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Trust Law:

The Future After *Clayton and Erceg*

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Trust Law: The Future After *Clayton* and *Erceg*

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Trust Law: The Future After *Clayton* and *Erceg*

ERCEG AND CLAYTON: THE LESSONS TO BE LEARNT

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CLAYTON V CLAYTON – QUESTIONS POSED

The Supreme Court's 2 separate Judgments addressed:

- First, whether or not:
 - the rights and powers held by Mr C under his Vaughan Road Property Trust (VRPT) were “property” for the purposes of the Property (Relationships) Act 1976 (PRA); and
 - whether or not the trust was a sham or illusory because of those powers.
- Secondly, whether or not Mrs C was entitled to relief under s 182 of the Family Proceedings Act against the Claymark Trust.

I address the Vaughan Road Property Trust decision only.

THE FACTS

- The Claytons commenced a de facto relationship in 1986 and married 3 years later.
- They separated after 17 years of marriage with their marriage being dissolved 3 years later.
- They have two daughters born in 1990 and 1994 respectively.

The Vaughan Road Property Trust was settled in 1999 (13 years after the relationship commenced). Mr C is the settlor and sole trustee. The discretionary beneficiaries included Mr C, Mrs C and their two daughters. The daughters are also named as final beneficiaries.

THE LEGISLATIVE SETTING

Section 2 of the PRA defines property as including:

- (a) real property:
- (b) personal property:
- (c) any estate or interest in any real property or personal property:
- (d) any debt or any thing in action:
- (e) any other right or interest

The Court saw the reference to “any other right or interest”, when interpreted in the context of the PRA as social legislation, as broadening traditional concepts of property and as

potentially inclusive of rights and interests that may not, in other contexts, be regarded as property rights or property interests (para. [38]).

ANALYSIS OF MR C'S TRUST RELATED RIGHTS AND POWERS

The Court of Appeal had held that Mr C had an unfettered right to remove Discretionary Beneficiaries and Final Beneficiaries. The Supreme Court held that this was an error in that Mr C could not remove the Final Beneficiaries.

Mr C argued that because he owed continuing fiduciary duties to the Final Beneficiaries, the Court of Appeal's conclusion that the exercise of the power of removal of beneficiaries was, in substance, the same as revocation was incorrect. Consequently, the power was not tantamount to ownership as it was found to be by the Privy Council in *Tasarruf Mevduati Sigorta Fonu v Merrill Lynch Bank & Trust Co (Cayman) Ltd* [2011] UKPC 17, [2012] 1 WLR 1721 (TMSF). More said on this case below in the context of insolvency.

Prior to the Supreme Court's judgment, many 'traditionalist' trust lawyers and commentators believed that the fiduciary nature of the appointor's power to appoint trustees and or beneficiaries prohibited the power from being used unlawfully with the consequence that the power could not be transformed into the appointor's property.

Despite accepting Mr C's 'interpretation' argument, it rejected the conclusion Mr C sought.

Instead, the Court considered it necessary to analyse the trust deed more closely to see whether Mr C's powers and entitlements as Principal Family Member, Trustee and Discretionary Beneficiary give him such a degree of control over the assets of the trust that it is appropriate to classify those powers as rights or interests in terms of s 2(e) of the definition of property in the PRA (para. [50]).

This comes very close to the old 'bundle of rights' argument of yesteryear that came in for trenchant criticism by trust purists.

The Supreme Court identified that Mr C had the following powers:

- He had power of appointment of both Discretionary Beneficiaries and Trustees.
- He could transfer the power of appointment of Trustees to another person.
- He had power to change any provision relating to the management and administration of the trust.

- There was a provision requiring the trust deed to be interpreted in a manner broadening the powers and restricting the liabilities of Mr C as Trustee.

And decisively:

- The Trustee held the power to pay or apply all of any part of the capital of the Trust Fund to any one or more Discretionary Beneficiaries. As Mr C is both Trustee and a Discretionary Beneficiary, he could therefore pay or apply the entire trust capital to himself.
- The deed provided for the distribution of the trust capital on the “Vesting Day”, that is, 80 years after the date of the deed or any earlier date that the Trustee (Mr C in this case, as Trustee) may appoint.
- The deed provides that the persons entitled to the trust capital will be such Discretionary Beneficiaries (one of whom is Mr C) as the Trustee (Mr C) appoints and, to the extent that any of the trust capital is not so appointed, to the Final Beneficiaries. So Mr C as Trustee can appoint the trust capital to himself to the exclusion of any other Discretionary Beneficiary and can also bring forward the Vesting Day to any date of his choosing.
- The Trustee may resettlement the Trust Fund upon the Trustees of any trust which includes any one or more of the Discretionary Beneficiaries (in this case, that class includes Mr C himself). On the face of it, this allowed Mr C to resettlement the trust capital on the Trustee of a trust of which he was a (or the) beneficiary.

Mr C’s lawyers argued that his fiduciary obligations to the Final Beneficiaries constrained his ability to exercise these powers simply in his own favour. However, the Court noted that the trust deed:

- Authorises a Trustee who is also a Beneficiary (as Mr C is) to exercise any power or discretion vested in the Trustee in his own favour; and
- Authorises the Trustee to exercise a power or discretion conferred on the Trustee even though the interests of all beneficiaries are not considered by the Trustee, the exercise would or might be contrary to the interests of any present or future Beneficiary and/or the exercise results in the whole of the trust capital or income being distributed to one Beneficiary to the exclusion of others;

- Authorises the Trustee to exercise any power or discretion notwithstanding that the interests of the Trustee may conflict with the duty of the Trustee to the Beneficiaries or any of them

These provisions meant Mr C was not constrained by any fiduciary duty when exercising the trust's powers in his own favour to the detriment of the Final Beneficiaries. In short, the normal constraints of fiduciary obligations are not of any practical significance in relation to his powers as Trustee (para. [67]), is no effective constraint on the exercise of powers in favour of himself (para. [64]).

The underlined parts indicate that the presence of a fiduciary duty may not preclude a Clayton result. Rather the duty will be a factor in the Court's consideration along with all the other factors.

SUBSTANCE OVER FORM – INSIDE RELATIONSHIP PROPERTY

The Court considered that the correct approach (looking at overseas authorities as a guide) was a "substance over form approach to the problem" (Para. [75]). And the need for: *"worldly realism" in this context and an acceptance that strict concepts of property law may not be appropriate in a relationship property context*" (Para. [74])

In this context, the Court pointed to the UK judgments of *Charman v Charman* [2005] EWCA Civ 1606, [2006] 1 WLR 1053, *Charman v Charman* (No 4) [2007] EWCA Civ 503, [2007] 1 FLR 1246 and *Whaley v Whaley* EWCA Civ 617, [2012] 1 FKR 735 from where the *"worldly realism"* phrase was lifted. However those cases addressed the likely provision from trusts in the context of s 25(2)(a) of the Matrimonial Causes Act 1973 (UK) which directs the court, in its exercise of powers to make orders following divorce, to have regard to the property and other financial resources which each of the parties to the marriage *"is likely to have in the foreseeable future"*.

I suggest that the 'bundle of rights' claims that emanated from *Walker v Walker* [2007] 2 NZLR 261 COA have now been supplanted by the *Clayton* "worldly realism" approach.

What then does *"worldly realism"* in the New Zealand context actually mean? I suggest it possibly means that the courts can no longer be counted on to recognise the existence of 'fiduciary duties' as a block to a claim that one spouse's power (direct or indirect) over a trust constitutes relationship property. And where does it end? Will *"worldly realism"* go so far as seeing that the 'independent trustee' is not more than the puppet of the settlor spouse?!

Those who saw the decision in *Financial Markets Authority v Hotchin* [2011] 3 NZLR 469 where the Court stated that the *"powers of appointment of trustees, and even of*

discretionary beneficiaries, are not sufficient to give Mr Hotchin control over the assets of the Trusts, because that control rests, at law, with the trustee once appointed" as a return to safer traditional trust principles will not be comforted by the new approach direction things have taken.

KENNON V SPRY

The Court referred to the Australian High Court's decision in *Kennon v Spry* [2008] HCA 56 with a friendly-eye, but said its facts were less compelling than in *Clayton*. In *Kennon*, the High Court held that the combination of the powers of Dr Spry to appoint the capital to Mrs Spry and the latter's right as beneficiary to be considered, represented property of the marriage.

The Supreme Court cautioned:

"Whether a New Zealand court would hold, in the same circumstances as in *Kennon v Spry*, that the combination of rights and powers of the parties to the marriage was property is not something we need to decide" (Para. [74]).

In *Kennon*, the legislation applying was the Family Law Act 1975 (Cth) (FLA) which defined "property" quite differently as:

Property, in relation to the parties to a marriage or either of them, means property to which those parties are, or that party is, as the case may be, entitled, whether in possession or reversion.

It is interesting how the FLA focuses on a spouse's 'entitlement' whereas our PRA's focus in s 2 is on the bare descriptive nature of the property i.e. real property, personal property, any estate or interest in any real property or personal property, any debt or any 'thing in action' and any other right or interest – without reference to who is entitled to it.

And then the PRA informs us by further definition whether the particular 'property' is relationship property or not – but always tying the property back to either spouse's ownership or acquisition.

In *Kennon*, the Court held that Dr Spry's power to appoint the assets of the trust to his wife and her equitable right to be considered constituted property, notwithstanding that Dr Spry could not distribute to himself.

Could *Kennon* apply in New Zealand? If a spouse has no more than a discretionary interest in trust property with no right to a distribution, but with a right to be duly considered, and this constitutes an 'entitlement' to property in Australia, then why should such an entitlement or 'right' not similarly apply in New Zealand. It is no less a jump in thinking in either jurisdiction.

The right to be considered is described in the authorities as a chose in action and, as noted above, a 'thing in action' is specifically named as 'property' in the PRA. It is a moot whether or not the courts will adopt the limited definition of a 'thing in action' as prescribed in section 48 Property Law Act 2007, namely:

- (a) ... a right to receive payment of a debt; and
- (b) includes part of a thing in action.

THE PRACTICAL CONSEQUENCES

As the trust powers, now determined to be property, were "acquired" by Mr C after his relationship with Mrs C began, they are relationship property under s 8(1)(e) of the PRA (Para. [86]).

It is important to note that the 'property' is not the trust assets – it is ultimately the power, directly and indirectly, to distribute those assets. That is why this form of 'property' will not sustain a caveat – *Heazlewood v Joie De Vivre Canterbury Limited* [2015] NZCA 213 at [53].

WHAT ABOUT SEPARATE PROPERTY?

Mr C's lawyers argued that an unfair result would follow from a 'powers = property' determination because Mr C owned some of the property transferred to the trust before the relationship began, and which was therefore separate property. He argued that the strict application of s 8(1)(e) of the PRA to the powers under the VRPT deed would, in substance, convert separate property into relationship property (Para. [86]).

This argument was rejected by the Court in this case, because in the Family Court Mr C accepted that the value of his separate property when the relationship began was \$500,000. Once Mr C's separate property interest of \$500,000 was recognised, the remaining property held by Mr C personally (which, on the Court's approach, included the assets of the trust) was relationship property.

If the underlying assets of the VRPT were all such that they would have been separate property but for having been settled on trust, it may have been necessary to consider whether s 13 of the PRA should be invoked. There was no basis to do so in the case before the court (Para. [89]). Section 13 allows the court to distribute property or money unequally "in accordance with the contribution of each spouse to the marriage" where there are "extraordinary circumstances that make equal sharing ... repugnant to justice".

The Court affirmed the Court of Appeal's determination that the value of the trust powers is equal to the value of the net assets of the trust (Para. [107]).

SHAM

The arguments advanced in support of the sham contention were the same as those supporting the contention that Mr C powers under the trust deed are to the same effect as a general power of appointment and are property as defined in s 2 of the PRA.

In addition, it was argued Mr C had little or no knowledge of the trust deed, the operation of the trust or his duties as Trustee. That he did not consider he was restrained in any way by the existence of the deed and that he treated the property of the trust as his own.

The Court reiterated its earlier decision in *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2008] NZSC 6, that a sham is a pretence: a document that does not evidence the true common intention of the parties.

The Court did not consider that Mr C's reliance on his advisors in relation to the trust and his lack of knowledge of the legal ramifications of the trust structure and the terms of the trust deed itself leads to the conclusion that the trust deed is a sham.

Mr C's reliance on his advisors does not indicate any lack of intent on his part to create a trust, nor does his lack of knowledge of the legal detail. The fact that the trust deed gives Mr C powers that amount in effect, to a general power of appointment does not indicate that when entering into the deed, Mr C in fact intended to create a structure different from that set out in the terms of the deed itself (Para. [115]).

There is no basis to extend the sham concept to encompass a trust created under a document that was not intended to be a pretence but that the Court considers is otherwise reprehensible in some way (Para. [116]).

The Court noted that the concept of "illusory trust" was described by Rodney Hansen J in the High Court as a trust under which the trustee retains such control that the proper construction is that he did not intend to give or part with control over the property sufficient to create a trust.

The Court observed that a finding that a trust deed is not a sham does not preclude a finding that the attempt to create a trust failed and that no valid trust has come into existence. That would lead to a finding that the trust is illusory, using the terminology adopted in the Courts below. But the Court added that it did not see any value in using the "illusory" label and "... if there is no valid trust, that is all that needs to be said" (Para. [123]).

The Court concluded that Mr C intended to create a trust on the terms recorded in the deed, so the issue became whether the powers held by him are so broad that what he intended to

be a trust was not, in fact, a trust. The Court decided it did not need to determine that issue.

ACROSS THE DITCH

In the *Marriage of Ashton* (1986) 11 FamLR 457, the husband, who had been a trustee of the trust but was now only the sole appointor, was ordered to cause the trustee to pay, or to appoint himself as trustee and cause the trust to pay, a lump sum payment to the wife, on the footing that the husband 'was in full control of the assets of the trust' and because 'no person other than the husband has any real interest in the property or income of the trust except at the will of the husband'. It may be noted that the beneficiaries included "any past or present wife of" the husband, but not the husband. Leave to appeal from that decision was refused by the High Court (5 December 1986, Gibbs CJ, Wilson and Brennan JJ).

In *Davidson & Davidson* (1990) 14 Fam LR 817; (1991) FLC ¶92-197, The Court said, in the context of a trust which the husband was conceded to control and direct absolutely:-

The wording of the provisions of the MAVK Trust Deed which have been cited above, coincides closely with those of the Ashton Family Trust considered in some detail by Strauss J when delivering the judgment of the Full Court in the marriage of Ashton (1986) 11 Fam LR 457; (1986) FLC ¶91-777. As was the case in Ashton the trustee of the MAVK Trust is a company of which the husband is ostensibly an equal shareholder but which the learned trial judge described as "the creature" of the husband. We are of the view that on the evidence this finding was open to him.

Moreover, as was the case in Ashton (Fam LR at 461; FLC at 75,652) the list of beneficiaries in para (8) includes a company in which the husband's present wife, child or other relative of the husband has a shareholding and there is nothing in the deed to prevent the husband from holding the overwhelming majority of the shares in such a company and from receiving the full benefit of a distribution to that company. The husband in the present case therefore has an ability through Lestato Pty Ltd to distribute capital or income to himself or through a company in which, say, his present wife or one of his children is a minority shareholder.

It was argued that such a manipulation of the provisions of the trust would amount to a breach of the fiduciary duty of the husband as appointor relying on the decision of KJ in the *Re: Skeats' Settlement*; *Skeats v Evans* (1889) 42 Ch D 522. Whatever may have been the position 100 years ago, Australian courts today have to look at the reality of the situation and the purpose which family trusts serve today. A limitation as to the husband's power to control the assets and income of the trust in accordance with the provisions of the trust deed, is inconsistent with the reasoning of the Full Court in Ashton above. Leave to appeal from that decision was refused by the High Court on 5 December 1986 by a bench composed of Gibbs CJ, Wilson and Brennan JJ. Whatever might be the remaining effect of Skeats case, it is not authority for the proposition that the husband is prevented from appointing a trustee who has complied to his wishes.

Leave to appeal from that decision was also refused by the High Court.

It appears that the classic proposition in *Gartside v Inland Revenue Commissioners* [1968] AC 553, 607 that the object of a bare power of appointment has no proprietary interest in trust but only a mere expectancy or hope of consideration by the trustee has been rather left in the dust of social and legislative change in Australia at least.

TAKE AWAYS

- A person's powers and entitlements as appointor, trustee and beneficiary may give them such control over the assets of the trust that they become property under the PRA.

Tips for trust advisors: Limit the settlor's/appointor's powers. Ensure there must be two beneficiaries at any time. Preclude the settlor from exercising their powers to self-benefit.

- The usual 'fiduciary obligation' constraints on the exercise of trustee powers do not alter the position unless they are of practical significance i.e. they constrain applying "worldly realism" assessment.

Tips for trust advisors: Worldly realism has not yet been extended so as to find that an independent trustee or appointor is the puppet of the settlor. But looking at the Australian examples, where the appointor can change trustees, then the existence of an independent trustee will not necessarily dissuade the Court from finding the powers to be property.

- If 'separate property' is settled into the trust, then the court may apply provisions of the PRA to ensure justice in its assessment of the division of value of the trust property.

Tips for trust advisors: But beware the *Kennon v Spry* scenario. In Australia, the mere power to distribute to a spouse coupled with the duty to consider them may itself be 'property'. Perhaps having 2 trustees may side-step this outcome, but perhaps the safer option would be to exclude the spouse as a beneficiary altogether.

- A sham is a pretence: a document that does not evidence the true common intention of the parties. A trust deed is not a sham simply because the settlor and or trustee relied on their advisors or lacked knowledge of the legal ramifications of the trust structure and the terms of the trust deed. The level of power given to the trustee is irrelevant as is the fact that the trust may be reprehensible in some way. So, Mr C's trust was not a sham.

Tips for trust advisors: A sham is truly the least of the advisor's worries.

- Although a trust deed is not a sham, the attempt to create a trust may fail for some other reason i.e. the lack of essentials of a valid trust.

Tips for trust advisors: What evidence would satisfy the Court that a settlor settling a trust in fact had no intention not to do so? If unbridled power of distribution or revocation does not infer that intention, then all one is left with – in terms of the required evidence - is presumably, a signed confession, a smoking gun and a trust body!

ARE THERE INSOLVENCY REPERCUSSIONS?

There are 3 sections of the Insolvency Act to focus on:

- Section 101 – “Status of bankrupt's property on adjudication” which provides:
 - (1) On adjudication,—
 - (a) all property (whether in or outside New Zealand) belonging to the bankrupt or vested in the bankrupt vests in the Assignee without the Assignee having to intervene or take any other step in relation to the property, and any rights of the bankrupt in the property are extinguished; and
 - (b) the powers that the bankrupt could have exercised in, over, or in respect of any property (whether in or outside New Zealand) for the bankrupt's own benefit vest in the Assignee.
 - (2) This section is subject to section 104.
- Section 3 which defines 'property' as property of every kind, whether tangible or intangible, real or personal, corporeal or incorporeal, and includes rights, interests, and claims of every kind in relation to property however they arise; and
- Section 104 which provides that property held by the bankrupt in trust for another person does not vest in the Assignee.

Comparing s 2 of the PRA which includes in 'property' any other right or interest, the Insolvency Act captures an even wider pool of property by specifically referring to rights and interests (like the PRA), but also including powers that the bankrupt could have exercised in, over, or in respect of any property for his/her own benefit.

One must proceed cautiously if applying *Clayton* in the insolvency context. The Supreme Court was at pains to emphasise that the property definition in s 2 of the PRA must be interpreted in a manner that reflects the statutory context. The Court stated “*We see the*

reference to “any other right or interest” when interpreted in the context of social legislation, as the PRA is, as broadening traditional concepts of property and as potentially inclusive of rights and interests that may not, in other contexts, be regarded as property rights or property interests”.

THE POWER OF REVOCATION – TMSF V MERRILL LYNCH

Tasarruf Mevduatı Sigorta Fonu v Merrill Lynch Bank & Trust Co (Cayman) Ltd [2011] UKPC 17, [2012] 1 WLR 1721 [TMSF] featured in the Court of Appeal and in the Supreme Court judgments in *Clayton*. The key facts are:

- Mr D was a bankrupt. He had earlier established two discretionary trusts in the Cayman Islands, which, between them, had assets worth more than US\$24 million.
- The discretionary beneficiaries included Mr D and his wife and children.
- Mr Demirel, as settlor, had a general power to revoke the trusts.

The issue before the Privy Council was whether this power of revocation was a property right that Mr D could be required to delegate to the receivers in his bankruptcy, allowing them to exercise the power and obtain access to the assets of the trusts for the benefit of Mr D's creditors.

The Court held that the powers of revocation are such that in equity Mr D can be regarded as having rights tantamount to ownership. The Court determined that the power in that case was not a fiduciary power, and so, he owed no fiduciary duties in its exercise. It stated:

There is no invariable rule that a power is distinct from ownership. Nor, (as the cases on the rule against perpetuities show) is there an invariable rule that any departure from the distinction between power and property is effected solely by legislation.

... where there is a completely general power in its widest sense, that is tantamount to ownership.

Powers of revocation are uncommon in New Zealand trusts, but in *Clayton*, the Court of Appeal applied *TMSF* stating:

Where the donee of a power is entitled to appoint the subject matter of the power to himself or herself without regard to the interests of others, it was appropriate to regard the donee as the effective owner of the property.

There was no practical distinction between the power to revoke the trust subject to the decision in *TMSF* and Mr C's power to appoint himself as the sole beneficiary of the VRPT. If Mr C had exercised the power he would effectively have revoked the trust.

The Supreme Court agreed with all this, but stressed that it depended on Mr C's power being non-fiduciary in nature. Mr C's counsel argued that because he could not remove the final beneficiaries (an erroneous assumption by the Court of Appeal) he was constrained by his fiduciary obligations.

The Supreme Court accepted the distinction with the power of revocation in TMSF, but on analysis of the broad powers and entitlements of Mr C, it was a distinction without substance. The reality was that without breaching his fiduciary duties he could nevertheless appoint the whole of the trust property to himself.

The Supreme Court's ruling that Mr C's powers constitute property is much less controversial than the High Court of Australia's judgment that a discretionary beneficiary's interest in a trust was property. The NZ decision is focussed on the existence of 'property' not entitlement.

NB: section 23(2) of the PRA provides:

The Official Assignee in Bankruptcy of the property of either spouse or partner may not apply for an order under section 25(1)(a), but may apply for an order under section 25(1)(b) or an order or declaration under section 25(3).

And section 25(3) provides:

... the Court may at any time make any order or declaration relating to the status, ownership, vesting, or possession of any specific property as it considers just.

This provides a vehicle for the OA to pursue its rights rather than creating those rights.

“SUBSTANCE OVER FORM” AND “WORLDLY REALISM” – OUTSIDE RELATIONSHIP PROPERTY

Morgan v IRC [1963] Ch. 438 (CA) was referred to in TMSF. It dealt with a revocable trust. It was held by a majority (Upjohn and Diplock LJ, Lord Denning MR dissenting) that estate duty was not leviable because the son created a mere life interest in property notwithstanding his power of revocation which could convert that interest into a full beneficial interest at which time it would become leviable.

Diplock LJ took the 'orthodox' view that the possibility that some subsequent event in the future may enlarge the defendant's beneficial interest did not constitute a beneficial interest accruing or arising at an earlier time.

Lord Denning MR dissented saying:

“I do not think that the defendant did dispose of his contingent capital interest. At any rate he

did not dispose of it so as to destroy it absolutely. The reason is because the settlement was revocable. [He] could revoke it at any time with the consent of his co-trustee.

Suppose that he revoked it the day after his father's death. He could then have become entitled to the capital interest in the fund, just as if the settlement had never been executed.

What does this come to? It means that, in order to avoid estate duty, the lawyer turns magician. He advises his client to execute a revocable settlement, and in an instant, before our very eyes, the contingent capital interest is gone. No one can see it. It is replaced by a continuous life interest. No estate duty is payable.

And then, whilst we sit admiring the performance, wondering what is coming next, he can, when he pleases, bring back the capital interest. He advises his client to revoke the settlement, with, of course, the consent of his co-trustee, and at once the capital interest is there intact.

It makes me rub my eyes. I cannot believe it is true. Those near me acclaim the feat. But I do not. I have a feeling that the contingent capital interest remained there all the time, cloaked by a revocable sub-settlement. Pull the covering aside and you will see it as it really is, a contingent capital interest which became absolute on the father's death; and on which, therefore, estate duty is payable."

***TMSF* IN NEW ZEALAND**

In *Peters v Marac* [2014] NZHC 1755, the OA argued that Mr Peters' powers of appointment of trustees and beneficiaries constituted property in reliance on the authority in *TMSF*, and so, these ought to have been disclosed to the OA as *his* property. The Associate Judge rejected application of *TMSF* stating:

- It would serve no purpose under the Act to do so, because trust property does not vest in the OA by reason of section 3 of the Act
- That although certain powers will vest in the OA, that provision is limited by section 104 to powers which the bankrupt can exercise for their own benefit.
- That the argument that Mr Peters could have exercised his powers to benefit himself was merely speculative.

The authority is difficult to reconcile with *TMSF* or *Clayton*. The speculative nature of how the trustees or appointors could exercise their powers was sufficient in those cases. And the limitation on the OA to claim property in a trust only applies where the bankrupt cannot claim or exercise a power to claim a beneficial interest. As with *TMSF* and *Clayton*, that is precisely what Mr Peters could do.

Finally, the purpose of finding that Mr Peters' powers were transferable to the OA is illustrated in *TMSF* where those powers were immediately used to distribute the assets out of the trust for the benefit of creditors.

TAKE AWAYS

The trust deed that enables the settlor to revoke it or by direct or indirect means acquire back the settled property runs the risk of being held to have powers constituting property which will pass to the OA on bankruptcy.

Tips for trust advisors: .It is insufficient to emphasise that the powers of revocation or appointment are fiduciary because this fails the "Substance over form" and "worldly realism" tests. What is required is a genuine practical fetter on the power, for instance, making it a joint power.

Removing the settlor as a beneficiary or prohibiting self-benefit.

One will see immediately that to secure the hitherto benefits of the trust, the settlor must really let go of the side of the pool and trust their co-trustees or appointors in a way that many will simply not be willing to do.

Trust Law: The Future After *Clayton* and *Erceg*

**RECENT INTERESTING TOPICS IN TRUST LAW
CLAYTON V CLAYTON: SECTION 182 EXPLORED
ERCEG V ERCEG: DISCLOSURE OBLIGATIONS**

Kate Davenport QC

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INTRODUCTION

1. This paper is going to explore two interesting developments which have arisen out of two recent decisions of New Zealand's higher courts. First, the implications of a decision of the Supreme Court in *Clayton v Clayton* [2016] NZSC 30 on section 182 Family Proceedings Act 1980 (FPA), and second, the decision of the Court of Appeal about a trustee's obligations to disclose trust material in *Erceg v Erceg* [2016] 2 NZLR 622.
2. *Erceg v Erceg* has been appealed to the Supreme Court. In *Erceg v Erceg* [2016] NZSC 69¹ the Supreme Court approved the following question to be determined by the Supreme Court: "Should the conclusion that disclosure not be made/required be set aside". This will hopefully provide some further answers on this topic.

CLAYTON V CLAYTON

3. The release of the Supreme Court's decisions in *Clayton v Clayton* has sparked considerable debate amongst trust practitioners. As readers will know, New Zealand does not have a relationship property regime that enables courts to access all material assets of the parties including any interests in trusts. Trusts are only vulnerable to attack if they have relationship property transferred to them,² if they fall within s 182 of the FPA, or if the "powers" one partner has under the trust amount to relationship property. Andrew Steele will deal with the "powers" aspect of the second *Clayton* judgment and s.44 issues are topics for another day. This paper deals with issues arising out of the s.182 (Claymark) judgment.
4. Section 182 has survived almost unchanged from 19th Century matrimonial causes legislation.³ It provides that where a settlement⁴ is referable to a marriage, a court may redistribute the settled assets as it thinks fit to address the fact that the premise of the settlement – the marriage – has failed. An application may only be made after a marriage has been dissolved.⁵ So its genesis was to provide for (usually) women and children when a marriage had ended and prior to statutory relationship property regimes⁶.

¹ 17 June 2016.

² Property (Relationships) Act 1976 (NZ), ss 44 and 44C.

³ Section 182 first appeared as s 37 of the Divorce and Matrimonial Causes Act 1867 (which was based on s 5 of the Matrimonial Causes Act 1859 (UK)). It then became s 48 of the Divorce and Matrimonial Causes Act 1908, then s 37 of the Divorce and Matrimonial Causes Act 1928, then s 79 of the Matrimonial Proceedings Act 1963, and finally s 182.

⁴ This section is generally regarded as applying to Trusts but the words in the section refer to 'settlements' - arguably a wider category than a Trust, as discussed below.

⁵ The section only applies to marriages or civil unions not de facto couples.

⁶ The House of Lords in *Brooks v Brooks* [1996] 1 NZ 373 per Lord Nicholls.

5. The facts of *Clayton* are not unusual. Mr and Mrs Clayton began a de facto relationship in 1986. They had two daughters. They married in 1989, separated in 2006, and their marriage was dissolved in 2009. When the Claytons began their relationship, Mr Clayton owned a small timber processing business and three properties. By the time of their separation, the business was worth approximately \$30 million.
6. The bulk of Mr Clayton's assets were held in various discretionary trusts. The Supreme Court decisions focus on two of the trusts: the Claymark Trust and the Vaughan Road Property Trust (VRPT).⁷ My co-presenter will address the VRPT judgment. The Claymark Trust held land leased to the timber business' sawmill, and 100% of the shares in a company which owned an orchard adjacent to the sawmill. The VRPT held the timber business and the land from which the business operated.
7. In the Family Court, Mrs Clayton argued that the Claymark Trust was a nuptial settlement under s 182 because it was set up during the marriage and she would have expected to benefit from it had the marriage continued. She was unsuccessful on this point in the lower Courts,⁸ but as discussed below, she prevailed in the Supreme Court.

PART I: NUPTIAL SETTLEMENTS

8. Section 182 of the FPA is similar, although not identical to, s 24(1)(c) of the Matrimonial Causes Act 1973 (United Kingdom) and s 85A of the Family Law Act 1975 (Australia).
9. Section 182 of the FPA provides:

"On or after the making of an order under Part 4 of this Act...[i.e a dissolution] the Court may enquire into the existence of any agreement between the parties to the marriage for the payment of maintenance or relating to the property of the parties or either of them, or any ante-nuptial or post-nuptial settlement made on the parties, and may make such orders with reference to the application of the whole or any part of any property settled, or the variation of the terms of any such agreement or settlement, either for the benefit of the children of the marriage or the parties to the marriage or either of them as the Court thinks fit..."

⁷ *Clayton v Clayton* [2016] NZSC 30 [Claymark judgment] and *Clayton v Clayton* [2016] NZSC 29 [VRPT Judgment].

⁸ *MAC v MAC* FAMC Rotorua FAM-2007-063-652, 2 December 2011; *Clayton v Clayton* [2013] NZHC 301, [2013] 3 NZLR 236; *Clayton v Clayton* [2015] NZCA 30, [2015] 3 NZLR 293.

10. s.182(6) also provides:

“Notwithstanding subsections (1) to (5) of this section, this Court shall not exercise its power under the section so as to defeat or vary any agreement entered into under part 6 of the Property Relationships Act 1976 between the parties to the marriage unless it is of the opinion that the interests of any child of the marriage so require.”

The Supreme Court's Judgment

11. The majority's decision emphasised that s 182 requires a two-stage process.⁹ Step one is to determine whether the arrangement in issue is a nuptial settlement. If it is, then at step two, the court determines whether and how its discretion should be exercised. As this paper sets out, step one itself requires two steps. The court must first determine whether there has been any “settlement” and then if so, is it “nuptial” in nature – i.e. referable to the parties' marriage.
12. The majority set out several factors which will guide a court's decision at step one. The Court held that the term “settlement” should be interpreted generously.¹⁰ However, to constitute a nuptial settlement, the arrangement must be one that makes continuing provision for both or either of the parties to the marriage in their capacity as spouses.¹¹ The majority interpreted this requirement as “meaning only that there must be a connection or proximity between the settlement and the marriage.”¹² The majority observed that a family trust set up during the marriage, with one or both parties to the marriage as beneficiaries, will almost inevitably have that connection.¹³ Last, the majority emphasised that whether an arrangement constituted a nuptial settlement turned on construction of the settlement documentation.¹⁴
13. The majority found that the settlement of the Claymark Trust was clearly a nuptial settlement. It was settled during the parties' marriage, shortly after the birth of their second child. Mr Clayton was the settlor and one of two trustees. The beneficiaries were the settlor, his wife, any former wife or widow, together with his children and grandchildren and their spouses.
14. The trustees had argued (successfully in the Courts below) that the Trust was not a nuptial settlement because it was established for business reasons. The evidence

⁹ Claymark judgment at [27].

¹⁰ Claymark judgment at [32], citing *Ward v Ward* [2009] NZCA 139, [2009] 3 NZLR 336, see also *Brooks v Brooks* [1996] 1 AC 375

¹¹ Claymark judgment at [33], citing *Ward v Ward* at [27].

¹² Claymark judgment at [34].

¹³ Claymark judgment at [34].

¹⁴ Claymark judgment at [38].

was that the Trust kept assets from being exposed to bank guarantees given in respect of Mr Clayton's business, and that a secondary purpose was to acquire land to assist with obtaining resource consent for the sawmill. The majority observed, convincingly, that separating property from business risk had the effect of protecting assets for the family.¹⁵ The settlement of the Trust therefore had the purpose of providing for the parties to the marriage in their capacity as spouses.

15. The majority then considered whether and how to exercise its discretion to vary the nuptial settlement. It directed that a court should examine whether the applicant as part of the family unit would have continued to benefit from the trust had the marriage continued.¹⁶ That hypothetical future position should be compared to the applicant's actual position in relation to the trust now that the marriage had ended.¹⁷ This reflects the purpose of s 182: to remedy the failure of the premise of the settlement, the premise being a continuing marriage.
16. The majority held that a wide range of factors could be considered in exercising the discretion. That included the circumstances of the parties and any change in them (for example, if one of the parties became sick, or if they had children since the settlement was made); the interests of the children; how the trustees would have exercised their discretion had the marriage continued; who established the trust; and the source and character of the assets.
17. The majority found that had the Claytons' marriage continued, Mrs Clayton would have benefited from the Trust as part of the family (even if she had not personally received distributions).¹⁸ In contrast, after dissolution of the marriage she was unlikely to benefit from the Trust.¹⁹ The majority concluded there was a clear basis for exercising the s 182 discretion,²⁰ and that had the matter not settled prior to judgment, they would have split the Trust equally into two trusts.²¹

Analysis

18. So what lessons can be learned from this judgment? What issues does it raise?

A. What qualifies as a "nuptial settlement"?

19. The *Clayton* facts are relatively clear-cut for the Trust being "nuptial": Mr Clayton

¹⁵ Claymark judgment at [40].

¹⁶ Claymark judgment at [49].

¹⁷ Claymark judgment at [53].

¹⁸ Claymark judgment at [76].

¹⁹ Claymark judgment at [77].

²⁰ Claymark judgment at [78].

²¹ Claymark judgment at [83].

settled it while married to Mrs Clayton, and the Claytons and their children were the beneficiaries. Any trust settled during a marriage will clearly be nuptial. It may be that a trust settled before a marriage may also qualify if there is another settlement during the marriage. However, the section captures all trusts in which one of the parties is a beneficiary – not just those settled by one or both parties. One can easily envisage a situation where a trust is settled by a third party, and the party to the marriage is only one of a wider class of beneficiaries. The majority in *Clayton* explicitly referred to this situation, but expressed no view on whether it would constitute a nuptial settlement²² (although the minority decision of Elias CJ seemed to suggest it would not).²³ Trustees of “non-family” trusts with married persons as beneficiaries may now ask whether any settlement of property on the trust could be captured by s 182, especially if the settlement benefits a party to the marriage.²⁴

- 20 Another point of debate is whether a settlement is “nuptial” if it is not made with the particular marriage in mind. In *Kennon v Spry*, ten years before marrying, Dr Spry settled a trust naming any future spouse (among others) as beneficiary.²⁵ The majority found it unnecessary to address Mrs Spry’s argument that the trust was a nuptial settlement. In a minority decision, Kiefel J held that the term “settlement” needed to be construed widely to achieve the purpose of the section.²⁶ She found that the trust was nuptial because by the time of the hearing, there was a sufficient connection between the trust and the marriage (even if that connection did not exist when the trust was created).²⁷ Alternatively, she reasoned, each disposition to the trust that occurred after the marriage created a separate trust and therefore a separate settlement.²⁸
21. Heydon J criticised Kiefel J’s approach. He considered there was one trust on which various assets were held as a mass, not separate trusts for each disposition.²⁹ The Supreme Court in *Clayton* did not need to address this issue as the Claymark Trust was settled after the parties’ marriage. However, it acknowledged that Kiefel J’s reasoning was a possibility.³⁰ In my view, however, the approach taken by Heydon J is correct. Sections such as s 182 and s 85A of the Family Law Act [Australia] are interpreted by courts to fit the needs of modern

²² Claymark judgment at [35].

²³ Claymark judgment at [114].

²⁴ Examples might include a trading trust for a business where key employees of the business are beneficiaries.

²⁵ *Kennon v Spry* [2008] HCA 56, (2008) 238 CLR 366.

²⁶ *Kennon v Spry* at [224]. See also *Brooks v Brooks* [1996] 1 AC 375 at 392 (HL).

²⁷ *Kennon v Spry* at [227].

²⁸ *Kennon v Spry* at [229].

²⁹ *Kennon v Spry* at [183].

³⁰ Claymark judgment at [36]. The Court of Appeal in New Zealand had earlier left the second approach (treating each disposition as a settlement) open: *Kidd v van den Brink* [2010] NZCA 169.

society, (the Supreme Court referred to this). However, the word “settlement” has long been interpreted liberally,³¹ and it does not require the legal fiction of a creation of a new trust every time property is settled on a trust. Each disposition of property can be a fresh settlement – thus bringing that property within the ambit of the section (but potentially not the whole of the Trust). This issue has not been the subject of careful judicial scrutiny in New Zealand and remains open for debate.

22. It should be noted that a nuptial settlement is not limited to a trust. It may be any disposition that makes continuing provision for a party to a marriage. It may not be a disposition which confers an immediate, absolute interest in property (e.g. a gift),³² but it may include spouses holding their home as joint tenants, or a covenant by one spouse to make periodic payments to the other.³³

B. Interaction with the PRA - Can it still be separate property?

23. The basic relationship property regime in New Zealand presumes that upon separation, a spouse's separate property will remain their separate property, and relationship property will be divided equally.³⁴ The definition of relationship property is detailed, but in simple terms it comprises the family home and chattels, jointly owned property and property acquired by either spouse during the marriage.³⁵
24. The majority in *Clayton* accepted that a trust settled with property that is not relationship property may still be a “nuptial settlement” and therefore subject to s 182.³⁶ This means that the settled property is accessible to a spouse following a relationship breakdown where it would not have been had the settlement not occurred. For example, imagine Mrs A had built up a business worth several million dollars before her relationship with Mr A began. The business increases in value during the parties' relationship, in part due to the efforts of Mr A. Applying the PRA, Mr A would receive a proportion of the increase in value of the business,³⁷ but none of the value of the business existing at the start of the relationship.
25. Now imagine that during the relationship, Mrs A settles the business on the A Trust. The beneficiaries are herself, the As' children and grandchildren and their spouses. Applying the *Clayton* reasoning, a court would likely find the A Trust is a nuptial

³¹ *Brooks* at 392.

³² *Brooks* at 391.

³³ *Brooks* at 392. For joint tenancies, see *Brown v Brown* [1959] P 68 and *Dewar v Dewar* [1960] HCA 79, (1960) 106 CLR 170.

³⁴ PRA, s 11.

³⁵ PRA, ss 8 and 9.

³⁶ *Claymark* judgment at [63].

³⁷ PRA, s 9A(2).

settlement: it provides for Mrs A in her capacity as a spouse. It is unnecessary that Mr A be named as a beneficiary to find a nuptial settlement.

26. The court could therefore exercise its discretion to vary the A Trust under s 182. It would consider Mr A's reasonable expectations of the settlement had the parties' marriage continued. Undoubtedly, Mr A would have benefited from the settlement as a part of the family unit. The A Trust may have paid for improvements on the As' home, or for their holidays or school fees. The court might find this justifies granting Mr A some access to part of the Trust fund.
27. However, this needs to be compared with the situation had Mrs A retained the business as her separate property, rather than settling it on the A Trust. Mr A may have benefited from the business during the marriage just as much as he would have done if it were held on the A Trust – Mrs A may have used the proceeds of the business to pay for family expenses. However, that would not be a justification for the court to give Mr A access to Mrs A's separate property. It is therefore anomalous that where separate property is settled on a nuptial trust, the other spouse may access it because they benefited during the marriage and had an expectation of a continued benefit. This must be of concern to those who give advice to clients on how best to protect themselves and their assets. However, the answer may lie in a s 21 agreement as set out below. Further, even if a trust is subject to s 182 it is still open to the spouse to argue that the property was still separate property.
28. In *Clayton*, the issue of separate property in a nuptial trust did not directly arise: Mr Clayton could not adduce evidence that the assets of the Claymark Trust had originally been his separate property.³⁸ If it had been, this would have factored in the Court's exercise of its discretion. However, the majority in *Clayton* seemed eager to emphasise this may not be a major factor.³⁹ It reiterated the importance of considering the expectations of the settlement from the perspective of the family unit. Yet as stated above, if the property were not settled on trust and remained separate property, it would be inaccessible to the other spouse regardless of the extent to which that spouse would have continued to benefit from its existence had the marriage continued.
29. *Clayton* leaves the door open for separate property to be treated differently depending on whether it is held absolutely by its owner or settled on a trust for the

³⁸ Claymark judgment at [81].

³⁹ Claymark judgment at [67].

owner and children. Discretionary family trusts are increasingly common – both for asset protection and tax minimisation reasons – and parties need certainty over how the trust's assets will be treated upon separation.

30. *Clayton* also leaves open whether our fictitious Mrs A could, after settling her trust, further protect herself against a s 182 claim through a pre-nuptial agreement. The Claytons' pre-nuptial agreement provided that if the parties separated, Mrs Clayton would receive no share of the timber processing business, but would receive \$10,000 for each year of marriage up to a maximum of \$30,000. This agreement had been set aside in the Family Court because it was unjust. The Supreme Court rightly held that the pre-nuptial agreement in *Clayton* was irrelevant to the exercise of the s 182 discretion, because it had been set aside.⁴⁰
31. However, the majority indicated that even a valid pre-nuptial agreement would be irrelevant. This is because a valid pre-nuptial agreement relates to what is to happen on the breakdown of the marriage, whereas s 182 requires a focus on the position had the marriage continued.⁴¹ In her concurring separate opinion, Elias CJ observed that a court may choose not to vary a settlement under s 182 if the pre-nuptial agreement specifically dealt with the settlement in issue.⁴² This "specific reference" requirement is potentially unduly onerous. The Supreme Court's view also cuts across s 182(6), which mandates that a court should not exercise its powers under s 182 to defeat a pre-nuptial agreement unless the interests of a child to the marriage so require.
32. So *Clayton* does create the uncertainty for trustees and spouses by a widening of s 182 to third party trusts. It creates unanswerable questions for trustees. If any beneficiary's spouse could argue that the non-family trust is caught by s 182, the trustees will need to consider ways to protect trust assets from married persons. New Zealand's Law Commission has announced a review of the PRA to see if it meets "modern" society's needs.⁴³ This affords an opportunity for legislative amendment to address these concerns.

Some Practical Ideas About Clayton

- (1) Consider a s 21 agreement (s 182(6)).
- (2) Don't get married or enter into a civil union (as s 182 only applies to marriage)

⁴⁰ Claymark judgment at [71].

⁴¹ Claymark judgment at [72].

⁴² Claymark judgment at [98].

⁴³ New Zealand Law Commission "Review of Property (Relationships) Act 1976" (press release, 25 May 2016).

or a civil union).

(3) Add more beneficiaries to a third party trust? Possibly not the most practical advice but as part of Elias CJ's minority decision she suggested the s 182 might not apply to third party trusts with a wide range of beneficiaries.

(4) Consider if a trust is the best vehicle for property ownership.

33. There is a case currently before the High Court, in which I am counsel, where a third party 'inheritance' trust was attacked by the spouse who sought orders under s 182 that all of the property in the trust created by the wife's mother was relationship property. When this decision is available it will, perhaps, answer some of the outstanding questions.

PART 2: *ERCEG V ERCEG*

34. The Court of Appeal decision *Erceg v Erceg*⁴⁴ is one of the series of cases brought by the mother and brother of Michael Erceg following his death.

35. Mr Ivan Erceg, the brother of the deceased, was seeking discovery of documents from the trustees of two trusts settled by his brother. Mr Ivan Erceg was a discretionary and final beneficiary of these trusts. The trusts were wound up in December 2010. At this time Mr Ivan Erceg was bankrupt. He was discharged from bankruptcy in 2014, and then sought orders in 2015 that certain information should be made available to him concerning the winding up. The Court of Appeal set out in its appendix the documents that he sought. They were:

- (1) The trust deed and any variation of the trusts;
- (2) Resolutions and minutes for the trusts;
- (3) Details and documents relating to all share transfers involving the sale, transfer, purchasing and/or other dealings between the trustees and Independent Liquor NZ Limited;
- (4) Share valuation reports and/or other financial material that supported the trustee resolutions in respect of Independent Liquor share transactions;
- (5) Details of debts due to each of the trust and all gifting documents prepared by Michael Erceg as settlor of the trusts;

⁴⁴ [2016] 2 NZLR 622

- (6) Financial statements, accountant's working papers for each of the trusts from the date of inception;
 - (7) Bank statements for each of the trusts since the date of inception;
 - (8) Financial statements of Independent Liquor New Zealand from 2002 to 2007 inclusive, and to include the Australian and English based manufacturing companies and activities of all the companies;
 - (9) Copy of the Independent Liquor NZ share register, interest register and minute book.
36. The Court declined to order that any of the documents be disclosed to Mr Erceg. The Court found that a beneficiary had no proprietary right to the information from the trustees. The trustees had a duty to account for their actions and to adhere to the terms of the trust. It was this obligation which gave the beneficiary's right to access information about the Trust. The Court held that it was not necessary or sufficient [to find] that a beneficiary had a proprietary right to the information. The Court held that a trustee's decision as to what to disclose was a discretionary decision in discharge of the trustees fiduciary duty. It required the trustees to take into account all the relevant circumstances including any confidence assumed by the trustee when accepting that role.
37. *Garrow & Kelly, Law of Trusts and Trustee*⁴⁵ published prior to the Erceg decision, attempts to provide some guidance to trustees as to what information must be given. They set out what they considered were the principles applicable to the obligations to disclose (summarized from text):
- Subject to the discretionary jurisdiction of the Court, beneficiaries are entitled to receive information which will enable them to ensure the accountability of the trustee.
 - 'Beneficiaries' include beneficiaries of whatever nature, potential, discretionary etc, but not a potential beneficiary.
 - Documents that would normally be disclosed include financial statements, trust deeds, deeds appointing previous and present trustees, gift statements, accounts relating to the distribution of the trust, details of the trust assets and liabilities, information provided to inform trustees of any exercise of

⁴⁵ Garrow & Kelly, *Law of Trusts and Trustees*, Sixth Ed, para 20.7.18

discretions, but not the trustee's reasons.

- Documents excluded will be memoranda or letters of wishes, trustee's reasons for exercising discretion, counsel's brief, communications between trustees and specific beneficiaries and confidential information. Courts can refuse to release information if the release is not in the interests of the beneficiaries as a whole.
- Entitlement to information is so fundamental because there cannot be a trust if there is no duty to account, therefore a clause in a trust deed ousting (but not limiting) the trustee's duty to account is not effective.
- Well intentioned trustees should generally respond generously to beneficiaries' reasonable request for information.
- Beneficiaries are entitled to inspect trust accounts and documents but may have to pay for copies.
- Where serious issues of confidentiality and privacy arise withholding of documents may be justified.

38. In *Equity & Trusts*⁴⁶, the learned authors describe the trustee's obligations as not being proprietary based, reflecting the Privy Council's decision in *Schmidt v Rosewood Trust Limited*⁴⁷ but being one aspect of the Court's inherent jurisdiction to supervise the administration of trusts. They say that a beneficiary is normally entitled to the production and inspection of documents relating to the title in the trust property and the nature and content of the beneficial interests. Where requests for other documents are made they suggest that the trustees consider:

- Whether there are interests of personal or commercial or confidentiality;
- Whether some or all of the documents can be withheld in full or redacted;
- What safeguards can be imposed on the use of trust documentation;
- The nature of the interests held by the person seeking access;
- The purpose of the access and what impact there could be on trustee's, other beneficiaries or third parties.

⁴⁶ Butler and Ors, *Equity and Trusts* 2nd Edition at pg 135

⁴⁷ *Schmidt v Rosewood Trust Limited* [2003] UKDC 26

39. It seems well settled even before the *Erceg* decision, therefore, that a beneficiary has no proprietary right or property right to disclosure of documentation.⁴⁸ This point had been argued in the High Court⁴⁹ where Courtney J had declined to give the appellant access to the requested documents on the basis that:
- The appellant's interests in the trust were property, as defined by s 3 Insolvency Act 2006;
 - That the right of a discretionary beneficiary to seek disclosure was a property right and as the property of Mr Erceg invested in the Official Assignee he could not seek the document.
40. Nevertheless, the Court considered whether she would have exercised her discretion had Mr Erceg not been bankrupt. Courtney J said that she would have declined to exercise her discretion to require discovery.
41. The Court of Appeal unanimously rejected this categorization of the right to seek discovery and also rejected the decision of Potter J in *Foreman v Kingston*⁵⁰.
42. The Court preferred the approach of Venning J in *Erceg v Erceg*⁵¹. This was an application by Mrs Millie Erceg for discovery of Trust information. Venning J held that at [32]:
- “The beneficiary does not have a proprietary right to information; rather, the Court will require disclosure of information to ensure that trustees meet their obligations towards the beneficiaries. The beneficiary's right is to have the trust property properly managed. There are corresponding obligations on the trustees to properly manage the trust and to meet their fiduciary obligations they owe to all beneficiaries. In order to ensure that the trustees are held to account it may be necessary for the beneficiaries to have access to relevant trust documents...What information may be required to enable the beneficiaries to hold the trustees to account in a particular case will depend on the obligation and issue. The matter must be considered in the context of the application, the disclosure sought and the relevant obligations at issue. Further, as the Privy Council confirmed, where there are issues of personal confidentiality disclosure may properly be limited.”
43. The Court also endorsed the approach of Justice Asher in *Re Maguire*⁵² NZLR 845 where disclosure was sought from executors and trustees as to information relation to the activities of the trustees and executors in calling in and winding up the estate.

⁴⁸ [2015] NZHC 594

⁴⁹ 2015 [NZHC] 594

⁵⁰ [2004] NZLR 841

⁵¹ [2014] NZHC 155

⁵² [2010] 2 NZLR 845

The Court held that the applicant's rights as residual legatees did not give them a right to invoke the Court's supervisory jurisdiction in relation to trusts that will arise once the administration of the estate is completed and the executors become trustees.

44. The Court of Appeal also approved the comments made by the English Privy Council in *Schmidt v Rosewood Trust Limited*⁵³. The Court of Appeal also gave some guidance to how the trustees might make their decision as to whether or not to disclose documents, which they stressed was a discretionary decision of the trustee. They said that the question will be what, if any, disclosure will best:

- (a) Ensure the sound administration of the trust;
- (b) Discharge the powers and discretions in respect of the fiduciary obligation the trustee owes the beneficiary, in particular the trustee's duty to account;
- (c) Meet the trustee's obligation to fulfill the settlor's wishes.

45. The Court commented that generally the considerations of the trustee as to what to disclose and on what terms are circumstances dependent, but they cited with approval the list given in *Schmidt v Rosewood Trust* as:

- (a) Whether there are issues of personal or commercial confidentiality;
- (b) Nature of the interest held by the beneficiary or the beneficiary seeking disclosure;
- (c) The competing interests of – and therefore the impact on – the beneficiary or beneficiaries seeking disclosure, the trustees themselves, other beneficiaries and any affected third parties;
- (d) Whether some or all of the documents can be withheld and formally disclosed only in a redacted form;
- (e) Whether safe guards should be imposed on the use of the disclosed trust documentation, e.g. undertakings or professional inspection to avoid illegitimate use; and
- (f) Whether, in the case of a family trust, disclosure would likely to embitter family feelings and the relationship between the trustee and the applicant beneficiary

⁵³ [2003] UKPC 26

to the detriment of the beneficiaries as a whole.

- (g) And the Court of Appeal added the nature and context of the application for disclosure.

46. The Court stressed that a decision on what to disclose was a discretionary decision and in judging whether the trustees had exercised their discretion properly, the Court should not intervene unless satisfied that the trustee had erred in law or principle, overlooked a relevant point, factored in an irrelevant point, or made a decision that was plainly wrong.

Questions Arising

47. One immediate issue is whether the right to discovery is any wider where the litigation involves a challenge to the trustees' actions. How do the High Court Rules [which provide for wide disclosure of relevant information] and the litigation process sit with the *Erceg* decision?
48. In some cases, clearly a wider discovery is called for. By way of example, cases under the Family Protection Act 1955, where a trust is involved an administrator is required to put before the Court all information relating to the financial affairs of the estate and the deceased's reasons for making his or her will [s 11(a) Family Protection Act 1955]⁵⁴. The Court will be required to balance the High Court Rules against the limited obligation to disclosure.
49. An example of the tension can be found in the recent judgment of Brewer J in *Burgess v Monk*.⁵⁵ Mr Burgess wanted the defendants to discover to him all documents relating to their dealings with the estate of his mother which were relevant to the proceeding. This includes, crucially, their requests for legal advice and the advice that they received.
50. The defendants responded that Mr Burgess was entitled to the discovery that any litigant may achieve under the High Court Rules but that the communications between the trustees and the estate's lawyer are privileged.
51. However, the Court found that privilege is held for the benefit of the beneficiaries rather than for the personal benefit of the trustees. As a result, legal privilege is not an answer to a beneficiary's demand for disclosure.

⁵⁴ But note Asher J's comments in *Re Maguire* [2010] 2 NZLR 845

⁵⁵ [2016] NZHC 527

52. However, if the trustees are being sued by beneficiaries, then litigation privilege applies and Trustees are not liable to disclose legal advice obtained for the purpose of their defence. They are entitled to assert privilege in the usual way and the beneficiaries' rights to disclosure under the trust make no difference to this position.
53. Brewer J noted that the same justification is readily apparent in the context of an unadministered estate. This is because executors must also account to the residuary beneficiaries by virtue of their duty to carry out their administration tasks honestly and diligently.

Practical steps when considering disclosure

54. What, therefore, should the take home message for the trustees be?
- (1) Consider the terms of the trust deed. Could it specifically provide for certain information to be confidential? It is clear that the trust deed cannot contain a complete prohibition on disclosure of any information, but it can limit it or provide guidance for the trustees as to confidentiality.
 - (2) Be as open as possible in the circumstances, because often secrecy can create further mistrust.
 - (3) Consider whether some of the information might be available to a professional advisor on a confidential basis.
 - (4) Consider the rights of the trustees to seek the Court's assistance and directions under the provisions of s 66 Trustee Act [or for beneficiaries s 68 Trustee Act].
 - (5) Await law reform. The Law Commission did a comprehensive report on trusts in New Zealand in 2013. The review suggested that the new Trusts Act could provide a mandatory obligation on trustees to provide sufficient information to sufficient beneficiaries to enable the trust to be enforced, but with some limitation relating to:
 - Confidentiality;
 - Settlor's expectations;
 - Age and circumstance of the beneficiary;
 - Impact on the other trustees;

- Practicality of providing information;
- Providing information in redacted form; and
- Trust information was defined to include any information regarding the terms of the trust, administration of the trust or the trust property.
- While the government agrees that the Trustee Act ought to be amended, there is no current bill before the house relating to the amendment of the Trustee Act.
- Await the Supreme Court decision.

Conclusion

The Trustee must consider carefully any request to disclose information and deal with each request in line with the suggested guidelines contained in the *Erceg* decision.

