**Trust Law**

Trusts are not "things". They are not legal entities. Instead, "trust" merely defines a relationship that is inherently fiduciary in which a trustee deals with property for the benefit of a beneficiary for a limited purpose. The trust relationship defines what a trustee must do, can do and must refrain from doing.

People use trusts for a number of reasons:

- To manage risk;
    - Risks that can be managed include control, how best to use the asset, mental stability of the beneficiary, insolvency.
    - However, statutory clawback measures can be implemented by Parliament at any time which would change the ability to manage certain risks.
- To protect family assets from people that might spend money;
- To have the assets regulated and managed by trust law.

A. Theoretical underpinning of trusts

From Rickett article: Commentators have struggled to determine whether trusts correctly sit within the law of property or the law of obligations. Typically, trusts need to be formed over something, necessitating some property aspect for their creation. Further, there are duties and obligations that come along with trusts and which cannot be excluded. Therefore, it may be most accurate to say that trusts exist in both property law and the law of obligations and have both property consequences, binding the world at large, and obligation consequences, restricting private parties. Further:

- Trusts involve both in personam and in rem rights.
- The rights belong to the beneficiaries and the duties are owed by trustees.
- In rem duties arise because the subject of the trust is property held by the trustees.
- The in personam duties owed by trustees to the beneficiaries arise because of the express obligations included in the relevant expression of intention e.g. the trust deed. Duties/obligations are also imposed by the default rules of equity e.g. duties of loyalty, compliance with terms of trust, and duty of care.

There must be separation of the legal and beneficial ownership (or of ownership and control). As a result, a trust will not be established by a settlor purporting to hold property, as trustee, for his own benefit.

B. What is a trust?

Rickett article below helps us to understand what a trust actually is.

The Trust Bill also helps to define the nature of an express trust. According to the Trust Bill:

| Clause 13 | (a) It is a fiduciary relationship in which a trustee holds or deals with trust property for the benefit of the beneficiaries for a permitted purpose; and<br>(b) The trustee is accountable for the way the trustee carries out the duties imposed on the trustee by law. |
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| | The fiduciary relationship is the essence of the trust relationship. Tripartite relationship between settlor, trustee and beneficiary. A "trust" does not exist without this relationship. |
| Clause 14 | A sole trustee of a trust must not be the sole beneficiary of the trust also. |
| Clause 15 | An express trust may be created:<br>(a) By or under an enactment; or<br>(b) By a person (the settlor) who, clearly and with reasonable certainty: (i) indicates an intention to create a trust; and (ii) Identifies the beneficiaries or the permitted purpose of the trust; and (iii) identifies the trust property.<br>(2) A trust created under this subsection commences when a trustee holds property of the trust. |
| Clause 16 | This clause sets the maximum duration of a trust.<br><br>Currently, the law of perpetuities states that a trust cannot exist longer than 80 years. However, cl 16 proposes to extend this to 125 years. |
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[Other trusts]?

C. Nature of beneficial interest in a discretionary trust

What is the nature of the beneficial interest in trust property in a discretionary trust? Firstly, a discretionary trust is one in which the trustee has a duty to distribute in some form but has a discretionary power as to how the property is distributed. Beneficial interest is unclear – no beneficiary is certainly going to get any property. They may *hope* or *expect* to get property, but they are not necessarily legally entitled to property. What is the nature of their interest? Rickett has three options:

1) There is no beneficial ownership – however this is unlikely. This creates an ownership vacuum, which equity abhors.
2) Beneficial ownership is in suspense – The beneficial ownership is in suspense until the trustee's discretion is exercised.
3) Beneficial ownership held by the whole body of beneficiaries. Geoff and Rickett prefer this conceptual understanding of beneficial interest in property held on a discretionary trust.

Key point is that an express trust creates rights in the beneficiaries.

D. Classifications of trusts

[summarise notes from Rickett's classification of trusts article].

**Trust Busting**

What is trust busting:

- In some cases, the Courts are driven by ideas of fairness to avoid the consequences of there being the particular circumstances a trust as opposed to there being no trust. The proprietary consequences of finding that a trust exists can cause great unfairness, particularly in the relationship property context.
- The Court typically responds in one of 2 ways.
    - Firstly, the Court might attack the foundations of the Trust itself. Argue that in the circumstances there is no trust at all. Demonstrate that it is a sham trust.
    - Secondly, by resorting to constructive trusts imposed on-top of express trusts in order to achieve fairness. However, a collision between these two trusts challenges the nature and foundations of trust law itself.
- Typically occurs in relationship property disputes where the Court needs to identify the relationship property pool. At some point, one of the parties has often established a trust and transferred property to trustees. This may include one of the parties to the relationship. The trust is usually a discretionary trust. When the relationship breaks down, the issue is how can the property held on trust be "recaptured by the relationship property pool"?

I. <u>Constructive trusts over an express trust</u>

A. What is a Constructive Trust

What is a constructive trust/types of constructive trust:

1. Remedial – imposed after the fact by the Courts. Remedial constructive trusts serve an important purpose. They are often used following a successful tracing exercise to vindicate the πs property rights. A constructive trust is used to find that the Δ holds the property on constructive trust for the π. Used in <u>*Boscawen*</u> case.
2. Institutional – imposed after the fact by the Courts.
3. Implied/Construed/<u>*Lankow v Rose*</u> – here, judges look to the conduct of the parties and infer an intention to create a trust. <u>*Lankow*</u> required certain criteria before a constructive trust would be construed.

<u>*Lankow*</u> criteria:

- Contributions, direct or indirect, to the property in question;
- The expectation of an interest in the property;
- That such expectation is a reasonable one;
- That the defendant should reasonably expect to yield the claimant an interest.

These trusts come into existence because it is the intention of the settlor that it does. The settlor cannot now retreat from the trust, because it is already in existence.

The consequences of finding a constructive trust on a <u>*Lankow*</u> basis are: "the constructive trustee holds the property on a bare trust for the identified constructive beneficiary who acquires in rem rights in respect of the property. The only effective duty on the trustee is to transfer the property to the beneficiary as soon as that beneficiary is known and/or requests such transfer." – Per Rickett.

B. What is Rickett's problem with this approach?

Rickett is <u>not</u> saying that property disputes following a marriage breakup are currently fair. Not saying that it is permissible to allow the current situation to continue. However, the present way in which the Courts seek to do justice has multiple problems:

- Naked instrumentalism – the Courts should not reason backwards in order to create fairness. Should reason forwards using correct legal reasoning and work within the framework of the current law to try and ascertain whether a just outcome can be delivered. Perhaps ***unjust enrichment*** would be a more appropriate area of law to resolve these issues.
- Theoretical incoherence – the current approach of the Courts is dangerous and theoretically incoherent.

The Courts typically rely on the constructive trust approach where they feel that otherwise, there would be an unjust enrichment for the Δ. This happened in <u>*Murrell*</u> at [30] where the Court stated that recognising a CT "averts the unjust enrichment which would otherwise result to the Trust – essentially the Trust getting $37,500 for nothing – a windfall."

Rickett thinks that imposing a CT on an express trust is effectively stealing:

- Trustees have limited rights in respect of the property. The property is in-fact beneficially owned by the beneficiaries.
- Trustees do not have beneficial ownership. They therefore do not have the power to alienate trust property or create new beneficial ownership rights in third parties; *nemo dat quod non habet.* A trustee cannot, per <u>*Lankow*</u>, reasonably expect to yield to a third party an interest that the trustee has no power to yield.
- Allowing this to occur is unfair. Regardless of what theory is adopted, beneficiaries have proprietary interests in the trust property. Robin Hood law. Stealing from beneficiaries.
- Moreover, you are giving the settlor's property to a π who the settlor has often never had any interaction with. Unjust as contrary to the settlor's intention. Assigning a beneficial interest in property that was never intended to exist.

Furthermore, it is doctrinally inconsistent and undermines the nature of the express trust:

- Equity recognises rights and duties based on the expressed intention of the settlor. Equity responds to this intention by creating an express trust.
- Express trusts allocated beneficial interest in certain property to certain beneficiaries.
- Imposing a CT over an ET dismantles the express trust by redistributing property interests in a <u>*different*</u> way than originally intended under the express trust.

C. Geoff's thinking on Trust Busting

Geoff thinks that trusts shouldn't be busted in this way:

- If you want to get the benefits that come with putting property in a trust, you must also therefore accept the concomitant conceptual and proprietary consequences. E.g. you do not legally own the property anymore. Other people own the property also and you have to consider their ownership interests and not just your own.
- Therefore, not justified to use instrumentalism as a basis for busting trusts.

D. <u>*Murrell*</u> and Rickett's response

| Facts | Murrell and Hamilton were in a relationship. During the relationship, a house owned by the W E Hamilton Family Trust (H's family trust) was renovated and landscaped. Briefly it was occupied by Murrell and Hamilton before being rented out and eventually sold. The trust had two trustees: Hamilton and Mirkin. Mirkin essentially left everything for Hamilton to do.<br><br>Murrell made a relationship property claim to be transferred half of the value of the property, claiming that a constructive trust had arisen over the express trust. At trial, a constructive trust was denied. The judge found that Murrell made contributions to the property and held a reasonable expectation that she would enjoy an interest in it. The judge declined a constructive trust, however, because, despite it being unconscionable for Hamilton to deny her interest, it would not be unconscionable for Mirkin to deny it. This result is appealed. |
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| Reasoning | Court judgment:<br>• Court found that all the elements of *Lankow* were satisfied.<br>• The fact that Mirkin left everything to do with the house to Hamilton is indicative that Hamilton's actions were treated as the actions of both trustees and so were binding on both of them.<br>• As a result, Mirkin's conscience is bound by Hamilton's actions. Therefore, it would be unconscionable for either of the trustees (and certainly for both acting in conjunction) to deny M's claim for an interest based on the expectation stimulated by H acting for the trust.<br>• Mr Hamilton made statements that the couple were working together on the property for their mutual benefit. Therefore, the Court found it was only fair that the trustees should yield a beneficial interest to the π.<br>• Court ultimately held that the π had made a 15% contribution to the value of the house. This was equivalent to $37,5000.<br><br>**Not stealing:** Importantly, the Court held at [30] that they did not see this as taking property from the beneficiaries. Instead, they saw it as taking part of the value of the trust property that should never have accrued to the trust and giving it to the π who was entitled to it. Constructive trust imposed over this part of the value of the asset. |
| Rickett response | Many problems.<br><br>First, there is no such thing as a "trust". The trust therefore cannot own property or be unjustly enriched. Instead, a trust is merely a relationship. The trustees legally own the property and the beneficiaries have a beneficial ownership in the property.<br><br>Secondly, the Court was incorrect to try and state that this was not "stealing". Court drew a false dichotomy between the value of an asset and the asset itself. People beneficially interested in property. They receive value from the assets themselves. You cannot separate value from the asset. If value is added to an asset, the value is *part* of the asset and is still beneficially owned by the beneficiaries. Requires the trust to liquidate assets in order to make the payment.<br><br>This is wrong. A better approach for allowing Ms Murrell to get paid is through concept of debt. Ms Murrell has performed a service for the trustees. The trustees are contractually obligated to pay for those services – they owe a debt. This gets around the conflicting proprietary interests. |

| | Thirdly, this is naked instrumentalism. Using language of "unjust enrichment" is merely an attempt to justify the decision morally. |
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E. *Vervoort* and Rickett's response

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| Facts | The π was in a relationship with Mr Duffy for 12 years. The Duffy family trust was settled by Mr Duffy before the relationship began. Trust owned significant assets in Fiji. Mr Forrest was one of the trustees.<br><br>From early in the relationship, Mr Duffy funded their life style through trust assets. Trust also purchased a lifestyle block in Auckland as a family home for him and Ms Vervoort. Lived there with their sons. V helped to find the house, redecorate, refurbish, establish a garden, maintain the property, the house, the garden, the pools and cared for the animals. Mr Duffy did little work on the property because of an injury.<br><br>After significant relationship troubles, they moved to Fiji for at time. Trust purchased an apartment for them to live in.<br><br>V ultimately separated from Mr Duffy. In 2011, Vervoort and Duffy separated. Vervoort claimed relationship property orders and alleged that the trust was a sham and, in the alternative, that a constructive trust had arisen over the trust property, allowing that property to be included as relationship property. Will address the Sham point later. |
| Reasoning | The High Court rejected the claim for a constructive trust in line with *Lankow*. The Court reasoned that in *Murrell*, the important fact was that the independent trustee had abjured his responsibility to Mr Hamilton. This meant that H's actions bound the trust. He engendered an expectation etc. Conversely, here:<br>• Court found that recognising a constructive trust would violate orthodox trust principles of unanimity and non-delegation. I.e. one trustee on their own cannot bind the trust. All trustees must act unanimously.<br>• Here, rather there was a complete abstention from all decision making by the other trustee.<br><br>**The Court of Appeal Decision**<br>The Court first referred to a number of cases in which a constructive trust was superimposed on top of an express trust to justify the authority for this position e.g. *Prime v Hardie*.<br><br>The Court rejected the HC's argument regarding unanimity:<br>• HC found that there was no unanimity of trustee action because Forrest and then Spear were not involved in decision making. Prohibition on truste delegation. Not sufficient unanimity to nake it equitable to hold that the Trust was obliged to V.<br>• Court found that the principles of non-delegation and unanimity must ben to practical realities when one trustee is in absolute control of all trust activities and the other trustees have abdicated their responsibilities. ← Another example of instrumentalism.<br>• Otherwise, settlors who appoint themselves as trustees would be able to take advantage of their position to receive windfall gains for the trust.<br>• Most trusts in NZ are of a similar structure to this. Would defeat many claims. |

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<tr><td></td><td>The Court also directly addressed the criticism from Rickett. Recognised that constructive trust may involve unilaterally redistributing property rights at the expense of the beneficiaries. However, the Court responded by saying:<ul><li>First, in a true <u>Lankow</u> scenario, the trust assets will reflect the value of the contributions of the π. Existing beneficiaries are therefore not being deprived of assets or increases in value of the assets that they would have otherwise enjoyed. Justifiable to separate this value and attribute to the π.</li><li>Allowing the trust to take advantage of trust principles and keep the added value is unfair.</li><li>Court recognised that remedies against the trustees may be available. But the Courts have turned to the constructive trust instead. Unjust enrichment and other concepts have not developed far enough yet. Constructive trust used instead and prevents an unjust enrichment from occurring.</li><li>Court stated it is conceptually sound. Equity is <u>not</u> reducing the value of the asset pool of the trust. Equity would never do this. Instead, it is compensating the π for the increase in value from their contributions.</li><li>Many NZ trusts involve situations where the settlor retains control. In reality, the trustee is the settlor and they are creating expectations that change how the disposition of property occurs.</li><li>Trust law cannot be used as a vehicle to extract unearned benefits by engendering expectations in third parties.</li></ul>Court found on these facts that there was a constructive trust made out. V's contributions were only cosmetic in nature and did not significantly add value to the trust assets.</td></tr>
<tr><td>Rickett response</td><td>Firstly, Rickett said the Court's decision was another blatant display of instrumentalism.<ul><li>The judgment made reference to the fact that a constructive trust is used to stop a windfall gain and avoid an unjust enrichment etc. Also discussed about how the laws of unanimity etc. must bend to the realities of the trust landscape in NZ. To do otherwise would be to defeat πs claims.</li><li>Rampant instrumentalism according to Rickett.</li><li>Cases should be decided through the application of legal rules rather than through policy decisions and the pursuit of justice. Otherwise, the private law merely becomes an organ of the state used to deliver public policy ends and achieve fairness. No longer a coherent body of rules.</li><li>This same critique applies to how the Court justified this as <u>not</u> stealing property.</li></ul>Second problem was the Courts failure to truly recognise how this was stealing from beneficiaries:<ul><li>Incredibly ironic that the Court earlier held that there was an express trust. Court rejected the argument that there was a sham trust, and illusory trust or an emerging sham.</li><li>Ironic: "To impose a constructive trust over those assets in favour of the claimant justified by the unconscionable behaviour of the trustee amounts to a denial of both eh (equitable property) rights of the "others" and a contempt of the very same trust the Court had earlier recognised."</li><li><u>Lankow</u> has taken on a life that is significantly different presumably from what the creators envisaged.</li></ul></td></tr>
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## II. Alternative ways of doing justice *without* a [constructive trust] – the Trust Bill

This is a common situation that occurs in more cases than just family context. Third parties often do work/provide services that increases the value of the trust and involves incurring obligations to third parties E.g. Trustees putting new window on a house and pay contractors to do so.

Law has developed systems to allow third parties to access trust property. The main way is through trustee indemnity.

A. Trustee indemnity

This is the <u>legal mechanism</u> that allows third parties to access trust property. It is an uncontroversial aspect of trust law. How does this work?

- When trustees incur personal obligations or do things like pay for contracts, they are entitled to be reimbursed from the trust for the cost of what they are doing.
- Otherwise, no one would be a trustee. Indemnity central to trusteeship.
- Operates as a mechanism for access to property in these cases.
- If a trustee deals with a third party (the plaintiff) and incurs obligations/expenses etc., the third party can sue the trustee. The trustee can claim that these actions were done in their capacity as trustee *on behalf* of the trust.
- Therefore, payment can be made from the trust assets. The creditor/plaintiff becomes subrogated to the rights of the trustee.

This <u>**avoids**</u> Rickett's conceptual issues:

- Indemnity does not grant the plaintiff a property right.
- Merely grants the plaintiff a personal claim against the trust property.
- Avoids Charles' concerns which focussed on creating 2 sets of competing property rights and allowing the Court to redistribute property rights contrary to pre-established property allocations set out in the terms of the express trust etc.

In the relationship property context (e.g. <u>*Murrell*</u> and <u>*Vervoort*</u>), it works like this:

- The plaintiff needs to make out a valid claim. This claim is what allows the mechanism to operate.
- Rickett discusses how a viable claim is unjust enrichment. This is where there is no legal reason for the defendant to retain the property/value anymore. Once relationship ends, there is no reason for the trustee to retain the value for the trust. The property/value was only provided by the plaintiff on the basis that the plaintiff and the defendant had a continuing relationship. Once that relationship ends, the justification for the trustee having the property expires.
- If the plaintiff can make out the claim, they can become subrogated to the trust property.

The Trust Bill addresses this in the following way:

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| Clause 77 | A trustee is personally liable for any expense or a liability incurred when acting as a trustee.<br><br>However, a trustee who incurs an expense or a liability when acting reasonably on behalf of the trust is entitled: |

| | (a) If the trustee has paid the expense or discharged the liability out of the trustee's own funds, to reimbursement from the trust property; or<br>(b) In any other case, to pay the expense or discharge the liability directly from the trust property (or to have it paid or discharged by a remaining trustee). |
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B. Problems with indemnity approach – Trust Bill solutions

There are two key concerns relating to the indemnity. Firstly, that important trust property may be alienated from the trust assets. Secondly, that creditors may be deprived of access to trust property in circumstances where the trustee acts in bad faith.

The Trust Bill addresses these problems in the following way.

| Clause | Problem | Solution |
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| 79 | The indemnity opens trust assets up for alienation. This can be especially problematic where there is important property held on trust that the beneficiaries do not want alienated.<br><br>Beneficiaries often do not want Taonga being vulnerable to alienation because trustees incur personal obligations or liabilities. | The Law Commission decided that people shouldn't be able to *exclude* property from alienation.<br><br>Instead, cl 79 allows the terms of the trust to rank the order in which trust property must be applied to reimburse the trustee or pay or discharge an expense or a liability.<br><br>Therefore, if indemnity used, you have effectively pre-ordained what order the property is liquidated in to pay the plaintiff.<br><br>The Court *may* set aside the ranking of trust property on the application of the trustee, a creditor or a beneficiary.<br><br>Surely the power of the Court to set aside rankings is a violation of settlor autonomy? Goes against the express terms of the trust? |
| 80 | Trustee indemnity in cl 77 only applies to the extent that the trustee is acting reasonably on behalf of the trust.<br><br>The indemnity is severed where the trustee acts in bad faith. This is an important protection for beneficiaries. Ensures property will not be vulnerable to alienation because of the trustees acts performed in bad faith.<br><br>Problem: in these circumstances, the trust may retain value that they wouldn't otherwise have. Creditors would not be able to access the property as the indemnity has been severed. | Clause 80 effectively creates a quasi-unjust enrichment remedy.<br><br>If the indemnity is severed, the creditor can still have access to trust property as if the trustee were indemnified.<br><br>The requirements are that:<br>• The creditor has given value; and<br>• The trust has received a benefit from the transaction between the trustee and the creditor; and<br>• The creditor has acted in good faith.<br><br>According to cl 80(3): "The creditor has not acted in good faith for the purposes of |

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| | The trustee could only be sued in a personal capacity. However, the trustee may not be able to pay.<br><br>According to LawCom, this situation was very common. | subsection (1)(b)(iii) if the creditor had knowledge of any circumstances that excluded or limited the trustee's indemnity (whether or not the creditor knew it would have that effect)." E.g. that the T was acting in BoT?<br><br>This is a personal remedy only. Does not create a proprietary remedy to trust property.<br><br>Problem: this doesn't fix the tax or GST scenarios. Provision requires you to have given value to the trust. Does not apply where an obligation is owed e.g. owing tax.<br><br>Commission didn't allow the tax example because this would be tantamount to recognising that the <u>TRUST</u> was liable for the tax. But this is doctrinally inconsistent as a trust does not exist and therefore cannot incur obligations or liabilities. |

## III. <u>Power of appointment as property</u>

*<u>Clayton</u>* held that where the powers of the trustee (who is the partner in the relationship) grant him/her extensive control over the assets of the Trust, those powers may quality as property under the PRA and therefore relationship property. Where this occurs, the value of those powers is typically equivalent to the value of the assets owned by the Trust.

In *<u>Clayton</u>* the relevant powers discussed by the Court were:

- Power to appoint all of the trust capital and income to himself
- Power to appoint and remove discretionary beneficiaries and trustees
- Transfer the power of appointment of trustees to another person
- Power to change any provision relating to the management and administration of the trust
- Requirement that the deed be interpreted in a manner that broadened the powers and restricted the liability of Mr Clayton
- The power to change the vesting day and exclude all other beneficiaries.
- **SLAM DUNK**: the exclusion of Mr C's fiduciary obligations owed to the final beneficiaries (found in cls 11.1, 14.1 and 19.1) meant that as trustee he could allocate himself all the trust property (to the exclusion of all beneficiaries) despite not being able to remove the final beneficiaries. Clause 14.1 expressly authorised such allocation and cl 11.1 said it could be done without considering the interests of the beneficiaries (both discretionary and final) and in a manner in inconsistent with the beneficiaries' best interests.

Given the extensive control My Clayton had, the Court concluded that there powers amounted to relationship property under the PRA. The Court concluded that the value of the trust powers was equal to the value of the net assets of the trust.

**Legal conclusion**: where a party has a power to add or remove beneficiaries and distribute trust property, at their absolute discretion and unfettered by fiduciary obligations, the subject of the trust will be susceptible to a claim for relationship property.

Potential instrumentalism in this case: Geoff said that the central fact was that the plaintiff was only ever going to get $30,000 as per the agreement between the parties. Whereas the trust had millions of dollars of assets. Potentially drove the Court to try and make a "fair" decision in this case.

## IV. Sham Trusts, Illusory Trusts and Alter Ego Trusts

### A. The Cases

| Case | Facts | Discussion |
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| *Clayton* | Mr and Mrs Clayton were married. Mr Clayton owned a sawmilling business and a block of land. In 1999 Mr C executed a trust deed, settling the land and buildings on the VRPT. The terms of the trust deed gave Clayton extensive control.<br><br>Mr and Mrs C separated and Mrs C made a claim for relationship property. Mrs C claimed that the trust was either a sham or illusory and so the property contained in it should revert to Mr C and therefore be available to answer a claim for relationship property. | **Central issue**: There is something that purports to be a trust and may look like a trust. However the trust is being used to defeat a legitimate claim. Is this really a trust? Is there are way around the consequences of finding that a trust exists?<br><br>**Sham**<br>The Court adopted the test from *Ben Nevis* (NZSC) case. A sham is a "pretence": a document that does not evidence the true common intention of the parties.<br><br>The Court must look to whether the settlor and Trustee intended to create a trust when they entered into the trust deed and settled the property. If there was no intention to create a trust, then the parties have not created a trust.<br><br>On these facts, the NZSC said it was not a sham:<br>• The fact that Mr C relied on advisors in relation to the trust and lacked knowledge of the legal ramifications of the trust structure and the terms of the trust deed do not indicate a lack of intention to create a trust.<br>• The fact that Mr C has extensive powers does not evidence a lack of intention to create a trust.<br>• Concurrent findings of fact that Clayton did indeed intend to create a trust.<br><br>**Illusory Trust**<br>The Court did not like the language of an "illusory" trust. They said that this obfuscates the true inquiry. An illusory trust is something that looks like a trust, but in fact no trust was ever created.<br><br>The Court stated at [129] that: "In such a case, the document as executed **does** represent the terms to which the party or parties intended to agree but, despite their subjective intention to create a trust, they failed in their attempt to do so." |

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| | | Was this an illusory trust? Very unclear. Arguments either way.<br><br>No trust arguments:<br>• Mr Clayton had such extensive powers under the Trust Deed that he cannot have been said to have parted with the legal and/or beneficial ownership of the property. This means that Clayton never established a trust as he has not disposed of the property.<br>• The powers afforded to Clayton were so broad that they "bring into question whether the irreducible core of trustee obligations referred to in *Armitage v Nurse*" are satisfied.<br>• However, this second argument does not deny the possibility that a valid trust may come into existence in the future e.g. if Clayton were replaced by a new trustee who was not the Principal Family Member and/or a beneficiary. This would mean the powers were not in breach of the irreducible core.<br><br>Argument for a trust:<br>• It is true that the powers in the deed enable Clayton to bring the trust to an end by giving himself both legal and beneficial ownership of the property.<br>• However, until those powers are exercised, there is no reason the trust cannot continue to exist and be recognised in the interim.<br>• Unclear whether this argument can succeed however, given the potential fact that the irreducible core was not met. Trust cannot exist without the irreducible core. |
| *Wilson* | Reynolds settled a house on trust in 1996 with W and H as the trustees. The property was subsequently sold to Reynolds by the trust. The trust then bought a property in Queenstown, in which Reynolds lived. Reynolds went bankrupt and owed creditors $500,000. The Official Assignee contends that the trust is a sham and that the property held on it should be available for Reynolds's creditors. The trust was never administered well and there was intermingling between the affairs of the trust and Reynolds. | **Procedural point**<br>The OA is attempting to allege the trust is a sham etc. The OA is standing in the shoes of the bankrupt and gets all of the rights of the bankrupt. Here, the OA was effectively trying to allege that its own trust (i.e. the trust that Reynolds settled) was a sham. You cannot do this.<br><br>This has now been changed and allowed by s 1 of the Insolvency Act 2006. OA can bring a claim even if the bankrupt cannot. Therefore, OAs can challenge the validity of trusts where the bankrupt is the settlor.<br><br>**Sham Trusts**<br>A Trust will be help to be a sham "where there is an intention to have an express trust in appearance only." E.g. where the settlor seeks the protection offered by the pretence of there being a valid trust. Requires an intention to mislead.<br><br>If held to be a sham, there will be no trust. The absence of an intention to create a genuine trust prevents the trust from being valid, because the core requirement of certainty of intention is absent.<br><br>Depending on the circumstances, the Court will look for either a unilateral or a mutual intention to sham:<br>• No one approach is appropriate. Need to adopt a nuanced approach which recognises the variety of circumstances of trusts and shams.<br>• Some trusts only require unilateral intention because the settlor and the trustee are not separate persons.<br>• Some require mutual intention because the settlor and the trustee are separate. |

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| | | • Where a trust objectively appears to be legitimate, it will be held to be a trust.<br>• Where there is good reason to look behind the ostensible appearance of a trust, the Courts will look to the subjective intention of the party/parties.<br>• This is a high threshold.<br><br>**Emerging Sham**<br>The Court rejected the emerging sham argument. Once a trust is validly created, the beneficiaries have a recognised property interest. This cannot be easily undone.<br><br>If later dealings demonstrate that the trust has always been a sham, then the trust may found to be invalid.<br><br>Subsequent transactions may be found to be a sham. Those transactions may be void, but the trust will continue to exist.<br><br>**Alter Ego Trust**<br>The plaintiff argued that there was an alter ego trust. This occurs where a person, other than a trustee, controls it to such an extent that the trustees are mere puppets.<br><br>In Australia this level of control over trust property justifies piercing the express trust. However, in New Zealand, in the absence of statutory authority, there must be an equitable basis for avoiding a trust. The assumption of factual control by someone other than a trustee cannot of itself invalidate a trust, extinguishing the rights of the beneficiaries under a trust. Therefore, in NZ the alter ego is a meaningless concept and it is not an independent cause of action.<br><br>Alter ego can be evidence of a sham trust however.<br><br>**Was this a sham?**<br>No. The trust was valid.<br><br>The way in which the trustees operated the trust was allow Reynolds to treat it as his own personal bank account. However, this does not mean that the trust was a sham.<br><br>The beneficiaries still have recognised property interests. The fact that the trustee acted poorly does not defeat their proprietary interests. Instead, they can sue the trustee for breach of trust.<br><br>Problem with this argument is that the beneficiaries may never sue the trustees because maybe some of the trustees are beneficiaries also. This is very common in NZ. |
| *Vervoort* | See above. | The Court first considered whether the trust deed was a sham. It concluded that it wasn't a sham, because:<br>• There was no evidence to suggest Duffy did not intend to create a trust in 1994. Duffy exercised de facto control over the trust yet a co-trustee was appointed, trust accounts were prepared, properties were purchased in the name of the trust and the formalities of a trust structure were put in place and retained. |

| | | • There does not appear to have been a deliberate change in the trust arrangement so that the use of the trust has become a pretence. This is despite Forest taking a very hands-off role as trustee. Further, Duffy's cavalry description of assets owned by the trust as being owned by him was merely careless.<br><br>**Note**: although it wasn't argued that Duffy had a general power of appointment which could be considered relationship property (*Clayton v Clayton*), the court noted that such an argument would likely fail because in this case Duffy's powers are extremely limited compared to Clayton's: Duffy cannot act without the fetter of fiduciary duties; there was a second trustee and Duffy could not make himself the sole trustee; Duffy could not appoint or remove discretionary beneficiaries. |
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B. Law Commission's approach to shams/illusory trusts/alter ego trusts etc.

What was the Law Commission's approach to shams/illusory trusts/alter ego trusts etc.?

- There is an issue around certainty. People need to know how certain their property interests are. If trusts increasingly become liable to be deemed a "sham" and rendered void, then there is no certainty in proprietary interests.
- "Sham" claims are particularly vulnerable to instrumentalism. Judges can latch onto the unfairness of a claim, and use "shamming" as a means of dismantling a trust in order to achieve justice for the aggrieved plaintiff.
- There are significant problems with this. Trust law is built around the capitalistic idea that people should be able to do what they want with their property. Judges shouldn't be able to second guess what parties do with their property.

Law Commission therefore chose not to put a specific trust busting power in the Trust Bill. Idea is that if you create a trust and you intend to do so, then you must accept the legal consequences that flow from that decision. Society must accept this too.

The Law Commission's response was to create some more certainty about what actually constitutes a Trust.

- This involved clarifying the core characteristics and requirements of a trust, and the minimum required duties of trustees to ensure that the trustees owed duties in respect of the property and management of the trust.
- The Bill also limited the scope of exemption clauses. This also creates certainty as to what constitutes a trust as it ensures that the Trust can be enforced by the beneficiaries.

| Clause 13 | (c) It is a fiduciary relationship in which a trustee holds or deals with trust property for the benefit of the beneficiaries for a permitted purpose; and<br>(d) The trustee is accountable for the way the trustee carries out the duties imposed on the trustee by law.<br><br>The fiduciary relationship is the essence of the trust relationship. Tripartite relationship between settlor, trustee and beneficiary. A "trust" does not exist without this relationship. |
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| Clause 14 | A sole trustee of a trust must not be the sole beneficiary of the trust also. |

| Clause 15 | An express trust may be created:<br>(c) By or under an enactment; or<br>(d) By a person (the settlor) who, clearly and with reasonable certainty: (i) indicates an intention to create a trust; and (ii) Identifies the beneficiaries or the permitted purpose of the trust; and (iii) identifies the trust property.<br>(2) A trust created under this subsection commences when a trustee holds property of the trust. |
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| Clause 16 | This clause sets the maximum duration of a trust.<br><br>Currently, the law of perpetuities states that a trust cannot exist longer than 80 years. However, cl 16 proposes to extend this to 125 years. |
| Clauses 22–26 | These set out the mandatory duties owed by trustees. These duties are non-excludable.<br><br>Without these duties, it is likely that the Trust does not meet the irreducible core of obligations articulated in *Armitage v Nurse* (although the duties at the irreducible core are expanded by the Trust Bill.<br><br>Mandatory duties:<br>• Clause 22 – Know the terms of the trust<br>• Clause 23 – Act in accordance with the terms of the trust<br>• Clause 24 – Act honestly and in good faith<br>• Clause 25 – Act for the benefit of the beneficiaries or to further a permitted purpose of the trust<br>• Clause 26 – Duty to exercise powers for a proper purpose |
| Clauses 27–36 | Default duties that can be modified or excluded.<br>• Clause 27 – General duty of care<br>• Clause 28 – Invest prudently<br>• Clause 29 – Duty not to exercise power for own benefit<br>• Clause 30 – Duty to consider exercise of power<br>• Clause 31 – Not to bind or commit trustees to future exercise of discretion<br>• Clause 32 – Avoid conflict of interest<br>• Clause 33 – Duty of impartiality<br>• Clause 34 – Duty not to profit<br>• Clause 35 – Duty to act for no reward<br>• Clause 36 – Duty to act unanimously |
| Clauses 37–40 | Clauses 37 – "The terms of a trust must not limit or exclude a trustee's liability for any breach of trust arising from the trustee's dishonesty, wilful misconduct, or gross negligence."<br><br>Clause 38 – "The terms of a trust must not give a trustee any indemnity against the trust property for liability for any breach of trust arising from the trustee's dishonesty, wilful misconduct, or gross negligence."<br><br>Clause 39 – "A clause in the terms of a trust is invalid to the extent that it purports to have the effect prohibited by section 37 or 38." |

| | Clause 40 – Paid advisor must alert settlor to liability exclusion or indemnity clauses. Otherwise, the clause may not have effect. |
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**Constructive Trusts**

There are multiple types of constructive trusts. Have already discussed the *Lankow v Rose* constructive trust. The other 2 central types are the remedial and the institutional constructive trust.

Institutional constructive trust: An institutional constructive trust arises by operation of the principles of equity, the Court recognising its existence in a declaratory way. Its existence arises upon the happening of the events which bring it into existence and is not dependent on any order of the Court which simply recognises that it came into being at the earlier time and provides for its implementation in whatever way is appropriate.

Remedial constructive trust: On the other hand, a remedial constructive trust depends for its very existence on the order of the Court, which is creative rather than confirmatory. An institutional constructive trust is a mandatory consequence of certain events; a remedial constructive trust is a discretionary remedy. Both unjust enrichment and unconscionability are triggers for the imposition of a remedial constructive trust.

In *Westdeutsche*, Lord Browne-Wilkinson explained it so: "Under an institutional constructive trust, the trust arises by operation of law as from the date of the circumstances which give rise to it: the function of the Court is merely to declare that such trust has arisen in the past. The consequences that flow from such trust having arisen (including the possibly unfair consequences to third parties who in the interim have received trust property) are also determined by rules of law, not under a discretion. A remedial constructive trust, as I understand it, is different. It is a judicial remedy giving rise to an enforceable equitable obligation: the extent to which it operates retrospectively to the prejudice of third parties lies in the discretion of the Court."

A. Examples of ICTs

*Keech* = constructive trust imposed over the lease obtained in breach of fiduciary obligations.

*Boardman* = the parties were found to be acting in fiduciary capacity. They breached their fiduciary duties when they obtained the shares. The Court imposed a constructive trust over the shares.

B. Property acquired by fiduciaries in breach of fiduciary duties

Traditionally, a breach of obligation led to a claim in damages whereas a breach of a proprietary right led to a proprietary remedy. However, in certain situations where property is obtained by a fiduciary, in breach of a fiduciary obligation owed to the principal, courts have held that the correct remedy is to impose a constructive trust over the property obtained. This has been criticized as an example of instrumentalism and contrary to traditional restitutionary principles.

*Boardman, Reid* and *FHR* have established that in the following situations, constructive trusts will be imposed:

- **Secret profits**: a fiduciary who obtains a profit by reason of his fiduciary position or by reason of the opportunity and the knowledge resulting from it, holds that profit on constructive trust for his principal unless he makes the profit with the full knowledge and assent of the principal (*Boardman v Phipps*; *FHR Ventures v Cedar Capital Partners*);
    - This is so whether or not the fiduciary acts fraudulently and whether or not the principal is able to or intends to take advantage of the information or opportunity (*Boardman v Phipps*).
- **Secret commissions**: when an agent makes a secret commission in the course of his agency, without the full and informed consent of the principal, he holds that secret commission on trust for his principal (*FHR Ventures v Cedar Capital Partners*);
- **Bribes**: when a bribe is accepted by a fiduciary in breach of his duty he holds that bribe in trust for the person to whom the duty was owed (*AG for Hong Kong v Reid*).

C. *Reid* and *FHR*

<table>
<tr><th>Issue</th><th>Explanation of problem</th><th>Legal reasoning/resolution</th></tr>
<tr><td rowspan="2">Precedent</td><td rowspan="2">Both Courts found that there were multiple cases in support of a constructive trust and also multiple cases that opposed a constructive trust and instead supported equitable compensation as the appropriate remedy.<br><br>Examples of cases in support:<br>• Keech – found a constructive trust over the lease obtained by fiduciary.<br>• Reid<br>• Other cases<br><br>Examples of cases against:<br>• Tyrell – The Court in this case suggested that if the fiduciary had been paid a bribe to induce the bank to purchase the property (in which the fiduciary had an interest) at excessive prices, the bank could only have recovered damages. There could not be a claim that the bank beneficially owned the money i.e. no constructive trust recognised.<br>• Heiron – denied the existence of a property interest in a bribe.<br>• Lister v Stubbs – Plaintiffs employed the defendant to purchase goods for the firm. The plaintiff received bribes from a company to purchase their goods. The defendant invested the money. Court said there was no proprietary interest in the money. Court said that the consequences of finding a constructive trust were unacceptable. Firstly, would mean that if the agent were to become bankrupt, the unsecured creditors could not claim against that property. Jumping the queue. Secondly, would allow tracing which cannot be right.</td><td>Reid<br><br>The Court had very little legal reasoning.<br><br>It got around precedent issues by overturning leading case of Lister. The Court held that cases such as Lister were inconsistent with well-established equitable principles.<br>• Not consistent with the idea that a fiduciary must not be allowed to benefit from his own breach of duty, that the fiduciary should account for the bribe as soon as he receives it, and that equity regards as done that which ought to be done.<br>• When a bribe is accepted, the property constituting the bribe belongs in law to the recipient. Equity acts in personam and insists that it is unconscionable for the fiduciary to obtain and retain the benefit in breach of the duty. Therefore, the fiduciary must pay and account for the bribe to the person to which the duty was owed.<br>• Equity regards as done what ought to have been done: As soon as the bribe was received, it should have been paid to the principal. Therefore, the agent holds the bribe on constructive trust.<br><br>Also another huge inconsistency. Cases such as Boardman and Keech found that even the innocent fiduciary acting honestly and in good faith who breach their duties by making a profit/COI are liable to account. A constructive trust was imposed in these circumstances.<br><br>It would be inconsistent if an agent who acted dishonestly and criminally accepted a bribe is only liable for equitable compensation. To be consistent, there must also be a constructive trust here.</td></tr>
<tr><td>FHR<br>The Court got around the precedent issue in 2 ways.<br><br>Firstly, the Court watered down the precedential value of the decisions by saying that the decisions are inconsistent over the years:</td></tr>
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| | | • There are conflicting views as to when a proprietary interest is created<br>• Equitably proprietary rights are paradoxical. They are clearly recognised in some cases but not recognised at all in other cases. This is largely due to equity's interrelationship with the Common Law. Equity is more willing that the CL to recognize proprietary rights.<br>• However, CL overrules equity.<br>• Therefore, the cases that have developed have been attempting to mitigate the harshness of the CL and have reached different conclusions as to whether equitable proprietary rights exist in respect of property.<br>• Given the conflicting decisions, this case should not be purely decided based on precedent. It should be founded on policy and principle etc.<br><br>Secondly, Lord Neuberger looked to cases that people have decided are correct.<br>• Holistically, the cases in-fact favoured the recognition of a constructive trust.<br>• There were only a few cases against this proposition.<br>• Those cases were notably *Lister*, *Tyrell* and *Heiron*.<br>• However, these cases were problematic, had very little legal reasoning, and had inconsistent judgments.<br>• Furthermore, these cases are "very difficult to reconcile" with the previous cases such as *Keech* and *Boardman*.<br>• These famous cases are cases which everyone agrees were correctly decided.<br>• Adopting *Lister* etc. would be to hold that those cases were wrongly decided OR recognise that the law is close to incoherent in this area. The Court was unwilling to do this. |

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| Legal/theoretical objections | One of the central theoretical/legal objections is that an institutional constructive trust is recognise or construed based on the actions of the parties and their relationships with one another.<br><br>E.g. in ***Boardman***, a constructive trust was construed over the shares because Boardman was acting on behalf of the trust in a fiduciary capacity.<br><br>Objection: there is a distinction between a profit which a trustee takes out of trust (or takes from an opportunity of being in a fiduciary capacity) and a profit such as a bribe received from a third party.<br>• In these circumstances, the property cannot be said to belong to the principal.<br>• The property was never intended to go to the principal and was not an opportunity to which the principal is beneficially entitled.<br><br>Top lawyers such as Professor Sir Roy Goode and Professor Worthington alive to these issues.<br><br>**Goode Model**<br>Goode saws that no proprietary interests arises unless the benefit either (i) flows from an asset which was (a) beneficially owned by the principal, or (b) intended for the principal, or (ii) was derived from an activity of the agent which, if he chose to undertake it, he was under an equitable duty to undertake it for the principal.<br><br>Recognising a proprietary interest outside of these circumstances results in an involuntary grant from the agent's estate to the Trust. Windfall gain.<br><br>**Worthington Model**<br>Proprietary interests arise where benefits are (i) derived from the principal's property, or (ii) derived from opportunities within the scope if the agent's endeavours on behalf of the principal, but not (iii) benefits derived from opportunities outside the scope of those endeavours. | **Reid and FHR**<br>Both cases deal with the conceptual issues in a similar fashion. However, *FHR* has much clearer legal reasoning than *Reid*. The following points are largely based off the discussion in *FHR*.<br><br>Reasons why the arguments against a constructive trust are wrong:<br>• **Slam dunk authority:** The idea that a constructive trust should not be recognised because the fiduciary could not have acquired the bribe for the trust anyway is doctrinally inconsistent. Cases such as *Keech* and *Boardman* have both recognised a constructive trust in these circumstances. In *Keech*, the beneficiary could never have acquired the lease because the landlord refused and he was an infant. In *Boardman*, the Trust could not have acquired the shares because they were not sanctioned investments by the Court.<br>• **Inconsistent**: bizarre if the principal is better off (gets a proprietary interest) when the fiduciary acts innocently but in breach, but gets only equitable compensation when the fiduciary is criminal or actively dishonest. Theoretically inconsistent to say that a fiduciary must account for benefits received in breach of their fiduciary obligations, but then say that only in some cases is the principal entitled to claim beneficial ownership of the property.<br>• **Strictness**: In *Reid,* the Court commented that *Boardman* reinforced the strict application of the duty of loyalty by imposing a constructive trust. Important to not derogate at all from this incredibly strict duty by not recognising a constructive trust in cases of a clear intentional breach of fiduciary duty of loyalty.<br><br>Other arguments:<br>• Concept that the money was never going to the trust anyway is economically wrong. Where the fiduciary receives a bribe, the principal typically suffers economic harm.<br>• The proposed tests (e.g. Worthington and Goode) are complex and overly nuanced. They do not promote simplicity and clarity.<br><br>Reasons why constructive trust approach is right:<br>• Consistent with the fundamental principles of fiduciary law. A fiduciary owes an absolute duty of undivided loyalty. The principal is entitled to all benefits of the fiduciary's actions within the course of their fiduciary duties, even where the fiduciary exceeds their authority or acts in breach of their duties. The fiduciary's duty is to deliver benefits to the principal, and not merely to pay compensation for the benefits received. The only way to enforce this is by recognising a proprietary interest over the property by way of institutional constructive trust.<br>• *Reid* noted how the above point is highlighted by Lord Millet's extra-judicial writing. The fiduciary must not put themselves in a conflict of interest. If they have done so, equity insists on treating him as having acted in accordance with his duties. Equity will not let the fiduciary say that they were in a conflict of interest. Similarly, equity will not let a fiduciary say that he obtained a benefit for himself. If fiduciaries accept bribes, equity insists that that payment be treated as if it were obtained for the benefit of the principal. |

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<tr>
<td rowspan="2">Policy</td>
<td rowspan="2">Competing policy considerations.<br><br>The consequences of recognising a proprietary interest rather than a personal obligation are significant. How do we balance the competing policy considerations out?<br><br>The key issue is insolvency. Recognising a proprietary remedy enables the fiduciary to jump over unsecured creditors and be in equal position with secured creditors over the property (or in a better position). This is important. If the fiduciary only had a personal claim, there may be no money left to pay out the debts owed. Alternatively, there may be some money, but the fiduciary will only get a share of the residue based on the number of unsecured creditors are leftover.</td>
<td><u>Reid</u><br>Bribery is an evil practice. This is particularly so when bribery is used to divert the course of justice and the administration of justice.<br><br>Bribery can also cause unquantifiable harm to the principal and wider societal interests.<br><br>Court also addressed the unsecured creditors argument. Stated that the unsecured creditors cannot be in a better position than the debtor/principal.</td>
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<tr>
<td><u>FHR</u><br>Considered that bribery is evil:<ul><li>Bribery is evil and this may justify recognising a proprietary interest in the bribe.</li><li>Secret commissions are also objectionable as they undermine certainty in the commercial world.</li><li>Concern about bribery has increased. Bribery is occurring more often.</li><li>Therefore, the law should be very strict on bribes. Justifies constructive trust.</li></ul>Consequence of recognising is a CT is that it prejudices the agent's unsecured creditors if the agent goes insolvent. It reduces the agent's estate as the property didn't belong to him.<br><br>This is not compelling in the bribery context however:<ul><li>The proceeds of the bribe or secret commission is property that was <u>never</u> meant to be in the agent's estate at all. Therefore, the creditors have no right to the money anyway.</li><li>Secondly, the principal has a more justified claim for a proprietary interest to the bribe. Typically, bribes or secret commissions reduce the benefit from the relevant transaction which the principal obtains e.g. coy would have paid extra $10m if it didn't have to pay a $10m bribe. Therefore, the principal has a good basis for a proprietary claim.</li><li>Given this right, the principal should have the ability to trace the bribe if it is transformed into different assets. Only get the full power of tracing rights if a proprietary right is first recognised.</li></ul></td>
</tr>
<tr>
<td>Remedial consequences</td>
<td colspan="2">The remedial consequences of recognising a CT are significant. The consequences were discussed in <u>Reid</u>:<ul><li>As soon as the fiduciary receives the bribe, they hold it on constructive trust for the principal and must account for the full value of the bribe.</li><li>If the bribe consists of property that <u>increases</u> in value or the cash is invested advantageously, the fiduciary cannot be allowed to keep the benefit of the added value. The bribe and its proceeds are held on constructive trust. Therefore, the fiduciary must account for the full benefits.</li><li>If the bribe <u>decreases</u> in value, the fiduciary must pay the difference between the current value and the initial amount of the bribe.</li><li>If the property changes form, the principal has the right to trace the property.</li></ul></td>
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## Certainty of Intention

For a trust to exist, there must be certainty of intention. This typically includes two distinct elements:

1. What do you have to intend? Or what must you not intend?
2. How do you prove intention to create a trust?

It must be shown that the settlor and the trustees intended to create a trust (*Paul v Constance*). This will be proved if it can be shown that they intended to dispose of property so that somebody else, to the exclusion of the settlor, acquires the beneficial interest in it (*Paul v Constance*).

- No specific words are required and, as a result, the inquiry is substance over form (*Paul v Constance*);
- Subsequent conduct can be used as evidence of a prior intention to create a trust. As a result, where somebody conducts themselves in accordance with being a trustee, an intention to create a trust may be inferred (*Paul v Constance*; *Thexton v Thexton*);
- The fact that a settlor does not understand the intricacies of trust law does not preclude an intention to create a trust (*Paul v Constance*);
- A clear intention to make a gift does not, of itself, import an intention to create a trust if that gift fails. Accordingly, a trust should not be used to perfect an imperfect gift (*Jones v Lock*; *Richards v Delbridge*).

### I. Paul v Constance

Facts: The deceased was married for many years. He and his wife separated but never got divorced. The deceased entered a new relationship with the π. The deceased was awarded a settlement for a workplace injury, which he placed in a bank account in his name. When setting up the account, the deceased made it clear that he wanted the π to be able to use money/access account. At various stages, the deceased declared that the money was "as much yours as it is mine." The deceased and the π also played bingo together and put all their winnings in that bank account. Upon death, the lawful wife claimed the account formed part of the deceased's estate. The π claimed it was held on trust for the benefit of her and the deceased.

#### A. What must you intend?

According to **Snell's equity**, you do not need to use words that expressly state that you intend to create a trust. There just needs to be words used that are imperative and that the Court can construes as an intention to create a trust.

You **cannot** attend to transfer property through some other form of transaction. According to the Court in *Richards*: " … if the settlement is intended to be effectuated by one of the modes to which I have referred, the ourt will not give effect to it by applying another of these modes. If it is intended to take effect by transfer, the Court will not hold the intended transfer to operate as a declaration of trust, for then *every imperfect instrument would be made effectual by being converted into a perfect trust.*"

*Jones v Lock* is an example of what you **cannot** intend:

- Husband wrote a cheque out for his son as a gift. Intended to gift the money to the son. But the gift was imperfect as the father didn't do everything necessary to carry out the gift. He needed to endorse the cheque, and talk to his solicitor etc.
- What the husband actually intended was to make a gift.
- The evidence of how the aspects of the gift failed and how the gift was therefore imperfect was evidence of his intention to gift the property.
- As the intention was to gift, the husband cannot have been intended to create a trust.
- Therefore, the Courts refused to recognise an express trust.

Other examples might be where you express a **future** intention rather than a **present** intention.

- This was discussed on the facts of this case. The intention was a present intention.
- If it is expressed as a future intention, this means that the purported settlor still retains legal ownership of the property. Therefore, this cannot be a declaration of trust.
- Instead, it is evidence of a **promise** to transfer the property in the future. This is a contract issue rather than an issue of a trust.

B. How do you prove intention?

On the facts of this case, the Court found that there was an intention to create a trust:

- The deceased stated regularly that the "money is as much yours as it is mine." This was a present statement about the current ownership of the property. Was evidence that the deceased intended to create a trust in which both parties had a beneficial interest in the property.
- Discussion when opening the bank account about how he wanted his wife to have access also supports this conclusion. Demonstrates that the husband intended the wife to have beneficial interest in the account.
- Depositing joint winnings in the account together and withdrawing money for their joint use were all factors that also supported an intention to create a trust.

II. Thexton v Thexton

Facts: David Junior started a company, Rio. When David Senior left his ordinary job it was agreed that he would become an employee of the company and hold a 50% shareholding. However, on taking up the position, David Senior was only allocated a 20% shareholding. David Junior held the rest of the shares and during a merger between Rio and Cerebos Greggs it was agreed that David Senior would step back from the business. David Junior contends that him and his father had reached a binding agreement by which David Senior would sell to him his 20% shareholding in Rio for $250,000. David Junior stated that David Senior agreed to hold the shares on trust for him, signing a trust deed backdated from 1997 to 1988. David Senior died before transferring the legal ownership of the shares so now the Court is attempting to determine who has the beneficial ownership of the 20% stake.

The Court could not find an intention to form a trust. The Court mainly focussed on how to prove that the parties did so intend. Key legal rules here:

- Equity looks for a manifestation of an intention to create a trust. Where there are no words used, the Courts may in exceptional circumstances look to see whether it can infer a declaration of trust from the acts of the parties.

- The acts required are acts that show that a person has constituted themselves as trustee or other acts that demonstrate an "intent to deal with the property so that somebody else to his exclusion acquires the beneficial interest in his property."

A Was there a Trust?

There was no clear intention to create a trust:

- No clear written documentation.
- Furthermore, the shares had not been transferred or any other evidence to show an intention.
- Court suggested that what was actually intended was a promise. The Court said that equity will not assist a volunteer. This is where a person has not provided consideration for a promise.
- Here, the son promised to transfer the shares to the father but he never did. Looks like he intended to promise to transfer. This is a contract rather than an intention to create a trust. No trust therefore.

III. Korda v Australian Executor Trustees

Facts:

The forest and milling companies had gone bankrupt. The bank was acting as receivers and wanted to distribute the assets to pay off the creditors. However, the investors wanted to be paid out. Alleged that there was a trust relationship so that they could have a proprietary remedy and jump over the other creditors.

A. Was there a Trust?

The central issue was whether there was an intention to create a Trust. The Court recognised that there was not a trust deed. However, as per cases such as *Thexton* and *Paul*, this does not prevent a trust from being inferred where there is clear intention.

The Court found that there was no such intention for a number of reasons:

1. **Contractual arrangement**: The Court considered the investors argument. Primary argument was that the contractual arrangements were designed to create a trust structure. The companies were obligated to generate income which was to be paid to AET. AET was therefore entitled to the money as beneficiary of a trust where the companies were trustees.
    a. The Court rejected this approach.
    b. This was in fact a complex multilateral agreement involving a number of different contractual obligations. The parties intended to create a contractual scheme. Therefore, they cannot have intended to create a trust relationship.
2. **Indemnity argument**: The Contract says that the coys owe the money to AET. However, the companies are entitled to take out their costs before paying the moey over to AET. Otherwise, the companies would be losing money.
    a. Court states that this term points away from an intention to create a trust. If this were a Trust, the trustees would have the right to indemnify themselves for any costs incurred. This is automatic. Therefore, the "indemnity" clause in the Contract would be unnecessary.
    b. Furthermore, the indemnity clause was backwards. Under this arrangement, the companies are actually indemnifying AET for the costs incurred. The money that AET would be liable to pay actually comes out of the money that the companies generate.
    c. The companies are in-fact indemnifying the alleged beneficiary of the trust. This doesn't look like an express trust.
    d. To look more like an express trust, AET would have to be indemnifying the companies. This would make the companies look like trustees.
3. **Beneficial ownership argument**: The deal is structured in such a way that the investors are <u>not</u> beneficial owners of the property. This is likely for tax reasons. Tax rates are likely higher if you own the property rather than merely derive an income. If the deal is structured so that the investors do not have beneficial ownership, then this clearly points away from an intention to create a trust.

NB: The Court may have been being particularly strict on these facts as this is a huge complex commercial transaction. Perhaps the threshold is higher. The parties are likely receiving legal advice. Therefore, more of a focus on the words used and the conduct in question. Courts appeared a little more relaxed in <u>*Paul.*</u>

<u>**Certainty of Objects**</u>

A trust will be void if the objects (the beneficiaries) of the trust are uncertain. Why?

- Trustees must be able to know the identity of the beneficiaries under a trust.
- If trustees do not know who the beneficiaries are, they cannot know who to distribute the property to.
- Furthermore, the Court cannot assess whether the Trustee has exercises their powers properly if it is unclear who has a beneficial interest in the trust property. Cannot police trustee conduct.
- The Court must also be able to take over control of the trust if there is a dispute about how the trust is being managed. It cannot do this where there is uncertainty.

The central issue is what level of certainty must there be as to the identity of the class of beneficiaries for the trust to be valid? This largely depends on the nature of the trust and the nature of the power in question.

Hudson suggests this approach to certainty of objects:

1. Identify the nature of the trust or power. It is a fixed trust, discretionary trust, fiduciary mere power, or purely personal power?
2. Apply the certainty test appropriate for the relevant category.
3. Consider the alternative approaches that may be used if the result is particularly unfair.
4. [See if I need this one].

Geoff said you need to analogise to decided categories e.g. "friends" (*Baden*) and "dependents".

A. Fixed Trust

A fixed trust occurs where the property is held for a fixed number of identified beneficiaries. E.g. "$10,000 is to be held upon trust equally for the complete team of 15 All Blacks who started the World Cup game at Eden Park in the 2012 NZ World Cup."

This is a "fixed" trust because it is only possible to divide the property 'equally' if you know the exact number of people between whom the property is to be divided.

**Test**: It is necessary for the trustees to be able to compile a complete list of the beneficiaries, as required by *IRC v Broadway Cottages* and by dicta of Lord Upjohn in *Re Gulbenkian*.

- Trustee must be able to compile a complete list by (1) naming each possible beneficiary, or (2) identifying all of the members of the appropriate class.
- If there is any uncertainty regarding who is in the class or the list cannot be compiled, the trust will be void for uncertainty.

B. Discretionary Trusts

A discretionary trust *requires* the trustees to exercise their discretion and carry out the power. This is different to a fiduciary mere power, which enables (but does not require) the trustee to carry out their trust obligations.

Example: "Timothy (trustee) **shall** divide the $1000 between any of my sons who become unemployed and whom he considers to be in difficulty."

This is a discretionary trust. The trustee must divide the property. But the trustee is given some discretion to decide whether or not the sons are in difficulty or not.

**Test**: The leading case here is *McPhail v Doulton* (HoL). The HoL adopted the test from *Re Gulbenkian* for discretionary trusts: this is the "is or is not" test. This is therefore the same test as for powers.

The trustees/fiduciary power holders must be able to decide whether any hypothetical beneficiary is or is not within the class of objects. If there is even one person in relation to whom the trustees cannot decide whether or not she falls within the class of objects, then the trust is invalid. The test is still therefore strict. ← Re Baden (no 2) mitigates the harshness of this below.

Whether the trust is invalid will depend on whether there is any conceptual certainty as to what the terms of the trust mean.

- E.g. "$10,000 for any of my good friends."
- This has significant conceptual uncertainty. Even if the trustees can distinguish "friends" from "acquaintances", it is difficult for them to ascertain what a "good" friend is.

The term in the trust deed in *McPhail* was: payments were to be made in favour of "employees, ex-officers or ex-employees of the Company or any relatives or dependents of any such person." The uncertainty surrounded "relatives and dependents". The House of Lords found that "relatives" could be rendered conceptually certain if it was interpreted to mean "descendants of a common ancestor."

**Re Baden (no 2) mitigates with less harsh test**
*McPhail* test is still harsh. If any hypothetical claimant cannot be determined it will invalidate the trust. *Re Baden* recognised that there were 2 things that needed to be ascertained: conceptual and factual certainty. A trust that has sufficient conceptual certainty shouldn't be invalidated because one hypothetical postulant cannot be decided whether they fit into the class of objects or not.

Instead:

- After ascertaining the category, there may still be factual uncertainty as to whether a beneficiary fits within the class of objects.
- The Court stated that: "Once the class of persons to be benefited is conceptually certain, it then becomes a question of fact to be determined on evidence whether any postulant has on inquiry been proved to be within it; if he is not so proved, then he is not in it…"
- Thus, the burden/onus is placed on the postulant to prove they fall within the conceptual class. If they cannot, they are deemed not to factually fall within the class.
- This approach ensures that more trusts are likely to be validated.
- Trusts will still be invalidated where the conceptual category is not sufficiently certain however.

Statement of the law from Baden: The test for determining certainty of object in respect of both mere powers and trust powers is that for a valid trust to exist it must be able to be said with certainty that any given individual is or is not a member of the class. This test requires the class of persons benefitted to be conceptually certain however not factually certain; it becomes a question of fact to be determined on evidence whether any postulant has been proved to be within the class. As a result, it is not necessary to prove that any given individual is not in the relevant class.

**Justification for the two approaches**
"Thus far we have seen that there are a number of cases which appear to be in conflict. In short, the principal dispute on the cases is as follows. The leading cases, such as Gulbenkian and McPhail v Doulton , are concerned that the beneficiaries can only control the trustees by applying to the courts for a declaration as or not power has been exercised properly. The court can only know whether or not power has been exercised properly if the terms of the trust or power are sufficiently certain for the purposes of that type of trust or power.

By contrast, judges like Lord Denning, Browne-Wilkinson J in Re Barlow and the judges in Re Baden (No 2) have taken the view that one should seek to uphold testamentary bequests wherever possible if, on the facts of the particular case, it is possible to know that there are some people who will definitely fall within the class of beneficiaries, even if there are also some people about whom one might not be sure. The motivation behind this second line of authority is to ensure that the testator's wishes are given effect to so far as possible and to ensure that people who were clearly intended to take a benefit from the power or trust should not be denied property because the power or trust is poorly drafted." – Hudson on Equity

C. Mere fiduciary powers

These also follow the is or is not test.

A mere fiduciary power is a power granted to a fiduciary which gives the power holder the ability to exercise the power, but imposes no obligation upon them to do so.

D. Examples of categories

<table>
<tr><td>Friends</td><td>In Re Gulbenkian Lord Upjohn simply accepted, without discussion, that the word 'friends' was an axiomatic example of something that would be uncertain. Other Courts have stated that term "friend" has almost infinite shades of meaning.<br><br>What about adding qualifiers like "old" friend?<br>• Cases such as <u>Brown v Gould</u> have held that the terms "old friend" or "dead friend" are too conceptually uncertainty for a trust to be valid.<br>• However, it is arguable that qualifiers like this make the class of beneficiaries conceptually more certain.<br>• "Old" narrows down the potential class of beneficiaries.<br>• Conversely, it may just compound the confusion. How do you measure "old"? Is it by the longevity of the relationship? If so, what is the qualifying period? Or is it by the age of the friend in question?</td></tr>
<tr><td>Customers</td><td>Case of <u>Sparfax v Dommett</u> struck this down as being invalid. Theoretically, it was possible to draw up a list of customers based on purchases and receipts etc.<br><br>However, conceptually the term customers is uncertain. Is it restricted solely to people who have made purchases? Or does it extend to include people who visit the shop? If these aspects are unclear, and not clarified in the trust deed, then there is too much conceptual uncertainty.</td></tr>
<tr><td>Relatives</td><td>This has been found to be sufficiently conceptually certain in <u>McPhail</u>. Although even that was ambiguous. The Court defined it as "descendants of a common ancestor."<br><br>Other Courts have decided it can be rendered conceptually certain by drawing the line at those relationships used in statute to regulate dying intestate. Or can be confined to next of kin etc.</td></tr>
<tr><td>Residents</td><td>This was from class.<br><br>This can be very uncertain. E.g. "Residents of Wellington."</td></tr>
</table>

| | |
|---|---|
| | • Is this just Wellington City or is it also Greater Wellington?<br>• What about dual identity. What if you live out of Wellington but you work in Wellington. Are you a resident?<br>• What does "reside" mean. Do you have to live there? How long do you have to live there for? |

## Certainty of Subject Matter

Certainty of subject matter is required so that trustees know which property is subject to the trust.

I. Orthodox/strict position

**Orthodox position**: The property that is intended to constitute the trust fund must be segregated from all other property so that the property held on trust is clearly identifiable. Without the property being clearly identifiable, it is impossible for the trustees or the Court to administer the Trust. The Trust will be void for uncertainty.
E.g. the settlor intends to create a Trust over 3 of his 12 vintage race cars. Here, the settlor has failed to identify the property with sufficient certainty. The trust would be void.

A. Re Goldcorp

Facts:

- Exchange said that it would buy and store gold on a non-allocated basis for its customers. The customers paid a price and were given a certificate which stated that they were the owners of a certain amount of gold stored on their behalf by Exchange. It is clear from all correspondence that the gold was to be kept in a mass, on a non-allocated basis.
- Exchange held the bullion in a mass, however, it did not hold enough to satisfy all of its customers' claims. BNZ appointed receivers to Exchange, crystallizing its floating charge over Exchange's assets, including the bullion.
- At this point, the customers were unsecured creditors. BNZ's debt was more than all of Exchange's assets and so unsecured creditors stood to gain nothing in Exchange's liquidation. The customers claim that they have proprietary interests in (a) the bullion (b) the purchase money paid and (c) the general assets of Exchange, thereby taking priority over BNZ's debenture.

No legal title passed to the purchasers on paying for the gold. This is because under the Sale of Goods Act 1908 (and now the CCLA at s 143), title to goods does not pass to property that is not ascertained. As the gold was not allocated, the goods were not ascertained and the parties had no proprietary interest. This is why the parties alleged the gold was held on trust.

The PC held that there was <u>not</u> a Trust over the gold:

- The Court stated that a Trust could be established over ex-bulk goods. This is where the goods are to be supplied from a "fixed and pre-determined source, from within which the seller may make his own choice but outside which he may not go. For example, 'I sell you 60 of the 100 sheep now on my farm.'"

- *Goldcorp* was not this kind of case however. Declaring a trust over the entirety of its gold stock would have inhibited any dealings with it otherwise than for the purpose of delivery under the non-allocated sales contracts. Furthermore, a customer cannot have intended their rights to be rights in a fund of gold, and for the value of their interest to be determined by the total stock of gold remaining and the number of other investors in the stock of gold. This cannot be the transaction.
- Here, the goods were "generic goods." This is where the seller retains the freedom to decide how and from what source to obtain the goods to meet the contract. The goods were non-allocated and the property was not segregated. Therefore, there was no identifiable property over which the trust could be established.
- The Privy Council focuses on the fundamental principles of equity, viewing the customers' claims as an attempt to better their position as unsecured creditors. The Court declined to employ instrumentalism, denying a trust over the bulletin, on the basis that there was no identifiable trust property.
- The Court also wanted to emphasise commercial certainty.

B. Intangible vs tangible distinction?

Following *Re Goldcorp*, the English Court of Appeal decided the case of Hunter v Moss.

Facts: The case concerned a trust over 50 shares. The 'settlor' had 950 shares total and allegedly declared a trust over 50 of those shares. However, the shares were not segregated from the wider pool of shares.

Following the strict *RE Goldcorp* approach, this trust should fail for lack of certainty of subject matter.

However, the Court found that there was nevertheless a trust.
- Firstly, the cases of *London Wines* and *Goldcorp* could be distinguished because those cases turned on property law concepts of when title to goods passed.
- Secondly, the judge suggested that there was no tangible distinction between the shares and so there was no need to physically segregate the shares in order to have certainty of subject matter.

**Potential distinction**: This case sparked a potential distinction between tangible and intangible property with a concomitant focus on whether the assets were fungible/homogenous or not. Commentators have suggested that where there is no difference between the goods in question, there can be certainty without segregation.

This distinction cannot be entirely correct however. The goods in *Goldcorp* were also fungible.

C. White v Shortall

Facts: A trust was allegedly declared over shares, but the shares were not segregated.

The Court found that there was a valid trust, but rejected the reasoning from *Hunter v Moss*:
- Court rejected the distinction between tangible and intangible goods. Thought this distinction was not valid and was not the rationale underlying *Hunter*.

- Instead, the Court adopted an approach (similar to *Goldcorp* obiter) where a trust was found to exist over all of the shares. The beneficiary was therefore entitled to a share of the trust fund of shares.
- The particular share did not need to be allocated. Certainty of subject matter was achieved merely by creating a trust over the entirety of the shares. It is up to the trustees to divide the property. There is an equitable tenancy in common. The settlor shares the shares with the beneficiaries.

The Court also discusses the *London Wines* case, which represents the orthodox view:

- Here, there was no allocation of the particular wine sold to each particular person. Or wines sold wee not segregated to represent the trust for the beneficiaries who purchased the wines.

**Legal outcome**: A trust can be held to be valid if the settlor intended to create one, single trust over all of the 1.5 million shares such that the trustees would hold 222,000 of those shares on trust for one beneficiary and the remaining shares on trust for the other beneficiary. As with an ordinary trust which has two or more beneficiaries, the trustees would have a power to decide which precise property is held for which beneficiary. The principle of certainty of subject matter only requires that the entirety of the trust fund is segregated from other property outside the trust: it does not require formal segregation within the trust fund because that is a task to be performed by the trustees.

D. Wakatu

Facts: Arose from Nelson. Nelson was a NZ company settlement. One of the Wakefields' plans was to preserve a certain portion of the land for the benefit of the people they bought the land off. Often this was Maori. Created the 10th Trust: 1/10th of the land set aside for Maori beneficial use. Crown did not honour this obligation.

Problem with certainty of subject matter:

- The property that was purportedly subject to a trust was never allocated. According to orthodox English trust law, the land is not fungible. The particular land in question matters. Land has different value etc.
- Crown had not allocated the particular land that was subject to trust. Merely a promise to allocate.
- Per *Goldcorp* and *London Wines*, there is no certainty of subject matter.

The CJ discussed these cases:

- In relation to *London Wines*, she stated that Oliver J considered that there could be a trust if it was a share/proportion of an entire stock of a particular vintage of wine. However there was no evidence of an intention to create this form of trust.
- Oliver J used example of a farmer who declares himself a trustee of 1 of 2 sheep without identifying which sheep is property of trust. No trust.
- Conclusion would be different if the farmer declared trust over a specified portion of a wider flock of sheep. If the pool of assets is clearly ascertainable, there can be a trust in these circumstances.
- CJ said that this case stands for the idea that there can be a trust where there is a pool of **undifferentiated** goods.
- Similar finding for *Goldcorp*

Reasoning in this case:

- The CJ said this case is different. There are pre-existing fiduciary obligations which distinguishes this case from the other cases. ← This shouldn't matter though. Firstly, have to be careful when calling Maori people part of a fiduciary relationship. This implies that they are vulnerable. According to historians like David Williams, this involves forcing modern legal concepts back in time = "presentism". Ironic because this law has been used to deny Maori land rights for years. Secondly, justyfing just on the basis that Crown are fiduciaries for Maori when other criteria for trusts aren't satisfied is instrumentalism.
- Furthermore, this is more of a case of ex-bulk goods. There is a specified proportion of land reserved for Maori out of a wider ascertained area of land. There is an agreed system of selection of land and the selection is made from within a defined geographic area. There is also sufficient land to fulfil the 1/10$^{th}$ obligation.
- There is a clear "fixed and predetermined source" per *Goldcorp*.
- Furthermore, there is no issue of inhibiting the Crown from dealing in the land per *Goldcorp*. This was the intention of the arrangement – preserve land for Maori.
- Finally, the CJ suggested that where there were clear fiduciary obligations, and a clear intention to reserve the land for Maori on trust AND a system for doing so, equity cannot countenance the trust failing for lack of certainty of subject matter. ← This suggests an approach whereby the CJ finds a clear and strong intention, and so is less concerned about no clear allocated property.

Discussion/issues:

- Elias CJ tries to say the distinction is not between tangible and intangible, but actually between tangible/intangible and REAL property. However, this distinction is not tenable. Land is not fungible. We would expect there to be a clear allocation of the land that is said to be subject to Trust.
- **Geoff** thinks the best distinction is that there was a system in place for determining what property was subject to trust. A set of rules was established.
- **Commentators** argued that there should be a trust system with reference to ideas of Tikanga. However, this argument cannot stand. We need clear certainty of property interests that are decided based on clear rules.
- **Furthermore,** Maori have chosen to bring their claim within the private law system in order to obtain the private law remedial consequences. If they choose to do this, then the private law will apply to them. Claims based on the honour of the Crown with reference to Tikanga will not prevail.
- **Threshold**: CJ seems to adopt an approach where she lowers the threshold for certainty because there is a clear intention to form a trust. However, this argument confronts the three certainties. All 3 certainties must be clearly established so that we have certainty of trust law.

**Duty to inform/Right to information**

The right to request trust information is central to the proper administration of the trust. Beneficiaries have the right to be able to hold trustees accountable for their performance/management of the trust. However, they cannot do this if they have no information about how the trust is run, or even that the trust exists in the first place.

The right to information is very contentious:

- If there is no requirement of providing information (or the right is very narrow), then the beneficiaries cannot effectively hold trustees accountable. There should be sufficient information that enables the beneficiaries to hold trustees accountable.
- If the requirement is very broad, then there are a number of consequences.
    - Firstly, settlor's sometimes intentionally want the existence of the trust or the beneficiary statuses to be kept secret. This might be to ensure that children/family/others don't rely on the assets held on trust.
    - Secondly, certain family members might not be informed of their beneficiary status because they may be overly litigious.
    - Thirdly, family members (e.g. black sheep) are only entitled to a very small amount of property. Providing information may cause these people to litigate or challenge the exercise of trustee discretion.
    - Fourthly, if trustees have to provide information to <u>every</u> beneficiary, even those beneficiaries who are unlikely to receive any property (such as nominal beneficiaries), then the trustee duties are onerous.

A. Traditional English Approach

Traditionally, English law held: "[A beneficiary] is entitled to see all trust documents because they are trust documents and he is a beneficiary. They are in a sense his own. Action or no action, he is entitled to access them … A proprietary right is a right to access documents which are your own."

Therefore, where there was a fixed trust, the traditional English approach stated that the beneficiaries had a proprietary right to information about the trust management.

This approach is not useful in NZ law due to the more popular use of discretionary trusts.

Furthermore, it has since been changed.

B. <u>*Schmidt v Rosewood*</u>

The Privy Council in <u>*Rosewood*</u> adopted an alternative approach regarding access to trust documents and the scope of the beneficiaries' rights to information.

- The right to access information is not a proprietary interest.
- The right to access is instead based on the Court's inherent jurisdiction to assume control of a trust and to supervise the actions of trustees. The Court can order access to information wherever it thinks it is appropriate to do so. Exercise of discretion.
- Supervisory jurisdiction of the Courts emphasised
- **Important dicta from <u>*Rosewood*</u>:** There must be sufficient information granted to beneficiaries to enable the trust to be enforced. Information should go to the beneficiaries who are likely to receive property from the Trust.

C. *Erceg*

Facts: Michael Erceg settled a family trust. There were a number of classes of beneficiaries. Brother Ivan was a beneficiary – but not a named beneficiary. Merely a discretionary beneficiary. Had an acrimonious relationship with this family and was particularly litigious. Ivan did not get any property when the trust wound up. Sought access to documents of trust management in order to create a basis for arguing for distribution of trust property etc.

**What jurisdiction does the Court have**?
The NZSC concluded that the Court's jurisdiction is not merely limited to reviewing the decisions made by trustees. Instead, the Court has full jurisdiction as a court of equity and may exercise its own judgment as to whether disclosure should be made, and to what extent disclosure should be made e.g. conditions etc.

**Approach to disclosure**
The NZSC stated that this jurisdiction is not the exercise of a discretion. More correctly, it is a jurisdiction that must be exercised in accordance with principle after weighing up the factors either way.

Approach:

- Starting point is the obligation on trustees to "administer the trust in accordance with the trust deed and the duty to account to beneficiaries." There is an **expectation** that beneficiaries be able to access trust documentation in order to assess whether the trustee has acted in accordance with the trust deed. This right is ancillary to the right to have the trust properly managed.
- The Court will look to the multiple balancing factors identified in *Foreman* to assess whether disclosure will be made.
- Circumstances will be assessed in the round. Have to consider whether disclosure will harm the wider class(es) of beneficiaries.
- The Court identified the following balancing factors:
  - The documents sought – evaluate documents separately
  - Context for the request and the objective of the beneficiary making the request – compelling case for disclosure if required to properly assess trust administration. May be relevant that disclosure made to other Bs.
  - Nature of interests held by Bs seeking access – Degree of proximity to trust or likelihood they will receive property.
  - Confidentiality
  - Practical difficulty in providing information
  - Do the documents disclose the reasons for trustee decision? This will not normally be disclosed.
  - Likely impact of disclosure on other Bs – net impact on Bs. Would it embitter family relationships? Litigious?
  - Impact on settlor and third parties
  - Can disclosure be made whilst also protecting confidentiality?
  - Safeguards can be imposed on the use of trust documentation? E.g. inspection by professionals?

**Resolution of case**

The NZSC did not allow disclosure. This was due to the particularly vexatious and litigious nature of the applicant. Also, it was unlikely that the claimant was ever going to benefit from the trust.

D. Trust Bill

The Law Commission's initial proposal was that beneficiaries should have the right to access trust information. However, this was strongly rejected in consultation because:
- Infringed the freedom of settlors to establish their trusts as they wish
- Lacked due regard for family dynamics. Most trusts are family trusts. Settlors often concerned about the effect of telling their children about substantial entitlements to trust property.
- Family concerns, such as in *Erceg*. Worry about litigious family members. These family members may disrupt the operation of the family trust and disrupt the way in which the settlor intends to dispose of his/her property.

Commission's revised proposal was as follows:
- **First**: Enacted the dicta from *Rosewood.* Requirement that enough information be given to allow the Bs to enforce the trust. Idea that should only give information to the Bs that were likely to receive the property.
- **Second:** Presumption of transparency for requests made to the trustees for information. Presumption similar to OIA – disclosure unless good reason to withhold. This was effected by:
  - Requirement of initial disclosure to beneficiaries – let them know that they are beneficiaries of a trust.
  - Some degree of continuing disclosure to some beneficiaries.
- However, people were confused about this approach. Confused about the relationship between the supervening *Rosewood* obligation and the 2 subsidiary obligations.

Trust Bill approach:

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| Clause 47 | Creates a presumption that a trustee must make available to every beneficiary the basic trust information:<br>• The fact that a person is a beneficiary<br>• The name and contact details of the trustee<br>• Information about the appointment, removal and retirement of trustees<br>• Information about the right of the Bs to request access to trust info<br><br>However, this presumption is subject to cl 49. The trustee must consider the factors set out in cl 49. Where the trustee reasonably considers that the information should not be made available to every beneficiary:<br>• The presumption does not apply; and<br>• The trustee may decide whether to withhold some or all of the basic information from beneficiaries |
| Clause 48 | Creates a presumption that a trustee (within reasonable time) must give a beneficiary trust information that they have requested = Transparency. |

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| | However, presumption is subject to cl 49. If factors made out, trustee can refuse the request. |
| Clause 49 | The trustee must consider the following factors:<br>(a) the nature of the interests in the trust held by the beneficiary and the other beneficiaries of the trust, including the degree and extent of the beneficiary's interest in the trust and the likelihood of the beneficiary receiving trust property in the future:<br>(b) whether the information is subject to personal or commercial confidentiality:<br>(c) the expectations and intentions of the settlor at the time of the creation of the trust (if known) as to whether the beneficiaries as a whole and the beneficiary in particular would be given information:<br>(d) the age and circumstances of the beneficiary:<br>(e) the age and circumstances of the other beneficiaries of the trust:<br>(f) the effect on the beneficiary of giving the information:<br>(g) the effect on the trustees, other beneficiaries of the trust, and third parties of giving the information:<br>(h) in the case of a family trust, the effect of giving the information on—<br>(i) relationships within the family:<br>(ii) the relationship between the trustees and some or all of the beneficiaries to the detriment of the beneficiaries as a whole:<br>(i) in a trust that has a large number of beneficiaries or unascertainable beneficiaries, the practicality of giving information to all beneficiaries or all members of a class of beneficiaries: **Relevant for Maori settlement trusts where there are a huge number of beneficiaries often.**<br>(j) the practicality of imposing restrictions and other safeguards on the use of the information (for example, by way of an undertaking, or restricting who may inspect the documents):<br>(k) the practicality of giving some or all of the information to the beneficiary in redacted form:<br>(l) if a beneficiary has requested information, the nature and context of the request:<br>(m) any other factor that the trustee reasonably considers is relevant to determining whether the presumption applies. |
| Clause 50 | Clause 50 was introduced because of the potential situation where, after applying cl 49, the Trustees decide that no one should receive trust information. This cannot be left to stand unchecked – otherwise, this may infringe the *Rosewood* conception as there is not enough information to allow the trust to be enforced by Bs.<br><br>Where the trustees make a decision that has the effect that no Bs have information. The trustees must apply to the Court to "mark" their work.<br><br>**Lacuna: Mark Bennet figured out that to get out of cl 50, the settlor can make themselves a B. Then the trustee can provide the settlor with trust information and discharge their obligations.** |
| Clause 118 | Originally, the LawCom agreed with the *Erceg* NZSC approach.<br><br>However, submitters argued that settlors give their property to trustees because they trust their decision making, their judgment and their independence. It is wrong to let judges interfere with these decisions unless they are manifestly wrong. |

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| | Therefore, the Court can only review acts, omissions, or decisions on the basis that it was not reasonably open to the trustee in the circumstances. This is very similar to *Wednesbury* unreasonableness. If the decision is *so* unreasonable, that the trustee cannot be said to be making a true exercise of their discretion. |
| Submissions | ADLS opposes and says these provisions shouldn't apply retrospectively. Infringes on freedom of K:<br>• However, *Erceg* stated that there was *already* an "expectation" in law that information be released. The Bill merely recognises this.<br>• Furthermore, cl 49(c) includes a requirement that the trustee considers the settlors intention and the terms of the trust deed. Has a provision to protect freedom of K/settlor autonomy.<br><br>Issue of family dynamics; children suing parents etc.<br>• This is provided for in cl 49 which requires looking at family relationships etc |

**Self-dealing**

The duty of loyalty is a fundamental duty owed by trustees that has been suggested to form the irreducible core of trustee obligations. This duty contains a prohibition on trustees from having conflicts of interest, giving rise to the self-dealing and account of profits rules, together forming the no conflict rule (*Fenwick v Naera*).

Under the self-dealing rule, if a trustee votes or participates in discussion on a transaction that they are interested in, the transaction is voidable by any beneficiary, however fair the transaction (*Fenwick v Naera*). For a trustee to be interested in a transaction, there must be a real sensible possibility of a conflict, objectively assessed, not just a remote, speculative, or negligible risk (*Fenwick v Naera*).

- A conflict arises and a duty is breached, even if the conflicted trustee's vote is not decisive of the outcome (*Fenwick v Naera*);
- This rule does not only apply to purchases of trust property (*Fenwick v Naera*);
- There may be a general limited interest exception, in that the rule does not apply to transactions where the trustee has a mere minority shareholding or beneficial interest in the counterparty, unless the trustee is also a director or trustee of the counterparty; (*Fenwick v Naera*);
- There may be an exception for trustees placed in the position of conflict, in that the rule does not apply where the trustee has been placed in the position expressly or by necessary implication by the settlor or the terms of the trust (*Fenwick v Naera*).

Under the account of profits rule, unless excluded by the trust deed, a trustee is not allowed to retain a benefit acquired or profit made by them from the use of trust property, or in the course of and by virtue of their trusteeship (*Fenwick v Naera*).

Liability for the breach of the no conflict rule is generally strict. It is usually no defence to show that a transaction was fair or that an unauthorised profit was made honestly (*Fenwick v Naera*).

I. *Fenwick v Naera*

Facts: The trustees of the Tiketere Trust unanimously voted in favour of entering a joint venture agreement with the Paehinahina Mourea Trust and the Manupirua Aha Whenua Trust. Mrs Fenwick, a trustee of Tiketere Trust, was also a trustee of the Paehinahina trust, of which she held 5% of the shares. A number of beneficiaries of the Tiketere Trust allege that Mrs Fenwick taking part in the vote gave rise to a conflict of interest.

**NZSC Decision**

The Court held that Fenwick was in a conflict of interest. The Court determined that this conflict was a breach of trust because all trustees participating in decision making must bring to bear a mind unclouded by any contrary interest. Therefore, a conflict arises and a duty is breached, even if the conflicted trustee's vote is not decisive of the outcome.

The Court then considered whether the self-dealing rule applies. It concluded that it does, because:

- It doesn't only apply to purchases:
  - No authority supports this contention and, in fact, it has been applied in circumstances other than sales. The self-dealing rule is based on the no-conflict rule: having an interest or duty on both sides of a transaction.
- There is probably not a limited interest exception to the self-dealing rule and, even if there was, it wouldn't apply:
  - A general limited interest exception would hold that the self-dealing rule, allowing a beneficiary to set aside a transaction, does not apply where a trustee deals with a company or trust in which the trustee is a mere minority shareholder or has only a limited beneficial interest, unless the trustee is also a director or trustee of the counterparty;
  - It is unlikely that such an exception exists. The authority cited does not support it and others doubt it. That said, it is not necessary to reach a conclusion because on the facts of the present case it wouldn't apply:
    - The limited interest exception does not apply where the trustee is a director or trustee of the counterparty. In the present case, Mrs Fenwick was a trustee of the Paehinahina Trust, excluding the limited interest exception;
    - The limited interest exception does not apply where the trustee has more than a limited interest in the counterparty. In the present case, Mrs Fenwick had a 5% beneficial ownership of the Paehinahina Trust, clearly not a limited interest.
    - **Fenwick would have been fine if the deed allowed the trustees to be in a conflicted position/self-deal. No liability. Can modify duties**.
- There may be an exception for trustees who have been placed in the position of conflict, however it doesn't apply:
  - It was submitted that the self-dealing rule does not apply where the trustee has not placed him or herself in a position of conflict of interest and duty, but has

been placed in the position expressly or by necessary implication by the settlor or the terms of the trust;
  - Despite many Maori being trustees of a number of trusts, it cannot be said that the Te Ture Whenua Act places them in a conflict of interest as it does not require cooperation between trusts. ← This was the argument made about the special Maori context at stake.

Given the special Maori context, the NZSC directed the MLC to consider certain factors to decide whether rescission was the appropriate remedy. Court had to look at the Taonga nature of the land in question, whether there were any cultural factors that might point away from rescission, the potential intergenerational value of the land to Maori beneficiaries of the trust etc.

II. Trust Bill Approach

Under the current Trust Bill approach, the case would likely be decided the same way.

| Clauses 22–26 | These set out the mandatory duties owed by trustees. These duties are non-excludable.<br><br>Without these duties, it is likely that the Trust does not meet the irreducible core of obligations articulated in *Armitage v Nurse* (although the duties at the irreducible core are expanded by the Trust Bill.<br><br>Mandatory duties:<br>• Clause 22 – Know the terms of the trust<br>• Clause 23 – Act in accordance with the terms of the trust<br>• Clause 24 – Act honestly and in good faith<br>• Clause 25 – Act for the benefit of the beneficiaries or to further a permitted purpose of the trust<br>• Clause 26 – Duty to exercise powers for a proper purpose |
|---|---|
| Clauses 27–36 | Default duties that can be modified or excluded.<br>• Clause 27 – General duty of care<br>• Clause 28 – Invest prudently<br>• Clause 29 – Duty not to exercise power for own benefit<br>• Clause 30 – Duty to consider exercise of power<br>• Clause 31 – Not to bind or commit trustees to future exercise of discretion<br>• Clause 32 – Avoid conflict of interest<br>• Clause 33 – Duty of impartiality<br>• Clause 34 – Duty not to profit<br>• Clause 35 – Duty to act for no reward<br>• Clause 36 – Duty to act unanimously |
| Clauses 37–40 | Clauses 37 – "The terms of a trust must not limit or exclude a trustee's liability for any breach of trust arising from the trustee's dishonesty, wilful misconduct, or gross negligence." |

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| | Clause 38 – "The terms of a trust must not give a trustee any indemnity against the trust property for liability for any breach of trust arising from the trustee's dishonesty, wilful misconduct, or gross negligence."<br><br>Clause 39 – "A clause in the terms of a trust is invalid to the extent that it purports to have the effect prohibited by section 37 or 38."<br><br>Clause 40 – Paid advisor must alert settlor to liability exclusion or indemnity clauses. Otherwise, the clause may not have effect. |
| Discussion | *Fenwick* could be decided differently under the Trust bill if the duty to avoid COI and the duty not to profit were excluded. This might enable the trustee to self-deal without breaching their obligations.<br><br>However, there is a potential complex interrelationship with the mandatory duties:<br>• The mandatory and default duties overlap<br>• At some point, the conduct of the trustee may be so severe/egregious that, regardless of the exclusion of default duties, it breaches a mandatory duty such as the duty of good faith.<br>• Key interrelationship: duty of good faith and default duties of avoiding a COI and profit duty.<br>• You can potentially still breach a mandatory duty therefore.<br><br>**Conceptual problem**: The Court in *Fenwick* conceptualises the self-dealing rule as a part of the no-profit/no conflict of interest rule, which is a part of the fundamental fiduciary obligation of loyalty. Bizarre that you can exclude the duty to not be in a conflict of interest and the duty not to profit. Effectively, this undermines the duty of loyalty by excluding or extensively modifying 2 of its pillars. |

## Investment

Previously, the CL gave no power to invest. The power needed to be conferred in the trust deed. However, the Trustee Act 1956 amended this position and granted trustees the power to invest. This is also effected by **Clause 54** of the Trust Bill.

I. Re Mulligan

Facts:

- The action was a challenge of the trustees' performance of the trust over 40 years.
- The central allegation is that the trustees took no steps to protect the trust capital from being eroded by inflation. The real value of the capital was grossly eroded. This amounted to a claim in BOT.
- Testator farmed a property. Property sold 16 years after his death. After legacy payment made to the widow, $108,000 was leftover. This was equivalent to $1.3m in 1998. Would have been able to buy 14 houses.

- BM, had a life interest in the estate and was also a trustee of it, alongside PGG Trust Ltd. The plaintiffs are residual beneficiaries of the estate.
- From 1969 until 1990 the estate was invested in fixed-interest investments - local body stock and first mortgages. BM was adamantly opposed to investing in equities. During the course of the trust, rampant inflation meant that interest returns were maximised, but cash assets were degraded over time.
- BM received a comfortable income as a result. In 1990, on BM's death, the capital in the estate stood at $102,000. Buying power = could only buy 1 house.

Claim by the beneficiaries against the trustees:

- The residual beneficiaries are aggrieved that the capital in the estate was allowed to significantly depreciate as a result of inflation. They allege that the trustee, PGG Trust Ltd, was not even-handed in his management, favouring the interests of BM as life tenant rather than those of the residuary beneficiaries.
- The contention is that investment in fixed-interest securities allowed maximum income, at a drastic cost to the maintenance of the real value of the capital. They argued that the trustees should have invested into a balanced portfolio approach to counter inflation.
- The trustees (who were accountants, and made trustees for that purpose) admitted that they would have taken such an approach but for BM's opposition to balancing the folio.

A. Trustee duties

Three general principles in this case:

1. Trustees under a duty to act with due diligence and prudence in the discharge of their duties.
    a. In *Re Speight* the court said trustee conduct must be to conduct trust business in the same manner as an orginary prudent man of business.
    b. Case of *Re Whiteley* stated that the duty is to take such care as an ordinary prudent man would take if he were minded to make an investment for the benefit of other people for whom he felt morally bound to provide.
    c. Duty may be higher for professionals.
    d. **Conversely: Brooke's class notes state that trustee have duties of diligence, care and skill. This is the duty to take reasonable care. This is only a standard of justifiability and not of prudence.**
    e. **Section 13B OF Trustee Act – Duty of trustee to invest prudently:**
        i. Subject to sections 13C and 13D, 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.
2. Trustees are subject to a duty of impartiality. Trustees must maintain a strict balance between the interests of the life tenant and the interests of the residual beneficiaries. Trustees therefore must be even handed as between income and capital beneficiaries.
3. Trustees have individual duty to ensure compliance with the terms of the trust. Trustees cannot delegate duties or powers, even to co-trustees. It is not open for a trustee to defer to the wishes of another trustee, especially where one trustee is under a potential COI as they are also a beneficiary.

Factual conclusions:

- The trustees were in breach of trust for failing to invest part of the estate capital in equities. The Court said to invest "prudently", the trustees should have invested in this way. This would protect the trust assets from erosion due to inflation. It was also a breach of the duty of impartiality because the trustees were unduly favouring Mulligan over the other capital beneficiaries. A portfolio investment approach was required to ensure no breach.
- PGG was not entitled to defer to Mulligan's wishes. Should have attempted to convince her or apply to the Court for directions.

II. Law Commission Approach

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| Clause 52 | Previously, trustees have only the powers or obligations granted to them by the settlor under the trust deed (except for the power to invest under the Trustee Act).<br><br>Clause 52 of the Bill grants trustees all powers necessary to manage the trust property including all the powers of an absolute owner of the property. |
| Clause 28 | Places a duty on trustees to invest prudently. This is a higher standard than reasonableness. It requires a smart decision.<br><br>Also requires that the assessment takes into account any special knowledge or experience that the trustee has, and whether that trustee ought to have certain skill or knowledge because they are a professional trustee. |
| Clause 33 | (1) A trustee must act impartially in relation to the beneficiaries, and must not be unfairly partial to one beneficiary or group of beneficiaries to the detriment of the others.<br>(2) This section does not require a trustee to treat all beneficiaries equally (but all beneficiaries must be treated in accordance with the terms of the trust).<br><br>Codifies impartiality as a default duty. Result would be the same if *Mulligan* decided today (unless this duty excluded). |
| Clause 55 | Clause 55 provides a list of considerations to assist trustees in exercising investment powers:<br>(a) the objectives of the trust or the permitted purpose of the trust:<br>(b) the desirability of diversifying trust investments:<br>(c) the nature of existing trust investments and other trust property:<br>(d) the need to maintain the real value of the capital or income of the trust:<br>(e) the risk of capital loss or depreciation:<br>(f) the potential for capital appreciation:<br>(g) the likely income return:<br>(h) the length of the term of the proposed investment:<br>(i) the probable duration of the trust:<br>(j) the marketability of the proposed investment during, and on the expiry of, the term of the proposed investment:<br>(k) the aggregate value of the trust property:<br>(l) the effect of the proposed investment in relation to the tax liability of the trust:<br>(m) the likelihood of inflation affecting the value of the proposed investment or other trust property:<br>(n) the trustee's overall investment strategy.<br><br>Re Mulligan would likely have been assisted by a list such as this, though it is similar to what's in the Trustee Act 1956. |
| Capital vs income | Another change the Trusts Bill makes is to the **distinction between capital and income.** |

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| | *Note: the common law has a series of tests to decide whether something is capital or income. The general rule of thumb is that income is the fruits of capital, and capital is the base - imagine capital as an apple tree, and income as the apples. Modern shift has been that no distinction exists (the legal distinction is different any accounting measure anyway).*<br><br>Section 15(1)(a) Trustees Act 1956 = power for trustees to make renovations to trust property, and to apportion the costs between capital and income. If mostly charged to capital, can recoup the capital using income.<br><br>Clause 56 Trusts Bill abolishes any distinction by giving trustees the power to determine whether return on investments are income or capital.<br><br>● Clause 57 limits this somewhat by requiring the decision to be fair and reasonable, and consistent with accepted business practice.<br><br>● It could be argued that accounting standards are objectively correct, and should just be used consistently. However, the Bill approaches this from the **policy perspective of encouraging trustees to exercise their discretion - and to protect them, as long as its exercise is legitimate.**<br>○ If a beneficiary brings a dispute and asks for a review, the Court would be entitled to consider investment strategy under Clause 120. |
| Clause 63 | The Law Commission wanted trustees to be able to hire professionals to do the trust management on their behalf. Wanted to recognise a delegable power of investment in particular. Clause 63 allows this for some powers/functions but not others.<br><br>Trustee can:<br>• appoint a person to exercise or perform, on behalf of the trustee, specified powers or functions in relation to the trust:<br>• appoint a person to make specified decisions in relation to all or part of the trust property:<br>• appoint an eligible person to hold or deal with all or part of the trust property as nominee or custodian and vest all or part of the trust property in that person.<br><br>A trustee cannot do a number of other things. See the trust bill. Mainly, cannot delegate functions that relate centrally to the administration of the trustee role itself. |
| Clause 64 | Although trustees can delegate, trustees must still:<br>• Keep under review the arrangements under which the appointee acts and how these arrangements are being put into effect; and<br>• If the circumstances make it appropriate to do so, consider whether the trustee should exercise any power to intervene (for example, a power to give directions to the appointee, or to amend, revoke, or replace the appointment).<br><br>The general duty of care in s 27 applied to the exercise of a power referred to in subsection 1. I.e. duty of care in relation to power of appointment.<br><br>Effectively, clauses 65–68 make it clear that the trustee is still responsible despite delegating their functions or making an appointment. |

**Review of Trustee Discretion**

Courts typically have the power to review trustee discretion. But what level of review should the Courts be able to undertake? There are 2 distinct poles. One pole looks to the substance of a decision and the other looks to the process/powers of the trustee only:

- Review decisions based on what a reasonable trustee would have done – this standard would enable the Court to assess what it thinks ought to have been done in the circumstances. More like a supervisory jurisdiction.
- Mere review – is the decision one that the Trustee was legally able to make? Was the trustee acting within the scope of his/her powers?

A. Law Commission Approach

The Commission opted for a conservative approach. Settlors give their property to trustees because they trust their decision making, their judgment and their independence. It is wrong to let judges interfere with these decisions unless they are manifestly wrong.

Therefore, the Court can only review acts, omissions, or decisions on the basis that it was not reasonably open to the trustee in the circumstances. This is very similar to *Wednesbury* unreasonableness. If the decision is *so* unreasonable, that the trustee cannot be said to be making a true exercise of their discretion. – s 118.

Practical problem: It is very hard for Bs to review trustee decisions where they have little access to trust information. The Commission proposed a potential approach to remedy this:

- **Shift the burden**: Shift burden to trustees. Where challenged, trustees must justify their decisions. However, this would be a practical nightmare for trustees. Onerous duty.

Trust Bill approach:

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| Clause 119 | Introduces a two-tiered approach to reviewing trustee's acts, omissions or decisions.<br>1. An applicant must produce evidence that raises a "genuine and substantial dispute as to whether the act, omission, or decision in question was or is reasonably open to the trustee in the circumstances."<br>2. If this is made out, then the onus **shifts** to the trustee to establish that the act, omission or decision is/was reasonably open.<br><br>**Remedies**: If the decision was *not* reasonably open, the remedies are set out in cl 119(3):<br>a) Set aside the act, or decision, or direct the trustee to act in the case of an omission<br>b) Restrain the trustee from acting or deciding in the case of a proposed act or decision, and direct the trustee to act in the case of a proposed omission |

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| | c) Make any other orders that the court considers necessary<br><br>NB: The threshold is still very high. Showing that it is *that* unreasonable is very difficult to do. However, this does still help π/beneficiary lawerys. |
| Clause 120 | In considering whether a trustee is liable, in respect of any investment made by that trustee, for any breach of trust in respect of any duty under section 28 (to invest prudently to the applicable standard), the court may take into account—<br>(a) whether the trust investments have been diversified, so far as is appropriate to the circumstances of the trust; and<br>(b) whether the investment was made in accordance with any investment strategy. |
| Clause 123 | (1) The court may relieve a trustee who is or may be personally liable for any breach of trust from personal liability for the breach if it appears to the court that—<br>(a) the trustee has acted honestly and reasonably; and<br>(b) the trustee ought fairly to be excused for the breach of trust.<br>(2) The court may relieve the trustee in whole or in part. |

**Resulting Trusts**

I. General law

What is the **purpose** of a resulting trust? According to Hudson:

- "There are circumstances in which the ownership of property will not be clear because a transfer of property has failed or is incomplete, or because a group of people have contributed to the acquisition of that property without allocating ownership of that property clearly between them."
- Disputes will arise as to the ownership of that property. Any system of law needs to have a rule which decides who should be deemed to be the owner of property in those circumstances. In such situations in English law it is the doctrine of resulting trusts which resolves those questions of ownership."

Thus, resulting trusts typically arise where there is a failed gift or a failed trust:

- Where A fails to make a trust and transfers property to B, if there is no trust, then B has full legal and beneficial title to the property.
- Often this is definitely not what A intended. A resulting trust might spring into existence to result the property back to A.

According to Lord Browne-Wilkinson in *Westdeutsche*, a resulting trust arises in 2 circumstances:

1. To recognise the equitable proprietary rights of someone who has contributed to the purchase price of property with an intention that she take some property rights in that property. Thus, a resulting trusts emerges where: "Where A makes a voluntary payment to B or pays (wholly or in part) for the purchase of property which is vested either in B alone or in the joint names of A and B, there is a presumption that A did not intend to make a gift to B; the money or property is held on trust for A (if he is the sole provider of the money) or in the case of a joint purchase by A and B in shares proportionate to their contributions."
    - This is a rebuttable presumption
    - Can be rebutted by showing a counter-presumption of advancement OR by direct evidence of A's intention to make an outright transfer.
2. To restore the equitable interest in property to its original beneficial owner. Thus: "Where A transfers property to B on express trusts, but the trusts declared do not exhaust the whole beneficial interest."

II. Crampton-Smith v Campton-Smith

Facts: A brother purchased land for $10,000. He paid the full purchase price and asked his sister to sign the documentation and register the title to land in his name. The sister instead registered the land title in her name. The brother later bought a second plot of land and a similar process occurred. The sister developed the land by subdividing and building townhouses on the land. She ultimately sold the properties for $511,000. The brother claimed he was entitled to the proceeds of the sale based on a resulting trust.

If the sister received the money as trustee, then she is responsible in equity for the profits made in breach of her fiduciary obligations. Conversely, if the sister merely received the money as a loan, then she only owes a personal obligation to repay the money – a debt for $23,000.

The presumption applied on these facts and there was no evidence to rebut the presumption:

- No evidence suggesting that this was in-fact intended to be gift or that the presumption of advancement applied
- Factors also pointed away from it being a gift. For example, if it was intended to be a loan, then the money would have been directly paid to the sister rather than invested in property. There was no evidence of the terms of the purported loan. Finally, there was no evidence that the daughter needed a loan at this stage – she was not in any financial strife.
- Therefore, there was a resulting trust.

The Court adopted the remedy of account of profits. There were no facts upon which the Court could justifiably grant an allowance to the sister. Therefore, the brother recovered the full proceeds of the sale of the property.

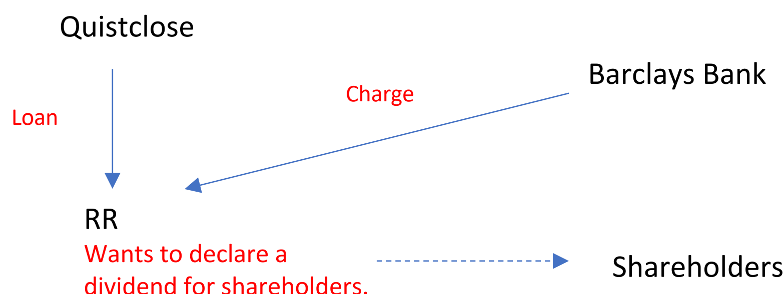
## Quistclose

*Quistclose* trusts are an important area of law. Context:

- Allegations of a *Quistclose* Trust usually arise in the insolvency context.
- Often, a lender has lent money to a company/person for a specifically defined purpose. The borrower can only use the money for that defined purpose. Usually the borrower goes insolvent.
- Without a QT, the money would form part of the borrower's estate. The money may be used to pay out creditors. Typically, lenders who lend money (absent a security interest) have to run the risk of the borrower's insolvency.
- However, if a QT can be established, then the lender has a proprietary right to the money/property. The money will not fall into the bankrupt's estate, and the lender can reclaim the money.

The proprietary consequences of the QT are significant. However, the true nature of the QT is unclear. There are competing views.

I. Quistclose




Facts: Quistclose loaned RR money to pay a dividend to its shareholders. The money was specifically loaned for this purpose and could not be used for any other purpose. Barclays Bank asserts a charge over RR assets (who was insolvent). Asserted right to claim the money as it was part of RR's estate.

**Normal position**: When you loan money, title to the property passes to the debtor. The creditor gets a contractual right to enforce the debt. This is a personal right only. On these facts, Barclays would be able to take the money as it has a registered charge. This gives it priority over unsecured creditors such as Quistclose.

**Court's approach** (Lord Wilberforce): Instead, Quistclose won the case. Although RR obtained legal title to the money, Quistclose retained an equitable proprietary right to the money. This is because a trust existed over the money. Reasoning:

- Quistclose granted a specific amount of money for a specified purpose. The money could not be used by RR for any other purpose.
- The terms of the loan also included the implication that the money must be returned if the primary purpose could not be carried out ← **Important**
- Because the money was granted for a specific purpose, this created a fiduciary relationship in respect of that money. Quistlclose was placing trust and confidence in RR that the money would only be used for that purpose. As the fiduciary relationship exited over a specified fund, it created a trust relationship.

The Court conceptualised there being **two** trusts: a primary and a secondary trust.

- Primary trust – a primary trust is created for payment to identified beneficiaries e.g. creditors, shareholders. The lender acquires an equitable right to restrain the money from being used for any other purpose than the purpose specified in the grant. When the purpose is carried out, the lender has a personal action for debt against the borrower.
- Secondary trust – If the primary trust fails, a secondary trust springs into existence in favour of the lender. This only occurs where the grant included (expressly or impliedly) repayment terms. The lender can use equitable remedies to get the money back. This secondary trust is a form of **resulting trust**.

One of the key objections to this approach was that when granting the loan, Quistclose received a right to an action in debt.

- This excluded the implication of a trust: a transaction may attract one legal form or the other, but not both.
- However, the Court responded by recognising that a transaction may attract both legal and equitable rights and remedies. The flexible interplay of law and equity should accommodate such transactions.

II. Twinsectra v Yardley

Facts: Yardley engaged Leach, a solicitor, to act for him in the purchase of a property. Twinsectra agreed to loan Yardley £1m in exchange for certain undertakings given by a solicitor. Yardley approached Sims, a solicitor who owed money to Yardley, and convinced him to give the undertakings. It was agreed between Yardley and Sims that Sims' guarantee would operate as though Sims was the principal debtor and he would repay the loan in exchange for Yardley forgiving Sims' debts.

Twinsectra loaned Yardley £1m and Sims undertook that he would retain the money until it was used to acquire property, ensure that the money would be used solely to buy property, and pay back the money. Sims transferred the money to Leach, another solicitor, who knew about the undertakings given. Leach then transferred the money to Yardley and a substantial amount of it, £357,000 was used for purposes other than the acquisition of property. Sims

subsequently went bankrupt and the loan was not paid back. Twinsectra sues Leach for assisting in a breach of trust.

A. Was there a *Quistclose* trust?

Lord Millett first explains what a *Quistclose* trust actually is:

- Typically, money advanced on loan becomes the property of the borrower, who is free to use the money for any purpose.
- However, where a loan is made for a specific purpose in circumstances that restrains the borrower from using the money for any other purpose, this gives rise to fiduciary obligations.
- The lender places his trust and confidence in the recipient of the money that the money will only be used for the designated purpose. Because the fiduciary obligations arise in respect of identifiable property, they give rise to a trust relationship. The lender obtains an equitable right to restrain the borrower from using the money for any other purpose.

On the **facts**:

- The terms of the loan make it clear that the money is *solely* to be used for the acquisition of the property and for *no other purpose*. Mr Yardley was restrained from using the money for any other purpose.
- Therefore, a *Quistclose* trust arose in favour of Twinsectra.

B. The nature of the *Quistclose* trust

Lord Millett grappled with the location of the beneficial interest of a *Quistclose* trust while the primary purpose can still be enforced.

<table>
<tr>
<td>Lender</td>
<td>Beneficial interest remains throughout with the lender. The Quistclose trust is similar to a Romalpa clause (retention of title clause) as it enables the borrower to have recourse to the lender's property without interfering with the lender's property rights.<br><br>Lender retains beneficial ownership of the money until the primary purpose is complete. At this point, the beneficial interest passes to the ultimate party (e.g. creditors). The lender will then have a legal action in debt.<br><br>Where the primary purpose cannot be performed, the money returns to the lender.</td>
<td>This is the only form of QT that is doctrinally consistent.<br><br>Firstly, it gets around the problem of the primary trust not failing because the purpose of the trust is frustrated. As stated below, trusts do not fail merely because the purpose is frustrated. The trust must be impossible or illegal to perform. A resulting trust where the interest remains with the lender resolves this:<br>• The borrower is treated as holding the money on resulting trust for the lender because the lender does not intend to exhaust their beneficial ownership of the property.<br>• The borrower retains a power to carry out the lender's revocable mandate.<br>• Where the lender's purpose is frustrated, they may <u>revoke</u> the mandate and demand the return of the money.<br>• The money is returnable therefore <u>not</u> as a new secondary trust, but because the resulting trust is no longer subjected to any "power on the part of the borrower to make use of the money."<br><br>Resulting trust enables the lender to enforce the trust as they are the beneficiary of the trust.<br><br>What about certainty?<br>The only requirement is that the power to use the money is sufficiently certain. If the power is not certain, the money results back to the lender.</td>
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| Borrower | Beneficial interest vests in the borrower. Borrower has both legal and beneficial ownership of the money.<br><br>Dr Chamber's argument was adopted by the Court of Appeal. The lender merely retains a contractual right to restrict the money from being used for any other purpose than the stated purpose. | **Cannot be located in the borrower**<br>Lord Millett holds that the beneficial interest cannot be located in the borrower for a number of reasons:<br>• Beneficial ownership cannot vest unconditionally in the borrower. This defeats the purpose of the *Quistclose* arrangement as the borrower would be able to use the money for any purpose they choose.<br>• Inconsistent with decided cases e.g. *Quisclose*. If the borrower had beneficial ownership of the property, then the money would fall into their estate and be subject to the bank's charge. This was not the result of *Quistclose* so cannot be the correct understanding of the trust.<br>• The borrower's rights are severely limited. Cannot be full beneficial ownership if limited in this way. For example, the borrower must keep the money separate; cannot use it except for the stated purpose; must return the money to the lender if demanded; and if the purpose fails, he cannot refuse to return the money.<br><br>**Dr Chambers' Perspective**<br>Dr Chambers argues that there is no trust created by a *Quistclose* arrangement:<br>• When the money is paid, the borrower obtains the entire beneficial ownership of the property. Have legal and beneficial title.<br>• The borrower's interests are subject to the lender's contractual right to restrain the borrower's use of the money for anything other than the purpose for which the money was originally loaned.<br>• If the purpose for the loan fails, something akin to a resulting trust springs into existence.<br>• The "thing" that springs into existence is a restrictive covenant enforceable by negative injunction that grants the lender a proprietary interest over the money.<br><br>**Dr Chambers' Perspective Wrong**<br>Wrong for a number of reasons:<br>• **Slam dunk:** Doesn't explain why the lender has proprietary rights against third parties. If *Quistclose* merely had a contractual right to the money, then they wouldn't be able to get the money back and beat the bank. Contractual right is merely a personal right not a proprietary right. However, Chambers tries to get around by stating that the lender has a restrictive covenant that grants proprietary rights to the property. **Contractual obligations would not prevail over secured creditors.**<br>• **No covenant:** Millett says that these covenants are part of land law. They do not arise in respect of money. There is merely a contractual obligation under Chambers' analysis.<br>• Provides no solution for where the loan was not made on a contractual basis<br>• Chambers describes the borrower's obligations as merely contractual. This is inconsistent with Lord Wilberforce's description in *Quistclose* of the borrower owing fiduciary obligations to the lender.<br>• Fails to explain the evidential significant of the money being kept in a separate account or segregated from other property. |
| Contemplated beneficiary | In cases like *Quistclose*, the primary purpose had either failed, or the purpose had been successfully carried out.<br><br>In these cases, it was not necessary to consider where the beneficial interest resided whilst the primary purpose was still *capable* of being carried out.<br><br>This analysis occurred in *In Re Northern Developments (Holdings) Ltd* where the contest was between the lenders and the creditors. The judge found that the primary trust was a trust for the benefit of the credtiors as the trust was created for their benefit. | Lord Millett first discussed the decision on the facts of the case:<br>• There was unlikely to be a QT at all on these facts<br>• The money was not loaned for the specific purpose of paying off short term creditors as the Judge stated.<br>• The understanding was that the money was to be treated as working capital that the company could use to stay afloat and incur fresh obligations etc.<br>• This suggests that the purpose of the arrangement was to vest absolute beneficial ownership in the money in the company itself. The company was to receive beneficial ownership so that they could use the money for any purpose. Therefore, likely cannot have been a Trust at all, especially because no confined purpose!<br>• Also, the bank's object was likely not to benefit the creditors. Likely cannot have intended this to be a trust for the benefit of the creditors therefore.<br><br>Conceptual problems with *Northern Developments* analysis:<br>• Cannot be a trust for the benefit of the contemplated beneficiary because in many circumstances, there is no contemplated beneficiary. The trust is instead for an **abstract purpose**. |

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<tr><td></td><td></td><td>• Millett used the NZ case of General Communications v DFN as authority for the argument that QT may be for an abstract purpose such as buying stationary/new equipment.<br>• Therefore, no certainty of objects or sometimes no certainty of subject matter.<br><br>Main rejection of the primary/secondary trust argument<br>Another reason it cannot be an express trust for the contemplated beneficiaries is that in these circumstances, the lender would never be able to get their money back.<br>• If the primary trust is an express trust for the benefit of the beneficiaries, then the lender is the settlor, the borrower is the trustee and the beneficiaries are the creditors (or other party).<br>• In these circumstances, the lender cannot enforce the primary trust. The authorities claim the lender can enforce the trust.<br>• But here, the lender is merely the settlor and has no right to enforce the trust.<br>• He also cannot enforce as the beneficiary of the secondary trust, as the secondary trust will not arise if the primary trust succeeds. Therefore, the lender has no standing to enforce the trust at all.<br><br>Furthermore, it cannot be a primary and secondary trust system:<br>• In Quistclose, the primary trust was said to fail because the purpose of the trust could not be fulfilled when RR went insolvent.<br>• However, in normal trust law this would not cause the primary trust to fail. A trust must be impossible to perform or illegal for it to fail. Merely frustrating the purpose of the trust will <u>not</u> cause it to fail.<br>• Therefore, Quistclose could not have got their money back in the case because the secondary trust would never have arisen. This analysis cannot be right.</td></tr>
<tr><td>In suspense</td><td>The beneficial interest is in suspense until the primary purpose is carried out or fails.</td><td>This approach ignores the role of the resulting trust in Trust law.<br><br>One of the forms of resulting trust arises where the settlor transfers property on express trust but does not exhaust the whole of the beneficial interest. Resulting trusts therefore often arise where there is an absence of an intention to pass the entire beneficial ownership in property to another party.<br><br>Where this happens, the resulting trust emerges to fill the gap and ensure there is no void of beneficial ownership.<br><br>Therefore, a resulting trust would emerge in these circumstances, leaving the beneficial ownership with the lender. There cannot be a situation in which the beneficial interest in property is in suspense – property likes to be owned.</td></tr>
<tr><td>Millett's analysis of DFC case is wrong</td><td colspan="2">Interestingly, Millett's analysis of DFC case is wrong. Millett used this as an example for the proposition that QTs cannot be a trust in favour of the contemplated beneficiaries because sometimes there is no certainty of objects.<br><br>However, in the DFC case there was no QT recognised:<br>• DFC loaned $950K to Video Workshop. The money was held by the workshop's solicitors on behalf of the workshop.<br>• The money was for the purpose of buying stationary/equipment<br>• The stationary was supplied by General Communications.<br>• Workshop went insolvent.<br><br>Workshop was trying to get the money back. This was a case where the "creditor" was fighting against the "lender".<br><br>The Court found that General Communications could get the money back as it was held on trust for them. Therefore, this cannot have been an example of a QT. If this was a QT, then DFC (the lender) would have gotten the money back. Instead, GC was seen as a beneficiary of something that was probably an express trust.<br><br>This cannot therefore have been a QT.</td></tr>
<tr><td>Quistclose trusts as security interest for PPSA</td><td colspan="2">Some commentators have suggested that the Quistclose trust is a form of security interest for the purposes of personal property security legislation. This is not correct, however, as the mechanism isn't intended to secure repayment of a debt, but rather to ensure that the credit is used for a specified purpose. This is clearly illustrated by the fact that, if the money is applied towards the intended purpose, the debt becomes unsecured in the absence of any other protective measures and the creditor must seek repayment through a debt claim.<br><br>Butler and Lord Millett both support the conclusion that a Quistclose trust is not a security interest however Lord Millett slightly contradicts himself by assimilating such trusts with retention of title clauses. If similar to a retention of title clause,</td></tr>
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| | then perhaps this might be deemed to be a security interest under the PPSA. In which case, the PPSA would override the lender's equitable title to the property. |
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## AIB

Facts: Borrowers borrow £3.3m from a bank to buy a new property. There is already a mortgage over the property to Barclays bank. Barclays has the first charge. New bank wants the primary charge. The solicitors to whom the loan is paid are supposed to get the primary charge for AIB. Solicitors underpaid Barclays when trying to discharge the mortgage. They then paid out the loan money.

After realising their mistake, the solicitors managed to fix the situation such that AIB did get a charge, but it was still only a second charge. The borrowers defaulted. The property was repossessed by Barclays and sold for £1.2m. After Barclays took their remaining £309,000, AIB only received £867,697.

**Legal issue:** How much is the bank entitled to recover from the solicitors? Bank claims that it can recover the full value minus the profit made from the resale. The solicitors claim they are only liable for the amount the bank lost compared to its position had the obligations been properly performed. The difference is between £2.5m and £275k.

A. Law from *Target Holdings*

Lorde Browne-Wilkinson made a couple of important observations in *Target Holdings*:

- Don't necessarily use CL rules in equity – there do not need to be the same legal rules that govern these disputes.
- Need to look at the nature of the equitable rules within the context of the purpose of equity:
    - Clearly in equity, there are cases where the trustee spends the beneficiary's money or takes the trust money for themselves. In these cases, everyone agrees that the trustee is liable to account for the profits. Have breached their fiduciary obligation of loyalty.
    - But, these cases are different. The trustee was always supposed to spend the beneficiary's money. The problem is that they did not strictly comply with the terms of the trust when they paid out the money.
- Common sense approach. Need to assess the extent of the loss that flows from the breach of trust. Here, the loss would have occurred anyway because of the inflated value etc. Therefore, the solicitors did not need to pay anything. The solicitors in *Target* still performed their obligation of obtaining a SI.

B. Discussion of duties in *AIB*

At the heart of this judgment is the interrelationship between equity and the common law. The issue is that under the CL, the solicitor's liability would be limited to £330,000. This is because their actions were negligent and caused this loss. Fundamentally, the question is whether the solicitor's should be liable for a different measure of loss merely because a claim was brought in equity rather than under the Common Law. What rules should be adopted? To what extent should the remedial consequences be analogous?

The Court from the outset is convinced that the solicitor's should only have to pay £330,000 to the banks. They discuss a number of potential routes for getting to this analysis.

**Custodial, management and fiduciary duties**
One analysis centres on the distinction between custodial, management and fiduciary duties.

Critics of the *Target Holdings* decision claim that LBW conflated the duties owed by trustees. Effectively, these duties can be subdivided as follows:

1. Custodial stewardship duty – duty to preserve the assets of the trust except insofar as the terms of the trust permit the trustee to do otherwise.
    a. Typically, this duty is enforced through substitutive performance.
    b. Remedy is not dependent on a breach of the obligation giving rise to a secondary right in the beneficiaries to seek remedy for the loss suffered.
    c. Instead, an account is given. The trustee must pay the difference between the current value of the trust and the value the trust ought to be. Substitutive performance involves paying the difference.
2. Management stewardship – duty to manage the trust property with care.
    a. This involves trustees managing property, making decisions on how to manage the property, investing, using reasonable skill, care and prudence etc.
    b. Where this duty is breached, an order for "reparative compensation" is made. This order reflects the loss suffered by the beneficiaries.
3. Fiduciary obligation – undivided loyalty.
    a. Where a breach occurs, there are alternative remedies.
    b. If the fiduciary benefits, they must account to the beneficiary/disgorge the profits. Constructive trust over the property. Proprietary remedy.
    c. Alternatively, the beneficiary may seek compensation reflecting the value of the benefit gained.

Management duty is about how you run the trust, the dispersements made, the investments made etc. The trustee makes decisions. We judge these decisions based on fault, reasonableness etc. Failing to exercise trust powers reasonably, prudently etc. If one of these duties is breached, then it might be more appropriate to use something analogous to CL damages.

- One example is *BNZ v Guardian Trust* (maybe a trust case)
- Guardian Trust was supervising an investment company. BNZ and other banks were using the Trust as a means of supervising on their behalf.
- Essentially, Guardian Trust acted negligently and breached its debt securities. Meant that GT should have/could have told the banks about the breach. The banks could have used remedies to get out.
- Argument made by GT was the same kind of argument about a managerial argument. Role was to manage the investment rather than look after the trust property. Therefore, should be subject to CL kind of causation rules. Even if GT had told, could the banks had done anything? Not on the balance of probabilities per CoA. Not a strict obligation.
- Trustee with management obligations/supervisory obligations. Really, these obligations could be done by someone who wasn't a fiduciary. Just so happened that they were a fiduciary.
- Millett in *Mothew* said that where you are basically doing the same thing as a normal professional, the apply normal CL rules effectively.

This distinction was not particularly helpful in this case. There was not a clear or easy categorisation of the solicitor's duties. If anything, their duties appear to be more of the custodial nature than the management or stewardship nature. This would point more towards an obligation to restore the trust fund.

**Particular duties must be assessed**
The Court recognised the case of *BNZ v NZ Guardian Trust* and stated that that case recognised that the Court's should focus on the nature of the duty in question as this can be most significant in identifying the remedial consequences that should flow from a breach.

- Tipping J identified 3 broad categories of breach by a trustee.
- First: breaches of duty leading directly to damage or loss of trust property.
- Second: breaches involving infidelity i.e. breach of fiduciary obligation.
- Third: breaches involving a lack of skill and care.
- In relation to the first kind of case, the trustee will often be required to restore the trust fund. The policy of the law is that the trustee will only be held accountable for the harm that flowed from the breach. A **stringent** but for test for causation is required. The Courts will not look to ideas of foreseeability and remoteness when assessing the loss.

Most significantly, the Court stated at [137] of Lord Reed's judgment that the Court must look to the particular obligation breached, and assess the remedial consequences that flow from that particular obligation. Courts should not adopt a blanket rule of equity that governs all claims in equity. As Worthington states: "Any analysis of remedial consequences must start with a precise understanding of the obligation which had been breached and the detailed performance requirements demanded by it. Only this would reveal the position the claimant would have been in if the obligation had not been breached." This is the **most important part** of the AIB decision.

**Resolution on these facts**

The Court identified the relevant obligation as the obligation to ensure that the trust fund was duly administered.

- Therefore, the remedy of equitable compensation is appropriate to remedy any loss suffered by reason of the trustees' failure to perform this obligation.
- The trustees must restore the trust fund to the position it would have been in if the trustee had performed his obligation.

The bank's case was based on 3 fallacies:

- Firstly, the bank assumed that Redler misapplied the entire £3.3m. In the Court's opinion. Only £309,000 was misapplied, which was paid to the borrowers and not Barclay's bank. ← Unclear whether this is a causation argument or a "duty" argument. Sounds like it's a duty argument. The duty was to pay out the money correctly and secure the charge. That duty was only breached to the extent that the £309,000 was wrongly applied.
- Secondly, the banks were wrong to assume that the loss was fixed at the time at which the payment was made in breach of trust. This is wrong and is contrary to authority. Courts can look back with a degree of hindsight. In the long run, the solicitors fulfilled their duty but for the money paid out incorrectly = £309,000.

- Thirdly, the banks were wrong to assume that liability does not depend on a causal link between the breach and the loss. Can't depend on an overarching equitable obligation to restore the trust fund without an assessment of causation etc. The loss was initially £309,000 but subsequently dropped to £273,777. This is the only loss they were liable to pay.

**Relationship between equity and the common law**

Although equity and the common law applied to these facts reach the same measure of loss/liability, the two systems are distinct.

The two regimes may appear similar:

- Both equitable compensation and damages aim to compensate for the loss suffered because of a wrong committed.
- Structural similarities in that both require an assessment of causation and whether the loss directly flows from the breach.

Despite these similarities, the rules are not identical.

- Trusts (and equity in general) impose a different type of relationship that contract or tort or other common law issues. With this different relationship comes different obligations.
- The law "responds differently to these different obligations by allowing a measure of compensation for breach of trust causing loss to the trust fund which reflects the nature of the obligation breached and the relationship between the parties."
- Equity focusses more on the particular obligation in question to assess the remedial consequences that should flow.
- Where the underlying principles between CL and equity are consistent, the rules should be consistent. Where the underlying principles are different, the rules should understandably be different.

This judgment (particularly at [138]) reflects a shift in equity jurisprudence from a concurrent to a concordant system.

- "Concurrence" = there may be both a CL claim and an equitable claim open to the π. Each system has separate rules and the systems are distinct. The π can choose which system to bring their claim in based on the rules that are most favourable to them.
- "Concordance" = promotes some degree of harmony between equity and CL. The idea underpinning [138] is very sophisticated. Instead of narrowly defining the rules based on the legal system, the Court will look to the substantive nature of the obligation and then derive the rules that ought to apply in the particular case. Equity and CL can borrow legal rules from each other where the underlying principles are consistent. Where the underlying principles are distinct, the rules differ in order to uphold the fundamental purpose of each system.
- If a "concurrent" perception was adopted, the relevant equitable rule would have been that the trustees owed a duty to completely restore the trust fund. This approach would have ignored any concepts of causation in constructing the loss for which the trustees were liable.
- Instead, the Court decided that it was appropriate in this context, based on the nature of the particular obligations owed, to borrow the concept of causation and apply it to

the facts. The principles of CL and equity aligned to this extent. However, the rules for causation were a lot stricter and do not involve foreseeability and remoteness. This difference is in order to promote the strict nature of equitable obligations.

**Sarah Worthington Conception of AIB**

Sarah Worthington speaks to this point and explains more clearly than the SC in *AIB*:

- The fiduciary's obligation on these facts is not to hold a particular sum on trust or to pay a particular sum.
- The obligation in question is far more complex and involves a number of steps if due performance is to be given. The numerous steps were designed to bring about a particular result e.g. in *AIB* to secure a mortgage over the property so that the loan could be made with adequate security.
- The obligations owed were therefore a mixture of custodial and management duties.
- If specific performance of the trustee's obligations were granted (per the primary obligation conception) the requirement of the solicitor would be to execute all of the steps and not merely to carry out the steps relating to their primary obligation.
- The end result if specific performance of primary obligations was awarded would be the same measure of loss that the Court found in *AIB*.

Even if the Court were to go down the "primary obligations" route, the measure of loss would have been identical:

- Remedies look to the nature of the trustee's obligation – both custodial and management.
- The obligations are to ensure that the trust pot is kept at the same state that it ought to be in.
- Given this approach, it is impossible to apply concepts of remoteness and foreseeability. Loss is invariably foreseeable if the trustee breaches their duty.
- Ultimately, *AIB* was correct to identify what full performance of the obligation would have delivered to the banks.
- The measure of loss is therefore: "The gap between factual delivery and what ought to have been delivered gives the measure of equitable compensation."

Beneficiary under a Trust has a right to have the Trust properly administered.

What that means in any case depends on the facts. In this case, not realistic or equitable to look at the trust in isolation from the commercial transaction from which it was part. If trustees had done duty properly, they would have paid 300K more. Bank would have obtained a first charge rather than a second charge.

Bank entitled to be put in the same position. This requires the solicitors to pay the sum ordered by the trial judge.

# Chirnside v Fay

| | Elias CJ | Tipping and Blanchard JJ |
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| Test for fiduciaries | The Chief Justice did not develop a clear test for how to ascertain when fiduciary obligations arise. Instead:<br>• The CJ stated that joint ventures are “inherently fiduciary”. Given that the CJ stated at [1] that she agrees with the majority but for slightly different reasons, this suggests that she agrees with their two-tiered approach to finding fiduciary obligations. Joint ventures fall into the category of inherently fiduciary relationships.<br>• CJ also referred at [15] to the obligation of loyalty as being the distinguishing obligation of a fiduciary. Suggests that one might look to relationships that involve loyalty at their core in order to ascertain that a fiduciary obligation existed. | Fiduciary duties/obligations arise in various relationships. Fiduciary obligations may arise irrespective of the other obligations to which the individual is subject e.g. in a contractual arrangement. Relationships that do not generally give rise to FOs may have a fiduciary dimension in particular circumstances.<br><br>Two approaches or tiers for/of identifying FOs.<br>• The relationship is of a kind which, by its very nature, is recognised as being *inherently fiduciary*. Recognised categories of relationships include solicitor and client, trustee and beneficiary, principal and agent, doctor and patient, and partnerships.<br>• *Particular relationships approach* – instead of being inherently fiduciary, the relationship will be classed as fiduciary where the relationship justifies recognition of fiduciary obligations. No single formula or test for identifying when a relationship is properly described as falling in this category. Typically, as identified by academics such as Ch arles Rickett, the Courts will draw analogies to the core inherently fiduciary relationships.<br><br>Some of the factors/ideas used to identify second category of FOs:<br>• Privy Council in *Kuys* recognised that FOs will depend on the nature of the relationship and may apply to certain aspects of the relationship.<br>• *Day v Mead*: looked to relationships where “one party is reasonably entitled to repose and does repose trust and confidence in the other, either generally or in the particular transaction.”<br>• *Arklow*: one person is in a relationship “which gives rise to a legitimate expectation, which equity will recognise, that the fiduciary will not utilise his or her position in such a way which is adverse to the interests of the principal.”<br><br>All relationships that are inherently fiduciary are “marked by the entitlement (or legitimate expectation per *Arklow*) of one party to place trust and confidence in the other. That party is entitled to rely on the other party not to act in a way which is contrary to the first party’s interests.” – at [79].<br><br>**Is an express undertaking required?**<br><br>Counsel argued that an express undertaking to act in a fiduciary capacity was required. Used case law and academic theory in support. |

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| | | Not correct:<br>• Has a strong contractual flavour that is not suited to equity. Equity imposes an obligation to eschew self-interest when the circumstances require. Requiring an express undertaking would "emasculate" the breadth of equity's reach. Conceptually inconsistent with ideas such as the constructive trust and imposition of fiduciary obligations.<br>• True position is stated above. Just so happens that an express undertaking is often a *manifestation* of this type of relationship.<br>• Case law recognises that undertaking is not required. For example, HCA decision in *United Dominions Corporation* in which their Honours held that a fiduciary relationship can arise between parties who have not yet and may never reach an agreement upon contractual terms to govern their relationship. |
| Was there a fiduciary relationship on these facts? Nature of duties owed? | There was a fiduciary relationship. The parties were in a joint venture. The CJ stated that: "Where parties join together in a venture with a view to sharing the profit obtained, their relationship is inherently fiduciary within the scope of the venture and while it continues." – at [14].<br><br>This is so *despite* the fact the parties were planning on finalising their relationship ultimately by contract or some other corporate structure. Does not alter the character of the relationship on the facts or prevent a finding of a fiduciary relationship. **← Inconsistent with the analysis from *Arklow*.** In that case, the Courts did not want to impose equitable obligations in lieu of contractual arrangements that were not finalised. Focal point for the analysis of a lack of a fiduciary relationship. Whereas in this case, Elias CJ looks to the nature of the relationship and states it is inherently fiduciary regardless of the lack of a contract. See also the majority's reasoning which is even more inconsistent.<br><br>Discussion of joint venture:<br>• Parties to a joint venture.<br>• Both undertook together to share in the development opportunity and carry out that opportunity to generate a profit.<br>• Clear actions they undertook together in pursuit of the joint venture: feasibility calculations, negotiating the purchase of the Speights site by progressing consents with the Dunedin City Council and working with architects and other advisors to develop plans, working to gain a tenancy commitment from Harvey Norman who was to be the principal tenant. | At [74] the Court discussed how there was a strong case for saying that most joint ventures are inherently fiduciary because of the analogies with partnerships. Partners must put the interests of the partnership ahead of their personal interests. Similar to JVs – venturers must always put the interests of the JV ahead of their personal interests.<br><br>This was a type of relationship in which the parties were entitled to repose trust and confidence in one another.<br><br>The fact that the parties had not thought "it necessary to enter into a detailed formal agreement before embarking on their joint venture suggests that each was reposing trust and confidence in the other as they had in their earlier venture." Lack of a formal agreement does not preclude recognition of fiduciary relationship. **← Again inconsistent with *Arklow*** – the parties *could* have contracted here to guarantee these benefits. But they didn't. In *Arklow*, this was a basis for finding that no relationship had arisen. The parties were at arm's length etc.<br><br>Maybe the principles at play are different here however. The contract/agreement would merely be recognising a relationship that already existed and formalising it in a contract/partnership document. There was already a pre-existing fiduciary relationship. Conversely, in *Arklow*, there was no pre-existing relationship between the parties. Nothing on which the Court could justify finding that Far was bound to act for the benefit of Arklow. The only basis was the contract that hadn't been signed etc. Reflected in the Court's reasoning below.<br><br>Joint ventures generally: |

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- Chirnside had primary responsibility for progressing the development – this was the same for the previous development.
- Fay acknowledged the Chirnside did more of the actual work. But their JV was *not* based on equal work but equal financial participation and risk. Fay contributed to the planning and negotiating with Harvey Norman. Fay was also introduced to other parties as a principal in the development. One of Fay's key roles was to fund the development. This was so until Chirnside excluded him.

**See Geoff critique in other column. The CJ's discussion on joint venture is a good rebuttal of this point!**

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- Essence of a JV which has not yet been finalised in contract is that it is "an arrangement or understanding between two or more parties that they will work together towards achieving a common objective. It is fallacious to think that there can be no joint venture unless and until all the necessary details have been contractually agreed." – At [91].
- Joint venture exists where parties are depending on each other to make progress towards the common objective. Where this happens, the parties are relying on the other to act in their best interest. This is where fiduciary obligations arise.

What work did Fay actually do in pursuit of the joint venture (including what the CJ discussed in her judgment):

- Both parties came up with the idea for the development. Visited the site together. Co-operated to come up with initial calculations of the potential value of the development. Identified a possible purchase price for Speights site together.
- Mr Fay approached Harvey Norman to try and lock down as principal tenant. Had a number of discussions with HN. HN initially rejected. But Fay convinced them to reconsider the development given the added value of obtaining the adjacent site for car parking. Chrinside took over from here.
- Fay and Chirnside worked together to generate financial arrangement terms to present to HN.
- Fay moved to Christchurch. But still returned to Dunedin from time to time. Engaged in meetings with Lion, architects, and Dunedin City Council planning staff.

After Harvey Norman locked in as tenant, project became viable without Mr Fay. Chirnside used other investors to provide the capital that Fay would otherwise have provided.

By the time of Fay's exclusion, a number of important steps towards the joint venture had already been taken. Clearly, a JV existed on the facts.

**Fiduciary obligation required in these circumstances?**

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<td>Potential discussion about whether correctly decided – was it right to recognise fiduciary relationship?</td>
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<u>Potential critiques of the case</u>

Geoff critique: Court appeared to assume that there was a joint venture that was fiduciary. Geoff critiques and says that Fay did not generally contribute much to the relationship. Thinks that Fay's contributions were minimal and can seriously question whether a joint venture arose in the first place and whether it is fair that a fiduciary obligation was found to exist, which grants Fay effectively a windfall considering he had not done any work. This was not a <u>longterm</u> relationship like partnerships – perhaps the analogy was inapt. Furthermore, partnerships are based on equal contributions which did not happen here.

Charles Rickett has made a compelling argument previously however:

- Argued that mere existence of a JV is not sufficient for the recognition of a fiduciary relationship giving rise to fiduciary obligations
- The Court ostensibly presumed that because a joint venture existed, and because JVs were analogous to partnerships, they were inherently fiduciary.
- However, Rickett argues that you need to look to the particular nature of the obligations to which the parties are subject to identify whether those obligations <u>require</u> a duty of loyalty.
- Referred to HCA case where the contractual terms of the joint venture actually <u>excluded</u> fiduciary obligations. Evidence of the fact that merely being in a fiduciary relationship is insufficient for an automatic application of fiduciary law.

This reasoning probably extends to this case. The Court was likely too quick to presume that the mere existence of a joint venture justified recognising fiduciary obligation of loyalty. The CJ merely stated that joint ventures were inherently fiduciary as a category of relationship. Similarly, the majority's reasoning was slim:

- Analogised to partnerships and said the analogy was sufficiently strong to that inherent category of relationship that this was likely a fiduciary relationship also – at [74]. Broad-brush approach that asserts essentially that *all* JVs are fiduciary relationships. Perhaps this is okay if the Court is desiring to recognise a new category of inherently fiduciary relationship. But if the Court was conceptualising JVs as fiduciary on the facts of <u>this</u> case, then there was not enough focus on the nature of the relationship and the obligations and whether they require a duty of loyalty.
- Only analysis that the Court really went into was this part from above – "Joint venture exists where parties are depending on each other to make progress towards the common objective. Where this happens, the parties are relying on the other to act in their best interest. This is where fiduciary obligations arise."

Further critiques arise in respect of the relationship between this case and <u>Arklow</u>. There are doctrinal and conceptual inconsistencies in some respects between the case.

- Relationship between equity and contract
- Use of equity to regulate commerce. Courts hesitant in some instances to intrude into commercial relationships and impose equitable rules to govern those relationships.

<u>Rebuttal</u>

A. There was a joint venture

Firstly, there was a joint venture on these facts. Court was justified in finding that a relationship existed between the parties despite the lack of a contract. The parties <u>both</u> contributed to the joint venture.

Discussion of joint venture by CJ:
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| | • Parties to a joint venture.<br>• Both undertook together to share in the development opportunity and carry out that opportunity to generate a profit.<br>• Clear actions they undertook together in pursuit of the joint venture: feasibility calculations, negotiating the purchase of the Speights site by progressing consents with the Dunedin City Council and working with architects and other advisors to develop plans, working to gain a tenancy commitment from Harvey Norman who was to be the principal tenant.<br>• Chirnside had primary responsibility for progressing the development – this was the same for the previous development.<br>• Fay acknowledged the Chirnside did more of the actual work. But their JV was *not* based on equal work but equal financial participation and risk. Fay contributed to the planning and negotiating with Harvey Norman. Fay was also introduced to other parties as a principal in the development. One of Fay's key roles was to fund the development. This was so until Chirnside excluded him.<br><br>What work did Fay actually do in pursuit of the joint venture (according to Tipping and Blanchard JJ):<br>• Both parties came up with the idea for the development. Visited the site together. Co-operated to come up with initial calculations of the potential value of the development. Identified a possible purchase price for Speights site together.<br>• Mr Fay approached Harvey Norman to try and lock down as principal tenant. Had a number of discussions with HN. HN initially rejected. But Fay convinced them to reconsider the development given the added value of obtaining the adjacent site for car parking. Chrinside took over from here.<br>• Fay and Chirnside worked together to generate financial arrangement terms to present to HN.<br>• Fay moved to Christchurch. But still returned to Dunedin from time to time. Engaged in meetings with Lion, architects, and Dunedin City Council planning staff.<br><br>After Harvey Norman locked in as tenant, project became viable without Mr Fay. Chirnside used other investors to provide the capital that Fay would otherwise have provided.<br><br>By the time of Fay's exclusion, a number of important steps towards the joint venture had already been taken. Clearly, a JV existed on the facts.<br><br>B. Circumstances required obligation of loyalty/involved an obligation of loyalty on the facts<br><br>Surely a fiduciary obligation of loyalty was required in these circumstances, especially where there was no contract entered into between the parties but a pre-existing relationship/joint venture had crystallised.<br><br>As Worthington argues, fiduciary obligations ought to be recognised where they are *required* in order to protect the interests of another party. This is recognised throughout the case law – the idea that fiduciary obligation of loyalty is inherently prophylactic. It is imposed to protect the interests of others by subjugating the fiduciary's interests to that of the other party. E.g. *Boardman* where strict obligation of loyalty recognised and imposed; very strictly adhered to. Similar with *Keech*.<br><br>Here, the only legal rights Fay or Chirnside had were equitable rights. Only protective measure was the obligation of loyalty. Without it, either party could take advantage of the opportunity that they had developed together; of the work they had done together to make the investment/development a possibility etc. and take the full value of the development for themselves. Equity is justified to intervene in these circumstances.<br><br>Analogous with case law such as *Boardman*: |

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<ul>
<li>In Boardman, one of the key discussions surrounding fiduciaries was the fact that the parties received information when acting on behalf of the trust for a limited purpose. The information they received only arose by virtue of their relationship with the trust. Some of the judges conceptualised this as triggering the existence of a fiduciary relationship. It would be a breach of that relationship to use that information in a way that led to an unauthorised profit OR put the party in a conflicted position.</li>
<li>Here, the information regarding certain specific elements of the development plan were derived from the joint venture relationship. The parties co-operated together to formulate pricing strategies, negotiate the purchase from Lion, lock in Harvey Norman etc. The opportunity to actual follow through on the development and make a profit only arose at all because of their joint efforts in a joint venture capacity. This is highly analogous to situations like Boardman.</li>
<li>As the opportunity only arose within the scope of the joint venture, and the parties were always going to be coming across this kind of information and business opportunities, and obligation of absolute loyalty to one another was necessary in order to ensure that the interests of each part were properly protected. This justifies the recognition of an obligation of loyalty.</li>
</ul>
C. Relationship with Arklow
See comments from above.
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<td>Breach of fiduciary duty</td>
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As the parties were subject to fiduciary duties, “neither was permitted to place himself in a conflict of interest.” They were also both obliged to account for any unauthorised profits obtained.
According to the CJ at [15]: “The appropriation of a joint venture by one of the parties to his sole account is as fundamental a breach of fiduciary duty as can be imagined.”
Chirnside was in breach of no conflict limb of the duty of loyalty by diverting the entire joint venture to his sole account. Additionally, he obtained payments from Rattray.
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<td>Similar reasoning.</td>
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<td>Loss of chance or account of profits?</td>
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Main remedies for breach of fiduciary duty of loyalty are rescission and account.
Distinction:
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<li>Compensatory damages are measured by what the π has lost.</li>
<li>Account of profits is measured by what the Δ has gained. Whether the π has suffered any loss or whether or not the beneficiary could have ever gained is irrelevant – see Boardman v Phipps and Keech v Sandford.</li>
</ul>
The “no-profit” rules is neither compensatory nor restitutionary. It is merely designed to strip a fiduciary of unauthorised profits made while they were in a position of conflict.
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Key difference between CoA and High Court approach:
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<li>HC: Damages based on notional disgorgement of profits made but not yet realised.</li>
<li>CoA: Compensation for having been deprived of the chance of participating in a profitable joint venture. Loss of chance approach involves discounting for contingencies. “Loss” is hypothetically constructed.</li>
</ul>
CoA approach is wrong. Fay was not deprived of chance of being in a profitable joint venture. He was already part of a JV.
Fay entitled to compensation on the basis of disgorgement of profits Chirnside made from the half-share of the venture he had appropriated from Mr Fay.
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| | No need for the errant fiduciary to have acted in bad faith. As explained in *Bray v Ford*, the justification for this strict equitable rule is to prevent human nature from prevailing and using one's fiduciary position to your own advantage.<br>• No profit rule is part of the wider no-conflict rule – it reinforces the duty of fidelity/loyalty.<br>• Loyalty enforced through requiring accounting for profits derived from position. This rule is designed to ensure that fiduciaries are "financially disinterested in carrying out their duties."<br><br>Accounting occurs in 2 scenarios: (1) If there was a conflict of interest or a possible conflict of interest between the fiduciary's duty and their personal interest; and (2) If benefit was obtained through the fiduciary's position or by his taking advantage of an opportunity or knowledge derived from that position.<br><br>After the Court of Appeal found a breach of fiduciary duties, they were **wrong** to employ the lost opportunity approach rather than the remedy of account. Wrong to look at the πs loss rather than the Δs gain. | Furthermore, there is no hypothetical construction of a loss required. The outcome on these facts is sufficiently known. |
| Approach to remedial consequences – allowance issue | Allowance was unjustified for 2 reasons: (1) The amount of money paid was unsubstantiated; (2) Awarding an allowance was principally/doctrinally incorrect in the way the High Court approached the issue.<br><br>**Allowance not substantiated**<br>Rattray paid Chirnside an initial $100,000 management fee which reflected the value of the venture delivered to Rattray. This fee included an assessment of the value of Chirnside's entrepreneurial efforts.<br><br>An allowance of less than $100,000 is indicated by this initial fee. Only part of the $100,000 is attributable to Chirnside even despite his disproportionate efforts.<br><br>CJ concluded that the $100,000 payment (as Fay had not sought to recover it) was sufficient to recognise the disproportionate efforts of Chirnside and extinguished the need for any further provision to be made for Chirnside's effort and skill. | **Law**<br>*Boardman* and other cases: errant fiduciary must disgorge all the profits made due to their breach. Court can exercise discretion to allow fiduciary some allowance to recognise effort, skill and enterprise in making the profit where it would be unjust not to do so. More reprehensible the fiduciary's conduct, the less likely an allowance will be made.<br><br>Often allowances are made where an errant fiduciary applies to raw material in respect of which he has committed a breach some skill, labour or experience which increases the value of the material. Inequitable to require the fiduciary to account for the full value, **especially** where the fiduciary is already beneficially entitled to a share in the venture. ← This is where the CJ disagrees. Conceptualises this NOT as something that has had work applied to it. Instead, conceptualises as property or an asset that has been appropriated.<br><br>Court discussed *Warman International* (HCA) case where the Cort drew a distinction between appropriating a business or business opportunity on the one hand, and a specific asset on the other. Business likely to generate profits based on work and labour etc. |

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| | **Doctrinal issues**<br><br>High Court was using a compensatory damages approach that was analogous to an account of profits.<br>• This led the Court astray as they sought to ascertain what the π had lost rather than what the Δ had gained.<br>• They did this based on the hypothesis that the fiduciary duties had been discharged and that there had been a concluded agreement that Chirnside would receive extra remuneration for his extra effort.<br>• Even though Court said that it would have made a similar formal allowance in an account of profits case, CJ doubts whether these inconsistencies can be reconciled.<br><br>Law states that an errant fiduciary is not to be stripped of gains not properly attributable to the breach of fiduciary duty. Therefore, in this case, Chirnside was allowed to retain his half-share of the profits. He was entitled to this profit on his own account because of the koint venture agreement.<br><br>Payment for extra effort in gaining the profit is not profit to which the fiduciary is entitled without authorisation. It is profit within the scope of the venture. Cannot be conceptualised as not part of the "profit" in order to construct the true loss of the π – this conflicts with the no-profit rule.<br><br>The only way payment can be made is if through a formal allowance.<br>• Allowance may be made to recognise skill and work if the profit is attributable to those efforts e.g. *Boardman v Phipps.*<br>• Exceptional to grant allowance.<br>• In *Boardman*, the Court emphasised that it is unlikely allowances will be made where the fiduciary has been dishonest, acted in bad faith etc. The Δs in Boardman were entirely innocent.<br>• Typically, allowances made where the fiduciary has generated extraordinary profits that were beyond what was envisaged could be achievable under the fiduciary relationship.<br><br>On these facts, allowance was not payable because:<br>• The profits made by Chirnside were not the result of extraordinary work. It was always contemplated that Chirnside would do this | Court in *Warman* noted that allowances were made to avoid accounting becoming a vehicle for the unjust enrichment of the π. Mitigates the harshness of fiduciary law. ← This is the odd inconsistency Geoff was talking about. Hard to be ultra harsh on the one hand in constructing a fiduciary duty and finding a breach, and then be relaxed about the remedy.<br><br>**Potential relaxation of equitable rules**<br>Traditionally, the rule is that a person who accepts a fiduciary position cannot profit from that position/cannot be remunerated unless expressly authorised.<br><br>The majority drew a distinction between taking on a fiduciary duty and having a duty imposed upon you. Where you have had a duty imposed, the strict rules should not be imposed so strictly. ← undermines the no-profit rule that the CJ outlined was vital to reinforcing the duty of loyalty.<br><br>Allowance should be awarded unless it would encourage fiduciaries to breach their duties.<br><br>**Size of the allowance**<br><br>Allowance was actually $150,000. This is because the difference in profit for Mr Fay when an allowance was paid and when no allowance was paid was $150,000. Therefore, this reflects the allowance that Mr Chirnside actually received. |

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| | work in pursuit of the joint venture. Granting allowance for merely fulfilling the role he was required to carry out conflicts with the no-profit rule – he made a profit from his fiduciary position and must account.<br>• Chirnside is effectively claiming compensation for the remuneration he might have received if the obligations were strictly fulfilled. Inconsistent with *Boardman*.<br>• Fair – Chirnside is already receiving his share. Doesn't need a fee as well.<br>• Bad behaviour: this conduct was a direct denial of fiduciary loyalty. Excluded his partner. Closer to the appropriation of a specific asset (per the majority's reasoning) than inputting extra skill and care to transform something into something worth more.<br>• **Critical**: Undermines the obligation of loyalty. "If Mr Chirnside is to receive by way of deduction from the profit obtained not only the 50 percent profit … but the full benefit he might have expected had he been wholly loyal, the obligation of loyalty is undermined." | |

| **Premium Real Estate** | | |
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| | **Elias CJ** | **Blanchard, McGrath and Gault JJ** |
| What fiduciary duties were owed? | Real estate agents are “on the fringe of the central agency principles” understood by the Common Law. Real estate agents’ relationships are shaped by Contract. As they are a form of agent, they are subject to certain fiduciary obligations. However, **the scope** of those obligations depends on the scope of the duties undertaken in Contract. Informed by contractual duties etc.<br><br>Factors that are relevant to informing the scope of fiduciary obligations:<br>• Real estate agents act for multiple principals. Often, they act for principals that are competing within the same market.<br>• If they owed full fiduciary obligations, they would be prohibited from acting for multiple parties – would be a conflict of interest.<br>• This is entirely unrealistic however, as this would mean that real estate agents (especially in small countries like NZ) would not be properly able to function.<br>• Furthermore, ability to handle multiple listings is of advantage to vendors. Attracts prospective buyers,<br>• Relationships maintained with potential purchasers and vendors also beneficial – especially those who are active parts of the real estate market.<br><br>These factors influence the scope of fiduciary obligations to which real estate agents can realistically be subject to.<br><br>**Recognised core duties**<br>Must act in good faith and must not profit/obtain a benefit without the informed consent of the principal. Fundamentally, this is the duty of loyalty.<br><br>But there is no allegation of a breach of these duties here. Instead, the πs contend that the Δs were subject to a duty to disclose a potential conflict of interest arising out of the previous and potential future dealings with Mr Larsen and to disclose material information about his property purchasing. | Real estate agents are fiduciaries and have a fiduciary obligation of loyalty to their principals.<br><br>Majority first found that actively misleading the Stevens was a breach of the obligation of loyalty. She helped to support his fiction that he was a residential purchaser by discussing how he wanted to reduce his traffic time to work and wanted a view of the sea etc. This was a clear breach of the fiduciary duty of loyalty owed by the real estate agent.<br><br>**Obligation to disclose conflict of interest**<br>Two issues: (1) Confidentiality argument; (2) Disclosure duty.<br><br>A. Confidentiality<br>Premium argued that it was bound to keep the information about Mr Larsen confidential. Court responded and said that if this was so, it was under a conflict between its duty of loyalty to the Stevens and a pre-existing duty of confidentiality to Mr Larsen.<br>• Cases have held that if you put yourself into a position of having irreconcilable conflicting duties, this is your fault. It will not be a basis for finding no liability.<br>• Could have modified the duty by agreement or informed consent to avoid this issue.<br>• Could have sought Mr Larsen’s permission to disclose the potential conflict. If he declined, could advise the Stevens that there was information about Larsen she could not tell them. They could decide what to do from there.<br>• Regardless, the information was not confidential at all. It was public knowledge. Therefore, the issue did not truly arise.<br><br>B. Disclosure<br>Regarding *Kelly v Cooper* and disclosure, Court stated that no need to disclose. Commercial reality that RAs acted for multiple principals and that there will often be a conflict between principals as the properties are competing on the same market. Despite this conflict, agents must be free to act for several competing principals as otherwise they would not be able to perform their functions. |

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<u>Obligation to disclose a fiduciary duty here?</u><br>Unrealistic to expect real estate agents to make formal disclosures. Hard for RAs to assess whether they are actually under a potential conflict based on previous or potential future dealings.
Furthermore, agents need to be able to deal with those in the market, and maintain and foster relationships. To be able to perform their functions.
Unlikely tenable to owe a duty to disclose a presumed conflict arising solely out of past and potential future dealings.
Drew on <u>Kelly v Cooper</u> in support:
<ul>
<li>Agent not required to disclose information to the vender that the prospective purchaser had also bought the adjoining property.</li>
<li>Information became known to the agent because they had acted for the vendor of the adjoining property.</li>
<li>Partly this case turned on the confidentiality of the information in question.</li>
<li>However, the Court also noted that it is not tenable to say that <u>all</u> agents owe the same duties. The duties owed are shaped by the duties undertaken expressly or impliedly by contract.</li>
</ul>
What is the scope of their obligations?
<ul>
<li>RAs are required to pass on offers to their principals. This falls squarely within their roles as expressed in contract etc.</li>
<li>If they <u>do not</u> disclose information that is relevant to the advice the RA gives (e.g. advice on price or sale terms) this may breach the obligation of loyalty.</li>
<li>If non-disclosure amounts to a preference of the interests of the agent or another party, then this may also breach FO.</li>
</ul>
However, these are breaches of the core obligation. Hesitant to recognise a general duty to provide material information. Sets the required standard of conduct of RAs too high. ← This statement is critical to the critique of the CJ position based on a comparison with <u>Chirnside</u>.
<u>Breach of FO on these facts</u><br>No need to resolve the issue.
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Majority agreed with the commercial reality that RAs often have to operate under a conflict of interest. Agreed that having numerous principals was actually of benefit to vendors. Increased likelihood of sale etc.
However, Court suggested that the rest of the reasoning was wrong:
<ul>
<li>Perhaps RAs <u>are</u> according to the majority subject to a duty to disclose.</li>
<li>If <u>Kelly</u> were adopted in NZ, “it would require of real estate agents in this county a lesser standard than is required of other agents.”</li>
<li>In these circumstances, an agent should decline to act for the vendor unless released by the first vendor from the obligation of confidence or unless they have disclosed they have a potential conflict of interest.</li>
</ul>
Majority seem to adopt a black and white approach. If you are a fiduciary, you owe full fiduciary obligations. If not, you do not owe any fiduciary obligations. Seem to reject the idea that there can be different degrees of obligations owed by fiduciaries (except that a strict no conflict rule would make the job of the RA untenable). This seems <u>very</u> inconsistent with fiduciary law i.e. obligations are shaped by the nature of the particular relationship etc.
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| | The Δ actively misled the πs. Gave a partial picture and then concealed other information. Gave the impression that Mr Larsen wanted to purchase the property for residential purposes. The Δ facilitated Larsen's purchasing strategy.<br><br>Concealment perpetuated a misleading impression and was thus a breach of the core fiduciary obligation of loyalty. | |
| What was the appropriate measure of loss and remedial approach? | **<u>Commission</u>**<br>An agent in breach of their duty of loyalty cannot recover the commission which would have been payable under the contract.<br><br>Sometimes an honest mistake may allow the agent to retain their commission.<br><br>But here, there was a clear breach of the obligation of loyalty. Therefore, the commission cannot be retained. The πs can sue for the commission's return.<br><br>**<u>Remedial Approach</u>**<br>Clear distinction between account of profits and equitable compensation.<br><br>For account, normal principles of causation are irrelevant (although allowance may be made for work e.g. *<u>Chirnside</u>*.) Account is not designed to remedy a loss by putting the π in the position they would have been but for the breach. It instead strips all gain attributable to the breach.<br><br>Equitable compensation is different. For breaches of fiduciary duties, it makes good losses that result from the breach of that duty. The loss must be causally connected with the breach and no more than is necessary to make good the loss. Anything more would be penal.<br>• Common law principles of damages are not necessarily abrogated.<br>• Foreseeability – overtaken in fiduciary relationship context.<br>• Remoteness – different policy considerations in cases of breach of FOs.<br>• Causation is still required however. This flows from the compensatory justification for the remedy.<br><br>**<u>What was the loss suffered on these facts?</u>** | **<u>Measure of loss</u>**<br>Could not be an account of profits. Premium did not make the profit – Larsen did. Larsen is not subject to any fiduciary duties here.<br><br>Equitable compensation that drew analogies to Mr Larsen's profits was correct measure. But the outer limit could **<u>not</u>** be the $3.55m resale value achieved by Mr Larsen. Agreed with CJ that this was due to advertising and rise in property market etc.<br><br>The market value of $3.25m represented the outermost value of loss suffered by the parties.<br><br>A. Legal justification for why $3.25m was outer limit of loss<br>Traditionally, the rule used to be very strict. A fiduciary who breached their duty had to pay the full loss regardless of whether the information would have materially altered the decision of the principal.<br><br>Led to unfair results. Rule modified – created a <u>narrow</u> escape for the fiduciary if they could show that some or all of the loss would have occurred even if the disclosure had been made (or the breach hadn't occurred). Recognised in NZ in *<u>Bank of NZ v NZ Guardian Trust</u>*. Policy is that it is only a narrow escape. The burden is on the fiduciary and not the π. This case concerned causation of loss.<br><br>Here, the majority said the same policy considerations underlie the measure of loss that is appropriate. The normal and natural measure is the difference between the sale price and the market value. The fiduciary has to justify a different measure. Have not done so here:<br>• Court too readily reached the conclusion that the Stevens would have sold at $2.8m. Stevens still believed their house was worth $3m.<br>• Stevens were <u>not</u> in a rush to sell. Would likely have rethought the sale and retained their house. Would likely have sought valuation advice.<br>• Probably would have extended sale period and achieved the true market value of the house - $3.25m. |

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<td>The CJ characterised the loss as: “What they lost in the sale to Mr Larsen was the opportunity, if in possession of the material information, to obtain a higher price.” This loss is comparable with cases such as <u>Kelly v Cooper</u>.<br><br>To assess the quantum of loss, have to look to the attitudes of the vendors, the history of the sale, the market, the opinion evidence, and valuation evidence.<br><br>Wrong to conclude that the true loss was that if the information was disclosed, the πs would have retained an asset worth $3.25 million.<br><br>As the loss constructed is the lost opportunity to sell at a higher price, the critical evidence is the attitudes of the parties:<ul><li>Evidence shows that the πs were happy to sell the property for $2.8m. This represents the high water mark for the loss suffered.</li><li>The evidence of the resale value of the house was not reliable evidence. The purchaser on-sold the property six months later when the property market had risen. Also, there had been an aggressive international advertising campaign to attract a lucrative sale price. Therefore, the higher price of $3.55m was not a basis for demonstrating the πs loss. This was unrealistic and not causatively connected to the breach.</li><li>“On the balance of probabilities” the πs would have sold at $2.8m if they had the full information.</li></ul></td>
<td>Crucial point: Departing from this view too easily permits the errant fiduciary to escape liability. Allows Premium to gain an advantage from its wrongdoing. Undermines fiduciary obligations.<br><br>Commission also has to be repaid.</td>
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<td>Comparisons with <u>Chirnside</u> decision</td>
<td>Two respects in which the CJ is inconsistent with her approach in <u>Chirnside</u>:<ol><li>Strictness when constructing/recognising the fiduciary obligations to which the Δ is subject</li><li>Strictness when choosing the appropriate remedy and quantum of loss/compensation/payment etc.</li></ol><u>Fiduciary obligations</u><br><br>In <u>Chirnside</u>, the CJ was stricter on fiduciaries. The obligations owed were more extensive. Both parties were subject to full obligations of loyalty, which included complete obligations to <u>not</u> be in a conflict of interest.<br><br>Here, the CJ was not so strict:</td>
<td><u>[Didn’t have chance to fully finish</u>]<br><br>Would say key points:<ul><li>Majority agreed that fiduciary duties owed. Were strict on the scope of those duties.</li><li>Much stricter on the remedy than in Chirnside.</li></ul></td>
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- When constructing the fiduciary obligations, the CJ recognised that the nature and scope of the obligations had to be informed by commercial realities.
- Unrealistic to required real estate agents to disclose potential conflict of interests to their principals. This would be inconsistent with commercial realities.
- Permissible for them to act for multiple principals, even where there is sometimes competition between those principals within the same housing market.
- Core duty only is owed i.e. cannot be disloyal.

In general, not as strict in imposing fiduciary obligations. This is despite the CJ saying in *Chirnside* how strict obligations MUST be enforced in order to avoid the danger of human nature taking over and undermining the fiduciary's role.

Possible explanation: in *Chirnside*, the CJ thought that the joint venture relationship was inherently fiduciary. Perhaps this justified more extensive fiduciary obligations more akin to trustees, lawyers, partnerships etc.

Here, the CJ thinks that real estate agents are close but outside the normal scope of agency law. Agents have full fiduciary obligations. As not quite agents, the CJ was drawing analogies to the inherently fiduciary category. Trying to use contract and commercial reality to identify on the particular facts the scope of RAs fiduciary obligations. This is a different exercise. Doesn't require FULL recognition of fiduciary obligations. More consistent with normal approach.

**Remedy**

CJ was less strict on the remedy as well.

Found that the true measure of the $\pi$s loss was less than the majority. Contrary to her extremely strict and principled approach in *Chirnside* where the CJ found that not being strict would undermine the fiduciary obligation of loyalty.

CJ approach perhaps wrong:

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| | • Perhaps unfair. Relied on the attitudes of the parties. This may not be reliable because the parties were under a lot of pressure to sell their house.<br>• Furthermore, the effect of the misleading conduct was that the parties were not fully aware of the market conditions. They were wrong about the nature of the market. Maybe with better information, what they were prepared to sell for would have been different. Their attitude would be different and the outer measure of loss would be wider.<br>• CJ relied on the balance of probabilities and did not seem to take into account the reverse onus or any of the policy considerations about a narrow escape route. Inconsistent with previous strictness on fiduciaries. | |