application to the Court by the responsible trustee mandatory and in the case of advice from an advisory trustee to remove the exculpation for following it to be found in section 49(3)(c):

  (c) 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.

A responsible trustee should not be permitted simply to shrug off the fact that advice or direction from an advisory trustee or protector is objectionable.

TRUSTEES' POWERS TO INSURE

21 The Trustee Act 1956 section 24 empowers a trustee to insure:

- any of the trust property up to the full insurable value;
- with the consent of the life tenant or of the High Court any of the trust property on a replacement basis;
- "against any risk or liability against which it would be prudent for a person to insure if he was acting for himself".

The main difficulty with this provision is the need for the consent of the life tenant rather than the remainderman to replacement cover, a provision presumably reflecting what was thought to be the unfairness of the life tenant's income being reduced by the additional cost of replacement cover. We invite discussion on the possibility of substituting for the present section 24(1) and (2) a new provision along the following lines:

(1) A trustee may insure any property which is subject to the trust against risks of loss or damage due to any event and upon such terms (including terms requiring replacement by the insurer) as he thinks fits and may also insure against any risk or liability against which it would be prudent for a person to insure if he were acting for himself.

(2) Subject to the express provisions of the instrument creating the trust the trustee may apportion the cost of premiums between income and capital as he thinks fit.

(2A) Nothing in this section authorises a trustee to apply any asset of the trust in payment of a premium under a policy of insurance indemnifying the trustee against the trustee's personal liability for breach of the trustee's obligations as trustee.

22 The proposal advanced in the previous paragraph carefully preserves the existing section 24(3) which reads:

Nothing in this section shall impose any obligation on a trustee to insure.

We agree with the view of the English and Scottish Law Commissions that trustees should be under no general obligation to insure.[20] There can be circumstances where a cost-benefit analysis justifies a decision not to insure. The absence of a blanket obligation does not preclude trustee liability in the event of failure to insure in circumstances in which the prudence of so doing is clear.

[20] See above n 3, para 6.8.

TRADING TRUSTS

23 We use the term 'trading trust' in the sense in which it is usually employed in Australia. There is established a trust, of which the sole trustee is a limited liability company. It is that company that trades, but the assets to which the company has title are beneficially owned by the beneficiaries of the trust, so that if the company fails the only assets available to the creditors of the company in liquidation are the trustee's right to indemnity out of such assets of the trust as may still be available. While it is probable that this right of indemnity may not be lawfully limited or excluded by the trust instrument, the risks to unsecured creditors remain substantial:

> This is especially so when persons dealing with the trustee of such a trust do not realise that a trust is involved at all, or that the trustee has no beneficial interest in the assets which he apparently owns. The problems are exacerbated when the trustee is a company of negligible paid-up capital …[21]

There are also risks to beneficiaries whose only recourse in the event of the failure of the business is against an assetless trustee.

24 The use of trading trusts seems clearly to be spreading. Although trading trusts introduce complexities and uncertainties that New Zealand law would be better without, this paper's concern is confined to the need to protect creditors and beneficiaries. So far as beneficiaries are concerned, our present view (on which we invite comment) is that there should be imposed on the directors of the trustee company the same obligations to beneficiaries to which they would have been subject if they personally had been the trustees.

25 As to creditors, one possibility would be to provide by statute that no corporation aggregate with limited liability may be appointed as an express trustee other than a trustee corporation. But this may be too big a sledgehammer. A second possibility might be to require disclosure by a company that was a trustee that that was its status, but it is not clear to us that, in practice, this would be sufficient to put potential unsecured creditors on guard. Our tentative view is that the best solution is:

- to put it beyond doubt that the trustee's entitlement to indemnity may not be excluded; and
- to impose on the trading company the same obligation, in relation to distributions to beneficiaries of the trust, to satisfy a solvency test as is imposed in relation to dividends and other distributions by the Companies Act 1993.

CHALLENGING THE EXERCISE OF POWERS OF APPOINTMENT

26 It is common for trust instruments to confer on trustees the power to allocate (appoint) capital and income among potential beneficiaries. The reasons for the popularity of this device include the difficulty that a settlor may have in determining future needs of beneficiaries in advance, and the fact that the device enables the distribution of income that incurs the least tax. Although it is

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[21] RP Meagher and WMC Gummow *Jacob's Law of Trusts in Australia* (Butterworths, Sydney, 6th ed 1997), 69.

common, for the reasons stated, to confer dispositive powers on trustees, the law as to powers of appointment is properly to be classified as part not of trust law but of property law. But it is convenient to include the subject matter of this part in the present paper.

27 There are well-settled rules determining when the exercise of a power is invalid, as it will be if it offends the rule against perpetuities, or exceeds the scope of the power (by annexing unauthorised conditions, for example), or if the method of execution is defective in a way that defeats the intention of the donor of the power, or if there is a fraud on a power. 'Fraud' in this context does not imply moral turpitude. There is a fraud on the power if the purpose of the appointment is to effect some object that is beyond the purpose and intent with which the power was created. The question discussed in this part of the paper is whether the exercise of a power of appointment should be open to challenge on grounds other than the ones indicated in this paragraph. As the law now stands, if the power has been exercised following proper consideration (as distinct from capriciously) in good faith and without improper motive there is no ground on which a court can interfere.[22]

28 One practical problem standing in the way of challenges on the grounds discussed in the previous paragraph is the rule that there is no obligation on the donee of the power to disclose the grounds for the appointment decision.[23] "A court does not presume impropriety."[24]

> This right to refuse to give reasons is, as a general rule, the haven for trustees, personal representatives, tenants for life and company directors, and their security is reinforced by the general unwillingness of the courts to draw adverse inferences from a refusal to give reasons. … Despite the large number of cases in which decisions have been challenged it would seem to be more than coincidental that only in a very few cases has an aggrieved beneficiary managed to prove misconduct in the face of a wall of silence erected by his fiduciary.[25]

Robert Walker J has advised that:

> If a decision taken by trustees is directly attacked in legal proceedings, the trustees may be compelled either legally (through discovery or subpoena) or practically (in order to avoid adverse inferences being drawn) to disclose the substance of the reasons for their decision.[26]

But this may not assist a plaintiff in formulating a claim.

29 It is against that background that the view is sometimes expressed that the courts should have a supervisory power. Hardingham and Baxt for example, point by way of analogy to the Trustee Act 1956 section 68 that gives a right to apply to the High Court to an interested party aggrieved by the exercise by a trustee "of any power conferred by this Act". (The wording of this provision as it stands makes it of no assistance to a potential appointee who has been passed over because such a disappointed person neither owns an interest nor bases any claim on a statutory power.) These authors also refer to section 2269 of the Californian Civil Code:

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22 A useful illustrative case is *Karger v Paul* [1984] VR 161.

23 *Re Londonderry's Settlement* [1965] Ch 918.

24 *Richard Brady Franks Ltd v Price* (1937) 58 CLR 112, 135 per Latham CJ.

25 PD Finn *Fiduciary Obligations* (The Law Book Company Limited, Sydney, 1977), 42.

26 *Scott v National Trust* [1998] 2 All ER 705, 719.

> A discretionary power conferred upon a trustee is presumed not to be left to his arbitrary discretion, but may be controlled by the proper court if not reasonably exercised unless an absolute discretion is clearly conferred by the declaration of trust.[27]

Tipping J has advanced the robust but novel view that there should be a power of review founded on *Wednesbury* style unreasonableness.[28]

30 But there are sound policy arguments pointing the other way. Absent intention to defeat creditors or other claimants one has the right, while *sui juris* to give away one's property as one pleases. If, instead of choosing for oneself the objects of one's bounty, one decides to have someone else do the choosing, what justification has the High Court or anyone else to pry into the gifts so made and the reasons therefor? In addition, there are cynics who would say that the history of the readiness of the courts to interfere with testamentary dispositions pursuant to the Family Protection Act 1955 inspires little confidence.

31 It may be that the best solution in the case of both the exercise of a power and a failure or refusal to exercise a power is to leave the substantive law as to the grounds for setting aside appointments untouched, but to impose an obligation to give reasons on request by a person contingently entitled. A failure to respond could be:

- a ground for removal of the trustee; or
- a circumstance treated as relevant to determination of the factual issue of whether there were grounds to set aside any appointment that had been made.

If there is a response it may or may not provide grounds for a challenge to the appointment. It must not be overlooked that the appointor may not necessarily have acted with *deliberate* unfairness. The power may have been exercised, or any exercise of the power may have been refused on the basis of a belief (as to a beneficiary's circumstances, for example) that was mistaken. Comment is sought.

TRUSTEES' OBLIGATION TO PROFFER INFORMATION

32 In the previous part we refer to the entitlement of trustees to decline to disclose reasons for the manner in which they have exercised, or for a refusal to exercise, a power of appointment. The question with which we are concerned in this part is a different one. The broad issue is as to whether there are circumstances in which trustees must proffer information to beneficiaries. The need for the existence of such an obligation is clearest where it would be open to beneficiaries if they were aware of the fact to exercise a *Saunders v Vautier* entitlement to put an end to the trust, and it is on the narrower question of a trustee's obligation in that situation that we will focus. We should emphasis that the fact scenario that we posit, of beneficiaries being unaware of their rights, is by no means a fanciful one. It is common for trustees to allocate income among beneficiaries who are minors, the allocation being tax-driven, and the beneficiaries having no knowledge of what is occurring. On attaining majority the beneficiary is entitled to call for payment of the accumulated allocations. In real life, trustees

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[27] IJ Hardingham and R Baxt *Discretionary Trusts* (Butterworths, Sydney, 1984, 2nd ed), para 515.

[28] *Craddock v Crowhen* (1995) 1 NZSC 40331, 40337.

often take the paternal view that it is better not to disclose to a 20-year-old an entitlement to a substantial sum with the consequential risk that the monies may be dissipated on the transitory excesses of gilded youths. On the other hand:

> A failure on the part of a remunerated trustee to disclose to a beneficiary that he may terminate the trust carries the added suggestion that the trustee is keeping the trust on foot for the purpose of continuing to receive his remuneration.[29]

33 Text-writers express differing views as to whether the decision of Havers J in *Hawksley v May*[30] that trustees were under a duty to inform a beneficiary on attaining his majority of his trust property entitlement imposed, in addition, a duty to advise him of his legal entitlements.[31] It seems plain that an obligation to disclose some matters is a necessary incident of the trust–beneficiary relationship, for without the beneficiaries having such knowledge there can be no effective accountability.[32] It seems desirable that the boundaries of the disclosure obligation should be clearly marked and that the relative rarity of litigation on the topic warrants the demarcation being done by statute. We invite discussion. Our tentative view is that any new obligation to proffer information should be confined to the situation where there is a *Saunders v Vautier* entitlement to put an end to the trust.

CONFLICT OF LAWS

34 Increasing globalisation in general and the increasing resort by New Zealanders to offshore trusts in particular make it important that there be removed uncertainties as to which law governs the operations of any particular trust. The problem is exacerbated by the fact that trusts are not usually provided for in the jurisprudence of civil law countries. The solution adopted in 1984 by the Hague Convention on Private International Law was to make the settlor's choice of a governing law determinative so doing away with any requirement of a connective link that might otherwise exist. There are rules that apply in the absence of such a choice. (There is an obvious analogy with the law of contract under which the agreement of the parties as to which law should govern the contract is paramount.) In the United Kingdom, the Recognition of Trusts Act 1987 gives the provisions of that convention the force of law in the United Kingdom. A copy of the statute which schedules the convention is to be found in Appendix A to this paper. This adoption by the United Kingdom is not subject to any condition of reciprocal adoption. (Section 1(4).)

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[29] HAJ Ford and WA Lee *Principles of the Law of Trusts* (The Law Book Company Limited, Sydney, 1983), 409. This sentence is not repeated in the current (third) edition (LBC Information Services, Sydney, 1996), para 912D.

[30] *Hawksley v May* [1956] 1 QB 304.

[31] Compare the observations of Ford and Lee that it is arguable that trustees have a general duty to inform beneficiaries of their relevant rights (set out in a passage preceding the excerpt quoted in the text at n 29) and the less tentative statement in the third edition and the conclusion expressed by Alec Samuels ("Must the trustees tell the beneficiary about *Saunders v Vautier*" (1970) 34 Conv 29) that if *Hawksley v May* is authority to the contrary effect it is wrongly decided with, on the other hand, the trenchant rejection of Ford and Lee's view expressed in RP Meagher and WMC Gummow *Jacobs' Law of Trusts in Australia* 6th ed (Butterworths, Sydney, 1997), para 1716.

[32] David Hayton "The Irreducible Core Content of Trusteeship" in AJ Oakley (ed) *Trends in Contemporary Trust Law* (Clarendon Press, Oxford, 1996), 47, 49.

35 New Zealand has not ratified the convention and the question on which we invite submissions is (whether or not it does so) should New Zealand enact legislation to the same effect as the United Kingdom statute? It should be noted that the effect of the words "or for a specified purpose" at the end of the first sentence of article 2 would be that a New Zealand settlor, by choosing the appropriate foreign law to govern the trust, can establish a non-charitable purpose trust. Purpose trusts, that is trusts lacking ascertained or ascertainable human beneficiaries, are, with insignificant exceptions, permitted under New Zealand law only where the trust is charitable. Adoption of the convention would, on the face of it, offer a simple way round this prohibition.

36 It may be noted that, apart from the more limited terms of Article 18, the Convention contains no equivalent to the troublesome proviso expressed by the Privy Council in relation to choice of law governing a contract that "the intention expressed is bona fide and legal, and provided there is no reason for avoiding the choice on the ground of public policy".[33] So there are, we think, reasons that will be obvious to them why this particular proposal needs careful consideration by (among others) both the Inland Revenue Department and the tax-avoidance industry.

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[33] *Vita Food Products v Unus Shipping Co* [1939] AC 277, 290.

Appendix A

Recognition of Trusts Act 1987 (c 14) 9 April 1987

An Act to enable the United Kingdom to ratify the Convention on the law applicable to trusts and on their recognition which was signed on behalf of the United Kingdom on 10th January 1986

1. Applicable law and recognition of trusts

(1) The provisions of the Convention set out in the Schedule to this Act shall have the force of law in the United Kingdom.

(2) Those provisions shall, so far as applicable, have effect not only in relation to the trusts described in Articles 2 and 3 of the Convention but also in relation to any other trusts of property arising under the law of any part of the United Kingdom or by virtue of a judicial decision whether in the United Kingdom or elsewhere.

(3) In accordance with Articles 15 and 16 such provisions of the law as are there mentioned shall, to the extent there specified, apply to the exclusion of the other provisions of the Convention.

(4) In Article 17 the reference to a State includes a reference to any country or territory (whether or not a party to the Convention and whether or not forming part of the United Kingdom) which has its own system of law.

(5) Article 22 shall not be construed as affecting the law to be applied in relation to anything done or omitted before the coming into force of this Act.

2. Extent

(1) This Act extends to Northern Ireland.

(2) Her Majesty may by Order in Council direct that this Act shall also form part of the law of the Isle of Man, any of the Channel Islands or any colony.

(3) An Order in Council under subsection (2) above may modify this Act in its application to any of the territories there mentioned and may contain such supplementary provisions as Her Majesty considers appropriate.

(4) An Order in Council under subsection (2) above shall be subject to annulment in pursuance of a resolution of either House of Parliament.

3. Short title, commencement and application to the Crown

(1) This Act may be cited as the Recognition of Trusts Act 1987.

(2) This Act shall come into force on such date as the Lord Chancellor and the Lord Advocate may appoint by an order made by statutory instrument.

(3) This Act binds the Crown.

SCHEDULE

CONVENTION ON THE LAW APPLICABLE TO TRUSTS AND ON THEIR RECOGNITION

CHAPTER 1–SCOPE

Article 1

This Convention specifies the law applicable to trusts and governs their recognition.

Article 2

For the purposes of this Convention, the term "trust" refers to the legal relationship created—inter vivos or on death—by a person, the settlor, when assets have been placed under the control of a trustee for the benefit of a beneficiary or for a specified purpose.

A trust has the following characteristics—

(a) the assets constitute a separate fund and are not a part of the trustee's own estate;

(b) title to the trust assets stands in the name of the trustee or in the name of another;

(c) the trustee has the power and the duty, in respect of which he is accountable, to manage, employ or dispose of the assets in accordance with the terms of the trust and the special duties imposed upon him by law.

The reservation by the settlor of certain rights and powers, and the fact that the trustee may himself have rights as a beneficiary, are not necessarily inconsistent with the existence of a trust.

Article 3

The Convention applies only to trusts created voluntarily and evidenced in writing.

Article 4

The Convention does not apply to preliminary issues relating to the validity of wills or of other acts by virtue of which assets are transferred to the trustee.

Article 5

The Convention does not apply to the extent that the law specified by Chapter II does not provide for trusts or the category of trusts involved.

CHAPTER II—APPLICABLE LAW

Article 6

A trust shall be governed by the law chosen by the settlor. The choice must be express or be implied in the terms of the instrument creating or the writing evidencing the trust, interpreted, if necessary, in the light of the circumstances of the case.

Where the law chosen under the previous paragraph does not provide for trusts or the category of trust involved, the choice shall not be effective and the law specified in Article 7 shall apply.

Article 7

Where no applicable law has been chosen, a trust shall be governed by the law with which it is most closely connected.

In ascertaining the law with which a trust is most closely connected reference shall be made in particular to—

(a) the place of administration of the trust designated by the settlor;
(b) the situs of the assets of the trust;
(c) the place of residence or business of the trustee;
(d) the objects of the trust and the places where they are to be fulfilled.

Article 8

The law specified by Article 6 or 7 shall govern the validity of the trust, its construction, its effects and the administration of the trust. In particular that law shall govern—

(a) the appointment, resignation and removal of trustees, the capacity to act as a trustee, and the devolution of the office of trustee;
(b) the rights and duties of trustees among themselves;
(c) the right of trustees to delegate in whole or in part the discharge of their duties or the exercise of their powers;
(d) the power of trustees to administer or to dispose of trust assets, to create security interests in the trust assets, or to acquire new assets;
(e) the powers of investment of trustees;
(f) restrictions upon the duration of the trust, and upon the power to accumulate the income of the trust;
(g) the relationships between the trustees and the beneficiaries including the personal liability of the trustees to the beneficiaries;
(h) the variation or termination of the trust;
(i) the distribution of the trust assets;
(j) the duty of trustees to account for their administration.

Article 9

In applying this Chapter a severable aspect of the trust, particularly matters of administration, may be governed by a different law.

Article 10

The law applicable to the validity of the trust shall determine whether that law or the law governing a severable aspect of the trust may be replaced by another law.

CHAPTER III—RECOGNITION

Article 11

A trust created in accordance with the law specified by the preceding Chapter shall be recognised as a trust.

Such recognition shall imply, as a minimum, that the trust property constitutes a separate fund, that the trustee may sue and be sued in his capacity as trustee, and that he may appear or act in this capacity before a notary or any person acting in an official capacity.

In so far as the law applicable to the trust requires or provides, such recognition shall imply in particular—

(a) that personal creditors of the trustee shall have no recourse against the trust assets;
(b) that the trust assets shall not form part of the trustee's estate upon his insolvency or bankruptcy;
(c) that the trust assets shall not form part of the matrimonial property of the trustee or his spouse nor part of the trustee's estate upon his death;
(d) that the trust assets may be recovered when the trustee, in breach of trust, has mingled trust assets with his own property or has alienated trust assets. However, the rights and obligations of any third party holder of the assets shall remain subject to the law determined by the choice of law rules of the forum.

Article 12

Where the trustee desires to register assets, movable or immovable, or documents of title to them, he shall be entitled, in so far as this is not prohibited by or inconsistent with the law of the State where registration is sought, to do so in his capacity as trustee or in such other way that the existence of the trust is disclosed.

Article 14

The Convention shall not prevent the application of rules of law more favourable to the recognition of trusts.

CHAPTER IV—GENERAL CLAUSES

Article 15

The Convention does not prevent the application of provisions of the law designated by the conflicts rules of the forum, in so far as those provisions cannot be derogated from by voluntary act, relating in particular to the following matters—

(a) the protection of minors and incapable parties;
(b) the personal and proprietary effects of marriage;
(c) succession rights, testate and intestate, especially the indefeasible shares of spouses and relatives;
(d) the transfer of title to property and security interests in property;
(e) the protection of creditors in matters of insolvency;
(f) the protection, in other respects, of third parties acting in good faith.

If recognition of a trust is prevented by application of the preceding paragraph, the court shall try to give effect to the objects of the trust by other means.

Article 16

The Convention does not prevent the application of those provisions of the law of the forum which must be applied even to international situations, irrespective of rules of conflict of laws.

Article 17

In the Convention the word "law" means the rules of law in force in a State other than its rules of conflict of laws.

Article 18

The provisions of the Convention may be disregarded when their application would be manifestly incompatible with public policy.

Article 22

The Convention applies to trusts regardless of the date on which they were created.

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