Are the Floodgates Open? A Brief Analysis of the Supreme Court's Decision in Clayton v Clayton [Vaughan Road Property Trust]

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I INTRODUCTION

This case note considers the Supreme Court's decision in *Clayton v Clayton [Vaughan Road Property Trust]*.[1] In holding that powers bestowed under a trust deed can be considered property in terms of the Property (Relationships) Act 1976 (PRA), the decision has wrought a clear change to New Zealand law. The decision is likely to see further claims made by spouses over assets previously thought out of reach, with potential ramifications in other areas of law such as insolvency. While the decision is to be commended in several respects, I caution it should not be extended too far. Further, the Supreme Court regrettably missed an opportunity to clarify the law regarding the validity of trusts that bestow wide powers on a trustee or settlor.

II BACKGROUND

The salient facts of the case are as follows. Mr and Mrs Clayton commenced a de facto relationship in 1986 and married in 1989. They separated in 2006 and were later divorced. Acrimonious relationship property litigation ensued. One aspect of the litigation concerned the Vaughan Road Property Trust (VRPT), settled by Mr Clayton in 1999. The VRPT held a variety of assets and essentially acted as banker to other entities associated with Mr Clayton.

Mr Clayton was both settlor and sole trustee of the VRPT. The discretionary beneficiaries were Mr Clayton in his capacity as Principal Family Member (PFM), Mrs Clayton and their two daughters. The daughters were also the final beneficiaries.

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1 *Clayton v Clayton [Vaughan Road Property Trust]* [2016] NZSC 29, [2016] 1 NZLR 551 [*Clayton* (SC)]. This case was one of two conjoined appeals handed down on 23 March 2016. The second appeal, *Clayton v Clayton [Claymark Trust]* [2016] NZSC 30, [2016] 1 NZLR 590, which was brought by Mrs Clayton in respect of the Claymark Trust, is not discussed in this case note.

The VRPT's trust deed conferred wide-ranging powers on Mr Clayton — it gave him significantly greater power than a typical trustee whilst, comparatively, imposing far fewer obligations. The deed gave Mr Clayton as "trustee" the powers to:[2]

(i) distribute the income and capital of the trust to himself as one of the discretionary beneficiaries: cls 4.1, 6.1 and 10.1(a);
(ii) make such distributions to himself without considering the interests of the other beneficiaries and notwithstanding any duty to act impartially towards beneficiaries: cl[s] 11.1, 12.2 and 14.1;
(iii) subject to the terms of the trust, to deal with the trust fund as if he was the absolute owner of it and beneficially entitled to it: cl 12.1;
(iv) exercise all the trustee's powers and discretions notwithstanding any conflict of interest: cl 19.1; and
(v) revoke any of the provisions of the deed concerning the management or administration of the trust: cl 23.1.

In his capacity as PFM, Mr Clayton had power to:

(i) appoint and remove any of the discretionary beneficiaries: cl 7.1; and
(ii) appoint and remove trustees: cl 17.1.

In short, Mr Clayton's powers were vast with few constraints.

Mrs Clayton's argument was twofold. First, she argued that provisions of the trust deed amounted to a "bundle of rights" or a "power" that was "property" under the Property (Relationships) Act 1976 (PRA).[3] Secondly, she argued that the VRPT was a sham or an "illusory" trust.

III PROCEDURAL HISTORY

Family Court

In the Family Court, Judge Munro held that the basic elements of a trust were not met and that the property of the VRPT was in fact in the hands of Mr Clayton personally.[4] She gave two principal reasons. First, that cls 11.1 and 19.1 negated the beneficiaries' ability to call

2 *Clayton v Clayton* [2015] NZCA 30, [2015] 3 NZLR 293 [*Clayton* (CA)] at [45]. An extract of the trust deed setting out the relevant clauses is attached as an appendix to *Clayton* (SC), above n 1.
3 Section 2 of the Property (Relationships) Act 1976 [PRA] defines "property" as including any "right" or "interest".
4 *MAC v MAC* FC Rotorua FAM-2007-063-652, 2 December 2011.

Mr Clayton to account in the discretionary exercise of his powers as trustee.[5] These clauses eroded the "irreducible core of obligations" Mr Clayton owed to the beneficiaries as trustee.[6] Secondly, cl 23 meant Mr Clayton could revoke the trust in his favour at any time.[7] Judge Munro relied on *Tasarruf Mevduati Sigorta Fonu v Merrill Lynch Bank and Trust Co (Cayman) Ltd (TMSF)*, where a power to revoke a trust was held to be tantamount to ownership.[8] Accordingly, the trust was "illusory" and Mrs Clayton was able to claim against property notionally held by the trust.

High Court

On appeal in the High Court, Rodney Hansen J affirmed the result with slightly different reasoning. He began with the proposition that the concepts of an "illusory trust" and a "sham trust" are different.[9] A sham will exist only where there is an intention to have an express trust in appearance only.[10] Whether a trust is illusory, however, requires a consideration of whether the settlor intended to part with control over the property sufficient to constitute a trust.[11]

Contrary to Judge Munro's findings, Rodney Hansen J held that cls 11.1 and 19.1 did not relieve Mr Clayton of the duties to act honestly and in good faith.[12] The Judge also distinguished the power of revocation in *TMSF* and said Mr Clayton's power was narrower and not tantamount to ownership.[13] However, he went on to say that cls 4, 6, 12 and 14 meant that Mr Clayton effectively retained all the powers of ownership.[14] Rodney Hansen J distinguished *Financial Markets Authority v Hotchin* where Winkelmann J held that two similar trusts were not illusory.[15] Here Mr Clayton was able to deal with trust property just as if the trust had never been created.[16] The VRPT was therefore illusory.[17]

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5 At [79] and [85].
6 At [75], citing *Armitage v Nurse* [1998] Ch 241 (CA) at 253H per Millett LJ.
7 At [80].
8 *Tasarruf Mevduati Sigorta Fonu v Merrill Lynch Bank and Trust Co (Cayman) Ltd* [2011] UKPC 17, [2012] 1 WLR 1721 [*TMSF*] at [59]. There, the Privy Council held a power to revoke a trust was "tantamount to ownership" (a property right) that could be delegated to receivers in personal bankruptcy litigation. At [60] the Board said there is no invariable rule that a power is distinct from ownership.
9 *Clayton v Clayton* [2013] NZHC 301, [2013] 3 NZLR 236 [*Clayton* (HC)] at [78].
10 At [78].
11 At [79] citing *Financial Markets Authority v Hotchin* [2012] NZHC 323 at [30] .
12 At [81]–[82].
13 At [83]–[84].
14 At [90].
15 At [89].
16 At [90].
17 At [91].

Court of Appeal

On the second appeal, the Court of Appeal rejected the finding of the lower Courts that the VRPT was illusory. The Court of Appeal said first that the VRPT met the legal requirements for a valid trust.[18] The three certainties were met[19] and the trust deed, although conferring wide-ranging powers on Mr Clayton, did not purport to eliminate his fiduciary obligations of honesty and good faith to the beneficiaries.[20]

Secondly, the Court held that a subjective "shamming intention" is required for a trust to be a sham.[21] Since Mr Clayton genuinely intended to create a trust for business purposes when settling the VRPT, the VRPT was not a sham.[22]

Thirdly, regarding whether the VRPT was illusory, the Court noted that neither Rodney Hansen J nor Judge Munro offered any authority for the proposition that an otherwise genuine trust, which is not a sham, might be declared not to exist because it is "illusory".[23] The Court held there is no such concept as an illusory trust — a trust is either valid or it is not.[24] The concept of an "illusory trust" purports to focus on the true intentions of the settlor (as does that of sham),[25] and, if a trust is not a sham, it should not be invalidated because of wide-ranging powers conferred on the trustee which allegedly render it "illusory".[26]

Despite this finding, the Court nevertheless considered whether provisions of the trust deed could be considered property under the PRA. The Court held that Mr Clayton's power of appointment as PFM in terms of cl 7.1 was such property.

In doing so, the Court first held that in his role as PFM Mr Clayton owed no fiduciary duties when exercising his power of appointment — nor would he be constrained by the "fraud on a power" doctrine.[27] Secondly, citing *TMSF*, the Court held that a general power of appointment may, in some circumstances, give rise to property rights.[28] There was no good reason to maintain the traditional distinction between property and power,[29] and no practical distinction between the power to revoke in *TMSF* and Mr Clayton's

18 *Clayton* (CA), above n 2, at [56].
19 At [50].
20 At [51] and [55].
21 At [66].
22 At [67].
23 At [74].
24 At [85].
25 At [78].
26 At [80].
27 At [88]–[93].
28 At [94]–[99].
29 At [100].

power to appoint himself sole beneficiary.[30] Mr Clayton clearly intended to hold the cl 7.1 power as PFM and not trustee, a division which should be respected in terms of the PRA's application.[31] Thirdly, the Court said its approach was supported by the broad definition of property in the PRA.[32]

Supreme Court Decision

Although the parties settled after the Supreme Court hearing but before judgment, counsel and the Court agreed the Court should still deliver judgment given the importance of the issues involved.[33] O'Regan J gave the reasons for a unanimous Supreme Court. Its key finding was that the VRPT powers held by Mr Clayton were property under s 2 of the PRA.

1 Key Reasoning

The Court began with an overview of the PRA, noting in particular its purpose of providing for a just division of relationship property.[34] The Court then turned to the Court of Appeal's conclusion that the cl 7.1 power of appointment was relationship property.[35] O'Regan J surveyed authorities pertaining to the definition of "property" in the PRA and accepted the submission of counsel for Mrs Clayton, Lady Chambers QC, that the definition ought to be read widely given its statutory context and the purposes of the PRA.[36] The Court emphasised the similar finding reached by the High Court of Australia in *Kennon v Spry*.[37] The Supreme Court accepted the Court of Appeal's decision in principle and its reliance on *TMSF*.[38] However, the Court accepted the submission of counsel for the trustees, Mr Carruthers QC, that the Court of Appeal's reasoning was premised on an erroneous reading of the trust deed.[39] Even though Mr Clayton could remove discretionary beneficiaries as PFM, he could not remove the *final* beneficiaries and would continue to owe fiduciary duties to them.[40] Even if he made himself sole discretionary beneficiary, the trust would continue as the final beneficiaries would still exist.

30 At [101].
31 At [102]–[103].
32 At [111]. See the wide definition of property in s 2 of the PRA.
33 *Clayton* (SC), above n 1, at [3].
34 At [15].
35 At [21].
36 At [38].
37 At [35]; and *Kennon v Spry* [2008] HCA 56, (2008) 238 CLR 366.
38 At [46].
39 At [46].
40 At [47].

Despite this finding, the Supreme Court examined other powers held by Mr Clayton to determine whether he had such control over the trust that his powers were property under the PRA.[41]

The Supreme Court accepted the traditional view that a general power of appointment is tantamount to conferring absolute ownership and relied on *TMSF* as holding that such can be treated as property for particular purposes.[42] However, the notion of absolute ownership is undermined if the donee of the power owes fiduciary duties to objects.

Taken together, cls 6.1(a), 10, 8.1, 14.1, 11.1 and 19.1(c) meant that Mr Clayton could exercise his powers as trustee in favour of himself to the detriment of the final and discretionary beneficiaries.[43] The terms of the trust deed meant he was not constrained by any fiduciary duties when exercising his powers in his own favour.[44] Though his powers were mainly held as trustee, cls 14.1, 11.1 and 19.1(c) meant the normal constraints of trustees' fiduciary obligations had no significance.[45] Thus, his powers under the trust amounted in effect to a general power of appointment.[46]

The Court considered the expansive definition of property in the PRA supported the VRPT powers being regarded as property, as did *TMSF*.[47] The Court also considered three English cases and a Hong Kong case as emphasising a need for "worldly realism" in the relationship property context.[48]

The above analysis shows that (a) general powers of appointment are tantamount to absolute ownership, (b) fiduciary duties may negate that principle, but (c) the court will examine whether, notwithstanding the existence of fiduciary duties, the donee has effective overriding powers in favour of themselves so that the disposition can be treated as a de facto general power. If powers under a trust amount to a general power of appointment, such will be considered property under the PRA.

2 Subsidiary Points

The Court rejected a submission from Mr Carruthers that its finding would be contrary to Parliament's intention. Counsel pointed to

41 At [50].
42 At [58] and [61].
43 At [52]–[58].
44 At [58].
45 At [65].
46 At [68].
47 At [70]; and *Kennon v Spry*, above n 37.
48 At [75]–[79]. The cases were *Kan Lai Kwan v Poon Lok To Otto* [2014] HKCFA 65, (2014) 17 HKCFAR 414; *Charman v Charman* [2005] EWCA Civ 1606, [2006] 1 WLR 1053; *Charman v Charman (No 4)* [2007] EWCA Civ 503, [2007] 1 FLR 1246; and *Whaley v Whaley* [2011] EWCA Civ 617, [2012] 1 FLR 735.

legislative documents evincing a parliamentary intention for courts not to have "trust-busting" powers under the PRA.[49] While the Court accepted this submission in principle, it said the legislative history was not determinative of what should constitute property under the PRA.[50] If trust powers are property, and are also *relationship* property, the result is merely that "the pool of assets subject to the default equal sharing regime in the PRA is greater than it otherwise would be".[51] A finding that trust assets are relationship property does not, per se, lead to an order requiring trust capital to be paid to a spouse.

From there, the Court noted the Court of Appeal's lack of examination as to whether the powers were *relationship* property and concluded that they were.[52] The Supreme Court also upheld the Court of Appeal's finding that the value of the general power of appointment was an amount equal to the net value of the assets in the VRPT.[53]

Turning to the VRPT itself, the Supreme Court upheld the lower Courts' finding that the VRPT was not a sham — Mr Clayton intended to create a trust.[54] The Court said that it did not find the term "illusory trust" to be helpful.[55] It observed, however, that even if there is a finding that a trust deed is not sham, a court could find that no valid trust has come into existence.[56] As such, all that needs to be said is that there is no trust — there is no value in the term illusory.[57]

Finally, the Court refused to determine the question of whether the VRPT is a valid trust.[58] It did, however, note two alternative lines of argument concerning the VRPT's validity:[59]

(a) The reservation of such broad powers to Mr Clayton means he cannot be said to have disposed of the VRPT property in favour of another.
(b) The VRPT is effectively defeasible as Mr Clayton can choose to bring it to an end.

49 *Clayton* (SC), above n 1, at [83].
50 At [84].
51 At [84].
52 At [86].
53 At [99]–[107].
54 At [110]–[115].
55 At [129].
56 At [123].
57 At [123].
58 At [127].
59 At [124]–[125].

IV COMMENT

The Supreme Court's decision is likely to have a major impact on relationship property litigation. The Court's finding that trust assets, previously considered to be outside the scope of the PRA, could be subject to its regime means that more claims similar to Mrs Clayton's will be attempted. The potential scope of these claims is compounded by the fact that trusts do not have to be registered in New Zealand. Out of court, Lady Chambers noted that "for all we know there could be another 50,000–100,000 trust deeds that are very similar to VRPT".[60] New Zealand settlors and trust lawyers are well advised to review trust deeds that may be similar in nature to the VRPT deed.

The decision may also have an impact on insolvency litigation, particularly as the key authority relied on by the Supreme Court, *TMSF*, was decided in the insolvency sphere. Assets previously out of reach of creditors may now be pursued in the courts. Naturally, this potential impact must be weighed against the Supreme Court's emphasis on the wide definition of property in the PRA.

In several respects, the Supreme Court's decision should be commended. The outcome accorded clearly with the substantive justice in the case. The degree of control wielded by Mr Clayton over the VRPT was such that any right-minded observer would think Mrs Clayton entitled to share in its assets.

Given Mrs Clayton's two broad claims, essentially the Court had two avenues open to it in achieving such substantive justice. The Court's determination that Mr Clayton's powers amounted to property is based on sound reasoning and high-level Commonwealth authority, and accords with the purposes of the PRA. As noted by Tobias Barkley, accepting that powers can be property long predates *TMSF*[61] and the Court's reliance on that decision is, in my view, well placed. *TMSF* supplies a lucid explanation as to why powers can at times be "property" and, coupled with the purposes of the PRA, formed solid ground for the Court to build its reasoning.

Although the Court's decision accords with the substantive justice in *Clayton's* case, the principle that trust powers are property should not be unduly enlarged and the courts should be wary about how far the principle in *Clayton* is extended. Taken too far, the decision could transition from principled legal development and

60 Nick Grant "Up to 100,000 trusts at risk, thanks to Clayton decision" *The National Business Review* (New Zealand, 24 June 2016) at 3.

61 Tobias Barkley "*Clayton v Clayton*: The Court of Appeal on the concepts of property and trusts" [2015] NZLJ 164 at 164.

devolve into unconstrained activism. As Heydon J warned in his dissenting judgment in *Kennon v Spry*, "it [could] follow in divorce proceedings that the assets of [a trust] could be disposed of to [a spouse] at the expense of other members of the class of objects".[62] While the justice lay with Mrs Clayton in this case, in others, the interests of other beneficiaries are likely to assume greater prominence.

In my view, the Supreme Court should have determined also whether the VRPT was a valid trust. It expressly noted it was not doing so,[63] with a curious explanation that "given the very unusual terms of the VRPT deed, the issue is unlikely to arise in future cases".[64] Yet ironically, as noted by Jessica Palmer in relation to the Court of Appeal's decision,[65] the Court's acceptance of Mr Clayton's powers as property in effect undermined the VRPT. Furthermore, the Court's explanation ignored the fact noted by Lady Chambers that many New Zealanders have intended to create discretionary family trusts but treat them as a "cupboard", and regularly insert and withdraw assets.[66] Considered guidance would have been helpful, particularly because of the Court's decision to leave open the decision's application to a trust deed bestowing less extensive powers.[67]

This issue is a live one, and is distinct from a settlor who has a shamming intent. Rather, it concerns someone who "fully intends his documentation to take effect according to its terms, but, as a matter of proper legal analysis, fails to create a trust".[68] In my view, the case was a missed opportunity for the Supreme Court to bring further clarity to trust law. The test, I posit, if such a claim reaches the courts, will be a question of degree and can be traced to the essential requirement of a trust laid down by Lord Langdale MR in *Knight v Knight* that a settlor must intend to "dispose of [trust] property".[69] Whether this point is to be considered as a separate, general requirement of a trust or a "subpart" of the requisite certainty of intention, and how the test should be formulated, is beyond the scope of this article. Regardless, an answer would have been helpful.

On a more positive note, the Supreme Court's disapproval of the term "illusory trust" should be commended as bringing certainty to

62 *Kennon v Spry*, above n 37, at [174].
63 *Clayton* (SC), above n 1, at [127].
64 At [127].
65 Jessica Palmer "Equity and Trusts" [2015] NZ L Rev 141 at 146.
66 Nick Grant, above n 60, at 3.
67 *Clayton* (SC), above n 1, at [80].
68 Lynton Tucker, Nicholas Le Poidevin and James Brightwell *Lewin on Trusts* (19th ed, Sweet & Maxwell, London, 2015) at [4–031].
69 *Knight v Knight* (1840) 3 Beav 148 at 172, 49 ER 58 (Ch) at 68.

the law. Both Judge Munro and Rodney Hansen J relied on Winkelmann J's judgment in *Hotchin* in finding that the VRPT was "illusory". Winkelmann J used no such term. Rather, her Honour referred to the allegation distinct from sham, noted above, where the beneficial interest in the trust corpus has not been "truly transferred" and the "requisite certainty of intention is missing".[70] That is what is being alleged — that no trust was created. The term "illusory trust" is inherently confusing as it implies there is a trust, albeit a defective one. In reality, if such a pleading is successful, there is no trust at all.

To conclude, the issues in the case are of obvious import and the case is a notable development in the law. Indeed, the Law Commission has announced a review of the PRA.[71] In the meantime, it will be interesting to follow other claims like Mrs Clayton's that are made.

70 *Financial Markets Authority v Hotchin*, above n 11, at [27].

71 Law Commission "Review of the Property (Relationships) Act 1976" (24 May 2016) <www.lawcom.govt.nz>.