



LAW COMMISSION  
TE AKA MATUA O TE TURE

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# THE DUTIES, OFFICE AND POWERS OF A TRUSTEE:

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REVIEW OF THE LAW OF TRUSTS  
FOURTH ISSUES PAPER



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

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## FOREWORD

The Law Commission has been asked to review the Trustee Act 1956 and the law of trusts as a whole. This review aims to modernise trusts legislation and to determine whether legislation can provide more effective regulation of trusts than it does currently.

This Issues Paper, the fourth in the Law Commission's review of the law of trusts, addresses significant issues in the day to day operation of trusts in New Zealand. The paper deals directly with the everyday pressing problems that affect the operation of trusts. It looks at the duties that trustees owe to beneficiaries and which of these may be excluded, the requirements for becoming a trustee and leaving the office of trustee, and the powers that trustees may exercise. The issues raised in this paper form a major part of the Trustee Act 1956 and raise many important questions for reform.

This paper is intended to outline the current law and highlight the areas that may be in need of reconsideration and reform, with a discussion of the options for how this may be addressed in new legislation. Many of the areas of trust law discussed in this paper raise difficult questions that go to the heart of the nature of the trust.

We pose a number of questions throughout the paper. We are keen to receive responses to these questions and comments on the topics raised in order to inform this review and the recommendations that will be included in our final report. Those who work with trusts or have experience with trusts will undoubtedly have come up against the issues and provisions discussed in this paper because they are central to the operation of trusts. The Commission is open to hearing views and argument regarding how trusts legislation should provide for these issues.



*Hon Sir Grant Hammond KNZM*  
President of the Law Commission

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Members of the reference group are:

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

The Commissioner responsible for this reference is George Tanner, QC.

The researchers for this Issues Paper were Susan Hall, Senior Legal and Policy Adviser, Jo Dinsdale, Senior Legal and Policy Adviser and Marion Clifford, Legal and Policy Adviser.

# Call for submissions

Submissions or comments (formal or informal) on this Issues Paper should be sent to Marion Clifford, Legal and Policy Adviser, by **31 August 2011**.

## **Law Commission**

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

There are questions at the end of chapters 1, 2 and 3, and throughout chapters 4 and 5 of the paper that pinpoint the queries on which comments would be most valued. Submitters are invited to focus on any of these questions, especially in areas that concern them, or about which they have particular views. It is certainly not expected that each submitter will answer every question.

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

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## **Official Information Act 1982**

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





# The duties, office and powers of a trustee

## Review of the law of trusts Fourth Issues Paper

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# Introduction

This is the Law Commission's fourth Issues Paper on the review of the law of trusts in New Zealand. This paper focuses on the role of a trustee and mechanisms for administering a trust. The issues considered in this paper range from those that ask fundamental questions about the nature of a trust, to those that focus on more technical or mechanical aspects of how trusts work. Trustees' duties, exemption clauses, the office of trustee, trust administration and trustees' powers are matters that are likely to be significant in the day to day operation of the hundreds of thousands of trusts in New Zealand. The Law Commission seeks comment from all people with views on the issues raised in the paper or with relevant personal or professional knowledge and expertise in these aspects of trusts. Submissions on the issues and questions in this paper will assist the Commission in developing recommendations for legislation to reform the Trustee Act 1956.

There will be five Issues Papers released in the Law Commission's review of the Trustee Act 1956 and the law of trusts. This is the fourth of these Issues Papers. The Issues Papers in this review are:

- the history and nature of trusts, recent developments in the structure of trusts, and the scope and framework of a revised Trustee Act (released November 2010);
- problems with the use of trusts, including issues relating to relationship property, creditor protection, and sham trusts (released December 2010);
- the Perpetuities Act 1964 and the revocation, variation and resettlement of trusts (released May 2011);
- trustees' duties and liabilities, including indemnity provisions and exemption clauses, and the office of trustee and trust administration, including the capital and income distinction, court supervision of trusts, and trustees' powers (such as delegation, investment and insurance) (this paper);
- any remaining issues, including trading trusts, registration of trusts, dispute resolution for trusts and court jurisdiction (third quarter of 2011).

Part one of this Issues Paper addresses trustees' duties. Chapter 1 looks at what the duties of trustees' are, including the duties that make up the irreducible core of trustees' duties that cannot be excluded by a trust deed. The Commission suggests a list of duties that could be included in legislation as a summary of the obligations of trustees. Chapter 2 focuses specifically on the duty of trustees to inform beneficiaries. Chapter 3 of the paper discusses exemption clauses that exclude or limit the personal liability of a trustee, including whether a different standard should apply to professional trustees.

The second part of this paper focuses on the office of trustee and trust administration. The appointment, retirement and removal of trustees is discussed in chapter 4. Chapter 5 looks at a variety of powers of trustees, such as the power to appoint agents, the power to delegate, investment powers and the power to appoint advisory trustees.

# Part 1

## TRUSTEES' DUTIES



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# Chapter 1

## Trustees' duties

- INTRODUCTION 1.1 Part one of this Issues Paper is concerned with the duties of trustees. A significant part of what makes a trust a trust and defines how the trust arrangement operates comes from the duties that trustees owe to beneficiaries. This chapter explores the basis for trustees' duties and seeks to bring greater clarity on what the obligations of trustees are. There are three primary questions. What are the duties? Should a statement of the duties be set out in trusts legislation? Which of the duties should the trust instrument be able to override and which should be irreducible (that is, unable to be excluded by the trust deed)?
- 1.2 Trustees' duties will often be correlative with beneficiaries' rights. For example, the duty of a trustee to adhere to the terms of the trust is directly connected with the right of a beneficiary to enforce compliance with the trust instrument. The duty to inform is the corollary of the right of a beneficiary to obtain sufficient information to enable trustees to be held to account. Because of the interrelationship, a related question is whether it would make sense to specify both trustees' duties and beneficiaries' rights. The Commission is of the view that it is more useful to focus on trustees' duties, in the same way that the Companies Act 1993 lists the duties of directors without separately listing the rights of shareholders and creditors. However, the Commission would be interested to know whether submitters agree with this approach.
- 1.3 Trustees' duties are partly imposed by statute,<sup>1</sup> but derive principally from case law. There is no definitive statement of all a trustee's duties. In their paper to the 2009 New Zealand Law Society/CLE Ltd Conference on Trusts, Chris Kelly and Greg Kelly identified 14 separate trustees' duties. With one exception, the authors say the duties can be waived either wholly or partly by the trust instrument or by consent of all the beneficiaries who are of full age and capacity. According to the authors, that exception is the duty to act in good faith in what the trustees believe to be the best interests of the trust and the beneficiaries (the good faith duty).<sup>2</sup>

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1 For example, s 13B of the Trustee Act 1956 requires a trustee exercising a power of investment to exercise the care, diligence, and skill that a prudent person of business would exercise in managing the affairs of others. Section 13C imposes a higher duty on a trustee whose profession, employment, or business is or includes acting as a trustee or investing money on behalf of others. See also AS Butler and DJ Flinn "What is the least that we can expect of a trustee?" [2010] NZ Law Review 459 at 462–465.

2 Chris Kelly and Greg Kelly "So you want to be trustee" (paper presented to NZLS CLE Ltd Trusts conference, Wellington, June 2009) at 31 [NZLS seminar].

- 1.4 The American Law Institute’s *Restatement of the Law on Trusts*<sup>3</sup> identifies nine duties which cover the same matters as the categorisation with which New Zealand readers will be more familiar.
- 1.5 In *Equity and Trusts in New Zealand*, Andrew Butler lists one core duty and 12 separate duties.<sup>4</sup> Other writers have similar lists; the differences may reflect different terminology rather than different views about the substantive content of the duties. Any attempt to formulate an exact list is bound to be contentious. In this paper the Commission proposes to adopt the “Butler list” of 12 default duties. It will be more familiar to New Zealand readers than some of the overseas classifications and appears to the Commission to be comprehensive and accessible.
- 1.6 Regardless of their categorisation, there is considerable overlap between trustees’ duties. One duty can be seen as a component of another. For example, the duty to keep accounts may be regarded as an element of the duty to inform. If there is no obligation on trustees to keep proper accounts, they will not be able to discharge their duty to provide beneficiaries with the information necessary to hold the trustees accountable for the administration of the trust. Likewise the duty to distribute trust assets to beneficiaries can be seen as part of the duty to follow the terms of the trust.
- 1.7 The terms of a trust instrument may override general principles of trusts law and the Trustee Act 1956 (the Act), except where the law or the Act provide otherwise.<sup>5</sup> In a joint paper to the 2009 Legal Research Foundation seminar, Butler and Flinn list the “default” obligations of trustees as obligations that will apply only to the extent they are not excluded or varied.<sup>6</sup> However, the good faith duty can never be excluded because it is inherent to the concept of a trust. It constitutes what Millett LJ described as an “irreducible core of obligations”.<sup>7</sup> Unless there is a trustee who is obliged to act honestly in what the trustee believes to be the best interests of the beneficiaries, there will be no trust.<sup>8</sup>
- 1.8 In the discussion that follows the Commission has tried to identify the key elements of each particular duty. The leading texts on trusts law contain extensive discussion of the individual duties. As with the statement of directors’ duties in the Companies Act 1993, there is considerably more involved than the short statement of each duty might suggest. Encapsulating every single element of each duty in statutory form would not be possible and risks inhibiting judicial development. Nevertheless, the Commission believes that the general themes

3 American Law Institute *Restatement of the Law of Trusts* (Third) (2003) vol 3 [Restatement].

4 Andrew S Butler (ed) *Equity and Trusts in New Zealand* (2nd ed, Brookers, Wellington, 2009) at ch 5 [Equity and Trusts].

5 Trustee Act 1956, s 2(4).

6 Butler and Flinn, above n 1, at 462–465.

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

8 Kelly and Kelly NZLS seminar, above n 2.

reflected in the case law can be stated simply and broadly in trust legislation in a way that would assist trustees in better understanding their role and give the principles a prominence which they currently lack. Any proposed list of duties in the legislation would, therefore, be only a summary. They would not be intended to replace the common law, but would concisely summarise the duties that generally apply to trustees. It is desirable that the list should be brief and straightforward as complex provisions are less likely to be read and understood by many lay trustees.

## THE THEORETICAL BASIS FOR TRUSTEES' DUTIES

- 1.9 In *Review of Trust Law in New Zealand: Introductory Issues Paper*, the Commission discussed the nature of a trust in exploring whether a definition of a trust should be included in trust legislation.<sup>9</sup> The paper considered alternative theories of conceptualising the trust. The proprietary view of trusts focuses on the property with which a trust is concerned and the variation in ownership of it such that there is a separation in legal and equitable ownership.<sup>10</sup> A contrasting view is that the trust is primarily a contract or obligation.<sup>11</sup> Under this conception, the trust property belongs to the trustee but is subject to special obligations on the trustee in relation to property, which the trustee undertakes voluntarily. Consequently, the trust is considered to be a negotiated relationship between the settlor and trustee that affects the trustee's relationship with the third party beneficiary.<sup>12</sup>
- 1.10 Some commentators have found this theoretical background to trusts to be helpful, and it may be that it provides a useful framework against which to consider trustees' duties. However, neither the proprietary view nor the obligational view appears to provide a complete understanding of trusts by itself. In combination they may provide a useful backdrop against which areas of uncertainty in trust law can be assessed.<sup>13</sup>
- 1.11 These views about the nature of trusts can have a bearing upon how the duties applying to trustees are understood. Many of the commonly accepted trustees' duties can be explained by the proprietary view of trusts. Trustees' duties can be seen as a natural consequence of a trustee holding property for the benefit of someone else. For example, the duty to keep proper accounts, the duty not to

<sup>9</sup> Law Commission *Review of Trust Law in New Zealand: Introductory Issues Paper* (NZLC IP19, 2010) at ch 3.

<sup>10</sup> Jessica Palmer "Controlling Trustees through Beneficiaries Rights" (paper given at the Legal Research Foundation Trusts Conference in Auckland, August 2009) at 1; T Lewin *A Practical Treatise on the Law of Trusts and Trustees* (A Maxwell, London, 1837) cited by Patrick Parkinson "Reconceptualising the Express Trust" [2002] CLJ 657 at 658.

<sup>11</sup> See, for example, Charles Rickett "The Classification of Trusts" (1990) 18 NZULR 305; Patrick Parkinson "Reconceptualising the Express Trust" (2002) 61 CLJ 657; JH Langbein "The Contractarian Basis of the Law of Trusts" (1995) 105 Yale LJ 625.

<sup>12</sup> Palmer, above n 10, at 2; J Langbein, above n 11.

<sup>13</sup> Jessica Palmer discusses the evidence for the proprietary model of trusts (such as, the rule beneficiaries acting together can force the winding up of a trust, the requirement that a valid trust has certainty of objects, trusts require someone to own the trust property beneficially, a trustee's liability for third party claims cannot be met from the trust property) and the obligational model of trusts (such as, the irreducible core of any trust that is expounded in terms of obligations owed by the trustee to the beneficiary, and the ability to create discretionary trusts where the beneficiaries do not have a property right): see Palmer, above n 10, at 3–6. Palmer states at 7:

... in determining particular areas of uncertainty or controversy in trust law, it is important to keep in mind both perspectives and, where each would demand a different outcome, careful consideration ought to be given to which approach is most apposite and relevant for the particular issue at hand.



profit from trusteeship, the duty to act gratuitously and the duty to adhere to the trust's terms can all be seen as arising from the notion that property held by a trustee belongs beneficially to the beneficiary.<sup>14</sup> However, it can be argued that this conception of trusts requires nothing more from trustees than that the trust property be preserved or maintained. If this is correct then the proprietary model does not provide sufficient explanation for the duties which require a higher standard of care from the trustee, such as the duty of prudent investment and the duty to perform the trust honestly and in good faith.<sup>15</sup>

1.12 It has been argued that the obligational view of trusts does not easily provide a basis for trustees' duties generally. It explains that trustees' duties exist when the settlor and trustee agree to them, but does not explain why they are needed or what they are.<sup>16</sup> However, the obligational conception of trusts can assist in understanding those duties that impose a standard of care on trustees. Jessica Palmer argues that as property is a means of realising individual autonomy, which is of significant value in society, where someone else has legal control of a person's property, the law imposes standard of care obligations on the trustee. The trustee is obliged to act as custodian of the trust property.<sup>17</sup>

1.13 The proprietary and obligational conceptions of the trust may provide assistance in understanding trustees' duties. It may also be useful to consider the equitable basis for trusts. In the opinion of Lord Browne-Wilkinson, it remains a fundamental principle that equity operates on the conscience of the owner of the legal estate and that the foundation of trusts is the conscience of the legal owner of the property.<sup>18</sup> Thus, equity operates on the conscience of trustees. Trustees must act in accordance with what is conscionable and this creates obligations on them in how they must treat trust property and the beneficiaries. According to Pettit:<sup>19</sup>

... in the case of a trust, the conscience of the legal owner requires him to carry out the purposes for which the property was vested in him ... Accordingly he cannot be a trustee if and so long as he is ignorant of the facts alleged to affect his conscience, that is, until he is aware that he is intended to hold the property for the benefit of others.

1.14 The trustee/beneficiary relationship is a fiduciary relationship. Fiduciary relationships are those in which equity accepts that one person owes a duty of loyalty to another. As a result of this duty a range of other duties flow.<sup>20</sup>

1.15 The Commission's view is that in delineating trustees' duties it should be asked whether it is equitable and just for a trustee to be required to act in a certain way.

14 Ibid, at 6 and 9.

15 Ibid, at 9; J Penner "Exemptions" in P Birks and A Pretto *Breach of Trust* (Hart Publishing, Oxford, 2002) at 261.

16 Palmer, above n 10, at 9.

17 Ibid, at 10.

18 *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] 2 All ER 961 (HL) at 988.

19 P Pettit *Equity and the Law of Trusts* (10th ed, OUP, Oxford, 2005) at 14.

20 Butler *Equity and Trusts*, above n 4, at 28.

CORE DUTIES  
OF TRUSTEES

- 1.16 It is generally accepted that there are some basic duties of a trustee from which no exceptions are possible because they go to the very core of what makes a trust a trust. These duties are the minimum that is necessary:<sup>21</sup>
- ...if one of the most important features of the trust is to be preserved – the distinction between trusteeship and beneficial ownership of particular assets. Without this core content, the owner of the assets whom the settlor has named as the 'trustee' would no longer be compelled to apply trust assets for the settlor's purposes, but instead can exploit them beneficially for himself.
- 1.17 In *Armitage v Nurse*,<sup>22</sup> Millet LJ said that there is an irreducible core of trustees' obligations that is fundamental to the concept of a trust: to act honestly and in good faith for the benefit of the beneficiaries. This is described as being the minimum necessary to give substance to a trust.
- 1.18 However, others have defined the irreducible core of trustees' obligations differently. Several commentators have suggested that other duties of trustees' are also inherently necessary to the trust concept. Professor Penner argues that *Armitage v Nurse* reduces the core duties of a trustee to a duty not to commit a fraud on the beneficiaries (fraud being intentional wrongdoing or reckless disregard of the beneficiaries' interests). He maintains that as a result, the core duty of a trustee is determined according to a standard of fault, not a kind of duty, an approach he considers to be misguided in confusing the nature of duty with the nature of liability.<sup>23</sup>
- 1.19 Professor Penner's view is that the core duties of a trustee follow from the essence of a trust from the trustee's perspective: that the property is not (wholly) his or her own (although he or she may be one of several beneficiaries) and cannot be put into a situation where it might be available to his or her creditors, or would otherwise be treated as part of his or her estate, either on death or bankruptcy.<sup>24</sup> Thus, according to Professor Penner, the core duties of a trustee are those that give effect to the idea that the trust property is not the trustee's own, namely:
- the duty to keep the trust property separate from his or her own, and to keep the trust accounts; and
  - to comply with the trust terms, if any.
- 1.20 Professor Hayton has suggested that the duties to disclose trust information and to account to beneficiaries for the stewardship of the trust property should not be able to be excluded from the trustee's obligations.<sup>25</sup> The Australian text *Principles of the Law of Trusts* gives the duty to account and consequentially the

21 T Zhong Wei "The irreducible core content of modern trust law" (2009) 15 *Trusts and Trustees* 477 at 480–481 quoted in J Palmer, above n 10, at 15.

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

23 J Penner, above n 15, at 250.

24 *Ibid*, at 252.

25 D Hayton "The irreducible core content in trusteeship" in A J Oakley (ed) *Trends in Contemporary Trust Law* (Oxford University Press, Oxford, 1996) at 57.

beneficiary's proprietary remedies for breach of trust precedence as core duties in addition to the *Armitage v Nurse* duties.<sup>26</sup> Butler and Flinn describe four irreducible duties as follows:<sup>27</sup>

- a duty to perform the trust;
- a duty to act for the benefit of the beneficiaries;
- a duty to ensure that the trust property can be identified at any given time; and
- a duty to act in good faith.

1.21 This paper looks further at the irreducible core of trustees' duties in the context of excluding trustees' liability for breach of their duties in chapter 3. A theoretical analysis of the nature of a trust can be helpful in determining for which duties exclusion or modification is possible and for which it is not.

## DEFAULT DUTIES OF TRUSTEES

1.22 The Butler list of default duties is:<sup>28</sup>

- (a) to make acquaintance with the trust's terms;
- (b) to adhere to the trust's terms;
- (c) to maintain impartiality between beneficiaries;
- (d) to act in the beneficiaries' best interests;
- (e) not to profit from trusteeship;
- (f) to act gratuitously;
- (g) to invest;
- (h) not to delegate;
- (i) to be active;
- (j) to act unanimously;
- (k) to pay correct beneficiaries;
- (l) to keep proper accounts and give information as required.

1.23 The trustees hold the assets of the trust for the benefit of the beneficiaries, so they owe these duties, and are accountable for their performance, to the beneficiaries, rather than the settlor.<sup>29</sup> These duties have been described as being subject to a contrary intention in the trust instrument. However, as the following discussion of the duties shows, some of these duties may be of such fundamental importance that they should be considered irreducible. Consequently, below the Commission asks whether any of the duties are also irreducible duties that should not be subject to exclusion in a trust deed.

### (a) The duty to make acquaintance with the trust's terms

1.24 To know and understand the terms of the trust is normally identified as the first duty of a trustee.<sup>30</sup> Trustees must acquaint themselves thoroughly with the terms of the trust, including the trust deed (if there is one), and all other relevant documentation. They need to understand the nature of all trust property that comes into their possession and control as trustee. The obligation extends to

26 HAJ Ford and WA Lee *Principles of the Law of trusts* (Law Book Co, North Ryde, NSW, 1990).

27 Butler and Flinn, above n 1, at 476.

28 Butler *Equity and Trusts*, above n 4, at [5.3.1].

29 Kelly and Kelly *NZLS seminar*, above n 2, at 28.

30 For example, Butler *Equity and Trusts*, above n 4, at [5.3.1].

taking reasonable steps to ascertain the liabilities associated with the trust property.<sup>31</sup> According to *Underhill and Hayton*,<sup>32</sup> having accepted the trust it is the duty of the trustee to acquaint him or herself, as soon as possible, with the nature and circumstances of the trust property, the terms of the trust, and the contents of the documents handed over to the trustee relating to the trust. Where necessary, he or she should obtain a transfer of the trust property to him or herself, and (subject to the provisions of the settlement) get in debts and trust money invested on insufficient or hazardous security.

- 1.25 A new trustee who leaves the trust fund in the sole name or control of his or her co-trustees will be liable if it is lost.
- 1.26 In *Hallows v Lloyd*, Kekewich J described the duties of new trustees as follows:<sup>33</sup>
- What are the duties of persons becoming new trustees of a settlement? Their duties are quite onerous enough, and I am not prepared to increase them. I think that when persons are asked to become new trustees, they are bound to inquire of what the property consists that is proposed to be handed over to them, and what are the trusts. They ought also to look into the trust documents and papers to ascertain what notices appear among them of incumbrances and other matters affecting the trust.
- 1.27 New trustees are entitled to require the old trustees to produce all trust documents, papers, and memoranda relating to the administration of the trust (including any memorandum of wishes), so that they can fulfil this duty. New trustees should also ascertain that the trust fund is properly invested and review the trust investments, to see that the trust portfolio comprises not just authorised investments but is sensibly balanced as far as capital and income growth is concerned, taking account of the terms, purposes and distribution requirements of the trust.<sup>34</sup> Where part of the trust estate has been lost, new trustees have a duty to inquire into the circumstances as to whether there is a possibility of recovering the loss or any part of it by appropriate proceedings.<sup>35</sup>
- 1.28 New trustees are not required to incur time and cost in hunting for breaches of trust committed by the former trustees, but can assume their predecessors acted properly in the absence of circumstances indicating a breach of trust or a possible breach. But if they do not inquire into suspicious circumstances and the trust estate suffers then a new trustee may be liable for a predecessor's breach even though the trustee did not take part in committing the original breach of trust.<sup>36</sup>
- 1.29 A trustee who discovers a breach of duty must rectify it.<sup>37</sup> However, there is no obligation on the new trustee to make investigation of the title to, or value of, existing securities of a nature authorised by the trust.<sup>38</sup>

31 Butler and Flinn, above n 1, at 462.

32 David Hayton, Paul Mathews and Charles Mitchell (eds) *Underhill and Hayton: Law Relating to Trusts and Trustees* (17th ed, LexisNexis Butterworths, Bath, 2006) at [46.1] [*Underhill and Hayton*].

33 *Hallows v Lloyd* (1888) 39 CH D 686 at 691. The same duties are binding on persons appointed as original trustees also.

34 *Underhill and Hayton*, above n 32, at [46.23].

35 *Ibid*, at [46.26].

36 *Ibid*, at [46.25].

37 *Harvey v Olliver* (1887) 57 LT 239; *Millar's Trustees v Polson* (1897) 34 SLR 798.

38 *Underhill and Hayton*, above n 32, at [46.25].

1.30 This duty is for the purpose of enabling a trustee to carry out his or her role. It follows from both the proprietary and obligational conceptions of trusts, and is undoubtedly required of trustees by the principles of equity. It is difficult to envisage a trustee being able to carry out their role without being aware of the trust's terms. For this reason it is worth considering whether this duty should be considered part of the irreducible core.

### (b) The duty to adhere to the trust's terms

1.31 Trustees must adhere to the terms of the trust as expressed by the settlor either in writing or orally.<sup>39</sup> *Underhill and Hayton* describe this obligation as the duty of the trustee to obey the lawful directions of the settlement.<sup>40</sup> Both the proprietary and obligational understandings of trusts require this duty, because it outlines how trust property is to be treated for the benefit of the beneficiaries, and because it ensures the trustee is keeping his or her side of the trust "bargain". This duty requires that trustees must not act beyond the limits of the powers conferred upon them by law or the terms of the trust instrument. If they do and a loss is sustained then they "will be liable to make it good, however unexpected the result, however little likely to arise from the course adopted and however free such conduct may have been from any improper motive".<sup>41</sup>

1.32 The duty to adhere to the terms of the trust is not binding on a trustee where the directions of the settlement are illegal. However, other than this, the terms of the trust instrument override the Trustee Act 1956, except where the Act provides otherwise, and general principles of trust law.<sup>42</sup>

1.33 In practice, adherence to the terms of the trust may not be easy. It can sometimes be impractical or even undesirable to do so, particularly where there have been significant changes in the surrounding taxation or legal context. Where the terms of the trust instrument or other directions have become impractical or otherwise unsatisfactory a variation in the terms of the trust can be sought.<sup>43</sup> There are a number of possible mechanisms for varying the trust instrument. The instrument can be varied by:<sup>44</sup>

- the consent of all the beneficiaries;
- the exercise of a power of amendment conferred by the trust instrument; or
- the court exercising a power of amendment (either under its inherent jurisdiction or in accordance with a statutory provision).

1.34 If the trustee honestly believed the breach to be in the interests of beneficiaries, the trustee will not be liable for breach of trust for deviating from the strict letter of the trust. This applies only as long as the deviation is necessary or beneficial to the interests of beneficiaries. The trustee will be protected from a deliberate

39 Butler and Flinn, above n 1, at 462, citing *Hallows v Lloyd* (1888) 39 CH D 686 and also *Smith v Hugh Watt Society Inc* [2004] 1 NZLR 537 (HC) at [62].

40 *Underhill and Hayton*, above n 32, at [47.1].

41 *Ibid*, at [47.2]. The passage quoted is from *Clough v Bond* (1838) My & Cr 490 at 496–497.

42 Trustee Act 1956, s 2(4).

43 Butler *Equity and Trusts*, above n 4, at 125.

44 *Underhill and Hayton*, above n 32, at [46.1]. The mechanisms for varying a trust deed are discussed in detail in the Law Commission's third Issues Paper on the law of trusts (Law Commission *Perpetuities and the Revocation and Variation of Trusts: Review of the Law of Trusts – Third Issues Paper* (NZLC IP22, 2011)).

breach by a clause exempting the him or her from liability for breach, unless he or she was dishonest or reckless.<sup>45</sup> However, if, as the authors of *Underhill and Hayton* state, this is the most important of all the duties,<sup>46</sup> and, as Butler states, it is fundamental,<sup>47</sup> it may follow that the duty to adhere to the trust's terms should be irreducible.

### (c) The duty to maintain impartiality between beneficiaries

- 1.35 Trustees must act fairly towards all beneficiaries when managing or distributing the trust property, unless the settlor has expressed another intention in the trust document (for example, an intention to prefer family members). This duty is perhaps best understood as being in accordance with the requirements of equity and fairness. This requirement for impartiality or even-handedness (as it is also called) involves the proper disposition and employment of trust property so that one beneficiary or set of beneficiaries is not benefited at the expense of another. Whether a trustee has discharged the duty to act impartially needs to be assessed, taking into account the circumstances existing at the time the particular action was taken.<sup>48</sup>
- 1.36 The duty is particularly relevant to questions of distinguishing between capital and income, to the selection of investments, and to the realisation of wasting property or reversionary property.
- 1.37 Impartiality is needed when balancing the rights of income and capital beneficiaries. In a traditional life interest trust, an income beneficiary will receive income from the trust investments during his or her lifetime. The trustee must therefore balance the interest of the income beneficiary (who will wish to maximise their income and will prefer investments that do this) against the interests of the capital beneficiaries (who will be more concerned with maintaining or even increasing the value of the capital so will prefer investments that do this).
- 1.38 In *Re Mulligan (Dec'd)* Pankhurst J confirmed that:<sup>49</sup>
- It is elementary that a trustee must act with strict impartiality and endeavour to maintain a balance between the interests of life tenant and remaindermen. Put another way, a trustee must be even-handed as between income and capital beneficiaries.
- 1.39 *Mulligan* is a particularly good illustration. The residual beneficiaries claimed there had been a breach of the trustee duty to be impartial. For a period of 25 years from the time the major asset of the estate, a farm, was sold until the death of the life tenant, the estate assets were all invested in fixed-interest securities.

45 *Harrison v Randall* (1851) 9 Hare 397; *Armitage v Nurse* [1998] Ch 241; *Underhill and Hayton*, above n 32, at [47.121].

46 *Underhill and Hayton*, above n 32, at [47.2].

47 *Butler Equity and Trusts*, above n 4, at 125.

48 N Kelly, C Kelly, and G Kelly *Garrow & Kelly Law of Trusts and Trustees* (6th ed, LexisNexis, Wellington, 2005) at [20.5.2] [*Garrow and Kelly*]. *Garrow and Kelly* cites a number of cases here in support: *Re Hurst, Addison v Topp* (1892) 67 LT 96, 99 (CA) (Lindley LJ); *Fenwick v Clark* (1862) 4 DeGF & J 240; *Re Winslow, Frere v Winslow* (1890) 45 Ch D 249; *Re Lepine, Dowsett v Culver* [1892] 1 Ch 210 (CA), [1891 – 1894] All ER Rep 945.

49 *Re Mulligan (deceased)* [1998] 1 NZLR 481 (HC).

At the time of the sale, the balance of the estate was about \$108,000. At the time of the life tenant's death 25 years later, the value of the residuary estate stood at a little under \$102,000. Pankhurst J held that the trustee has to endeavour to maintain a balance between income and capital beneficiaries and, quoting Hoffmann J in *Nestle v National Westminster Bank plc*<sup>50</sup>, said that the trustee has to act fairly as opposed to holding the scales between the different classes of beneficiaries.

- 1.40 The trustees were permitted to take into account the close relationship between a tenant for life and a testator as opposed to a more remote relationship between the testator and the persons entitled to an estate in remainder. This was a factual consideration that, along with others, must be evaluated by the trustees and the weight to be given to such factors depends on the facts of the case.<sup>51</sup> In this case the Court found the trustees had not acted impartially but rather had consistently favoured the life interest holder. They were found to be in breach of the trust by failing to invest part of the estate in equities and were liable to place the trust estate in the same position as it would have been had there been no breach. A prudent trustee should, in 1972, have invested 40 percent of the fund in equities. The trustees were held liable for the consequential diminution in capital.
- 1.41 The rules relating to what is income and what is capital have been described by Chris Kelly and Greg Kelly as something of a minefield and difficulties arise in relation to the correct treatment of receipts and payments.<sup>52</sup> This matter is addressed in greater detail in chapter 5.
- 1.42 The duty of impartiality can give rise to difficulty in discretionary family trusts where there is a tacit understanding that the settlor will benefit during his or her lifetime and, after their death, the settlors' children will be the beneficiaries. Such trust deeds typically have a long list of beneficiaries including a broad range of relatives and charities. In principle they should all be treated equally and there is no reason in law why only the settlor should benefit.<sup>53</sup> In *Morris v Sumpter* the surviving settlor, who was also the trustee, was challenged by his stepchildren, who questioned why they never received any benefit from the trust despite being beneficiaries. The Court appointed two additional independent trustees to ensure the terms of the trust deed were adhered to in an impartial manner.<sup>54</sup> It is clear that the duty of impartiality can be overridden by the terms of the trust and frequently is. In addition, how trustees exercise their discretionary powers will often be affected by a letter of wishes which, while not binding, can have a significant influence.
- 1.43 Where the terms of the trust give a trustee a discretionary power to choose between different beneficiaries, it might be appropriate to prefer some beneficiaries over others. Chadwick LJ stated in *Edge v Pension Ombudsman* that:<sup>55</sup>

50 *Nestle v National Westminster Bank plc* [1992] EWCA Civ 12; [1993] 1 WLR 1260.

51 *Underhill and Hayton*, above n 32, at [48.4].

52 Kelly and Kelly *NZLS seminar*, above n 2, at 33.

53 *Ibid*, at 32.

54 *Morris v Sumpter* HC Auckland CIV-2004-404-3060, 6 April 2005.

55 *Edge v Pension Ombudsman* [1999] 4 All ER 546 at 566, cited in *Garrow and Kelly*, above n 48, at [20.5.3].

...the so-called duty to act impartially ... is no more than the ordinary duty which the law imposes on a person who is entrusted with the exercise of a discretionary power: that he exercise the power for the purpose for which it is given, giving proper consideration to the matters which are relevant and excluding from consideration matters which are irrelevant.

1.44 In *Manukau City Council v Lawson Patterson J* said that:<sup>56</sup>

...the impartiality principle applies where the rights of the tenant and remaindermen are set out in the trust instrument. There is often a need in such cases for a trustee to make an appropriation between income and capital. In such circumstances there is a duty of impartiality. The relevance of the *Edge* case is that in this case the trust deed contains in clause 2.3 a provision that in exercising a discretion the trustees are entitled to prefer the interests of consumers over the interests of the Councils. In exercising such a discretionary power they do not have to act impartially although they cannot take into account irrelevant, irrational or improper factors. The *Edge* case demonstrates that the terms of the trust instrument can in appropriate circumstances modify that impartiality obligation.

1.45 If the intention is to prefer some beneficiaries over others then the trust deed needs to make this clear, as it did in *Edge*. Discretionary family trusts can do this by defining carefully those who are primary and secondary beneficiaries.<sup>57</sup> If the intention is to prefer the income beneficiary then the standard duty of even-handed investment similarly needs to be overridden.

#### (d) The duty to act in the best interest of the beneficiaries

1.46 Trustees must act in the best interest of the beneficiaries, including those who are not yet born. The duty is said to stem from the fact that the trustee is appointed as custodian of the trust property.<sup>58</sup> The most important interest of the beneficiaries is considered to be their financial one, although sometimes non-financial interests will be important factors for the trustees to consider. The example given by Butler<sup>59</sup> is where beneficiaries hold particular religious or social beliefs. An investment that is contrary to those beliefs may not be in the beneficiaries' best interests, even if it is a sensible financial decision.<sup>60</sup> A trustee has a fiduciary role and equity requires trustees to ensure beneficiaries' interests are promoted as far as the trust property is concerned. This duty could be considered irreducible as it is essential to what defines the trustee/beneficiary relationship and the nature of a trust. This duty is in line with the view of trusts as being a property relationship, but one where the trustee undertakes obligations towards the beneficiary because of his or her role as a custodian of the trust property.<sup>61</sup>

56 *Manukau v City Council v Lawson* [2001] 1 NZLR 599 (HC) at 617; cited in *Garrow and Kelly*, above n 48, at [20.5.2]

57 This needs to be done carefully to avoid giving fixed rights or expectations to members of the family; or creating a vested interest that can be claimed as relationship property or is susceptible to attacks by creditors or the official assignee. See *Kelly and Kelly NZLS seminar*, above n 2.

58 *Butler Equity and Trusts*, above n 4, at 126.

59 *Ibid.*

60 *Harries v Church Commissioners of England* [1992] 1 WLR 1241; 2 All ER 300 is cited in support.

61 See above, [1.12].



### (e) The duty not to profit from trusteeship

1.47 Trustees have a fundamental obligation not to profit personally from their position as trustees. The duty is designed to ensure that the trustees' loyalty to the beneficiaries is not subverted by a desire for personal gain.<sup>62</sup> This duty arises from the equitable nature of the role of trustee as a fiduciary. It can be seen as a natural consequence of the proprietary conception of a trust as it is necessary for the preservation of trust property. This duty is strictly applied. Even where the trustee acts honestly and for the benefit of the beneficiaries, he or she must not profit.<sup>63</sup> Each case depends on its own facts. In *Jones v AMP Perpetual Trustee Company Ltd*<sup>64</sup> Thomas J referred with approval to a passage from the judgment of Lord Upjohn in *Boardman v Phipps* that:<sup>65</sup>

It is an inflexible rule of a Court of Equity that a person in a fiduciary position ... is not, unless otherwise expressly provided, entitled to make a profit; he is not allowed to put himself in a position where his interest and duty conflict ... it means the reasonable man looking at the relevant facts and circumstances of the particular case would think that there was a real sensible possibility of conflict; not that you could imagine some situation arising which might, in some conceivable possibility ... result in a conflict.

### (f) The duty to act gratuitously

1.48 Butler and Flinn suggest that the duty to act gratuitously might be properly regarded as a subset of the duty not to profit from the trusteeship, but is targeted particularly at trustee remuneration.<sup>66</sup> The office of trustee is voluntary and a trustee cannot derive any benefit (even payment for services) from trust property. Again, the rationale behind the duty is to prevent trustees from having personal interests that conflict with their duties as trustees.<sup>67</sup> There are, however, well-established exceptions, each of which is discussed briefly below.

#### *Express provision in the trust deed*

1.49 Provisions permitting remuneration of trustees are commonly included in trust deeds and wills. These are interpreted strictly and only remuneration of the type authorised is permitted.

62 Butler and Flinn, above n 1, at 463. They cite *Jones v AMP Perpetual Trustees Co NZ Ltd* [1994] 1 NZLR 690 (HC) at 711.

63 Ibid, citing *Broadman v Phipps* [1967] 2 AC 46; [1966] 3 All ER 721 (HL).

64 *Jones v AMP Perpetual Trustee Company Ltd* [1994] 1 NZLR 690 (HC) at 711.

65 *Broadman v Phipps* [1967] 2 AC 46; [1966] 3 All ER 721 (HL) at 124–125.

66 Butler and Flinn, above n 1, at 463.

67 Ibid. They cite *Bray v Ford* [1896] AC 44 (HL) and *Space Investments Ltd v Canadian Imperial Bank of Commerce Trust Co (Bahamas) Ltd* [1986] 1 WLR 1072; [1986] 3 All ER 75 (PC) at 1075 per Lord Templeman.

*Prior agreement with beneficiaries*

- 1.50 Another exception is where there is a prior agreement between the trustee or trustees and the beneficiary or beneficiaries, all of whom must be of full age and legal capacity.<sup>68</sup> The agreement must be clear and definite,<sup>69</sup> and must be made prior to the trustee taking up the trusteeship. Butler says the courts generally view agreements of this kind with suspicion.<sup>70</sup>

*Authorisation by the court*

- 1.51 Under section 72 of the Trustee Act 1956 the High Court may order the payment of a “commission or percentage” to a trustee of an amount that is just and reasonable for the person’s services before, during or on termination of the administration of the trust. The section lists factors to which the court must have regard, including amounts already paid, the amount and difficulty of the services, the trustee’s liabilities, the trustee’s skill and success in administering the trusts, the value of the trust property, and whether there should be a reduction for delay on the part of the trustee in administration of the trust.

*Payments received from overseas*

- 1.52 Trustees who receive remuneration in the course of administering assets overseas do not have to account for it if remuneration is normally allowed to trustees within the overseas jurisdiction.<sup>71</sup>

*Reimbursement of out-of-pocket expenses and indemnity for costs and expenses*

- 1.53 Under section 38(2) of the Act, a trustee may be reimbursed out of trust property for expenses incurred in administering the trust. However, a trustee is not allowed the costs of professional services performed in discharging the trustee’s responsibilities unless the beneficiaries agree, the trust instrument provides otherwise, or the court allows them. This is presumably because there is a profit element in the provision of professional services and arm’s length transactions under which those services are purchased by the trustees from other providers ensure that such services are obtained at the market price. The trustees’ costs and expenses are normally taken out of the capital.<sup>72</sup>
- 1.54 The right to reimbursement applies only to properly incurred expenses and there is case law as to what may be considered reasonable. If the court considers that a trustee has acted in an unreasonable manner the trustee will not be entitled to indemnity from the estate for costs or disbursements.<sup>73</sup>
- 1.55 A trustee’s right to indemnity for costs and expenses is a first charge on both the capital and income of the trust. This gives the trustee a lien on the trust property. It has priority over claims of beneficiaries and third parties. The indemnity

68 Butler *Equity and Trusts*, above n 4, at 128. He cites *Ayliffe v Murray* (1740) 2 Atk 58; 26 ER 231.

69 *Graham v Harris* (1883) 2 NZLR 90 (SC).

70 Butler *Equity and Trusts*, above n 4, at 128.

71 *Ibid*, at 129; *Garrow and Kelly*, above n 48, at 562.

72 Butler *Equity and Trusts*, above n 4, at 130.

73 *Re O’Donoghue* [1998] 1 NZLR 116 (HC).

allows the trustee to be reimbursed where the trustee has paid liabilities of the trust (such as insurance premiums) out of the trustee's own funds. The trustee's right to an indemnity for liabilities properly incurred in carrying out the trust extends beyond the trust property. It is enforceable in equity against the beneficiaries where the beneficiaries have capacity, have accepted beneficial ownership of the trust property knowing the relevant assets were held by the trustees, and can together terminate the trust at any time.<sup>74</sup>

#### *Payment under the rule in Cradock v Piper*

- 1.56 The rule permits solicitor-trustees or their firms to receive usual legal costs for work done in a court proceeding on their behalf, and on behalf of a co-trustee, if the costs of appearing and acting for all trustees have not added to the expense that would have been incurred if the solicitor had appeared only for the co-trustees.<sup>75</sup>

#### **(g) The duty to invest**

- 1.57 Before the Trustee Amendment Act 1988 and subject always to the terms of the trust instrument, the Trustee Act 1956 adopted the “legal list” approach to investment by trustees. Trustees were authorised to invest in a list of “authorised investments”, a policy that reflected risk aversion and that led to distortion of trust fund investment. The term “authorised investment” became something of a marketing tool by institutions seeking investment funds.
- 1.58 The 1988 amendments changed the approach with the enactment of a new Part 2 containing 17 new sections 13A to 13Q,<sup>76</sup> some of which relate to particular types of investment and were carried over from the earlier legislation. The powers are subject to the terms of the trust instrument.
- 1.59 Section 13A expressly authorises trustees to invest trust funds and to vary trust investments from time to time. Section 13B requires a trustee to exercise the level of care, diligence and skill that a prudent business person would exercise when managing the affairs of another person. Under section 13C, a trustee whose “profession, employment, or business involves acting as a trustee or investing money on behalf of others” has a higher duty. In such a case, the trustee must exercise the care, diligence, and skill that a prudent person engaged in that profession, employment, or business would exercise in managing the affairs of others. This can be seen as a duty that imputes a standard of behaviour that goes beyond what is required to merely preserve the trust property. However, it could also be seen as only being what is required to maintain the value of the property in line with inflation, which would be justified through a proprietary conception of the trust. Investment by trustees is discussed in chapter 5.

<sup>74</sup> Butler *Equity and Trusts*, above n 4, at 131, citing *Hardoon v Bellios* [1901] 1 Ch 342.

<sup>75</sup> *Cradock v Piper* (1850) 1 Mac & G 664; 41 ER 1422 cited in Butler *Equity and Trusts*, above n 4, at 129.

<sup>76</sup> These sections can be viewed at < [www.legislation.govt.nz](http://www.legislation.govt.nz) >.

- 1.60 There is an issue as to who falls within the category of the professional trustees described in section 13C. Several court decisions indicate that lawyers may not be considered to be in the business of acting as trustees. In *Hansen v Young*, the Court of Appeal decided that, in absence of agreement to the contrary, trusteeship is not part of the ordinary business of a law firm.<sup>77</sup> In *Dubai Aluminium Co v Salaam*, Lord Millett commented that it was a solicitor's business to advise, but not to make a decision about how to invest.<sup>78</sup> The same argument could be made with reference to other professional groups, such as accountants. However, it is clearly arguable that "investing money on behalf of others" describes the role of a wide variety of investment advisers and investment managers.<sup>79</sup> It may be thought that section 13C should apply to lawyers and accountants if it is to apply to investment advisers, yet the legislation does not clearly provide for this. Should section 13C be amended so that it covers lawyers and accountants who act as trustees?
- 1.61 Section 13E lists 12 factors to which a trustee may have particular regard in exercising an investment power. Butler and Flinn state that "prudence" requires trustees to consider an investment's prospects of both "yield of income and capital appreciation"<sup>80</sup> and that what is 'prudent' will vary according to the circumstances of the trust<sup>81</sup> and "will change with economic conditions and in light of contemporary thinking and understanding".<sup>82</sup>

#### (h) The duty not to delegate

- 1.62 The general rule is that trustees must not delegate their duties and powers as trustees – not even to co-trustees.<sup>83</sup> Delegation is, however, permitted where it is specifically authorised by statute, by the trust instrument, or by necessity. It is not easy to see how this duty can arise from a proprietary conception of the trust, but it relates more to the high standards of responsibility that are required of trustees because of the obligations they undertake. Section 29 of the Act deals with the appointment of agents to carry out business or do any act in connection with the trust. It does not authorise the delegation of a trustee's fundamental decision-making powers. Section 31 permits delegation by a trustee in certain limited circumstances. The topic of delegation is considered chapter 5.
- 1.63 The delegate will have the same trusts, powers, authorities, discretions, liabilities, and responsibilities as the trustee had. If the trustee appointed the delegate in good faith and without negligence he or she has a good defence against any claim by a beneficiary for any act or omission of the delegate.

77 *Hansen v Young* [2003] 1 NZLR 83 (CA).

78 *Dubai Aluminium Co v Salaam* [2003] 1 All ER 97 at 129.

79 *Garrow and Kelly*, above n 48, at [21.4.4].

80 Butler and Flinn, above n 1, at 463, citing *Jones v AMP Perpetual Trustees Co NZ Ltd* [1994] 1 NZLR 690 (HC) at 706.

81 *Ibid*, stating that section 13E recognises this by providing that trustees may have regard to a number of matters "so far as they are appropriate to the circumstances of the trust".

82 *Ibid*, citing *Re Mulligan (deceased)* [1998] 1 NZLR 481 (HC) at 500.

83 *Garrow and Kelly*, above n 48, at [20.9.1]; *Langford v Gascoyne* (1805) 11 Ves 333; *Clough v Bond* (1838) 3 Myl & Cr 490; and *Re Mulligan (deceased)* [1998] 1 NZLR 481 (HC) at 502.

(i) The duty to be active

1.64 A trustee has to perform the duties of office; the trustee cannot passively rely on co-trustees. Trustees are under a duty to actively participate in trust-related decisions. The law does not differentiate between active and passive breaches of trust.<sup>84</sup>

(j) The duty to act unanimously

1.65 Unless the trust instrument provides otherwise, trustees must act unanimously.<sup>85</sup> It has been suggested that this rule may hinder the efficient administration of a trust. The report of the British Columbia Law Institute's Committee on the Modernization of the Trustee Act (British Columbia Committee) proposed that the rule be reversed and that trustees be able to act by majority unless the terms of the trust provide otherwise.<sup>86</sup> If a trustee disagrees with the majority, the trustee may record the disagreement in writing. Unless the decision or act is unlawful, the trustee must join with the majority in giving effect to the decision if it cannot be carried out otherwise, but the trustee is not liable for breach of trust or resulting loss. Clause 12 of the Committee's draft Bill provides that if the trustees are deadlocked, one or more may apply to the court to resolve the matter.

1.66 The Committee suggested the change would bring the law into line with practice as it is common for trust instruments to empower trustees to act by majority.<sup>87</sup> A number of Commonwealth jurisdictions have changed the unanimity rule. Section 39 of the American Law Institute's *Restatement* states that, subject to a contrary intention in the trust instrument, if there are only two trustees, they must be unanimous but if there are three or more trustees, they may act by majority.<sup>88</sup> The commentary notes that at one time in private trusts all trustees had to agree but that considerations of sound and efficient administration tend to be better served by the rule in section 39, which is evidenced by widespread drafting practice and that most states provide for majority rule by statute. The statutory provisions usually protect a dissenting trustee from liability for an act authorised by the majority while preserving the co-trustee's duty to participate in deliberations and to act reasonably to prevent a breach of trust. An alternative view is that it is better to have the problems caused by a requirement for unanimity than the problems of majority rule.

84 Butler and Flinn, above n 1, at 464, citing *Turner v Turner* [1984] Ch 100; [1983] 2 All ER 745, *Bobin v Hughes* (1886) 31 Ch D 390 at 397, and *Rodney Aero Club Inc v Moore* [1998] 2 NZLR 192 (HC) at 195.

85 *Luke v South Kensington Hotel Co* (1879) 11 Ch 121 (CA). This rule appears not apply to charitable trusts (*Re Whiteley* [1910] 1 Ch 600; *Blackett v Blizard* (1829) 109 ER 317), nor to certain types of trust constituted under the Te Ture Whenua Maori Act 1993, where a majority can make a decision which will bind the minority. Under s 227 of the Te Ture Whenua Maori Act 1993 where there are three or more responsible trustees of a trust constituted under Part 12 of that Act, a majority of trustees is authorised to exercise any powers conferred upon the trustees.

86 British Columbia Law Institute, Committee on the Modernization of the Trustee Act *A Modern Trustee Act for British Columbia* (BCLI Report No 33, 2004) at 40.

87 Ibid.

88 American Law Institute *Restatement*, above n 3, vol 2 at 164.

**(k) The duty to pay correct beneficiaries**

1.67 Trustees must pay the correct beneficiaries and will be liable for wrongly paying persons who are not beneficiaries. They will not be liable for paying money to a bankrupt in good faith, without negligence, and without knowing the person is a bankrupt<sup>89</sup> or for paying money in good faith in reliance on a power of attorney where there is sufficient evidence that the power had not been revoked.<sup>90</sup> This duty flows from the duty to adhere to the trust's terms. It may also be one that should be considered to be irreducible because of its centrality to the operation of a trust.

**(l) The duty to keep proper accounts and give information as required**

1.68 The Act says nothing about the provision by a trustee of information to beneficiaries.<sup>91</sup> The duties of trustees and the entitlement of beneficiaries in this regard are governed by case law and the duty is linked to the related duty of a trustee to maintain proper accounts and records. They may be seen as separate components of the same broad duty to inform. It is an area of the law rightly described as controversial<sup>92</sup> and has been the subject of several significant court judgments in recent years. Because of the complexity of the issues involved, this duty is addressed separately in chapter 2.

**A LIST OF TRUSTEES' DUTIES**

- 1.69 Earlier in this chapter, the Commission raised the question of listing trustees' duties in trust legislation. The Commission is particularly interested to know whether it would be possible and useful to do so. Before enactment of the Companies Act 1993, the duties of company directors were contained in a complex mass of case law. The Companies Act distilled the essence of the duties and enacted them in a statute so that they would be clear and accessible. There was, however, much more to them than the somewhat bare terms of the statutory enactments in the Companies Act would suggest. Enacting directors' duties in this form has not, however, prevented the courts from elucidating and developing the content of the duties in the cases that have arisen under the Act where the actions of directors have been in issue. The Commission thinks that a similar approach could be followed in relation to trustees' duties.
- 1.70 As noted earlier in this Issues Paper, the Commission is of the view that it is more useful to focus on trustees' duties than beneficiaries' rights, in the same way the Companies Act 1993 lists the duties of directors without separately listing the rights of shareholders and creditors. However, the Commission is interested in submitters' views on this matter.

89 Trustee Act 1956, s 39(2) according to Butler and Flinn, above n 1, at 464.

90 Trustee Act 1956, s 37 according to Butler and Flinn, above n 1, at 465.

91 The Trustee Act 1956 does provide beneficiaries with the right to seek an audit of a trust's accounts. Section 83A allows a beneficiary of a trust estate administered by a trustee corporation, through a solicitor or accountant, to examine the accounts of the estate. Under s 84B the accounts of any other trust estate can be investigated and audited by a solicitor or accountant on behalf of a trustee or beneficiary. There are a number of conditions on this power under s 84B, however, and it is a provision that is rather out-dated and cumbersome.

92 Butler *Equity and Trusts*, above n 4.

## QUESTIONS

- Q1 Have the duties of trustees' been correctly identified? Are there any other duties that should be included?
- Q2 Should trust legislation contain a list of trustees' duties?
- Q3 How should such duties be expressed? Should they be stated in general terms like the duties of directors in the Companies Act 1993 or in greater detail?
- Q4 Which duties should be treated as irreducible core duties that cannot be excluded?
- Q5 Should trust legislation contain a list of beneficiaries' rights?
- Q6 Is reform of any of the trustees' duties listed in this chapter desirable?
- Q7 Should provision be made in new trust legislation for trustees to act by majority? If so, what safeguards, if any, should be provided to protect the position of a dissenting trustee? Should a dissenting trustee have continuing obligations to assist in giving effect to a decision by a majority of trustees?

# Chapter 2

## The duty to inform

**INTRODUCTION** 2.1 The duty of trustees to inform beneficiaries is linked to the duty to maintain accounts and records. This area of trust law is controversial. There are potentially competing interests involved. Beneficiaries have an interest in accessing trust information if trustees are to be held accountable for their administration of a trust. If beneficiaries cannot access that information, they will not be able to call the trustees to account either directly or by asking the court to intervene in the exercise of its supervisory powers.

2.2 Trustees have different interests to beneficiaries. They have onerous obligations. For many the position of trustee is taken on voluntarily. The trustee has been entrusted by someone else to perform an important function and should be allowed to get on with it unimpeded by constant demands from beneficiaries for a raft of information about what the trustee has done and why or what the trustee ought to do in exercising a discretionary power. A settlor may, for good reasons, wish to ensure that certain kinds of information are not disclosed or not disclosed to certain beneficiaries. It is also possible that disclosure of information that may seem uncontroversial may nevertheless damage the interests of someone who is neither settlor, nor trustee, nor beneficiary. Disclosing certain information to a beneficiary might give the beneficiary a commercial advantage that he or she would not otherwise have; for example, access to information that is commercially valuable to the beneficiary in a different capacity. A balance has to be struck between these competing interests.

### THE PROPRIETARY APPROACH

2.3 In one of the earliest cases on accessing trust information, *Clarke v Earl of Ormonde*,<sup>93</sup> access to information was ordered by the Court as part of its supervisory jurisdiction of trustees. However, from the latter part of the 19th century until recent years the courts have adopted what has been described as the proprietary approach in trust information cases. If the beneficiary had a proprietary interest in the assets of the trust, it followed that the beneficiary was entitled to see the documents and information. In a sense, they belonged to the

93 *Clarke v Earl of Ormonde* (1821) Jacob 108; 37 ER 791.



beneficiary just as much as the trust assets themselves.<sup>94</sup> This right did not extend to discretionary beneficiaries because they do not have proprietary rights in trust property but only a mere hope or expectation.<sup>95</sup>

A NEW  
APPROACH:  
SCHMIDT V  
ROSEWOOD  
TRUST LTD

- 2.4 Two recent decisions have changed the approach to accessing trust information. They raise several questions:
- Is the current law on the subject of access to trust information satisfactory or in need of change?
  - Is there a case for incorporating the current law in new trust legislation?
  - In the interests of providing trustees and beneficiaries with greater certainty, is legislative reform needed so that the duties of trustees to inform beneficiaries are stated with greater specificity?
- 2.5 In *Schmidt v Rosewood Trust Ltd*,<sup>96</sup> the Privy Council rejected the proprietary approach in favour of basing the right to information on the inherent jurisdiction of the court to supervise and, if necessary, intervene in the administration of the trust. This might be seen as a return to the early 19th century approach of which *Clarke v Earl of Ormonde* is an example. Even if a beneficiary could be said to have a proprietary interest in trust property, the Privy Council said it did not follow that he or she would automatically be entitled to trust information. Although the beneficiary had no such proprietary right, it did not follow that access to trust information should be denied. The purpose of providing beneficiaries with trust information is to enable them to ensure accountability by the trustees for their administration of the trust in accordance with the trust instrument. The question whether a beneficiary should have access to a particular document or class of documents turns not on whether he or she can claim an interest in the trust property, but on whether access to the information is necessary in order to ensure the trustees have acted properly.
- 2.6 In some situations it may be inappropriate for a discretionary object or a beneficiary with only a remote or defeasible interest to have access to trust information. On the other hand, in many situations, even though a beneficiary has no absolute right to access trust information, there will be certain kinds of information that ordinarily the beneficiary should be provided with.
- 2.7 When the trust information may be of a personal or confidential nature, a balance is required between the interests of beneficiaries, trustees, and third parties. Disclosure may have to be limited and safeguards put in place. Whether a beneficiary can access trust information will depend on the nature of the beneficiary's claim assessed on the materials before the court. No distinction is

94 *Re Cowan, Cowan v Gravett* (1886) 33 Ch D 179; *Re Tillot, Lee v Wilson* [1892] 1 Ch 86; *O'Rourke v Darbishire* [1920] AC 581; *Re Londonderry's Settlement, Peat v Walsh* [1964] 3 All ER 855.

95 *Worn v Ellis & Buxton* HC Auckland M125-SD01, 17 June 2002. However, some cases did suggest that all beneficiaries, regardless of whether they had a fixed or discretionary interest, should be entitled to see the accounts (*Armitage v Nurse* [1998] Ch 241 at 261 and 263).

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

to be made, the Privy Council said, between beneficiaries with an equitable interest, discretionary beneficiaries, and persons who are the objects of a mere power.

*SCHMIDT V ROSEWOOD APPLIED IN FOREMAN V KINGSTONE*

- 2.8 *Schmidt v Rosewood* was followed by Potter J in *Foreman v Kingstone*,<sup>97</sup> and both decisions have been recently referred to with approval by Asher J in *Re McGuire (deceased)*.<sup>98</sup>
- 2.9 While it may be relatively easy to state the general principle regarding access to trust information, as with most principles the difficulties come in applying it. In *Foreman v Kingstone* Potter J helpfully identified a list of factors that may be taken into account by a court in the exercise of its supervisory jurisdiction. These are:
- whether there are issues of personal or commercial confidentiality;
  - the nature of the interests held by the beneficiaries;
  - the impact on the trustees, other beneficiaries, and third parties;
  - whether some or all of the documents can be disclosed in full or in redacted form;
  - whether safeguards can be imposed on the use of the documents (for example, undertakings, professional inspection);
  - whether, in the case of a family trust, disclosure may embitter family feelings and the relationship between the trustees and beneficiaries to the detriment of the beneficiaries as a whole.
- 2.10 Although the issue did not arise in *Schmidt v Rosewood* or in *Foreman v Kingstone*, there is little doubt that in order for a beneficiary to be able to hold trustees to account for the management of the trust, the beneficiary needs to know that he or she is in fact a beneficiary and who the trustees are. A trustee is under a duty to take reasonably practicable steps to inform beneficiaries of the trusts in their favour. A capital beneficiary may want to make a case for the exercise of a power of advancement and an income beneficiary may wish to make a case for the exercise of a discretionary power to apply income in their favour.<sup>99</sup> Unless they know they are beneficiaries and who the trustees are, they will be unable to do so.
- 2.11 What amounts to reasonably practical steps will depend on the circumstances. It would not seem sensible to require trustees to ascertain the identity of every possible beneficiary under a discretionary trust for a very wide class of beneficiaries and inform them individually of the existence of the trust. One of the trusts in *Foreman v Kingstone* included within the class of discretionary beneficiaries “any charity within New Zealand”. As Potter J said, it is unlikely a request from a random charity for trust information would be considered favourably. Similarly, it would hardly be practicable for the trustees to identify every charity and inform it of the fact that it was a member of a class in whose favour the trustees might exercise their discretion. If, on the other hand,

97 *Foreman v Kingstone* [2004] 1 NZLR 841 (HC).

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

99 David Hayton, Paul Mathews and Charles Mitchell (eds) *Underhill and Hayton: Law Relating to Trusts and Trustees* (17th ed, LexisNexis Butterworths, Bath, 2006) at [60.10].

the beneficiaries or the trust are named in the instrument or are known or can easily be identified, there is no reason why the trustees should not be obliged to inform them of these basic matters.

- 2.12 *Foreman v Kingstone* is notable for the practical way in which Potter J applied the *Schmidt* principle to the point where it is possible to state with a degree of assurance what the position is or is likely to be in relation to different classes of trust information. But for this, trustees and beneficiaries would be at the mercy of a broad and uncertain concept that depends on judicial discretion in every case. There will always be grey areas and recourse to the court or to an alternative dispute resolution process may be the only option to resolve disputed claims. However, the decision provides a degree of practical guidance in what are likely to be common enough situations.
- 2.13 It seems clear that, unless there are reasons to withhold the information, beneficiaries will have access to:
- the trust documents, including instruments of appointment and resignation of trustees and instruments varying the terms of the trust;
  - particulars of the assets and liabilities of the trust;
  - financial statements of the trust, including accounts and accounting information relating to the winding up of a trust and final distributions;
  - information about distributions of capital and income and settlements;
  - legal advice obtained by the trustees for the purposes of administering the trust.
- 2.14 Access to other trust information is less certain. Access to minutes or records of decisions, information received by trustees from advisors, and communications between trustees themselves and between trustees and beneficiaries will depend on the circumstances of each individual case. If the material is in reality evidence of the trustees' reasons for their decisions, it will in most instances not be appropriate to disclose it.
- 2.15 Beneficiaries will not usually be entitled to the trustees' reasons for decisions.<sup>100</sup> In *Foreman v Kingstone*, Potter J would have declined to order disclosure of advice or information obtained by trustees in relation to the management of trust property or to future conduct concerning the trust property on the ground that beneficiaries are not entitled to the trustees' reasons for decisions, as distinct from the information that informed those decisions.<sup>101</sup>
- 2.16 Unless there are reasons to withhold it, a beneficiary will be able to see a letter (often called a memorandum) of wishes irrespective of whether the letter is expressed to be binding on the trustees or intended to provide only guidance. In the case of a letter of wishes that is expressed to bind the trustees, the letter may be regarded as part of the trust itself. In the case of a letter of wishes that is not binding, but intended to provide only guidance, the letter is nevertheless an important document that is likely to influence the trustees. There is an argument that beneficiaries should be able to see the letter in both cases because of its

100 *Schmidt v Rosewood Trust Ltd* [2003] 3 All ER 76; *Foreman v Kingstone* [2004] 1 NZLR 841 (HC); *Re Londonderry's Settlement* [1965] Ch 918; [1964] 3 All ER 855.

101 *Foreman v Kingstone* [2004] 1 NZLR 841 (HC) at [101].

relevance to ensuring that trustees comply with their obligations, take proper account of the settlor's wishes, and do not base their decisions on irrelevant considerations or fail to take relevant considerations into account.

- 2.17 A related question is whether the fact that a settlor makes it clear in a letter of wishes that the letter is confidential and not to be disclosed to a beneficiary should prevent the letter from being disclosed. There can be situations where settlors have personal information about a beneficiary that they want trustees to know but which could lead to family disharmony if it was made known to all beneficiaries. Any decision not to disclose a letter of wishes based on the factors in paragraph 2.9 needs to be considered against the need for a beneficiary to have access to the letter if he or she is to be able to hold the trustees to account, regardless of the fact that the settlor has endeavoured to restrict or prevent it being seen. In *Foreman v Kingstone*, Potter J said that the desire on the part of a settlor to maintain confidentiality should not override the duty of trustees to be accountable, and prevent beneficiaries being informed.<sup>102</sup> This is broadly in line with the approach in the United States. More recently in *Breakspear v Ackland*,<sup>103</sup> Briggs J ordered the disclosure of a letter of wishes despite the fact that the letter was intended to be confidential. However, in that case it was accepted in principle that letters of wishes could be withheld on the basis that the reasons for trustees' exercising their discretion are protected from disclosure.<sup>104</sup>
- 2.18 Although the *Schmidt v Rosewood* principle is open-ended, the Commission believes it would be impossible to lay down hard and fast rules about accessing differing varieties of trust information held by trustees under different kinds of trusts and where there may be sensitivities relating to certain kinds of information. There will be difficult cases where it is not clear on which side of the line a particular document or piece of information falls, and where agreement between claimant and trustees is not possible. There is also the risk that trustees may try to exploit the open-ended nature of the principle by refusing a perfectly reasonable request by a beneficiary to access trust information. Resolution in such cases may be achieved only by recourse to the courts or through protracted negotiation.
- 2.19 Professor Hayton suggests that the Privy Council in *Schmidt v Rosewood* would have been better to base any entitlement to information on what information a settlor intended a claimant to have since it is the settlor's intent that is the foundation of the trust obligation and the extent of it.<sup>105</sup> An object of a discretionary fiduciary power of appointment has no more than a right to be considered for a distribution from time to time. The effect of *Schmidt v Rosewood*, it is claimed, blurs the distinction between trusts that are imperative and powers that are optional. It should be possible for a settlor to ensure that the object of a discretionary power has no right to hold the trustee accountable for administrative and management functions, but only to be considered for a distribution.<sup>106</sup>

102 *Ibid*, at [93].

103 *Breakspear v Ackland* [2008] EWHC 220 (Ch).

104 *Ibid*, at [58].

105 David Hayton "Beneficiaries' and Objects' Rights to Information" (King's College London: Archived LLM teaching material, 2003) < [www.kcl.ac.uk](http://www.kcl.ac.uk) > .

106 *Ibid*.

- 2.20 There seems to be no reason, however, why the principle in *Schmidt v Rosewood* could not work in this situation. In such a case, a court is likely to require compelling reasons why trustees should provide information relating to the management and administration of a trust to a claimant who is only the object of a fiduciary power, but it does not follow that such a claimant should never have access to it.
- 2.21 The conventional and established view, confirmed by Potter J in *Foreman v Kingstone*,<sup>107</sup> is that trustees are never to be required to disclose the reasons for their decisions. The argument for this view is that disclosure would prevent trustees from carrying out their role as it would make them constantly subject to scrutiny and criticism. Regulation to provide beneficiaries with reasons may well be inefficient and may make trusteeship more onerous. On the other hand, there are arguments that disclosure is necessary in order to hold trustees accountable and that trustees' reasons should not be treated differently to other trust documentation. A possible approach would be to provide for beneficiaries to apply to the court for an order directing trustees to disclose reasons for their decisions if it is necessary for them to do so in order to hold them to account or to ensure that they have acted in good faith and in the best interests of the trust.
- 2.22 It is useful to consider the position in the United States. Section 82 of the American Law Institute's *Restatement of the Law of Trusts* divides the duty of a trustee to disclose into two separate components, both of which are subject to the terms of the trust. The first component is the duty to:
- promptly inform representative beneficiaries of the existence of the trust, of their status as beneficiaries and their right to obtain further information, and of basic information concerning the trusteeship;
  - inform beneficiaries of significant changes in their beneficiary status;
  - keep fairly representative beneficiaries reasonably informed of changes involving the trusteeship and about other significant developments concerning the trust and its administration, particularly material information needed by beneficiaries for the protection of their interests.
- 2.23 The second component is the duty promptly to respond to a request from a beneficiary for information concerning the trust and its administration and permit beneficiaries on a reasonable basis to inspect trust documents, records, and property holdings.<sup>108</sup>
- 2.24 The commentary on the section notes that trustees are required to alert a reasonable cross-section of beneficiaries as to the existence of the trust and give them initially useful information about it. Thereafter, if and as circumstances warrant, trustees must appraise them of significant information or developments to enable them to protect their interests. It specifically notes that because differences in trust and beneficiary circumstances preclude imposing precise and universal rules in all circumstances, the trustee's duty is to exercise reasonable judgement in deciding when, about what, and to whom information is to be provided.

107 *Foreman v Kingstone* [2004] 1 NZLR 841 (HC) at [101].

108 American Law Institute *Restatement of the Law of Trusts* (Third) (2003) vol 3 at 180–181.

- 2.25 As regards the type of information a trustee should normally provide, the commentary observes that, subject to considerations of practicality or sensitivity, trustees should inform beneficiaries when there are significant changes in trustee circumstances, including changes in identity, number or roles, and methods of determining trustee remuneration; important adjustments being considered in investment or other management strategies; significant actions under consideration that may involve special sensitivity to beneficiaries (liquidating or selling shares in a closely held business or sale of major real estate); plans for distribution on termination or partial termination; and other transactions or developments that beneficiaries should be made aware of. In addition, trustees should advise discretionary beneficiaries of information the trustees may need regarding the beneficiaries' circumstances, needs, resource concerns, or wishes that may be relevant to the exercise of a fiduciary discretion. The extent of the duty to inform probably goes well beyond what trustees in New Zealand would regard as normal.
- 2.26 Disclosure, it is said, is fundamental to sound administration of the trust and to both the trustee's performance and the beneficiaries' monitoring of the trustee's fiduciary obligations. It seems clear that the duty to inform extends to beneficiaries with present as well as future interests, whether the interest is vested or contingent or under a discretionary trust.<sup>109</sup>
- 2.27 Even though the rule in section 82 is stated to apply "except as permissibly modified by the terms of the trust", this does not entitle a settlor to create a trust without any accountability. If that were possible, beneficiaries would be in the dark as to whether there had been a breach of trust.<sup>110</sup> A trust can, however, limit the duty to disclose trust information on a reasonable basis, in order, for example, to lessen the risk of unnecessary or unwarranted loss of privacy or the risk of adverse effects on young or problem beneficiaries. Such limitations cannot, however, prevent beneficiaries or their representatives from requesting and receiving information to the extent necessary to protect their interests.<sup>111</sup>

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VALUES TO  
BE BALANCED

- 2.28 It should be noted that the courts have attempted to maintain a careful balance of divergent values in the cases regarding disclosure of information to beneficiaries. Trustees do need to be held to account and beneficiaries need sufficient information to be able to do this. However, this must be balanced against the need of trustees to be able to get on with the business of administering a trust and not to be impeded by constant demands from difficult beneficiaries. Tipping the balance in either direction risks making some trusts dysfunctional. A discretionary beneficiary with a remote interest who becomes concerned about the way in which trustees and beneficiaries with vested interests are acting may be able to make life difficult for everyone. The trustees are the real defendants and naturally may be defensive to challenges from such beneficiaries. If they want to resist contingent beneficiaries' claims, they may have to apply for directions under section 66 of the Trustee Act 1956 which requires an application to the High Court under Part 18 of the High Court Rules. The time and costs involved in such an application can be significant.

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109 *Ibid*, at 196–197.

110 *Ibid*, at 192–194.

111 *Ibid*, at 187.

DO SCHMIDT  
V ROSEWOOD  
AND FOREMAN  
V KINGSTONE  
GIVE SUFFICIENT  
GUIDANCE?

- 2.29 There are a number of issues regarding access to trust information on which the Commission would appreciate receiving views. As discussed, the principle in *Schmidt v Rosewood* is that whether a beneficiary should have access to a particular document or class of documents does not depend on whether he or she has a proprietary interest, but on whether access to the information is necessary in order to ensure the accountability of the trustees. If one considers the duty to disclose information in light of the proprietary and obligational models of the trust, it seems that the proprietary view has been superseded by the decision in *Schmidt v Rosewood*. The requirement to disclose information can be seen as following from an obligational conception of the trust as the custodial duties of trustees, the duties of honesty and good faith in the performance of the trust, can only be enforced when sufficient information for the beneficiary to ascertain whether the trustee has acted honestly and in good faith is disclosed.<sup>112</sup>
- 2.30 The Commission is particularly interested to know whether the principle in *Schmidt v Rosewood* provides a workable and effective basis for enabling trustees and beneficiaries to determine what trust information beneficiaries are entitled to access. Does it provide sufficient guidance in practical situations or is it so uncertain and elastic that it creates more problems than it solves? Are the circumstances regarding access to trust information so variable that only a broad principle approach will ever be possible?
- 2.31 Butler suggests that the decision in *Schmidt v Rosewood* has both liberalised and reduced the extent of beneficiaries' rights to information. The rationale has created doubts as to the certainty of access rights previously thought to be held by beneficiaries with fixed interests. Do they still have a right to access trust documents?<sup>113</sup> The answer appears to be that they do not. Noel Kelly, Chris Kelly and Greg Kelly say that the law relating to beneficiaries' rights to information is not clear and suggest that settlors, trustees and beneficiaries would all benefit by a clearer statement of what is required.<sup>114</sup> There are practical problems with relying on the court's inherent jurisdiction. Beneficiaries are not in a position to know whether information they seek should be made available. Trustees may know, but if they refuse to provide information it may be seen as an attempt to protect their own position. They suggest that the High Court may not be the most appropriate arbiter. If court action is taken disputes become drawn out and relationships break down. Such action can be expensive and takes time. One approach used is to provide for the settlor or a named protector to make such decisions. However, only some trust documents do this so Chris Kelly and Greg Kelly have suggested that an approach, such as a Trusts Ombudsman, to provide prompt, inexpensive resolution of these matters is worth considering.<sup>115</sup>

112 Jessica Palmer "Controlling Trustees through Beneficiaries Rights" (paper given at the Legal Research Foundation Trusts Conference in Auckland, August 2009) at 24.

113 Andrew S Butler (ed) *Equity and Trusts in New Zealand* (2nd ed, Brookers, Wellington, 2009) at 135, citing R E Megarry, "Notes: The ambit of a trustee's duty of disclosure" (1965) 81 LQR 192.

114 Noel Kelly, Chris Kelly and Greg Kelly "Submission to the Justice and Electoral Committee on the Trustee Amendment Bill 2007" at 10.

115 Chris Kelly and Greg Kelly "So you want to be trustee" (paper presented to NZLS CLE Ltd Trusts conference, Wellington, June 2009) at 33.

### Option one: General principles approach

- 2.32 The first option for law reform is to continue to base the approach to beneficiaries' access to information on the principle in *Schmidt v Rosewood*. If the principle is workable and effective, should it remain part of the common law or is there a case for incorporating it in new trust legislation (the general principle approach)? An advantage of leaving it as part of the ordinary law is that it can be developed in the context of later cases whereas a legislative enactment of the principle risks setting it in stone and necessitating possible further legislation. A disadvantage in both cases, as already noted, is that the principle is expressed in such general terms that its application to particular situations may be difficult for trustees and beneficiaries as well as their advisers. Are they any further ahead by knowing only that a beneficiary can access trust information that will assist in holding trustees to account?

### Option two: List approach

- 2.33 Alternatively, should new trust legislation specify the kinds of information that should be provided to beneficiaries (a list approach)? The advantage of a list approach is that it would better inform trustees, beneficiaries, and advisers of the kinds of information to which beneficiaries may have access, even though there will be inevitable uncertainty in some situations, particularly where there are sensitive issues or information involved. Access to trust information has long been problematic so a measure of clarity which a list approach might provide could be in everyone's interests. A disadvantage of a statutory list is that the flexibility afforded by judicial development disappears.
- 2.34 A possible option is the model recommended by the British Columbia Law Institute's Committee on the Modernization of the Trustee Act (British Columbia Committee) in its report *A Modern Trustee Act for British Columbia*.<sup>116</sup>
- 2.35 Clause 8 of the draft Bill which forms part of the Institute's report would require a trustee, for each calendar year, to deliver to a qualified beneficiary a report of the trust property that includes:
- in the first year of the trust, a statement of trust assets and liabilities at the time of its creation and at the end of the year, and in each subsequent year, a statement showing the trust assets and liabilities at the beginning of the year;
  - a statement of the values of the trust assets and liabilities and the basis of those valuations;
  - a statement of receipts and their sources;
  - a statement of disbursements and who received them.

The report would have to be delivered within 60 days after the end of the calendar year to which it related. A beneficiary would also be able to require the source documents for the information in the report. This proposal has some

<sup>116</sup> British Columbia Law Institute, Committee on the Modernization of the Trustee Act *A Modern Trustee Act for British Columbia* (BCLI Report No 33, 2004).



similarities to the requirement under the Protection of Personal and Property Rights Regulations 1988 that a property manager for an incapacitated person is to file an annual statement in a set format in the Family Court.<sup>117</sup>

- 2.36 Under the British Columbia Committee's proposal, a trustee could withhold information if, in the trustee's opinion, disclosure would:
- be detrimental to the best interests of a beneficiary;
  - be prejudicial to the interests of the trust;
  - conflict with a duty owed by a trustee as a company director;
  - reveal a trustee's reasons for the exercise of a discretion;
  - place an unreasonable administrative burden on the trust;
  - place the trustee in breach of an obligation of confidence.
- 2.37 A beneficiary denied access to trust information would be able to apply to the court for an order requiring disclosure of information regarding the terms of a trust, the administration of the trust, and the trust assets. A beneficiary could also waive the right to receive information under the clause.
- 2.38 The provision does not limit the common law duty of a trustee on request to provide accounts and trust information to a beneficiary within a reasonable period. It is thus not a complete codification.
- 2.39 A list approach may have to address the differing extent of the obligation to provide information to beneficiaries depending on the type of beneficiaries, such as vested or discretionary, depending on the degree of remoteness. The British Columbia Committee approached this issue by recommending that the draft clause apply to "qualified beneficiaries". A qualified beneficiary is defined as:
- a beneficiary who has a vested interest in the trust property and who is entitled to receive a distribution of income or capital;
  - a beneficiary who has given notice to the trustee that the beneficiary wishes to receive notices, notifications, and reports to which a qualified beneficiary is entitled under the draft Bill.
- 2.40 It may be too onerous to require that annual accounts are produced for every trust. Potter J noted in *Hills v Public Trust* that there are many trusts in New Zealand where full annual financial statements are not prepared and that the trustee's duty to account does not require that they are.<sup>118</sup> Many family trusts involve settlors transferring their family home into the trust as the trust's only asset. In these cases there is very little point in requiring an annual statement of account. Instead of a blanket requirement that annual accounts be produced for every trust, there could be a right for beneficiaries to request the filing of accounts by trustees and their review by Public Trust.

117 Protection of Personal and Property Rights Regulations 1988, reg 4.

118 *Hills v Public Trust* HC Auckland CIV-2008-404-2217, 15 March 2010; [2010] BCL 274 at [144].

### Option three: Principles and list approach

- 2.41 A third option is to combine elements of both the general principle approach and a list approach. This would involve a statutory provision stating that the trustee of a trust must make available to a beneficiary sufficient information to enable the beneficiary to hold the trustee to account for the trustee's administration of the trust. It could be made clear that there is no absolute right to the information and consequently no unqualified obligation on the trustee to provide it. The provision would list the kinds of information to be disclosed:
- information that a person is a beneficiary of the trust;
  - the names of the trustees and any advisory trustee;
  - the trust instrument and any instruments varying the trust;
  - any memorandum or letter of wishes;
  - instruments appointing new trustees;
  - instruments resettling the trust;
  - the assets and liabilities of the trust;
  - the financial statements of the trust;
  - particulars of distributions of capital and income;
  - minutes of trustees' meetings;
  - reports by legal, financial, or other advisers to the trustees paid for by the trust.
- 2.42 Adopting the British Columbia Committee's model, a trustee would be able to withhold information if disclosure would have an effect listed in paragraph 2.36 above.
- 2.43 It could also be made explicit that a trustee may decline to make information available to a person who has only a remote possibility of benefit under the trust. The legislation could also clarify whether, if a beneficiary is a minor, the trustee is obliged to provide statements of account to the beneficiary's parent or guardian.
- 2.44 As with the British Columbia Committee's model, provision could be made for enabling either a trustee or a beneficiary to apply to the court for an order or directions as to whether any particular information should be made available.
- 2.45 Even though the courts in both *Foreman v Kingstone* and *Breakspear v Ackland* were not inclined to allow the wishes of a settlor for confidentiality to override a beneficiary's access to trust information, the question remains whether it ought to be possible for a settlor to prevent disclosure either completely or partially as to only certain kinds of information and, if so, whether this should be provided for in any legislation. The Commission is interested in views regarding whether the duty to disclose is of such fundamental importance to the proper administration of trusts that it should be seen as an irreducible core duty and incapable of being displaced, although it would be subject to a discretion to withhold information if disclosure would meet any of the factors described in paragraph 2.36. New trust legislation could make this clear.

## QUESTIONS

Q8 Is the current law regarding access to trust information as stated in *Schmidt v Rosewood Trust Ltd*, *Foreman v Kingstone*, and *Re McGuire (deceased)* satisfactory?

Q9 Should the current law regarding access to trust information be enacted in new trust legislation (option one)?

Q10 Should the current law on access to trust information be reformed and, if so, how might it be done? Would it be possible for legislation to list certain kinds of trust information that trustees must make available (option two)? Alternatively, could the principle in *Schmidt v Rosewood* and *Foreman v Kingstone* be combined with an indicative list of information that trustees would normally be required to disclose (option three)?

Q11 What kinds of information might be included in such a list? Are there certain kinds of information that should always be disclosed, or never disclosed?

Q12 Should trustees be required, as in some jurisdictions in the United States, to disclose information regarding:

- significant investment or management strategies;
- significant transactions or possible transactions under consideration;
- plans for distribution on termination or partial termination;
- resettlement proposals; and
- information known to be of particular significance to a beneficiary?

Q13 Should there be an obligation on trustees to disclose trust information as a matter of course or should disclosure depend on a request from a beneficiary? Should trustees be required as a matter of course to provide certain key information, for example, notifying persons of the existence of the trust, that they are beneficiaries, and the identity of the trustees, coupled with an obligation to provide other trust information only on request?

Q14 Should a duty to disclose trust information be a duty that cannot be overridden or should a settlor be able to prevent disclosure and, if so, in what circumstances?

Q15 Should legislation provide for differing amounts or kinds of information to be provided to different categories of beneficiaries (such as vested or discretionary beneficiaries) depending on their degree of remoteness?

# Chapter 3

## Excluding the duties of a trustee

- INTRODUCTION 3.1 Many trust deeds contain trustee exemption clauses: clauses that exclude or restrict the liability of a trustee for failure to carry out properly the duties imposed on the trustee by the law or by the trust instrument. These clauses may seek to exclude or restrict liability for breach of trust, or they may limit the scope of the trustees' duties, extend their powers, or entitle them to indemnity from the trust fund.<sup>119</sup>
- 3.2 Exemption clauses limit or exclude the personal liability of a trustee. While personal liability of the trustee is not the only way to remedy a breach of trust,<sup>120</sup> excluding liability does appear to conflict with a strict proprietary conception of the trust as the trustee escapes liability for actions that fail to preserve the trust property.<sup>121</sup> Under the obligational view of trusts there is nothing theoretically objectionable about exemption clauses, as a similar approach can be taken to trusts as to contracts where there is freedom among the parties to agree as to their obligations.<sup>122</sup> However, even if this is so, there are nevertheless core duties which must apply in order for the arrangement to constitute a trust.
- 3.3 How far can such exemption clauses go? This section discusses the so-called irreducible core of duties and, if so, what duties come within it and whether there should be limits to clauses in trust instruments that purport to restrict the liability of a trustee.

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119 Law Commission for England and Wales *Trustee Exemption Clauses* (Law Com No 301, London, 2006) at [2.2].

120 For instance, an application for the removal of the trustee, an injunction to prevent breach of trust, an application for directions that would give effect to the duty owed (Jessica Palmer “Controlling Trustees through Beneficiaries Rights” (paper given at the Legal Research Foundation Trusts Conference in Auckland, August 2009) at 12; J Penner “Exemptions” in P Birks and A Pretto *Breach of Trust* (Hart Publishing, Oxford, 2002) at 251 – 252; A Butler (ed) *Equity and Trusts in New Zealand* (2nd ed, Thomson Reuters, Wellington, 2009) at [5.5.4] [*Equity and Trusts*]).

121 Palmer, above n 120, at 13.

122 *Ibid*, at 13.

- 3.4 In setting out its general proposals in relation to trust law, the Irish Law Reform Commission noted:<sup>123</sup>

...the tension in respect of trustee exemption clauses lies in the conflict between settlor autonomy and the entitlement of trustees to be protected from liability on the one hand with the entitlement of beneficiaries, the “irreducible core of trustee obligations” and public policy on the other.

- 3.5 As discussed above, the concept of an “irreducible core of trustee obligations” comes from the judgment of Millett LJ in *Armitage v Nurse*,<sup>124</sup> where the English Court of Appeal held that trustee exemption clauses can validly exempt trustees from liability for all breaches of trust except fraud. Millett LJ said that there is an irreducible core of obligations owed by the trustees to the beneficiaries and enforceable by them which is fundamental to the concept of a trust – the duty to perform the trust honestly and in good faith for the benefit of the beneficiaries:<sup>125</sup>

If the beneficiaries have no rights enforceable against the trustees there are no trusts. But I do not accept the further submission that these core obligations include the duties of skill and care, prudence and diligence. The duty of the trustees to perform the trusts honestly and in good faith for the benefit of the beneficiaries is the minimum necessary to give substance to the trusts, but in my opinion it is sufficient.

- 3.6 It followed, he said, that a trustee may be exempted from liability for loss or damage to the trust property no matter how indolent, imprudent, lacking in diligence, negligent or wilful the trustee may have been, as long as the trustee has not acted dishonestly.<sup>126</sup> This means that a trustee may be exempted from liability for breach of trust. To many, that may seem odd. In other areas of the law, exemption clauses have not generally been looked upon favourably by the courts and have been construed narrowly. Are trustees different? A trustee is appointed to carry out an important role and is often chosen to do so because of the trustee’s expertise, knowledge, judgement, or good character. Both settlor and beneficiaries rely on the trustee to give effect to the terms of the trust. Trusteeship is not something undertaken lightly, and trustees have significant expectations placed upon them. While it is always open to a settlor to require a trustee to exercise a particular level of skill and care, in the current state of the law it is equally open to the settlor to permit the trustee to be completely incompetent.
- 3.7 Looked at from that perspective, it could be argued that the settlor should be able to choose whoever he or she wishes to be a trustee and for whatever reason (professional adviser or just family friend) without requiring the trustee to meet any particular standard of performance. After all, the trustee is likely to be unpaid and the settlor will not want to make the trustee’s life too difficult.

<sup>123</sup> Irish Law Reform Commission *Trust Law: General Proposals* (LRC 92-2008, Dublin, 2008) at 76–77.

<sup>124</sup> *Armitage v Nurse* [1998] Ch 241.

<sup>125</sup> *Armitage v Nurse* [1998] Ch 241 at 253–254.

<sup>126</sup> *Armitage v Nurse* [1998] Ch 241 at 251.

On the other hand, why should a beneficiary not be entitled to expect the trustee to carry out the trust at least with a reasonable degree of skill and care? If the trustee does not exercise such a level of skill and care, the beneficiaries have to live with the consequences or have the incompetent trustee removed.

- 3.8 In its 2008 report, the Irish Law Reform Commission recommended regulation of trustee exemption clauses to ensure that liability for breach of the irreducible core obligations of a trustee could not be excluded.<sup>127</sup> It considered that the irreducible core content of trusteeship consisted of the duty to act in good faith and the duty to account to the beneficiaries for the manner in which the trustee has discharged the duties imposed.<sup>128</sup>

### The scope of the irreducible core

- 3.9 As discussed above,<sup>129</sup> not everyone agrees with the *Armitage v Nurse* statement of the irreducible core of duties of a trustee. There is a strong argument that other duties, such as the duty to account and the duty to perform the trust, form part of the irreducible core of duties that can never be excluded if the arrangement is to be a trust. The Commission is interested in views about the scope of the irreducible core of trustees' duties that should never be excluded. It is the Commission's view that legislation should set out which duties cannot be excluded.

### Type of behaviour that cannot be excluded

- 3.10 In *Armitage v Nurse*, it was held that liability can be excluded for anything other than fraud. Millett LJ described actual fraud, in the context of the relevant exemption clause, as simply meaning dishonesty.<sup>130</sup> The Irish Law Reform Commission accepted the view from *Armitage* that only breaches of trust that were fraudulent could not be exempted.<sup>131</sup>
- 3.11 However the *Armitage* decision regarding the type of behaviour that cannot be excluded has not had universal acceptance. In *Walker v Stones* the English Court of Appeal subsequently held that where a solicitor-trustee honestly believed that he was acting in the best interests of the trust, his actions could still be held to be fraudulent, if no reasonable solicitor-trustee would have thought that what was done was for the benefit of the beneficiaries.<sup>132</sup> The recently enacted Trusts (Guernsey) Law 2007 provides a statutory prohibition on terms of a trust that relieve a trustee of liability for breaches of trust arising from "his own fraud, wilful misconduct or gross negligence".<sup>133</sup> The British Columbia Law Institute recommended that courts should be able to ignore exemption clauses where a

127 Irish Law Reform Commission, above n 123, at 79.

128 Ibid, at 79–80.

129 See [1.16] to [1.20].

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

131 Irish Law Reform Commission, above n 123, at 80.

132 *Walker v Stones* [2001] QB 902 at 941.

133 The Trusts (Guernsey) Law 2007, s 39(7).

trustee has committed a breach that is “so unreasonable, irresponsible or incompetent that, in fairness to the beneficiary, the trustee ought not to be excused.”<sup>134</sup>

3.12 Butler and Flinn consider that Millett LJ’s approach of limiting conduct that cannot be excluded to fraud has the following strengths:<sup>135</sup>

- it provides consistency with the law of contract;<sup>136</sup>
- it disposes of the need to draw a distinction between negligence and gross negligence, an exercise which can be virtually impossible;
- it gives trustees greater protection; and
- it is commercially sensible for settlors to empower trustees to invest in a way that maximises investment returns.

Butler and Flinn’s own view is that the principled distinction between a person who acts honestly and in good faith on one hand, and a person who acts with a guilty mind on the other is a clearer line to draw than one involving an examination of “wilful misconduct” or “gross negligence”. They reiterate Millett LJ’s statement that there may be a stronger argument for professional trustees being required to conform to a higher standard of care than other trustees, but that this is a matter for Parliament to decide.<sup>137</sup> This is an issue which this chapter explores below. The Commission is interested in hearing views about whether limiting the type of conduct for which liability cannot be excluded by an exemption clause to fraud is appropriate in New Zealand.

## PROFESSIONAL TRUSTEES **England and Wales**

3.13 In 2006, the Law Commission for England and Wales described the decision of the Court of Appeal in *Armitage v Nurse* as having put largely beyond doubt the question of how far trustees are currently able to rely on exemption clauses. The question the Law Commission for England and Wales considered was whether or not the current law is fair, and accords sufficient protection to beneficiaries.<sup>138</sup>

3.14 The Law Commission for England and Wales considered there was a stronger case for regulation of reliance on exemption provisions for trust corporations and professional individuals, who are paid for their services as trustees, hold themselves out as having special skills and expertise, and are in a better position than lay trustees to obtain indemnity insurance. Responses to the Commission’s consultation paper revealed general distaste for the wide and sometimes indiscriminate inclusion of trustee exemption clauses in trust instruments, especially where the settlor is unaware of their existence or

134 British Columbia Law Institute *Exculpation Clauses in Trust Instruments* (No 17, 2002).

135 AS Butler and DJ Flinn “What is the least that we can expect of a trustee?” [2010] NZ Law Review 459 at 473–474 and 780.

136 A contrary view is that there cannot be such all-pervasive exclusion clauses in a contract either, as this would negate any obligation at all and there would be no contract.

137 Ibid, at 471, citing *Armitage v Nurse* [1998] Ch 241 at 256.

138 Law Commission for England and Wales, above n 119, at [3.6].

meaning. But although there was support for a degree of regulation of trustee exemption clauses, this was balanced by concerns about its implications for settlor autonomy and the appropriate protection of trustees.<sup>139</sup>

- 3.15 The Law Commission for England and Wales noted that exemption clauses operate to control risk and keep costs down, thereby encouraging a sufficient number of trustees to operate in the market. It concluded that there was a significant risk that any legislation restricting trustees' reliance on exemption clauses could lead to damaging adverse consequences. Examples of these include significant premium increases and possibly the unavailability of affordable indemnity insurance, the deterrence of potential trustees, a transfer of trusteeship to other jurisdictions, increasingly defensive behaviour by trustees, and an increase in trust litigation.<sup>140</sup>
- 3.16 The Commission believed that any statutory prohibition of reliance on trustee exemption clauses would restrict the autonomy of settlors to determine the terms on which they settle assets on trust, which would in turn limit the flexibility of the trust vehicle, one of its greatest attractions.<sup>141</sup>
- 3.17 The Commission favoured an alternative approach: ensuring that trustee exemption clauses should not be included in a trust instrument without the full knowledge and consent of the settlor. It recommended a rule of practice requiring paid trustees to ensure that before a trust is created, the settlor is aware of the meaning and effect of any clause in the trust instrument which has the effect of excluding or limiting liability for negligence.<sup>142</sup>

### New Zealand

- 3.18 In New Zealand, section 73 of the Trustee Act 1956 is relevant to consideration of trustee exemption clauses.<sup>143</sup> That section gives the court the power to relieve a trustee wholly or in part from personal liability for a breach of trust if the trustee has acted honestly and reasonably, and ought fairly to be excused for the breach of trust and for omitting to obtain the directions of the court in the matter in which the trustee committed the breach. The section covers executors and administrators of deceased estates. A trustee must have acted reasonably as well as honestly and the court must determine that it is fair to excuse the breach of trust or the failure to obtain directions from the court in the matter in which the breach was committed. A number of principles have been developed through case law and underpin the exercise of the court's discretion.<sup>144</sup>

139 Ibid, at [1.12].

140 Ibid, at [1.16] and [5.12] and following.

141 Ibid, at [1.17].

142 Ibid, at [1.22].

143 Section 73 can be viewed at < [www.legislation.govt.nz](http://www.legislation.govt.nz) > .

144 N Kelly, C Kelly and G Kelly *Garrow and Kelly Law of Trusts and Trustees* (6th ed, LexisNexis, Wellington, 2005) at 836–842.



- 3.19 In 2002, the New Zealand Law Commission recommended that paid trustees should be prevented from relying on exemption clauses, noting:<sup>145</sup>

The issue is whether losses should be borne by trustees or beneficiaries. It is appropriate to considering loss allocation, as between two classes, to take into account which class is in a better position to insure against the loss. The professional can be expected to insure (usually in practice as part of cover for all his professional activities) but the lay trustee may well either not realise the need to insure or find it difficult to obtain cover.

- 3.20 The Commission recommended that section 73 should be amended by the inclusion of a new subsection (2), providing that an exemption provision purporting to exempt paid trustees from liability for negligence would have no effect. This recommendation was not included in the Trustee Amendment Bill 2007.

- 3.21 The Commission referred to recommendations for change by law reform bodies in Ontario and British Columbia. The Ontario Law Reform Commission had recommended that exculpatory clauses have no effect as regards both professional and lay trustees with a residual discretion in “hard cases”. The British Columbia Law Institute’s Committee on the Modernization of the Trustee Act (British Columbia Committee) recommended a provision in its proposed Trustee Act that was designed to clarify the role of exculpation clauses. It was intended to strike a balance between legal policies aimed at the protection of beneficiaries and the rights of settlors to include provisions in trust instruments aimed at protecting trustees. Thus, an exemption clause would be effective according to its terms but a beneficiary would have the right to apply to the court for relief. The court could declare the clause to be ineffective if the conduct of the trustee was so unreasonable, irresponsible, or incompetent that, in fairness to the beneficiary, the trustee ought not to be excused.<sup>146</sup> Neither recommendation has yet been adopted.

- 3.22 The British Columbia Committee recommended a provision requiring a trustee to administer a trust in good faith, in accordance with the terms and purposes of the trust, and in the interests of beneficiaries. It provided that in discharging a duty or exercising a power the trustee exercise the same degree of care, diligence, and skill that a person of ordinary prudence would exercise in dealing with the property of another person. If the trustee possesses, or because of the trustee’s profession, business or calling ought to possess, a particular level of knowledge or skill, the trustee must employ that particular level of knowledge or skill.<sup>147</sup> The duty is not listed in the Committee’s draft Bill as one not capable of being overridden by the trust instrument. The reason for this may be that any exculpatory clause in a trust instrument that relaxes the duty will be subject to the power of the court to declare the clause to be ineffective if the trustee’s conduct was unreasonable, irresponsible, or incompetent.

145 Law Commission *Some Problems with the Law of Trusts* (NZLC R79, 2002) at [14].

146 British Columbia Law Institute, Committee on the Modernization of the Trustee Act *A Modern Trustee Act for British Columbia* (BCLI Report No 33, 2004), clause 59(2) and (3).

147 *Ibid*, cl 6.

### The United States position

- 3.23 The American Law Institute's *Restatement of the Law of Trusts* lists as one of a trustee's duties the duty of prudence. The trustee must administer the trust as a prudent person would, in light of the purposes, terms, and other circumstances of the trust. The duty of prudence requires the exercise of reasonable care, skill, and caution. If a trustee possesses, or procured appointment by purporting to possess, special facilities or greater skill than that of a person of ordinary prudence, the trustee has a duty to use those facilities and skill.<sup>148</sup> The commentary notes that although some aspects of a trust's administration may require knowledge and experience greater than that of a particular individual of ordinary intelligence, this does not prevent the person serving as a trustee, but emphasises the importance of obtaining competent guidance and assistance to meet the required standards. Essentially, the trustee may either possess or get in the degree and types of skill needed for a specific transaction or required more generally by the strategies of the particular trust. Thus the two basic standards are seen as not excessively demanding, neither precluding conscientious service by friends and family nor permitting inattentive behaviour by trustees who are capable of meeting the appropriate standards.<sup>149</sup>
- 3.24 The duty of prudence is default law and may be modified or relaxed by the terms of the trust. Provisions of a trust that fix a lower standard will be strictly construed but may never altogether dispense with the fundamental requirement that trustees not behave recklessly but act in good faith with some suitable degree of care and in a manner consistent with the terms and purposes of the trust and the interests of beneficiaries.<sup>150</sup>

### Comparison with directors' duties

- 3.25 The Companies Act 1993 imposes a number of duties on directors. The duties cannot be overridden by a company's constitution. A director must act in good faith and in the best interests of the company (section 131), exercise powers for a proper purpose (section 133), comply with the Act and the company's constitution (section 134), not agree or allow the business of the company to be carried on in a manner likely to create a substantial risk of serious loss to creditors (section 135), and not allow the company to incur an obligation the director does not believe the company will be able to perform (section 136). A director is required to exercise the degree of care, diligence, and skill that a reasonable director would exercise in the same circumstances taking account of the nature to the company, the nature of the decision, and the position of the director and the nature of his or her responsibilities (section 137): an objective standard.

148 American Law Institute *Restatement of the Law of Trusts* (Third) (2003) vol 3 at 81.

149 *Ibid*, at 83.

150 *Ibid*, at 81.

- 3.26 Earlier case law had imposed a lesser standard of care on directors requiring the degree of care of an ordinary person with the same knowledge and experience of the director: a subjective standard.<sup>151</sup> The Act raised the standard of care and skill required of a director and requires account to be taken of the type of company, the type of decision involved, and the nature of the director's responsibilities. It is not possible to exclude or modify these duties although directors are able to insure. It was feared at the time of enactment of the Companies Act 1993 that raising the standards of performance would discourage people from becoming company directors. It would appear, however, that such fears did not eventuate. The Commission is not aware that the change has had any adverse impact on the numbers of people willing to take on the role of company director.
- 3.27 Although there are significant differences between trusts and companies, at common law, directors were nevertheless seen as fiduciaries and this principle is reflected in the Act together with an objective standard of care and skill. Most directorships are paid offices and most companies can take out insurance on behalf of their directors to protect them. On the other hand, most trusts in New Zealand are discretionary family trusts where the trustees are likely to be family members or friends who take on the role voluntarily.

#### OPTIONS FOR REFORM

- 3.28 Options for reform range from the status quo (clauses that exempt from all liability except the duty to act in good faith) to prohibiting exemption clauses completely. The fact that a number of law reform agencies have proposed reform and that some jurisdictions have implemented changes suggests concern about the current state of the law. The law in both Jersey and Guernsey prohibits the exclusion of gross negligence and wilful misconduct,<sup>152</sup> and the law of the Turks and Caicos prohibits exclusion of liability for negligence.<sup>153</sup>
- 3.29 The Commission is concerned that the present law, which allows a trustee to be indolent, imprudent, lacking in diligence, negligent, or wilful, provides not only insufficient assurance for settlors that the responsibilities of trusteeship will be properly carried out, but also insufficient assurance for beneficiaries that their rights and interests will be adequately protected. But any move away from the current trustee-friendly position has consequences. If the law were tightened, insurance premiums might go up, beneficiaries might become more litigious, the pool of willing trustees might dry up, and there might be fewer trusts.
- 3.30 An important consideration is whether the current law condones poor performance by trustees. Is there sufficient concern about the overall performance of trusteeship in New Zealand that the law needs changing to lift standards? Are beneficiaries being disadvantaged to such an extent that the law needs to intervene? Viewed in the abstract, the current permissive approach may seem unsatisfactory, but is there a problem that needs to be addressed? All these policy considerations are relevant in considering whether, and how far, the law should go in regulating exemption clauses.

151 *Re City Equitable Fire Insurance Co Ltd* [1995] Ch 407, followed in *Grayburn v Laing* [1991] 1 NZLR 482 (HC) and *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* [1990] 3 NZLR 513 (PC). See *Brookers Company and Securities Law* (looseleaf ed, Thompson Brookers) at [CA137.02].

152 Trusts (Jersey) Law 1984, art 29(6) as amended in 1989; Trusts Law (Guernsey) 1990, s 1(f).

153 Turks and Caicos Islands Trusts Ordinance 1990, s 29(10).

- 3.31 If the law were changed to prohibit or restrict the use of exemption clauses, it would seem necessary also to state the minimum standard of performance required of a trustee. Just as an exemption clause cannot, under the current law, absolve a trustee from the duty to act honestly, the law would provide that no exemption clause would be effective to protect a trustee from failure to comply with whatever standard of performance is appropriate. The Commission has identified the following possible approaches to reform of the current law regarding exclusion of liability on the part of trustees and would appreciate receiving views on them or any other suggestions respondents may have to address these issues.

#### Option one: Status quo – no regulation of exemption clauses

- 3.32 The option of no regulation amounts to maintaining the status quo. The problem with leaving things as they are is that the tension between the various parties to the trust relationship, settlor, trustee, and beneficiary, can be resolved in favour of settlor and trustee, leaving a beneficiary without an effective means of redress when things go wrong. Some may say, however, that a person is free to do whatever he or she likes with their property and owes no duties to anyone while they own it absolutely. If I owe someone no special consideration as regards my property today, why should the position change merely because I give it to a trustee for them tomorrow?
- 3.33 The answer lies in the fact that trusteeship is, or at least should be seen and treated as, altogether different. On the creation of a trust, the original owner is no longer the legal owner of the property in his or her own right. By specifying beneficiaries, the settlor has to accept the notion that others have rights in the property or rights to enforce the performance of duties by the trustees in relation to the property. It is true that a trust instrument may be drafted so that settlor, trustee, and beneficiary may all be one and the same person, creating the appearance that nothing has changed and absolving the trustees from everything except dishonesty. In the eyes of the law, however, the legal situation has changed.
- 3.34 The Commission considers that it may not be satisfactory to leave matters as they are. The balance appears to be too much in favour of settlor and trustee, and a greater measure of accountability is needed.

#### Option two: No prohibition but beneficiary can apply to Court for relief

- 3.35 This option would effectively leave it up to any exclusion clause in a trust instrument to take effect according to its terms, but a beneficiary would have the right to apply to the court to exclude its operation. The court could set the clause aside if, for example, the conduct of the trustee was so unreasonable or unsatisfactory that the trustee should not be permitted to take advantage of the clause. This is the reverse of the option of total prohibition, with the trustee having the ability to apply to the court to be exonerated. It is the option favoured by the British Columbia Committee. It raises issues of cost and uncertainty.

### Option three: No prohibition, but duty of paid trustee to inform settlor

- 3.36 The Law Commission for England and Wales recommended against changes to the law. Instead, it proposed that where a clause in a trust deed exonerates a paid trustee for liability for negligence, that trustee must take steps to inform the settlor of the meaning and effect of the provision. The Commission considered that failure to do so could be satisfactorily enforced by the appropriate regulatory body.
- 3.37 In New Zealand this might be achieved in the case of lawyers who are trustees and in the case of companies incorporated by lawyers to perform trustee services by the rules relating to the conduct of solicitors. The requirement to inform the settlor could be enforced against accountants through the regulatory requirements under the New Zealand Institute of Chartered Accountants Act 1996. The Trustee Companies Act 1967 could be amended to impose the requirement on trustee companies subject to the Act. However, that would still leave many persons or bodies not subject to oversight.
- 3.38 Another potential problem is that different regulatory agencies might adopt different sanctions for non-compliance, resulting in inconsistent treatment for the same conduct. The only effective way of achieving coverage and consistency would be to include the requirement in trust legislation with an appropriate sanction for failure to comply.
- 3.39 Should a commercial trustee have to inform a commercial settlor of the meaning and effect of an exclusion clause? It may be assumed they are acting at arm's length in what is essentially a commercial transaction in which both parties can look after their own interests. There would seem to be a strong case for excluding this kind of situation from regulation. A solution to this could be to allow such settlors to sign an acknowledgement that they have obtained their own legal advice or that they understand the relevant limitation of liability provisions.

### Option four: Partial prohibition – trustee excused if exercises reasonable skill and care

- 3.40 Another possibility is to prohibit exculpatory clauses to the extent they absolve trustees who are individuals from liability for acts or omissions in bad faith or without reasonable skill and care. This would require a higher standard than *Armitage v Nurse*. It means, in effect, that the trustee will not be protected for negligence. As long as a trustee acts in good faith and with reasonable skill and care, the trustee will not be subject to liability. It would probably be necessary to retain the power in section 73 to enable the court to absolve a trustee who has acted honestly and reasonably and ought fairly to be excused. Nevertheless, such a standard might still discourage individuals from becoming trustees. Having to go to court is not an attractive option for a trustee who, despite his or her best efforts, has still fallen short of having acted with reasonable skill and care.
- 3.41 The position of the professional trustee raises different considerations. The professional trustee is paid for his or her services and is also in a better position to obtain insurance, the cost of which can be passed on to the trust. Even so, application for relief would still be required with inherent cost and uncertainty.

### Option five: Requirement for reasonableness

- 3.42 In its Consultation Paper on Trustee Exemption Clauses, the Law Commission for England and Wales proposed a test of reasonableness, such that a trustee could only take advantage of an exemption clause that was reasonable.<sup>154</sup> What is reasonable might be determined by reference to a list of factors. The Law Commission for England and Wales considered that an analogy could be made with legislation regulating unfair contract terms and that the development over time of a body of case law would produce eventual clarity. Such an approach might also influence the way in which exemption clauses were drafted.
- 3.43 While this approach has some attraction, until the ambit of the legislation is settled by the courts it creates uncertainty for trustees and beneficiaries and would inevitably lead to considerable litigation to determine its precise scope and operation in a great many different situations. The Law Commission for England and Wales expressed reservations about an approach that confined application of the test to the circumstances prevailing at the time the trust was executed. Such an approach would require a trustee's conduct many years later to be evaluated by reference to the standards prevailing at the time of the original instrument. However, a possible response to concerns of that kind is that the same is true of legislation. The courts adopt an ambulatory approach to the construction of legislation and apply it to circumstances as they arise. There would seem no reason why the same approach could not apply to the construction of exemption clauses. After all, a settlor may intend the trust to continue for many years, with numerous changes in trustees and beneficiaries and in the circumstances in which the trust is to operate, many of which may have been completely unforeseen at the time the trust was created.

### Option six: Dual standard

- 3.44 Another option is to distinguish between lay trustees and professional trustees. Lay trustees would continue to be able to rely on exemption clauses that limited their liability for all conduct short of dishonesty. Professional trustees would not be able to rely on an exemption clause to the extent it purported to absolve them for failure to exercise reasonable skill and care. Such an approach avoids the risk that trusteeship may become unattractive for people who would otherwise be good trustees and who would do their conscientious best. On the other hand, it would require a standard of skill and care that is nothing more than what could be expected from a person or corporation that carries on the business of providing trustee services.

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<sup>154</sup> Law Commission for England and Wales *Trustee Exemption Clauses: A Consultation Paper* (Consultation Paper No 171) 2003.

### Option seven: Total prohibition

- 3.45 It would be possible to prohibit all exclusion clauses in trust deeds both for individual and professional trustees. The Commission does not favour this option. Total prohibition of exclusion clauses would place an impossibly high standard on individual trustees and the majority of trustees are individuals who act voluntarily. The Commission is not aware of concerns that the performance of trustees is such that a shift from the current comparatively low standard to what amounts to a standard of absolute liability is required. Individuals are unlikely to take on the role and settlors will be forced to appoint trust companies or other experienced professionals, with the costs involved in insuring their liabilities thus pushing up the overall costs of trusteeship. It would be unrealistic to expect the voluntary trustee to insure even if they could.
- 3.46 Setting the duties at such a high a level may also discourage the very creation of trusts in situations where there are excellent reasons for having them. Nor does the Commission see a case for imposing such a high standard on professional trustees. Such an approach might be supportable if a trustee, whether individual or professional, could seek to be exonerated by the court on specified grounds as, for example, under section 73 of the Act. However, the trustee is then in the position of having to seek relief, a factor that may also act as a disincentive to trusteeship. In addition, the need to go to the court for relief is both costly and uncertain. It seems in any event that the courts have been reluctant to grant relief to professional trustees.
- 3.47 The issue has been raised with the Commission that a prohibition on exemption clauses could also cause problems where a settlor has particular views about a form of investments for a trust fund, for instance, requiring purely ethical investments. Such a policy may mean that a trustee breaches the prudent person investment rules. Exemption clauses have been used to prevent liability arising from following the settlor's investment policy. Without exemption clauses some trustees may feel forced back to investing in accordance with the 'prudent person' rules. However, it is the Commission's view that rather than a wide exemption power, trust deeds in these situations should include greater specificity in the investment powers.

QUESTIONS

Q16 How should trust law deal with exemption clauses in trust instruments? Do you think regulation of exemption clauses is needed?

Q17 Is the current law too favourable to trustees? Are beneficiaries disadvantaged by the current law?

Q18 Should fraud (dishonesty) continue to be the only type of behaviour for which liability of trustees cannot be excluded by exemption clauses? Or should exemption clauses excluding liability for other types of behaviours, such as wilful misconduct, negligence or gross negligence, also be prohibited?

Q19 How valuable is the court's discretion under section 73 of the Act to relieve trustees from personal liability in certain circumstances? Should such a power be retained in legislation?

Q20 Do you support any of the options listed above as possible approaches to exempting trustees from liability? Are there any other options for reform?



**Part 2**  
**OFFICE OF**  
**TRUSTEE**  
**AND TRUST**  
**ADMINISTRATION**



**LAW COMMISSION**  
**TE AKA MATUA O TE TURE**

# Chapter 4

## Appointment, retirement and removal of trustees

- INTRODUCTION** 4.1 The chapter is concerned with a variety of matters relating to trusteeship such as appointment, removal, and replacement of trustees. There is, effectively, no restriction on who a settlor can choose to be a trustee or on how many, or few, trustees a settlor can appoint. This reflects the principle of settlor autonomy in the creation of trusts. However, it may be that some people are not suited to the role. Indeed, this is implied in the provisions in the Act relating to the removal and replacement of trustees. Below, this chapter reviews these provisions and asks whether they need any amendment. It also asks whether any restrictions should be placed on the original appointment of trustees.
- 4.2 No one can be forced to be a trustee<sup>155</sup> and there are well-established common law rules that relate to how a person can accept or “disclaim” (reject) the office and to what happens when the settlor’s appointments fail. The Law Commission asks whether these rules should be included in a new Act.

### WHO MAY BE APPOINTED AS A TRUSTEE UNDER THE TRUSTEE ACT 1956

#### Appointment of original trustees

- 4.3 The Trustee Act 1956 (the Act) is silent as to who may be appointed a trustee when a trust is established. Under the general law, any person who has legal capacity to own property can be appointed a trustee. There is no restriction on a settlor or beneficiary being a trustee, although a person cannot be both the sole beneficiary and sole trustee of a trust. In those circumstances a valid trust does not exist since the legal and equitable interests in the trust property reside in the same person.<sup>156</sup>

<sup>155</sup> With one exception: the Trustee Act 1956 provides that in certain circumstances, the Public Trustee cannot decline an appointment.

<sup>156</sup> *Re Heberley* [1971] NZLR 325 (CA); *Re Cook, Beck v Grant* [1948] 1 All ER 231 at 232 (Ch).

- 4.4 The Act makes it clear that any corporation can be a trustee.<sup>157</sup> “Trustee corporations” are given an elevated status since they can act as a sole trustee even if the trust instrument requires there to be two or more trustees.<sup>158</sup> Trustee corporations are defined as Public Trust, Māori Trustee or any corporation authorised as such by any Act. There is no restriction on a foreigner being a trustee, although a trustee may be replaced if he or she remains outside New Zealand for 12 months.
- 4.5 There is no automatic disqualification for appointment as a trustee. A person who is a bankrupt or under a mental incapacity can be appointed a trustee, but his or her bankruptcy or incapacity may be a ground for removal. This contrasts with the appointment of a company director under the Companies Act 1993, which has a series of grounds in section 151, such as being under 18 years and being an undischarged bankrupt, that disqualify persons from holding the office of director. Under section 104 of the Insolvency Act 2006, property held on trust by a bankrupt does not vest in the Official Assignee. There would appear to be nothing to prevent a minor being appointed as trustee, but enforcement of a contract against a minor will require an order of a District Court or the High Court under section 6 of the Minor’s Contracts Act 1969.<sup>159</sup>

### Appointment of subsequent trustees

- 4.6 Part 4 and section 51 of the Act relate to the appointment of new trustees and the removal and discharge of existing trustees. The rules are subject to anything contrary in the instrument creating the trust.<sup>160</sup> It is evident from the grounds on which a trustee can be replaced or removed that the provisions are there to facilitate the proper administration and performance of the trust, and this was the foundation of the High Court’s inherent jurisdiction to intervene in trusts.<sup>161</sup>

### Section 43

- 4.7 New trustees may be appointed under section 43 of the Act.<sup>162</sup> Because section 43 is a default power, any power to appoint new trustees contained in the trust instrument will take precedence. If the power in the trust instrument permits the appointment of new trustees in a wider range of circumstances than those set out in section 43, the instrument will prevail.

<sup>157</sup> Provided that this is not precluded by the corporation’s constitution.

<sup>158</sup> Trustee Act 1956, ss 2 and 48.

<sup>159</sup> A minor under the Minor’s Contracts Act 1969 is any person under 18 years. Under the Age of Majority Act 1970 a minor is any person under 20 years.

<sup>160</sup> Trustee Act 1956, s 2(4). See *Donovan v Lynskey* HC Blenheim CIV-2006-406-293, 26 June 2009.

<sup>161</sup> *Letterstedt v Broers* (1884) 9 App Cas 371 (PC).

<sup>162</sup> Trustee Act 1956, s 43 can be viewed at < [www.legislation.govt.nz](http://www.legislation.govt.nz) > .

- 4.8 Section 43(1) of the Act provides that trustees may be replaced by deed in certain circumstances. The power facilitates the on-going administration of a trust when a trustee cannot or will not act, without the need for costly recourse to the court. Section 43 can be used to replace the following seven categories of trustees:
- a trustee who is dead;
  - a trustee who is and has been outside New Zealand for 12 months without a delegation under section 31 in force (section 31 enables a trustee who is out of New Zealand or about to leave to delegate trust powers, functions, and discretions);
  - a trustee who wishes to be discharged;
  - a trustee who refuses to act;
  - a trustee who is unfit to act;
  - a trustee who is incapable of acting; and
  - a trustee corporation which has ceased to carry on business, is in liquidation, or has been dissolved.
- 4.9 The power to appoint a new trustee may be exercised by a person nominated in the trust instrument or, if no one is nominated or willing to act, by the surviving or continuing trustees or the personal representatives (executors and administrators) of the last surviving or continuing trustee. The power is discretionary. It is not mandatory to replace trustees when they cannot or will not act.<sup>163</sup>
- 4.10 Section 43 is silent about who may be appointed as a replacement trustee. In *Commissioner for Inland Revenue v Chester Trustee Services Ltd*<sup>164</sup> the Court of Appeal said that the underlying principle regarding appointment of trustees is that the dominant consideration is the interests of beneficiaries. Bankrupts or insolvent companies are generally regarded as unfit to act as trustees. There is a presumption against appointment of a bankrupt or insolvent company and it will be a rare case that a bankrupt or an insolvent company can be appointed to the position of trustee.<sup>165</sup> The judgment in *Chester* refers specifically to section 51(2)(d) and (e) of the Act which enable the court to make an order substituting one trustee for another if the trustee has been adjudged bankrupt or, in the case of a corporation, it has ceased to carry on business, has been placed in liquidation or has been dissolved. The same principle should apply to appointments under section 43.
- 4.11 Issues relating to the specific grounds for removal of trustees in section 43 are discussed below.

163 Subject to the rules relating to numbers of trustees.

164 *Commissioner for Inland Revenue v Chester Trustee Services Ltd* [2003] 1 NZLR 395 (CA).

165 *Commissioner for Inland Revenue v Chester Trustee Services Ltd* [2003] 1 NZLR 395 (CA) at 411–412 per Baragwanath J. The Judge quotes Paul Heath QC and Michael Whale in saying that the provisions of s 51(2)(d) and (e) of the Trustee Act reflect the policy judgement of the Legislature that individuals who become bankrupt or companies which are placed in liquidation are generally unfit to act as trustees (Paul Heath QC and Michael Whale “Trust Busting and the Impact of Insolvency” (paper presented to Accountants Trust Conference, Auckland, May 2001) at 12).

#### Absent trustees: section 43(1)(b)

- 4.12 It is questionable whether it should be possible to replace a trustee just because the trustee has been out of New Zealand for 12 months and has not delegated his or her powers under section 31 of the Act. Modern communication avoids the need for face to face meetings of trustees. It should be possible to remove a non-performing trustee irrespective of where the trustee lives. It does not follow just because a trustee lives overseas that he or she is not conscientiously carrying out his or her duties.
- 4.13 On the other hand, the power under section 43(1)(b) is discretionary. It is more likely to be exercised if the absence of the trustee is hindering the administration of the trust, rather than where a trustee is working effectively from abroad. From that perspective, there may be merit in retaining the provision to provide a line in the sand that allows a person with the power to act under section 43 to do so. The Commission is interested in your views about whether this ground should be retained.

#### Unfit or incapable trustees: section 43(1)(e) and (f)

- 4.14 The full extent of the terms “unfit” and “incapable” under section 43(1)(e) and (f) cannot be considered settled by the courts and there is a question about the ability of trustees to adequately interpret and apply the terms. Law reform agencies in some other jurisdictions have concluded that where subjective value judgements concerning the ability of a person to act as trustee are concerned, those determinations should be made by the court. They have thus recommended the removal of these grounds from their section 43 equivalents.<sup>166</sup>
- 4.15 Some rules about the application of the terms have emerged from the case law. Courts have tended to restrict “incapacity” to personal, that is physical and mental, incapacity. It does not include absenteeism.<sup>167</sup> Bankruptcy may render a trustee unfit to act, particularly if the trust has assets that could be easily misappropriated.<sup>168</sup> In a 1992 case, the High Court seems to have treated bankruptcy as a clear ground for removal under section 43.<sup>169</sup> The editors of *Hayton and Underhill’s Law of Trusts and Trustees* suggest that each of the criteria in section 51 relating to removal by the court (which include misconduct, conviction of an offence of dishonesty and bankruptcy) would likely enable the displacement of a trustee under section 43(1)(e).<sup>170</sup>

166 Law Reform Commission of Ontario *Report on the Law of Trusts* (1984) at 107; Saskatchewan Law Reform Commission *Proposals for Reform of the Trustees Act* (2002); Law Reform Commission for England and Wales *Trust Law: General Proposals* (LRC 92-2008) at 33.

167 *Re Bignold’s Settlement Trusts* (1872) 7 Ch App 223.

168 *In re Barker’s Trusts* (1875) 1 Ch D 43.

169 *R v Raymer* HC Wellington T119-89, 10 December 1992.

170 David Hayton, Paul Mathews and Charles Mitchell (eds) *Underhill and Hayton: Law Relating to Trusts and Trustees* (17th ed, LexisNexis Butterworths, Bath, 2006) at 929 [*Underhill and Hayton*].

- 4.16 As a minimum, the breadth of the terms “unfit” and “incapable” could be clarified. It may be that spelling out a list of criteria, as in section 51 of the Act, would give greater guidance to trustees and reduce the possibility of recourse to the court.

Corporations which have ceased to carry on business: section 43(1)(g)

- 4.17 A corporation may be replaced if it has ceased to carry on business, is in liquidation or is dissolved. There is an outstanding question as to who can exercise the power of replacement under section 43(1)(g) if the corporation was a sole trustee and no one has been given the power of appointment in the trust deed. The definition of “personal representative” in section 2 of the Act does not include a liquidator in the case of a corporate trustee. The Commission is interested in feedback on whether the definition should be extended accordingly for the purpose of section 43(1)(g).

*Section 51*

- 4.18 The court may appoint new trustees under section 51 of the Act.<sup>171</sup> The power may be exercised whenever it is expedient to do so and “it is found inexpedient, difficult, or impracticable to do so without the assistance of the Court”. The court may appoint a replacement trustee or an additional trustee. It may also appoint a trustee if there is no current trustee. Without limiting the grounds on which an appointment may be made, the section provides specifically that a new trustee may be appointed to replace a trustee who:
- has misconducted himself in the administration of the trust;
  - has been convicted of a crime involving dishonesty as defined in section 2 of the Crimes Act 1961;
  - is mentally disordered within the meaning of the Mental Health (Compulsory Assessment and Treatment) Act 1992 or whose estate is subject to a property order under the Protection of Personal and Property Rights Act 1988;
  - is a bankrupt; or
  - if the trustee is a corporation, has ceased to carry on business, is in liquidation, or has been dissolved.
- 4.19 In specifying grounds for removal, both section 43 and section 51 recognise that there may be instances where a trustee becomes unfit or incapable of the role. Like section 43, section 51 is discretionary. The grounds apply to an existing trustee.

<sup>171</sup> Trustee Act 1956, s 51 can be viewed at < [www.legislation.govt.nz](http://www.legislation.govt.nz) > .

## Minors

- 4.20 Minors are a category of persons that are not dealt with by either section 43 or section 51. A minor may be appointed a trustee, however it is likely that, upon application, the court will appoint another trustee to act until the minor reaches the age of majority, or presumably an age that the court considers appropriate. The age of majority is currently 20, unless a different age is expressed in a particular statute.<sup>172</sup> There is no age restriction on who can hold land under the Land Transfer Act 1952, but the Minors' Contracts Act 1969 is relevant since a contract cannot be enforced against a person under 18 years unless it is "fair and reasonable".<sup>173</sup> Under section 22 of the Property Law Act 2007 a person under 18 years cannot execute a deed, appoint an attorney, or accept an appointment or act as an attorney.
- 4.21 Some jurisdictions place a bar on minors acting as trustees.<sup>174</sup> Others provide specifically for the replacement of minor trustees.<sup>175</sup> It is unlikely that a minor could adequately perform the office of trustee. It also seems that, at present, the only means of replacing a minor would be by application to the court (rather, for example, than by other trustees (if any) under section 43 of the Act). While it is likely that the scenario arises infrequently, minors can find themselves appointed a trustee under a will if the testator dies prematurely.
- 4.22 The Commission is interested in whether the Act should place a prohibition on minors being appointed trustees. Such a bar might have the same effect as when a trustee disclaims the office, so that the trust property vests back in the settlor or his or her personal representatives to be held on the terms of the trust. Alternatively, should minors be in a category of trustees that can be replaced without recourse to the court under section 43? If so, should the replacement take office permanently, or (to give effect to the settlor's wishes) only until the minor achieves a certain age?

### OPTIONS FOR WHO MAY BE A TRUSTEE

- 4.23 One of the main issues with the provisions relating to the appointment of trustees is that the grounds for removal are not grounds for disqualification for appointment. So, in theory, a person who came within one or more of the grounds for removal could be appointed as a trustee. While a court is unlikely to ever take that extraordinary step, there is nothing to prevent such a person being appointed under section 43 or section 51.
- 4.24 The Commission considers there may be merit in trusts legislation specifying categories of persons who may not be appointed as trustees, either initially when the trust is established, by the trustees under a section 43 type power, or by the court under a section 51 type power. A trustee who subsequently comes within one of the categories would automatically be disqualified from continuing in office.

<sup>172</sup> Age of Majority Act 1970, s 4(1).

<sup>173</sup> Minors' Contracts Act 1969, ss 2 and 6(1).

<sup>174</sup> For example, England and Wales: Law of Property Act 1925 (UK), s 20; Australian Capital Territory: Trustee Act 1925 (ACT), s 7A.

<sup>175</sup> For example, New South Wales: Trustee Act 1925 (NSW), s 6; Victoria: Trustee Act 1958 (Vic), s 41.

- 4.25 The Commission suggests that the categories of persons who would be prohibited from becoming a trustee and who could be replaced as trustees if they later fall within one of the categories could include:
- a person under 18 years of age;
  - an undischarged bankrupt;
  - a person who is mentally disordered or whose property is subject to a property order under the Protection of Personal and Property Rights Act 1988;
  - a person convicted of a crime involving dishonesty within the meaning of section 2 of the Crimes Act 1961; and
  - a corporation that has ceased to carry on business, is in liquidation, or has been dissolved. This could also include a company that has entered into a compromise with its creditors under Part 14 of the Companies Act 1993 or which is under voluntary administration under Part 15A of that Act or which is an assetless corporation.<sup>176</sup>
- 4.26 Additionally, persons outside New Zealand, and unfit and incapable persons could be included as categories of persons disqualified from being a trustee if it is thought that these continue to be helpful categories.
- 4.27 A settlor who knows and trusts a particular individual may be willing to appoint that individual as trustee despite the person coming within one or more of the criteria. Should the law prevent a settlor from making that judgement? The question is really whether the law should automatically prohibit certain categories of persons from being appointed and continuing to hold office as trustee or whether it should continue to specify the categories of persons who may be removed from office by the continuing trustees or the court. If certain categories of persons are prohibited from holding office as a trustee, there could be difficulties in enforcing this law, particularly in relation to trustees who only fall within one of the categories after already holding the position of trustee. The legislation could provide, similarly to the Companies Act 1993 in respect of directors,<sup>177</sup> that trustees cease to hold office when they fall into one of the prohibited categories.
- 4.28 The grounds on which a trustee may be removed either by the trustees under a section 43 type power or by the court could include the same grounds (apart from the age restriction) and also additional grounds such as the trustee:
- has died;
  - wishes to be discharged; or
  - has failed or is unable to perform the duties of trustee.
- 4.29 The court could also be empowered to remove a trustee if, for any other reason, the court is satisfied that the person should not hold office as a trustee. This might be appropriate in a situation of serious conflict between the trustees or with the beneficiaries or where there is a significant conflict of interest affecting the trustee.

176 *Commissioner for Inland Revenue v Chester Trustee Services Ltd* [2003] 1 NZLR 395 (CA).

177 Companies Act 1993, s 157.



- 4.30 In *Mendelssohn v Centrepont Community Growth Trust*<sup>178</sup> the Court of Appeal held that in exercising its jurisdiction under section 51 to appoint a new trustee, the Court should consider the settlor's intentions, neutrality between beneficiaries, and promotion of the purposes of the trust. If it were implicit or explicit that the settlor intended trustees to be or not to be of a particular description, the Court should give considerable weight to those wishes but was not bound by them and was entitled to depart from them for good cause. Should this principle be incorporated in legislation?
- 4.31 While in most cases it may be possible to appoint a new trustee under section 43, in cases where this is not possible, section 51 enables the court to do so. However, this is likely to be a costly option which not all trusts would be happy to adopt. The question has been raised with the Commission whether there ought to be a cheaper and more efficient means of appointment. A number of alternatives could be considered. These include:
- the District Court or a special division of the District Court with jurisdiction to deal with trust and property matters;
  - the Family Court in cases involving relationship property disputes;
  - a Trusts Commission or other statutory body;
  - a Trusts Ombudsman; and
  - Public Trust.
- 4.32 There are likely to be objections to all of these options. It is often claimed that the District Courts and Family Courts lack jurisdictional expertise in trust matters. Setting up a commission or ombudsman or some other statutory entity will not be without cost. The fact remains, however, that the High Court is an expensive forum for what may be a routine matter. These issues will be addressed more generally in the Commission's fifth Issues Paper on the law of trusts.

Q21 Should trusts legislation specify grounds on which a person is prohibited from being appointed or continuing to hold office as a trustee? What should those grounds be? Should they include:

- persons who are overseas;
- unfit and incapable persons;
- minors; and
- any other grounds?

Q22 Should trusts legislation continue to specify the categories of persons who may be removed from office by the continuing trustees or by the court? What should be the grounds for this? Should it still be possible to remove a trustee who has been absent from New Zealand for 12 months and has not delegated his or her powers?

178 *Mendelssohn v Centrepont Community Growth Trust* [1999] 2 NZLR 88 (CA), per Tipping J at 97.

Q23 Should trusts legislation continue to allow the court to appoint new trustees? What should be the grounds for this?

Q24 Should the principle in *Mendelssohn v Centrepont Community Growth Trust* be incorporated in legislation?

Q25 Is there an alternative to the High Court power to appoint trustees? Should District Courts or Family Courts have this jurisdiction?

Q26 Should the liquidator of a corporate trustee be able to appoint a new trustee in the place of the company in liquidation?

#### REPLACEMENT OF INCAPACITATED TRUSTEE

4.33 Section 43 does not provide for the replacement of a single trustee who becomes mentally incapable. If the last remaining trustee dies, his or her personal representatives can appoint a replacement trustee, but that option is obviously not available if the incapacitated trustee is still alive. An ordinary power of attorney cannot be used because it ceases to have effect if the donor becomes mentally incapable. There is doubt whether an enduring power of attorney can be used because section 95(4) of the Protection of Personal and Property Rights Act 1988 prevents delegation of the power to delegate under section 31 of the Trustee Act 1956. The only option would seem to be an application to the court under section 51 of the Act. The matter has been raised with the Commission as needing a legislative response. It is suggested that the holder of an enduring power of attorney or possibly a property manager under the Protection of Personal and Property Rights Act 1988 should be able to appoint a replacement trustee if no one else can.

Q27 Should the holder of an enduring power of attorney or a property manager of a trustee who has become mentally incapable be able to appoint a replacement trustee if no one else is able to do so?

#### REMOVAL OF TRUSTEES

4.34 There is no statutory power simply to remove a trustee. Sections 43 and 51 of the Act permit removal and replacement of a trustee, rather than just removal. If it is desired to remove a trustee without appointing a replacement, it may be necessary to invoke the inherent jurisdiction of the court.

- 4.35 The High Court acting under its inherent jurisdiction has the power to remove a trustee. This is a broad discretionary power which is derived from the Court's general supervisory powers in equity. The main guide for its exercise is the "welfare of beneficiaries".<sup>179</sup> As Dixon J said in *Miller v Cameron*.<sup>180</sup>

[T]he jurisdiction to remove a trustee is exercised with a view to the interests of the beneficiaries, to the security of the trust property and to the efficient and satisfactory execution of the trusts and a faithful and sound exercise of the powers conferred on the trustee. In deciding to remove a trustee, the Court forms a judgment based on considerations, possibly large in number and varied in character, which combine to show that the welfare of the beneficiaries is opposed to his continuation in office. Such a judgment must be largely discretionary.

- 4.36 In *Miller v Cameron*, a sole solicitor-trustee was removed from office on account of the state of his financial affairs. Other considerations may be relevant such as conflict between trustees, conflict between trustee and beneficiaries, breach of trust, and conflict between the duty of a trustee and his or her personal interest.<sup>181</sup> Section 43(2)(c) makes it clear that if there are more than two trustees originally appointed, it is not necessary to appoint up to the original number so long as there is either a trustee corporation or there are two trustees.<sup>182</sup> Section 51 appears to require the appointment of a replacement trustee. The Commission suggests that the rules relating to the circumstances in which a trustee needs to be replaced could be expressed more clearly. The Commission would be interested to know whether it should be possible for the court to remove a trustee on any of the grounds listed in the section without appointing a replacement.
- 4.37 The Commission is also interested in whether the Act should include an express power for trustees (in the absence of a power in the trust instrument) to remove one of their number, without recourse to the court. For instance, where there are three or more trustees and one will not or cannot act, there may be circumstances where it is preferable that the other trustees can discharge the incapable or unwilling trustee and continue in their reduced number. The requirement that trustees must act unanimously would seem to favour this approach, since exercise of the trustees' powers would be hindered until the undischarged trustee is either willing or capable again. Discharging a trustee when he or she is not being replaced would also make it clear that the unwilling, unfit or incapable trustee is no longer subject to the trustee duties. As a minimum, the Commission suggests that it should be clear that where a replacement is not required, the absent or incapacitated trustee can be clearly discharged from his or her duties.

179 See *Letterstedt v Broers* (1884) 9 App Cas 371 (PC), applied in *Hunter v Hunter* [1938] NZLR 520 (CA) at 529–530.

180 *Miller v Cameron* (1936) 54 CLR 572 at 580–581.

181 For a full discussion see N Kelly, C Kelly and G Kelly *Garrow and Kelly's Law of Trusts and Trustees* (6th ed, LexisNexis, Wellington, 2005) at 484–488 [*Garrow and Kelly*].

182 This reflects the common law position: *Garrow and Kelly* notes that in *Emmet v Clark* (1861) 3 Giff 32 an appointment of three trustees in place of four original trustees was valid. In *Reid v Reid* (1862) 30 Beav 388 an appointment of three in place of five was also valid, as was an appointment of two in place of three in *re Poole Bathurst's Estate* (1854) 2 Sm & G 169 (*Garrow and Kelly*, above n 181, at 467).

- 4.38 In its departmental report to the Select Committee on the Trustee Amendment Bill 2007, the Ministry of Justice expressed the initial view that it was in the best interests of a trust to retain the court as the appointer of new trustees when there was no one else capable of acting. The Ministry considered that giving trustees the power to simply remove other trustees could potentially be problematic if there was friction between trustees, and could be inconsistent with a settlor's wishes.<sup>183</sup> On the other hand, leaving the power with the court alone means that seeking simply to remove an incapacitated trustee can be a costly process. Any power of removal by the trustees could be limited to circumstances such as those in section 43 and subject to challenge in the High Court. If the criteria in section 43(1) were framed so that each could be objectively determined, there might be less potential for abuse of such a power.

Q28 Should the court be able to remove a trustee without necessarily having to appoint a replacement trustee?

Q29 Should the statute make it clear that where three or more trustees were originally appointed, a trustee can be discharged without the need for a new appointment to be made? Should there be a power for trustees to simply remove and discharge a trustee, in limited circumstances?

## RETIREMENT OF TRUSTEES

- 4.39 The usual way for a trustee to retire is under section 43 of the Act. Sections 45 and 46 also provide a mechanism for a trustee to retire. Section 45 provides that if there are two or more trustees, a trustee may retire by deed, with the consent (also by deed) of his or her co-trustees and any other person who has power to appoint trustees. There is no requirement to appoint a replacement trustee. There must be at least two trustees or a trustee corporation remaining, although this is not required if there was originally only a single trustee.
- 4.40 Section 46 enables a trustee to retire by “passing his accounts before the Registrar” (of the High Court), and giving notice to any co-trustees and any other person empowered to appoint trustees. The retiring trustee may apply to the court to appoint a replacement trustee if the co-trustees do not do so, do not consent to an appointment, or it is impractical or difficult for the retiring trustee to do so. The court may appoint a replacement, order an inquiry, and discharge the retiring trustee from any liability. The court may also appoint Public Trust in place of the retiring trustee. The Commission understands that the use of these applications is rare and that High Court Registrars have seldom encountered them. The Commission would be interested to know whether this provision is still needed in trust legislation.

183 Ministry of Justice *Trustee Amendment Bill: Departmental Report* (April 2008) at 24.

- 4.41 The Commission has not been made aware of any particular problems with these sections but would appreciate being advised if they have caused problems in practice.
- 4.42 More generally, the section 46 mechanism seems onerous for a trustee who wants to retire. It is far from clear what is involved in producing accounts to a Registrar or what the Registrar is required to do. If it means that the Registrar has to check them to see that they are satisfactory, it is questionable whether a Registrar is best placed to perform what is essentially an audit role. The trustee may also have to apply to the court to appoint a replacement. It has been suggested to the Commission that there should be a simple straightforward way for a trustee to retire. The Commission would be interested in views as to how this might operate.

Q30 Are there any problems with the operation of sections 45 and 46 of the Act and, if so, how might they be addressed?

Q31 Is section 46 still needed?

Q32 Is there a more effective way of enabling a trustee to retire?

## REMOVAL OF APPOINTORS AND PROTECTORS

- 4.43 Increasingly, trust deeds give powers to settlors or other named individuals as appointors or protectors. Depending on the terms of the trust instrument, these may be fiduciary positions or not. In cases where the courts have removed an appointor or protector and appointed another in their place, they have relied on the court's inherent power. This depends on finding that the appointment is of a fiduciary character. The question has been raised with the Commission whether it would be desirable to include in trusts legislation a specific power for the court to remove anyone holding such a position and appoint someone in their place where the court considers it inappropriate for the person to continue in that office. There appear to be two possible situations where the power would be useful. The first is where a trustee is removed but reappointed by an appointor. The second is where the appointor is no longer mentally competent and it is necessary for someone else to have the relevant powers.

Q33 Should trusts legislation enable the court to remove an appointor or a protector and replace that person with someone else? On what grounds should this be possible?

VESTING  
OF TRUST  
PROPERTY ON  
REMOVAL OR  
DISCHARGE  
OF TRUSTEE

- 4.44 Section 47 of the Act relates to the vesting of property on the appointment of a new trustee or on the retirement of a trustee without a replacement trustee being appointed. A deed of appointment or discharge operates to vest trust property in the new trustee or the continuing trustees. The section, however, has its limitations. It does not apply to land under the Land Transfer Act 1952, any mortgage of land, land subject to a lease which precludes assignment without permission or consent, and shares, stock, annuities, or property transferrable only in the books of a company or other body. In practice, a deed may provide for vesting in a new trustee or the existing trustees but a transfer of any land subject to the Land Transfer Act will also be required plus any share transfer where the trust property includes shares.
- 4.45 Under section 52 of the Act, the court can make an order vesting land or an interest in land in a range of situations. These include where:
- a trustee has been appointed by the court or under any Act or express power;
  - a trustee is under a disability,<sup>184</sup> out of New Zealand, cannot be found, or is a corporation that has ceased to carry on business;
  - if it is not known whether the last known trustee is alive or dead or which of the last of two or more trustees was the last to die;
  - land is vested in a trustee who has died and there is no executor or administrator or it is uncertain who that is;
  - the personal representative of a person entitled to an interest in land is under a disability;
  - a trustee wilfully refuses to convey land; and
  - the court decides a vesting order is expedient.
- 4.46 Under section 57 of the Act, the vesting order takes effect as if the persons who were the trustees before the appointment of a new trustee had done whatever was required to transfer the land. In the case of land subject to the Land Transfer Act 1952, a copy of the order must be registered under section 99 of that Act.
- 4.47 Section 59 relates to stock. The term “stock” is widely defined to include money and securities. It enables the court to make a vesting order in circumstances similar to those listed in section 52 in relation to land to give a person the right to transfer stock or receive dividends or sue to recover a chose in action. If the order is consequential on appointment of a trustee, the right must be vested in the persons who on that appointment are the trustees.
- 4.48 There would seem to be a case for relaxing the requirement to have to apply to the court under either section 52 or section 59 where it would be possible for the continuing trustees to effect the transfer. For example, where a trustee becomes incapacitated, it may be possible for the continuing trustees to appoint a replacement trustee under section 43 of the Act. If land is involved and is registered in the names of all trustees, a deed of appointment will not be sufficient to transfer the land into the names of the new trustees. An application to the court under section 52 may be the only option. It may be better if it were possible for the remaining trustees to sign the necessary documents or give the necessary authority to effect a transfer of all the trust assets into their names, as it is hard

<sup>184</sup> A person is deemed to be under a disability while he or she is not of full age or of full mental capacity (Trustee Act 1956, s 2(2)).

to see the justification for requiring the court's intervention in what is essentially a machinery matter. However, without the court's oversight, with its primary concern to protect trust property and the beneficiaries' interest, there may be a risk that there would not be sufficient safeguards to prevent abuse of power by the continuing trustees.

- 4.49 A problem arises where a trustee is replaced due to unfitness or incapacity, since he or she may not be able to sign the required transfer documents. In those circumstances, the remaining trustees must apply to the High Court under section 52 of the Act for the land to be vested in the names of the continuing trustees.
- 4.50 The removal of an incapacitated trustee from a land title can be expensive, particularly where a mentally incapacitated trustee is a trustee of many trusts, since a separate application to the High Court is required in respect of each trust. It has been suggested that the person authorised under the trust instrument to replace trustees could be given the power to also sign documents to transfer trust assets into the name of the existing or replacement trustees. Where no one has a power to appoint a replacement, a person holding an enduring power of attorney for the incapacitated trustee could be able to appoint a replacement trustee and sign the documents to vest the trust assets in the replacement.
- 4.51 Should the court be able to combine multiple proceedings into one proceeding, and to make one vesting order which would affect all of the trusts of which the person being transferred was trustee?
- 4.52 The Commission would be interested to know of problems with the operation of these sections and what improvements might be made to improve their effectiveness. The British Columbia Law Institute's Committee on the Modernization of the Trustee Act recommended a simplified statutory provision that would apply in relation to the vesting of trust property where a trustee ceases to hold office or is replaced or a new trustee is appointed whether under the Act or the trust instrument. The effect would be that:<sup>185</sup>
- when a person ceases to be a trustee, trust property ceases to vest in that person without any declaration or court order;
  - property vests in any new or replacement trustee without any declaration or court order; and
  - if a sole trustee ceases to be a trustee and a new trustee has not been appointed, the trust property vests in the court until a new trustee is appointed.
- 4.53 The vesting would have the same effect as if the legal or other estate in the property had been actually transferred. In the case of land subject to the Land Transfer Act 1952, it would be necessary to provide evidence of the vesting, possibly in the form of a statutory declaration by a continuing trustee.

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

Q34 What problems, if any, exist with regard to sections 47, 52, 57, and 59 of the Act? How might the operation of these sections be improved and simplified? Does the British Columbia model provide a satisfactory basis for this? Are there other ways in which the current legislation could be made simpler and more efficient?

APPOINTMENT  
OF FIRST  
TRUSTEES:  
ACCEPTANCE  
AND  
DISCLAIMER

**Acceptance of office**

- 4.54 Certain propositions relating to the appointment of original trustees are settled.<sup>186</sup> A person cannot be compelled to accept the office of trustee,<sup>187</sup> and the office is not assumed until the named person expressly or impliedly accepts it. Acceptance may be implied by conduct. Any interference with the subject matter of the trusts by a person appointed trustee will be regarded as an acceptance, unless it can clearly be explained on some other ground.<sup>188</sup> The same applies to the exercise of the trustee's rights. For example, acceptance has been construed where a person has permitted an action to be brought under his name,<sup>189</sup> and where a trustee gave directions to sell the trust property and made enquiries about accounts.<sup>190</sup> Where a person is named an executor and trustee in a will, he or she is deemed to have accepted the office if he or she proves the will.<sup>191</sup> However, a person was held not to have accepted the office merely by holding the trust deed for six months for safe custody.<sup>192</sup> Acceptance of part of the trust is regarded as acceptance of the whole, and once the office is accepted, it cannot then be disclaimed.<sup>193</sup>

**Disclaimer of office**

- 4.55 A person named as a trustee can disclaim the office at any point before he or she does any act in the way of acceptance. The person cannot disclaim only part of the office, nor can he or she retain title to the trust property. However, an act of disclaimer has no impact on the person's position as a beneficiary of the trust. There is no requirement at common law that a disclaimer must be in writing, but for evidential reasons, disclaimer in writing is to be preferred. The onus of establishing a disclaimer lies on the party alleging it,<sup>194</sup> and a trustee who disclaims is entitled to his or her expenses of disclaiming out of the trust fund.<sup>195</sup> At common law, there is no time limit within which a person named as a trustee must disclaim, and it appears that the longer the period of inaction on his or her

186 See generally, *Underhill and Hayton*, above n 170; N Richardson *Nevill's Law of Trusts, Wills and Administration* (9th ed, LexisNexis, Wellington, 2004) at 164; *Garrow and Kelly*, above n 181, at 475; A Butler (ed) *Equity and Trusts in New Zealand* (Brookers, Wellington, 2003) at 125; P Pettit *Equity and the Law of Trusts* (10th ed, OUP, Oxford, 2005) at 373.

187 Except in the case of constructive and resulting trusts.

188 P Pettit, above n 186, at 373.

189 *Lord Montfort v Lord Cadogan* (1816) 19 Ves 635; 34 ER 651 (Ch).

190 *James v Frearson* (1842) 1 Y & C Ch Cas 370.

191 See *Re Sharman's Will Trusts* [1942] Ch 311 at 317; [1942] 2 All ER 74 at 78.

192 *Evans v John* (1841) 4 Beav 35.

193 *Re Sharman's Will Trusts* [1942] Ch 311; [1942] 2 All ER 74.

194 *Lady Nass v Westminster Bank Ltd* [1940] AC 366.

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



part, the stronger the presumption of disclaimer.<sup>196</sup> However, there is also case law supporting the alternative view that the presumption of *acceptance* of the trust increases with each year of the period of inaction.<sup>197</sup>

- 4.56 It seems undesirable that a trust can sit unmanaged for a long period of time. However, the presumption of disclaimer (rather than acceptance) after a period of inaction is in line with the principle that no one can be compelled to be a trustee and thus compelled to assume the liabilities of the office. The United States' Uniform Trust Code provides that a person must disclaim within a reasonable time or he or she will be deemed to have rejected the office.<sup>198</sup> What will constitute a reasonable time depends on the facts and circumstances of the particular case. The Commission is interested in whether there would be any practical benefit in including a provision to this effect in a new Act. To do so may aid those with a power to replace trustees by giving them a basis on which to act. However, the phrase "reasonable time" may be too open to interpretation to be of any great use. Furthermore, if reasonable time were the test, when would it start to run? Would there be a requirement of notice? An alternative could be to impose a definite time limit on disclaimer. It is of note that trustees can currently be replaced if they are absent from New Zealand for more than 12 months. This is discussed further below, but presumably the original policy for that provision was to avoid inaction in the trust. Is a similar time limit desirable here?

### Effect of disclaimer, death or incapacity of original trustee

- 4.57 A trust is not allowed to fail for want of a trustee.<sup>199</sup> If a sole trustee or all the named trustees disclaim, the trust property vests back in the settlor, or if he or she is dead, in his or her personal representatives, to be held on the terms of the trust. The court, (or the person (if any) nominated in the trust instrument with the power of appointing new trustees) may appoint a trustee or trustees to carry out the trust. A disclaimer by one of two or more trustees vests the property in the remaining trustee(s).<sup>200</sup>

Q35 Should the common law rules relating to acceptance and disclaimer (rejection) of the office of trustee be set out in legislation? If so, should a time limit be imposed, with the effect that a person would be deemed to have disclaimed the office if he or she has not indicated his or her acceptance within a certain period of time?

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

197 *Re Uniacke* (1844) 1 Jo & Lat 1.

198 National Conference of Commissioners on Uniform State Laws *Uniform Trust Code* (Chicago, 2005) §701(b).

199 *Attorney-General v Downing* (1767) Wilm 1; 97 ER 1. Except where the settlor's intention was that the trust's creation depends on a specific person serving as a trustee: see *Re Lysaght* [1966] Ch 191; [1965] 2 All ER 888.

200 A new trustee may be appointed under s 43(1)(d) to fill the vacancy.

## CUSTODIAN TRUSTEES

- 4.58 Section 50 of the Trustee Act 1956 provides for the appointment of any corporation as a custodian trustee of a trust in any case where it could be appointed as trustees. It appears that section 50 gives adequate power to appoint a custodian trustee without the need for a specific power in the trust instrument. Unless the trust instrument states otherwise, the trust property is in the name of the custodian trustee as if it were the only trustee. The managing trustees, however, have responsibility for the management of the trust property and the exercise of all powers and discretions exercisable by the trustee, as if there were no custodian trustee. The custodian trustee's sole function is to hold the trust property, invest its funds, and dispose of its funds in the manner directed by the managing trustees. The custodian trustee is not liable for any act or default of the managing trustees. *Garrow and Kelly* suggests that the custodian trustee arrangement can be helpful in involving those who:<sup>201</sup>
- are closely connected with the trust property (for example, Māori Land or a family farm);
  - have special skills in managing the particular trustee investment; or
  - have a good understanding of the needs of the beneficiaries.
- 4.59 The major advantage of appointing a custodian trustee is that it saves the recurring expense of having to register a change of ownership of the assets every time one of the trustees is replaced, which can be a significant cost saving.<sup>202</sup> The Commission is interested to know whether custodian trustees continue to be used and whether there are any issues with the operation of section 50.

Q36 How commonly are custodian trustees appointed under section 50, and for what purpose? Are there any problems with the operation of section 50?

201 *Garrow and Kelly*, above n 181, at 446.

202 *Ibid.*

# Chapter 5

## Trustees' powers

**INTRODUCTION** 5.1 Trustees derive their powers from the trust instrument, the Trustee Act 1956, or a combination of both. Many trust instruments list the various powers of the trustees, often repeating what is in the Act. It is possible to group trustees' powers into three broad categories: those relating to management and administration; those relating to investment; and those that are dispositive such as the power to advance income and capital for the maintenance, education, or advancement of a beneficiary. Part 2 of the Act sets out trustee's powers of investment. Part 3 of the Act, under the heading "General powers and indemnities of trustees", contains a mixture of administrative powers and dispositive powers. Powers that may be regarded as administrative in nature, for example, are set out in sections 14 to 18 in relation to property, the power in section 24 to insure, and the power in section 32 for a trustee under a will trust to carry on a business for a limited period. Powers that may be regarded as dispositive and going beyond pure administration are contained in section 40, which allows a trustee to advance income for the maintenance, education, advancement or benefit of a beneficiary who is a minor. Section 41 is a similar power in relation to capital except that it is not restricted to minors. Many of the statutory powers are subject to restrictions and conditions.

**ADMINISTRATIVE POWERS** 5.2 The powers in section 14 include the power to sell trust property, dispose of trust property by way of exchange, grant a lease or sublease for a term of not more than 21 years, purchase land, erect a dwellinghouse, acquire a flat or apartment, and accept the surrender of a lease. Section 15 contains a long list of additional powers including the power to maintain trust property, subdivide, grant an easement, pay rates, renew or vary a mortgage, and surrender a life insurance policy. These are among the longest sections on the statute book. They are supplemented by other sections. For example, section 16 confers power to sell all or part of the trust property, whether by auction or private contract, and section 17 expressly authorises the sale of property on deferred payment or other terms. These long and complex provisions do little to inform trustees who could easily overlook something material or useful as regards a matter of trust administration.

5.3 Section 24 confers power to insure trust property and to insure against any other liability against which it would be prudent to insure. The section precludes insuring trust property for its replacement value without the consent of the income beneficiaries or the court.

- 5.4 Many modern trust deeds contain a short and succinct clause enabling trustees to effect any transaction relating to the management or disposition of trust property as if the trustees were the absolute owners of the property. The British Columbia Law Institute's Committee on the Modernization of the Trustee Act (British Columbia Committee) recommended a similar provision in its draft Bill, namely, that a trustee have the same powers in relation to trust property that the trustee would have if the property were vested in the trustee absolutely and for the trustee's own use. This general power would be supplemented by express powers to sell or lease trust property, borrow and give security over trust property, purchase or rent or construct accommodation for a beneficiary, and appropriate trust property in or towards satisfaction of the share or interest of a beneficiary. The Commission would be interested in comments as to whether new trusts legislation might take a similar approach.
- 5.5 Although not an exact parallel, under the Companies Act 1993 companies have full capacity to carry on any business or activity, do any act, or enter into any transaction and, for that purpose, full rights, powers, and privileges.<sup>203</sup> This provision removed the need for a company to have a memorandum of association that set out, usually in considerable detail, all its objects and powers. Would a similar approach work in relation to trusts? It would always be open for the trust instrument to list the trustee's powers or limit them if that was considered desirable.
- 5.6 Another approach is for a new Act to contain a list of common administrative powers or the powers normally found in most trust deeds, possibly in a schedule that could be adopted, modified, or added to by the trust instrument. In that way, the relevant powers could be stated in plain language and be more accessible and useful to trustees and their advisers than they are in the current Act. The precise content of such a list would require further consideration, but it should be possible to get consensus as to what it might contain.

Q37 Should trusts legislation confer on a trustee the same administrative powers in relation to trust property that the trustee would have if the trustee were the absolute owner of the property?

Q38 Would it be desirable for trusts legislation to list the administrative powers of trustees, possibly in a schedule, in clear terms? What powers should such legislation contain?

203 Companies Act 1993, s 16.

- 5.7 Section 29 authorises trustees to employ agents to transact trust business or do anything required in executing the trust or administering trust property.<sup>204</sup> It permits delegation of administrative or ministerial functions, but does not enable a trustee to delegate the trustee’s fundamental decision-making powers such as those relating to distributions and other fiduciary discretions. A trustee is not liable for the acts of the agent if the agent was employed in good faith. The section also permits a trustee to appoint an agent to carry out the trust outside New Zealand including exercising any discretion, trust, or power vested in the trustee.
- 5.8 In its 2002 report *Some Problems in the Law of Trusts*, the Commission recommended replacing section 29 with a new provision that would allow trustees to appoint agents to perform all their functions other than fundamental trustee functions. The Trustee Amendment Bill 2007<sup>205</sup> proposed new sections 29 and 29A. The essence of the new section 29 was that a trustee could appoint an agent to exercise administrative functions. An “administrative function” was defined as any function other than a “trustee function”. “Trustee function” was defined as determining how capital and income should be distributed, deciding what fees should be paid out of capital or income, whether payments should be appropriated to capital or income, appointing new trustees, applying to the court, and exercising a power to delegate. The new section 29 required the trustee to keep the arrangement under review, consider whether to intervene, and intervene if necessary. The trustee would not be liable unless the appointment was not made in good faith or the trustee failed to review it or an intervention was not in good faith.
- 5.9 The select committee that considered the Bill recommended a number of changes to both sections. It proposed that it be made clear that in reviewing the agency the trustee must consider whether a trustee exercising reasonable care would intervene and intervene if such a trustee would consider it necessary to do so. The committee proposed enlarging the list of trustee functions to include removing a trustee, appointing and removing beneficiaries, appointing or changing the date of distribution, resettlement, and changing the terms of the trust. It recommended making it clear what fees and charges the trustee may pay the agent and what the trustee may be paid for employing the agent and reviewing the arrangement. It also proposed that a professional trustee would be judged by the standards applicable to such a person.
- 5.10 The Bill is not likely to proceed further and the issues regarding delegation still remain.

Q39 Should trust legislation allow trustees to appoint agents to perform their administrative functions along the lines of the proposed new sections 29 and 29A of the Trustee Amendment Bill 2007?

204 Trustee Act 1956, s 29 can be viewed at < [www.legislation.govt.nz](http://www.legislation.govt.nz) > .

205 The Trustee Amendment Bill 2007 (144-2) is available at < [www.legislation.govt.nz/bill/government/2007/](http://www.legislation.govt.nz/bill/government/2007/) > .

Q40 Do you agree with the changes recommended by the select committee?

POWER TO  
DELEGATE

- 5.11 Section 31 of the Act enables a trustee by power of attorney to delegate his or her duties, powers, and discretions if the trustee is leaving or is about to leave New Zealand, or expects to be absent from New Zealand from time to time, or is or may become temporarily incapable on account of physical infirmity of performing his or her duties.<sup>206</sup> The section makes provision for a number of related matters. The delegation cannot be to the only other co-trustee unless the co-trustee is a trustee corporation. The attorney stands in all respects in the same position as the trustee but cannot sub-delegate. The trustee is protected from proceedings by a beneficiary as regards the actions of the attorney if the attorney was appointed in good faith and with reasonable care. The appointment does not take effect until the trustee is out of New Zealand or becomes incapable of acting.
- 5.12 The power in section 31 to delegate differs from the power in section 29 to appoint an agent. Under section 31 the trustee may delegate his or her entire powers, discretions, and duties. Section 29 only permits a trustee to appoint an agent to carry out essentially administrative functions. The changes proposed by the Law Commission and included in the Trustee Amendment Bill 2007 made this clear. Although the power to delegate in section 31 extends to all the trustee's powers, discretions, and duties, it is limited to the situations referred to. Should the power to delegate be expanded?
- 5.13 Section 25 of the Trustee Act 1925 (UK) enables a trustee to delegate the execution or exercise of all or any of the trusts, powers, and discretions vested in the trustee. Such a delegation may be for 12 months or any shorter period specified in the instrument of delegation. The British Columbia Committee recommended following the United Kingdom model.<sup>207</sup> The Committee suggested that although delegation of a trustee's entire powers and discretions would be an unlikely occurrence there may be circumstances when it might be desirable. These could include a trustee being out of the country for an extended period where a timely response is not possible or where a trustee has business or other commitments that make attention to trust matters difficult or impossible. While it would be possible for the trustee to resign and be replaced, the other trustees and beneficiaries may prefer the trustee to remain in office.
- 5.14 Should there be constraints on such delegation? An unrestricted power to delegate all a trustee's powers and discretions would be open to abuse in the hands of an unscrupulous or incompetent delegate. It would also enable a trustee to avoid his or her responsibilities by handing them over to someone else. A number of safeguards could be employed. First, there could be a time limit on the delegation, say, no longer than 12 months, as in the United Kingdom statute. Secondly, the trustee could be required to notify his or her co-trustees, any person with power to appoint trustees, and beneficiaries. However, as the British Columbia Committee observed, requiring notice to all beneficiaries may be

206 Trustee Act 1956, s 31 can be viewed at < [www.legislation.govt.nz](http://www.legislation.govt.nz) > .

207 British Columbia Law Institute, Committee on the Modernization of the Trustee Act *Statutory Powers of Delegation by Trustees* (BCLI Report No 11, 2000) at 16.

impractical in many cases and recommended notice be given to co-trustees and any person with power to appoint trustees.<sup>208</sup> In the absence of co-trustees or a person with power to appoint trustees, the notice would be given to all adult beneficiaries with a vested interest in the trust property or the guardian of a minor or manager of any incapacitated person. Third, there could be an explicit duty on the trustee to exercise reasonable care in appointing the attorney. This is implicit in section 31 of the Act because it provides that the trustee is not liable to a beneficiary for the acts or omissions of the delegate if the trustee proves that the delegate was appointed in good faith and with reasonable care. Fourth, the trustee might remain liable for any loss caused by the attorney to the same extent as the trustee would have been had the trustee caused the loss.

- 5.15 Section 31 prevents delegation to a sole co-trustee unless the co-trustee is a trustee corporation. Should this restriction remain? The British Columbia Committee recommended that it should be possible to delegate to a co-trustee if the delegation is reasonable and prudent. However, delegation to a co-trustee should not be permitted if the trust instrument requires a minimum of two trustees and there are only two trustees at the time.
- 5.16 What if there is no co-trustee? Should a sole trustee be unable to appoint a delegate in circumstances where it is sensible to do so? The solution proposed by the Committee was that the sole trustee be required to notify all adult beneficiaries who have vested interests in the trust property.
- 5.17 It may need to be made clear, as does section 25 of the Trustee Act 1925 (UK), that a failure to give notice does not as against a person dealing with the attorney invalidate anything done by the attorney.

Q41 Are there any problems with section 31 of the Trustee Act 1956 that require attention? Is the section used in practice?

Q42 Should section 31 be expanded to allow a trustee to delegate all trusts, powers, and discretions?

Q43 What safeguards, if any, should there be in relation to such a power of delegation?

Q44 Should a trustee be required to give written notice to co-trustees and any person with power to appoint trustees or, in the absence of such persons, to all adult beneficiaries with vested interests and the guardian of any minor and the manager of any incapacitated persons?

208 Ibid, at 15 – 17.

Q45 Should the trustee be required to exercise reasonable care in making such a delegation?

Q46 Should the trustee remain liable for the default of the delegate?

Q47 Should a trustee be able to delegate to a sole co-trustee?

Q48 Should a sole trustee be able to delegate? To whom should notice of the delegation be given in such a case: to adult beneficiaries with a vested interest in the trust property and any guardian or manager of an incapacitated person?

Q49 Are there any other matters regarding delegation of trustees' powers, duties, and discretions that should be addressed?

## INVESTMENT POWERS

- 5.18 Until 1988 the Trustee Act 1956 permitted trustees to invest only in investments specifically authorised by the Act. The Act applied subject to a contrary intention in the trust instrument which could confer different investment powers on trustees. The Act contained a long list of authorised investments. The objective of the legislation was to protect the capital of the trust and direct investment away from risk. Initially, the classes of authorised investment were confined principally to government and local body stock and first mortgages of land. The list was added to over the years to include company shares and debentures, group investment funds of Public Trust Office and trustee companies, on deposit with short term money market dealers approved by the Reserve Bank, and various other forms of investment. Some of the particular investment types were subject to restrictions. The fact that a particular type of investment was on the list was used as a marketing tool to attract trust funds.
- 5.19 The legal list was abolished by the Trustee Amendment Act 1988 and replaced by the prudent person principle. Under the regime, a trustee may invest in any property but must exercise the care, diligence, and skill that a prudent person of business would exercise in managing the affairs of others.<sup>209</sup> If the trustee's profession, employment, or business involves acting as a trustee or investing money for others, the trustee must exercise the level of care, diligence, and skill of a person engaged in that profession, employment, or business.<sup>210</sup> Professional trustees thus have to meet a higher standard. These duties apply subject to any contrary intention in the trust instrument.<sup>211</sup>

209 Trustee Act 1956, s 13A – 13B.

210 Trustee Act 1956, s 13C.

211 Trustee Act 1956, s 13D.



- 5.20 Section 13E sets out a non-exhaustive list of factors a trustee may have regard to, including diversification, maintenance of the real value of capital and income, capital appreciation, and inflation. Section 13F preserves general legal duties of trustees including the duty to act in the best interests of present and future beneficiaries, the duty of impartiality, and the duty to take advice.
- 5.21 Section 13M allows the court, in considering a trustee's liability as regards investment powers, to have regard to diversification of the trust fund and any investment strategy.
- 5.22 Section 13Q effectively abolished the anti-netting rule which operated to prevent a loss on one investment by a trustee to be offset by a gain on another. In an action for breach of trust, the court may set off a loss arising from an investment against a gain from any other investment. Other sections in Part 2 largely re-enact pre-1988 provisions.
- 5.23 Before 1988, trustee investment was governed by a number of rules which effectively prevented portfolio management by trustees. Trustees were permitted to invest only in investments that would produce income; they were confined to the legal list; loss on one investment could not be off-set against profits from another (the "anti-netting rule"); trustees had to be impartial as between capital and income beneficiaries; and investment decision-making could not be delegated. The 1988 changes followed recommendations by a Working Party on Trust Investment Powers designed to assist trustees to follow a portfolio management approach to investment.<sup>212</sup> The changes, while preserving the prudent person principle, authorised trustees to invest in any property, abolished the legal list, and abolished the anti-netting rule. Diversification was expressly recognised as was the adoption of an investment strategy.
- 5.24 It has been argued that the changes did not go far enough in permitting adoption by trustees of a full portfolio management approach. In particular, trustees may not disregard the distinction between capital and income and the duty of impartiality remains in section 13F. Nor did the new regime permit delegation of investment decision-making.<sup>213</sup> This paper discusses these matters briefly.

### Capital and income

- 5.25 One of the challenges faced by most trustees in the investment of trust funds is achieving a proper balance between capital and income. The duty to be even-handed requires a trustee to balance income and capital growth. The duty can be overridden by the terms of the trust instrument and very often is but, if it is not, the duty applies and the trustee must ensure that the trust investment policy does not unfairly prejudice income and capital beneficiaries alike. Problems arise where, for example, a substantial capital return can be obtained by investment in company shares that may pay only a small dividend compared with what might be obtainable from investing in bonds or on deposit with a financial institution. Under the ordinary law, the capital beneficiary is entitled to the

<sup>212</sup> Joint Working Party on Trustee Investment *Trustee Investment – The Prudent Man Approach* (Government Printer, Wellington, 1986).

<sup>213</sup> See the discussion on the impact of the regime on portfolio management theory by Dr Andrew Butler *Modern Portfolio Theory* (1995) 16 NZULR 349.

capital return and the income beneficiary who will usually be the life tenant is entitled only to the dividends. The trustee cannot distribute part of the capital return to an income beneficiary. The trustee is unable to adjust the classification of receipts. The requirement to be even-handed can prevent a trustee from obtaining the maximum gain for the trust. One of the key principles of modern day portfolio investment theory is that it is artificial to distinguish between capital and income.

- 5.26 Overseas law reform bodies have recommended legislation that permits trustees to follow a total return investment policy. Notable among them is the British Columbia Committee's report *Total Return Investing by Trustees* published in 2001. The Committee stated that:<sup>214</sup>

While the duty of evenhandedness retains its validity as a general principle, the way present trust law requires it to be applied has been seriously out of keeping with the nature of the investment market for the last three decades, at the very least.

The Committee observed that if trustees were free from the requirement to select investments with regard to the legal category of the returns received, they would be able to maximise the gain to the trust portfolio within the parameters of the duty of prudence.<sup>215</sup> The duty to be even-handed and the traditional capital and income allocation rules should not stand in the way of efficient investment so as to frustrate the intentions of a settlor whose objective is to maximise the benefits able to be conferred on beneficiaries. The key principle is that investment decision-making should be separate from distributional issues.

- 5.27 One of the ways in which total return investment can be facilitated is through the "percentage trust". This was recommended by the British Columbia Committee. It was also considered by the Law Commission for England and Wales to be the model most likely to be successful in facilitating total return investment. However, the Law Commission for England and Wales felt unable to formally recommend its adoption because of the tax implications involved.<sup>216</sup> The key features of the percentage trust are that the trust assets are valued on a periodic basis and a percentage of the total value may be distributed without regard to the distinction between capital and income. Payments may be made first from revenue and then to the extent of any deficiency from capital. Revenue in excess of the percentage amount is added to capital. A statutory regime for percentage trusts would need to provide both for valuations and the percentage.
- 5.28 How often the assets should be valued may depend very much on the nature of the assets. If the period is too long, it may fail to take account of changes in asset values. If it is too short, it may be burdensome. Where the major asset of a trust is a commercial building or shares in an unlisted company, obtaining annual valuations could become expensive whereas annual valuations of a fund the assets of which are shares in listed companies could be done quickly and cheaply.

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

215 *Ibid*, at 6.

216 Law Commission for England and Wales *Capital and Income in Trusts: Classification and Apportionment* (LAW COM No 315, 2009) at 72 [*Capital and Income*].

The British Columbia Committee considered a fund should be valued at least once every three years with more frequent valuations if required by the trust instrument.<sup>217</sup>

- 5.29 What is an appropriate percentage rate? A rate that is too low may prejudice income beneficiaries. A rate that is too high may prejudice capital beneficiaries because the trustees will have recourse to the capital to pay the income beneficiaries and deplete the capital fund. In the United States, some states have a four percent rate based on the average value of the trust fund over a three year period.<sup>218</sup> Other states allow the trustees to make a choice between three and five percent<sup>219</sup> while others simply specify a minimum with no upper limit.<sup>220</sup> The British Columbia Committee considered the best option was to use an existing statutory benchmark for fixing the real rate of return for a fund after allowing for inflation.<sup>221</sup>
- 5.30 A related question is whether the frequency of valuations and the percentage should be fixed by statute or regulation. Using regulations allows flexibility to take account of market circumstances.
- 5.31 The percentage trust will not be suitable for every kind of trust. It may not be suitable for discretionary trusts that give trustees a discretion whether to make distributions and, if so, how much. Nor would it be suitable for a trust the primary purpose of which is to allow for capital accumulation and distribution later on. Following the model proposed by the Ontario Law Reform Commission,<sup>222</sup> the British Columbia Committee recommended a statutory provision recognising “discretionary allocation trusts”.<sup>223</sup> If a trustee was directed by the instrument to hold the trust property on a discretionary allocation trust, the trustee could allocate and apportion receipts between income and capital accounts without regard to their legal categorisation. It was also proposed that trustees be able to recover disbursements from either income or capital regardless of the account from which the disbursement was paid or to which it was allocated and that it be possible to deduct for depreciation from income and add an equivalent amount to capital to protect capital beneficiaries.
- 5.32 The Commission would be interested in receiving views as to whether trust legislation that permits percentage trusts or discretionary allocation trusts should apply to existing trusts. The Trustee Amendment Act 1988 amended the Trustee Act 1956 to make it clear that a power to invest in specified property did not constitute a contrary intention that would prevent a trustee from exercising the new investment powers in Part 2 of the Act. Is a similar approach appropriate with percentage trusts?

217 British Columbia Law Institute *Total Return Investing*, above n 214, at 11.

218 See, for example, An Act to Amend the Estates, Powers and Trusts Law and the Surrogate’s Court Procedure Act, in Relation to Trust Accounting Income, Laws of NY 2001 c 243, s 4 (adding s 11-2.4 to the Estates, Powers and Trusts Law).

219 For instance, Delaware (Law Commission for England and Wales *Capital and Income*, above n 216, at 37).

220 For instance, Missouri (Law Commission for England and Wales *Capital and Income*, above n 216, at 37).

221 British Columbia Law Institute *Total Return Investing*, above n 214, at 12.

222 Ontario Law Reform Commission *Report on the Law of Trusts* (1984) at 298 – 300, Recommendation 60, *Draft Trustee Act*, s 41.

223 British Columbia Law Institute *Total Return Investing*, above n 214, at 14.

Q50 Are the current powers of investment in Part 2 of the Act adequate? In what respects, if any, do they require change?

Q51 Should trust legislation allow trustees to follow a total return investment policy?

Q52 Should trust legislation allow trustees to invest trust assets without regard to whether the return is of an income or capital nature? Should trustees still be required to maintain a fair balance between income and capital beneficiaries and ensure a reasonable level of income is obtained?

Q53 Should trust legislation provide that trustees may, if authorised by the trust instrument, invest on a percentage trust? Should there be a requirement to value the trust assets on a regular basis and, if so, how often and on what basis should the period be set? What percentage is appropriate and how should it be set?

Q54 Should trust legislation provide that trustees may, if authorised by the trust instrument, allocate or apportion receipts and outgoings between income and capital accounts without regard to the legal categorisation of those receipts and outgoings (a discretionary allocation trust)?

### *Apportionment of outgoings between capital and income*

5.33 The basic principle is that the character of an expense or receipt determines who bears it or who receives it. Thus expenses that are of an income nature are borne by income beneficiaries and expenses of a capital nature are borne by capital beneficiaries. The person for whose benefit the expense was incurred is also relevant. The rules are difficult to apply. It is often hard to determine who benefits from particular expenditure. Expenditure on refurbishing a commercial building will benefit capital beneficiaries, but it will also benefit income beneficiaries through the ability to obtain higher rentals and sustain the income stream. Many trust deeds will enable trustees to exercise discretion as to how to apportion expenses. If the instrument is silent on the matter, the ordinary rules apply.<sup>224</sup> The Commission would be interested in views as to whether trusts legislation should allow trustees to apportion outgoings between income and capital accounts or charge an outgoing exclusively to or from income or capital in accordance with accepted business practice. A similar approach was recommended by the British Columbia Committee. It proposed that a trustee have the power to apportion or charge if it is just and equitable, in accordance with sound business practice, and in the best interests of beneficiaries. The

<sup>224</sup> See N Kelly, C Kelly and G Kelly *Garrow and Kelly Law of Trusts and Trustees LexisNexis* (6th ed, LexisNexis, Wellington, 2005) at ch 22 [*Garrow and Kelly*].

Committee also recommended trustees have power to transfer funds between capital and income accounts to recover or reimburse an outgoing previously charged to the account that is to receive the funds. It recommended a trustee be able to deduct from income an amount that is fair and reasonable to meet the cost of depreciation and add the amount to capital.<sup>225</sup>

Q55 Should trusts legislation allow trustees to apportion expenses between income and capital accounts or charge an outgoing to one or the other? Should the power be subject to the trustee being satisfied that doing so is just and equitable, in accordance with normal business practice, and in the best interests of beneficiaries?

Q56 Should trusts legislation allow trustees to transfer funds between capital and income to recover expenditure previously charged to one or the other?

Q57 Should trusts legislation enable a trustee to deduct an amount from income derived from trust property subject to depreciation and add the amount to capital?

### Delegation of investment decision-making

- 5.34 The 1988 reforms did not change the law regarding delegation by trustees in relation to investment decision-making. The power of a trustee to delegate is extremely limited and the Commission has suggested that it be extended to enable a trustee to delegate trust duties, discretions, and powers for up to 12 months. However, that would not enable trustees to delegate investment decision-making to an investment manager on an on-going basis. The power to appoint agents is also constrained although the Commission asks whether the proposals in the Trustee Amendment Bill 2007 are supported, that is, whether an agent could be appointed to perform administrative rather than trustee functions. Even if the power to appoint an agent is extended in the way suggested, it might be argued that this would not permit trustees to appoint an investment manager to make all investment decisions regarding investment of the trust fund. It is one thing to appoint a broker to buy and sell shares; it is another to hand over responsibility to someone else for deciding what shares to buy and what to sell.
- 5.35 The 1988 reforms have been in place for over 20 years. The Working Party recognised the limits placed on trustees by the Act but did not go so far as to propose more extensive powers of delegation in relation to investment. The managed funds industry has developed significantly since the 1988 reforms. Particularly, if the fund is substantial should it still be necessary for the trustees personally to make all the investment decisions for the fund? Trustees will, or at least should, get advice but they must then assess it and decide whether to accept or reject it. Acting on advice is different from saying “you are the experts

<sup>225</sup> British Columbia Law Institute *Total Return Investing*, above n 214, at 14 – 15.

in this area; you decide.” Many trust deeds enable trustees to use investment managers to make investment decisions. This recognises that making sound investment decisions in today’s world requires considerable skill and judgement. The range of potential investment products and combinations is immense. Investment techniques and methodologies are various and complex. Trustees of many private trusts take on the role of trustee without payment and do not have the time or expertise to make complex investment decisions or monitor on a regular basis the investment performance of the fund as well as a professional investment manager. If the reality is that most modern trust instruments permit delegation, it is hard to see any good reason for not permitting it in trust legislation.

- 5.36 The Commission is interested in hearing views on whether there are grounds for enabling trustees to delegate all their duties, discretions, and powers in relation to investment and that trust legislation should provide explicitly for this subject to suitable safeguards regarding the appointment of the delegate (investment manager) and to reviewing the manager’s performance. There could be a requirement for the trustees to set out the investment objectives and for the delegate to act within the limits of those objectives. It would still be possible for a settlor to exclude such a power in the trust instrument.
- 5.37 Should a trustee remain liable for the actions or decisions of a delegate? If a trustee has delegated investment decision-making because the trustee does not have the necessary expertise, it would seem anomalous for the trustee to remain liable for what the delegate does. If the trustee remained liable, he or she would likely feel obliged to take a much greater interest in investment matters. On the other hand, trustees should not be able to abdicate responsibility for no good reason. There are three possible safeguards. The first would be a requirement for the appointment of an investment manager to be made in good faith. It is likely that this would be covered by the content of the trustee’s fiduciary duty to beneficiaries. It is, however, still worth considering whether it should be spelt out in legislation. The second is to require that a trustee have reasonable care in appointing an investment manager. A third would be a requirement that trustees review the investment manager’s performance periodically. These latter options lead to the difficult question of what standard of care trustees must meet. Part one of this paper discussed trustees’ duties, including different theories about the existence and extent of any non-excludable core duties owed by trustees.<sup>226</sup> Failure to comply with either requirement would render the trustee liable for any loss sustained as a result of the investment manager’s failure to exercise the degree of skill and care expected of an expert.

Q58 Should trust legislation allow trustees to delegate their duties and powers in relation to investment of trust property? What safeguards, if any, should there be in relation to such delegation? Should the legislation prescribe the classes of organisation or people that can be delegated investment decision-making (such as financial advisers, banks etc)?

226 See ch 1.

Q59 Should a trustee remain liable for the actions and decisions of a person to whom the duties and functions of investment have been delegated? Could a trustee be liable if the decision to appoint an investment manager was not made in good faith or the trustee failed to monitor the investment manager's performance?

Q60 Are there any other matters relating to trustee investment that should be considered?

## BUSINESS-RELATED POWERS

- 5.38 Trustees may be given power under the trust instrument or will to carry on business. If there is no such power, section 32 of the Act may apply. Section 32 applies to the trustees of an estate of a person who was at the time of his or her death carrying on a business, trade, or occupation. The trustee can carry it on for:
- two years from the date of death;
  - as long as necessary to wind up the business; or
  - any longer period approved by the court.
- 5.39 Section 32(2), reflecting its age, confers a number of specific powers including purchase of stock, machinery, implements and chattels, and employment of managers, agents, servants, clerks, workmen, and others. An application to the court can be made by the trustees or a beneficiary and may be made even after the expiry of a previous authority. There is also an express power to pay subscriptions to any fund supporting the trade or business. Although this power appears in section 32, it is not limited to estate trusts.
- 5.40 The section does not apply to *inter vivos* trusts. If there is no power in the trust instrument to carry on a business, the trustees will have to apply to the court under section 64 of the Act. The Commission would be interested in views as to whether trust legislation should contain a general power to carry on business applicable to estate trusts and *inter vivos* trusts. Even though the situation may not arise that often, it would seem burdensome and costly to require trustees to have to apply to the High Court to obtain authority to run a business.
- 5.41 Section 32A enables trustees who have the power under the trust instrument to carry on a business to acquire shares in a co-operative company or in any other co-operative enterprise if “essential or highly advantageous” to carrying on the business or marketing the products of the business. The section, which largely re-enacts section 6 of the Act as part of the 1988 reform, probably reflects concern that the trustees of a farming trust who have power to carry on the farming business can also hold shares in a co-operative company under co-operative companies legislation (the Co-operative Companies Act 1996 and its predecessors) as they may have to do. The section states that the exercise of the power is not the exercise of a power of investment under Part 2 of the Act no doubt to recognise the fact that the trustees may have no alternative to being a shareholder in the co-operative.

- 5.42 Section 33 enables a trustee to convert a business into a company. The trustee may form the company or sell the business to a company having for its objects the purchase of the business. The consideration may be shares, debentures, and cash. Without this power, a trustee may remain liable for the debts of the business if carried on by the trust. The Commission believes the provision should be retained in trust legislation subject only to updating the wording.
- 5.43 Section 42A is a special provision that enables trustees who hold property used in a business on trust for successive interests to establish a capital reserve out of income and apply it for a number of purposes including:
- payment of debts;
  - improving or developing the assets of the business;
  - replacement, repair, and maintenance of the assets of the business;
  - purchase of other business assets;
  - provision of additional capital;
  - meeting losses; and
  - other related trust purposes.
- 5.44 Section 42B enables a trustee to apply capital from a business carried on by the trust for the maintenance of an income beneficiary if the income from the business is insufficient. The trustee can recoup the whole or part of any amount paid from income from the business in later years if that income is more than sufficient for the income beneficiary. The section is more concerned with distribution than with carrying on business and, with section 42A, is linked to section 42C.
- 5.45 Section 42C applies to both sections 42A and 42B. It requires the trustee to consider both what is proper as regards the maintenance and support of the beneficiary entitled to the income from the business and the preservation and improvement of the business in the interests of the capital beneficiaries.
- 5.46 Section 42D allows a trustee who carries on a business to adopt an accounting period for the business that commenced before the start of the trust and adopt as a final accounting period a period that ends before the termination of an interest in the trust.
- 5.47 The Commission has earlier asked whether trust legislation might simply give a trustee the powers of an absolute owner of the property.<sup>227</sup> The Commission considers that there should be no doubt about whether this would extend to carrying on a business and, if trustees are to have the power, trust legislation should make this quite clear.

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227 See [5.2] to [5.6].



Q61 Should trusts legislation confer power on trustees of all trusts, whether estate or inter vivos trusts, to carry on business? If so, what ancillary powers might also be desirable?

Q62 Is it necessary to retain an express power to acquire shares in co-operative companies (section 33)?

Q63 If the power to carry on business were to remain limited to estate trusts, should any changes be made to section 32 of the Act?

Q64 Should trustees continue to have express power to convert a business into a company? Is section 33 adequate for this purpose?

Q65 Should the powers in section 42A (establishment of capital reserve), section 42B (application of capital of business to income beneficiary), section 42C (exercising powers under section 42A and 42B), and section 42D (adoption of accounting periods) continue?

Q66 Are there any other matters relating to these provisions that require attention?

## LIABILITY FOR ACTIONS OF A CO-TRUSTEE

5.48 In general trustees are jointly and severally liable for the actions of co-trustees.<sup>228</sup> However, section 38 of the Trustee Act 1956 provides an exception to this in that:<sup>229</sup>

- a trustee is only liable for any breach in respect of trust property that the trustee has received;
- even if a trustee has signed a receipt, the trustee is not liable for the money or asset received if the receipt was only signed because all trustees were expected to sign;
- a trustee is only responsible for the trustee's own "acts, receipts, neglects, or defaults";
- a trustee is not answerable or accountable for the "acts, receipts, neglects, or defaults" of any other trustee, any bank, broker or anyone else with whom any trust money or securities have been deposited;
- a trustee is not liable for the fact that any security proves to be inadequate; and
- a trustee is not liable for any other loss, unless this was caused by the trustee's own deliberate wrongdoing.

<sup>228</sup> *Lang v Southen* HC Christchurch AP12/01, 24 July 2001.

<sup>229</sup> Kelly, Kelly and Kelly *Garrow and Kelly*, above n 224, at 823.

- 5.49 The Commission is not aware of any specific issues arising from section 38 of the Act, but is keen to hear whether there are concerns with the operation of this section in practice or suggestions for how this may be improved.

Q67 Are there any issues or problems with section 38 of the Trustee Act? How can this provision be improved?

#### POWER TO APPOINT ADVISORY TRUSTEES

- 5.50 Section 49 of the Act provides for the appointment of advisory trustees. An advisory trustee can be appointed by:
- the creator of the trust in the trust instrument;
  - the court on the application of a beneficiary or a trustee or a person on whose application the court could appoint a new trustee;
  - the responsible trustee or any person with power to appoint a new trustee; and
  - the court in the case of the estate of a mentally disordered person or of a person in respect of whom an order has been made under the Protection of Personal and Property Rights Act 1988.
- 5.51 The trust property remains vested in the responsible trustee who retains sole management and administration of the trust. The responsible trustee may consult the advisory trustee who may advise on any matter relating to the trust or the trust property. The advisory trustee is not a trustee. The responsible trustee may, but is not required to, follow the advice and is not liable when following the advice. The responsible trustee may apply to the court for directions if he or she thinks the advice conflicts with the trusts, is contrary to law, exposes the trustee to liability, or is objectionable. There is no obligation to apply. The court's decision is binding on the responsible trustee and the advisory trustee. The responsible trustee may also apply to the court if the advisory trustees are not unanimous and give conflicting advice, but there is no obligation to apply. If the responsible trustee is entitled to be paid, the advisory trustee may also be paid.
- 5.52 In its report *Some Problems in the Law of Trusts*,<sup>230</sup> the Law Commission recommended that a responsible trustee should have to apply to the court for directions if the responsible trustee intends to follow the advice of the advisory trustee but considers the advice conflicts with the trust or the law or would expose the responsible trustee to liability. The Trustee Amendment Bill 2007 contained an amendment to section 49 to this effect but had an additional provision that there would be no requirement to apply for directions if the advisory trustees are not unanimous and give conflicting advice, or are unanimous but the responsible trustee considers the advice objectionable. The proposed changes met with opposition and the select committee recommended omitting the mandatory requirement and retaining the status quo. It considered

<sup>230</sup> Law Commission *Some Problems with the Law of Trusts* (NZLC R79, 2002) at 11.

imposing an obligation on responsible trustees to apply to the court would be onerous, expensive, and time-consuming. It has been said that in practice these situations can usually be resolved without resort to the High Court.<sup>231</sup>

- 5.53 The select committee did, however, recommend that the responsible trustee should not be able to escape liability for following advice of an advisory trustee if the responsible trustee would have been liable for taking the action he or she took in the absence of advice.<sup>232</sup> The select committee also recommended including a statement to clarify that a responsible trustee is not protected from a breach of trust or failure to comply with general duties in law by following the advisory trustee's advice or direction, which arguably just emphasises the existing position.<sup>233</sup>
- 5.54 The role of advisory trustees and their impact on the responsibility and liability of responsible trustees may need to be considered against the nature of the trust and the duties of trustees. Advisory trustees under section 49 are potentially problematic because it is possible that a responsible trustee would not be liable even for breaching one of the trustees' core duties.<sup>234</sup> The question then needs to be asked whether a trust is in place at all at that point. This is an issue that can be seen as going to the heart of the concept of the trust.<sup>235</sup> If it is accepted that an irreducible core of trustees' duties are necessary for a trust to exist, does the situation of an advisory trustee warrant an exception such that there is a trust despite the trustees potentially escaping liability for actions taken on advice of the advisory trustee?

Q68 Are any changes needed to section 49?

Q69 Do you agree with the changes to the section proposed by the Law Commission and included in the Trustee Amendment Bill?

Q70 Do you agree with the position recommended by the select committee that the responsible trustee should not be under an obligation to apply to the court but should still be liable for following the advice of an advisory trustee if the responsible trustee would have been liable for the action he or she took in the absence of any such advice?

231 Kelly, Kelly and Kelly *Garrow and Kelly*, above n 224, at 444. See also A Butler (ed) *Equity and Trusts in New Zealand* (2nd ed, LexisNexis, Wellington, 2009) at 110 where the view expressed by the author of ch 5, "Trustees and Beneficiaries", is that it is to be hoped that the amendments are not enacted.

232 Trustee Amendment Bill 2007 (144-2) (select committee report) at 2.

233 Trustee Amendment Bill 2007 (144-2) (select committee report) at 3.

234 The irreducible core of trustee's duties is discussed in ch 1.

235 The nature of the trust is discussed in Law Commission *Review of Trust Law in New Zealand: Introductory Issues Paper* (NZLC IP19, 2010) at ch 3.

POWER TO  
APPLY TRUST  
PROPERTY FOR  
MAINTENANCE,  
EDUCATION, AND  
ADVANCEMENT

- 5.55 Most wills and trust deeds enable trustees to use income or capital for the maintenance, education, advancement, or benefit of a beneficiary before the beneficiary attains a specified age or otherwise acquires a vested interest in the trust property. The Act contains powers to do this in sections 40, 41, and 41A which apply in addition to the powers in the instrument, but are subject to any contrary intention in the instrument.
- 5.56 Section 40 permits a trustee to pay the income from property held in trust for a minor, whether the interest in the property is vested or contingent, for the maintenance or education (including past maintenance or education) or advancement or benefit of that minor. The effect of the section is to enable trustees to pay the income from the property in which the minor has a vested or contingent interest for the minor's benefit. It cannot be paid out of the income of someone else. The section applies only if the beneficiary has an entitlement that includes income before the capital is able to be distributed (intermediate income). The power exists as long as the beneficiary's interest continues and is subject to any prior interest such as a life interest in the income. The trustee must consider the age of the minor and his or her requirements and "generally the circumstances of the case" and whether there is any other income that may be applied for the same purpose. The payment must be to the parent or guardian of the minor or used in some way for the beneficiary's maintenance, education, or advancement. If the beneficiary on reaching 20 does not have a vested interest, the income is payable directly to the beneficiary until his or her interest becomes vested. If there is more than one fund involved, a proportionate part of each fund must be used. There is no limit on the amount that may be paid under the section. Surplus income must be retained by the trustee and held for the minor until he or she is 20 or marries or enters into a civil union before reaching 20.
- 5.57 The words "maintenance, education, advancement or benefit" do not appear to have caused problems in practice for trustees of the courts and provide them with considerable discretion. Maintenance implies periodic payment while advancement suggests a one-off payment for a specific purpose such as assistance in setting up a business. In *Re Gerbich*<sup>236</sup> Hammond J commented that initially, the concept of advancement was taken to involve the setting up in life of a young person, starting a business or apprenticeship, or providing capital to allow a business to continue. It does not include a loan or debt. The words "education" and "benefit" were added by will drafters and later found their way into statutory provisions.
- 5.58 The Judge noted examples of the exercise of the power in a wide range of circumstances, including payment of the cost of sending a beneficiary on a sea cruise to enable recuperation from a breakdown in health associated with studying for a degree at Melbourne University, making a charitable donation out of a sense of moral obligation, and in the resettlement of trusts for the purpose of avoiding estate duty. Although *Re Gerbich* concerned an application under section 41 of the Act, the language of the sections is the same and the Judge accepted that the provision of housing was a benefit for which a payment could be made. It has been suggested to the Commission that including in the legislation

236 *Re Gerbich* [2002] 2 NZLR 791 (HC).

examples of circumstances in which the courts have approved advances would assist trustees in making decisions. The Commission would be interested in submitters' views in this regard.

- 5.59 The British Columbia Committee has recommended distinguishing between payments in the case of minors on the one hand, for their maintenance, education, advancement, or benefit, and adult beneficiaries on the other, for the adult's benefit.<sup>237</sup> Would a distinction between minors and adults in this way assist? The Commission's tentative view is that maintenance, education, advancement, and benefit are well understood and do not appear to have caused problems for trustees. Without compelling reason to change, they should most probably be continued in any new trust legislation.
- 5.60 It has been suggested to the Commission that the requirement to hold surplus income until a minor reaches 20 or marries or enters into a civil union before reaching 20 should be abolished on the basis that marrying or entering into a civil union under 20 does not necessarily mean that a minor is any more capable than a minor who does not. Also the law increasingly treats those who reach 18 as adults. Under the Care of Children Act 2004, guardianship ends when a person reaches 18, although it also terminates on marriage or civil union,<sup>238</sup> and 18 is the age of majority for the purposes of the Minors' Contracts Act 1969.<sup>239</sup> Under the Property Law Act 2007, persons under 18 cannot execute a deed, appoint an attorney or accept an appointment as or act as an attorney.<sup>240</sup>
- 5.61 Section 41 is a similar power in relation to capital. It applies to both minors and adult beneficiaries. Trustees may pay or apply capital for the maintenance, education (including past maintenance or education), advancement or benefit of any beneficiary entitled to trust capital. Payments may be made even though the beneficiary's interest is conditional on the beneficiary reaching a specified age or any other event, or is subject to a gift over to another person if the beneficiary dies under a specified age or for any other reason, or is liable to be defeated by the exercise of a power of appointment or revocation or reduced if the number of members of the class of beneficiaries increases.
- 5.62 There are limits on how much capital can be paid out. The total amount cannot exceed half the beneficiary's vested or expectant share in the trust capital (where the value of that share exceeds \$15,000) or \$7,500 in any other case. Both amounts are subject to change by Order in Council although neither amount has ever been increased. The court may, however, approve payment of a greater amount. The amount of any advance is brought into account as part of the beneficiary's share when he or she becomes absolutely entitled to it. No advance may be made that would prejudice someone with a prior life or other interest unless that person consents or approval of the court is obtained.
- 5.63 Under section 41A, a trustee may advance capital subject to conditions including repayment, payment of interest, or giving security.

237 British Columbia Law Institute, Committee on the Modernization of the Trustee Act *A Modern Trustee Act for British Columbia* (BCLI Report No 33, 2004) at 64.

238 Care of Children Act 2004, s 28.

239 Minors' Contract Act 1969, s 2.

240 Property Law Act 2007, s 22.

- 5.64 The Commission would be interested to receive views regarding the operation of these sections. Concerns have often been expressed about the limits on capital advances in section 41. Is it necessary to impose limits at all? Modern day trust deeds do not usually restrict trustees in this way. Even if some limitations are still considered desirable, would it be useful to reset the amounts and provide, as is the case with some duties and benefits, for continuous indexation based on movements in the Consumer Price Index or some other suitable index? Do the provisions give rise to practical difficulties?

Q71 Are there problems with the operation of sections 40, 41, and 41A of the Act?

Q72 Do the terms maintenance, education, advancement, and benefit provide trustees with sufficient guidance? Is more specificity required in this regard? Would examples help?

Q73 Is it appropriate to retain the requirement in section 40 to accumulate income for an infant beneficiary until he or she reaches 20 or marries or enters into a civil union under that age? Is 20 still an appropriate age or should it be reduced to 18?

Q74 Should the monetary limits in section 41 be removed or made subject to a legislative mechanism that ensures continuous updating?

Q75 Would the provisions benefit from being rewritten in more accessible language?

#### APPLICATIONS FOR DIRECTIONS

- 5.65 Under section 66 of the Act, a trustee can apply to the High Court for directions concerning property subject to the trust, the management or administration of the trust property, or the exercise of any power or discretion. The application must be served on any person interested in the application who is also entitled to appear at the hearing. Section 69 provides protection for a trustee acting under a direction of the court unless the trustee has been guilty of fraud or wilful concealment or misrepresentation in obtaining the direction.

- 5.66 There is a considerable amount of case law on the scope of section 66 which is helpfully summarised in *Garrow and Kelly*.<sup>241</sup> The main principles are that:
- the section is intended to provide trustees with a means of obtaining advice from the court where there is doubt about the validity of action that is contemplated rather than to validate past action. Several options can be put forward. Trustees can apply to correct a past error if there is no impediment to the order and directions are appropriate;
  - the section is not intended for questions of substance or importance involving matters in dispute between trustees, allegations of breach of trust, difficult questions of law, or interpretation of the trust instrument. The section is not to be used for determining the rights of adversarial parties;
  - the section is concerned with matters of trust administration, but should not be used by trustees to immunise themselves against possible claims. Trustees should exercise discretions which competent trustees would be expected to exercise or where the trustees are not in any doubt and should not have the benefit of section 69 in such cases;
  - while trustees can surrender their discretion under the section, the role of the court is to advise the trustees rather than make their decisions for them; and
  - having obtained a direction under section 66, the trustees should follow it if they wish to get the benefit of section 69.
- 5.67 Cases on section 66 and the comparable United Kingdom provision have considerably defined the scope and meaning of the bare words of the section. It might be possible to incorporate some of the principles in an expanded version of the section so that its limits are plain on the face of the statute. The key principles are that the section is to be used to resolve issues of trust administration rather than disputes and that trustees are expected to do their job and not go to the courts simply for protection. On the other hand, the principles are well established and it is hard to see what real benefit there would be in a limited codification. The Commission would be interested in views on this.

Q76 Does section 66 of the Trustee Act 1956 operate satisfactorily?

Q77 Is the scope of the section clear or would there be benefit in incorporating some of the key common law principles in a new provision?

<sup>241</sup> Kelly, Kelly and Kelly *Garrow and Kelly*, above n 224, at 711–713.





# Appendices



LAW COMMISSION  
TE AKA MATUA O TE TURE

# Appendix 1

## Consultation List

The Law Commission has consulted with the following during the review of the law of trusts:

- Auckland Energy Trust Board
- Ayres Legal
- David Bigio
- John Brown
- Chapman Tripp
- United Kingdom Law Commission
- Glaistor Ennor Solicitors
- Anthony Grant and Richard Green
- Inland Revenue
- KPMG
- Legal Services Agency
- Ministry of Economic Development
- Ministry of Justice
- Ministry of Social Development
- Anthony Molloy QC
- New Zealand Law Society
- New Zealand Trustee Services
- Office of the Official Assignee
- Professor John Prebble
- Price Waterhouse Coopers
- Reserve Bank of New Zealand
- Scottish Law Commission
- Taylor Grant Tesiram
- The Treasury

We are grateful for their contribution.

# Appendix 2

## Questions

### CHAPTER 1 – TRUSTEES’ DUTIES

- Q1 Have the duties of trustees’ been correctly identified? Are there any other duties that should be included?
- Q2 Should trust legislation contain a list of trustees’ duties?
- Q3 How should such duties be expressed? Should they be stated in general terms like the duties of directors in the Companies Act 1993 or in greater detail?
- Q4 Which duties should be treated as irreducible core duties that cannot be excluded?
- Q5 Should trust legislation contain a list of beneficiaries’ rights?
- Q6 Is reform of any of the trustees’ duties listed in this chapter desirable?
- Q7 Should provision be made in new trust legislation for trustees to act by majority? If so, what safeguards, if any, should be provided to protect the position of a dissenting trustee? Should a dissenting trustee have continuing obligations to assist in giving effect to a decision by a majority of trustees?

### CHAPTER 2 – THE DUTY TO INFORM

- Q8 Is the current law regarding access to trust information as stated in *Schmidt v Rosewood Trust Ltd*, *Foreman v Kingstone*, and *Re McGuire* (deceased) satisfactory?
- Q9 Should the current law regarding access to trust information be enacted in new trust legislation (option one)?
- Q10 Should the current law on access to trust information be reformed and, if so, how might it be done? Would it be possible for legislation to list certain kinds of trust information that trustees must make available (option two)? Alternatively, could the principle in *Schmidt v Rosewood* and *Foreman v Kingstone* be combined with an indicative list of information that trustees would normally be required to disclose (option three)?
- Q11 What kinds of information might be included in such a list? Are there certain kinds of information that should always be disclosed, or never disclosed?

- Q12 Should trustees be required, as in some jurisdictions in the United States, to disclose information regarding:
- significant investment or management strategies;
  - significant transactions or possible transactions under consideration;
  - plans for distribution on termination or partial termination;
  - resettlement proposals; and
  - information known to be of particular significance to a beneficiary?
- Q13 Should there be an obligation on trustees to disclose trust information as a matter of course or should disclosure depend on a request from a beneficiary? Should trustees be required as a matter of course to provide certain key information, for example, notifying persons of the existence of the trust, that they are beneficiaries, and the identity of the trustees, coupled with an obligation to provide other trust information only on request?
- Q14 Should a duty to disclose trust information be a duty that cannot be overridden or should a settlor be able to prevent disclosure and, if so, in what circumstances?
- Q15 Should legislation provide for differing amounts or kinds of information to be provided to different categories of beneficiaries (such as vested or discretionary beneficiaries) depending on their degree of remoteness?

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CHAPTER 3 –  
EXCLUDING  
THE DUTIES  
OF A TRUSTEE

- Q16 How should trust law deal with exemption clauses in trust instruments? Do you think regulation of exemption clauses is needed?
- Q17 Is the current law too favourable to trustees? Are beneficiaries disadvantaged by the current law?
- Q18 Should fraud (dishonesty) continue to be the only type of behaviour for which liability of trustees cannot be excluded by exemption clauses? Or should exemption clauses excluding liability for other types of behaviours, such as wilful misconduct, negligence or gross negligence, also be prohibited?
- Q19 How valuable is the court's discretion under section 73 of the Act to relieve trustees from personal liability in certain circumstances? Should such a power be retained in legislation?
- Q20 Do you support any of the options listed above as possible approaches to exempting trustees from liability? Are there any other options for reform?

### Who may be a trustee?

- Q21 Should trusts legislation specify grounds on which a person is prohibited from being appointed or continuing to hold office as a trustee? What should those grounds be? Should they include:
- persons who are overseas;
  - unfit and incapable persons;
  - minors
  - any other grounds?
- Q22 Should trusts legislation continue to specify the categories of persons who may be removed from office by the continuing trustees or by the court? What should be the grounds for this? Should it still be possible to remove a trustee who has been absent from New Zealand for 12 months and has not delegated his or her powers?
- Q23 Should trusts legislation continue to allow the court to appoint new trustees? What should be the grounds for this?
- Q24 Should the principle in *Mendelsohn v Centrepoint Community Growth Trust* be incorporated in legislation?
- Q25 Is there an alternative to the High Court power to appoint trustees? Should District Courts or Family Courts have this jurisdiction?
- Q26 Should the liquidator of a corporate trustee be able to appoint a new trustee in the place of the company in liquidation?

### Replacement of incapacitated trustee

- Q27 Should the holder of an enduring power of attorney or a property manager of a trustee who has become mentally incapable be able to appoint a replacement trustee if no one else is able to do so?

### Removal of trustees

- Q28 Should the court be able to remove a trustee without necessarily having to appoint a replacement trustee?
- Q29 Should the statute make it clear that where three or more trustees were originally appointed, a trustee can be discharged without the need for a new appointment to be made? Should there be a power for trustees to simply remove and discharge a trustee, in limited circumstances?

### Retirement of trustees

- Q30 Are there any problems with the operation of sections 45 and 46 of the Act and, if so, how might they be addressed?
- Q31 Is section 46 still needed?
- Q32 Is there a more effective way of enabling a trustee to retire?

### Removal of appointors and protectors

- Q33 Should trusts legislation enable the court to remove an appointor or a protector and replace that person with someone else? On what grounds should this be possible?

### Vesting of trust property on removal or discharge of trustee

- Q34 What problems, if any, exist with regard to sections 47, 52, 57, and 59 of the Act? How might the operation of these sections be improved and simplified? Does the British Columbia model provide a satisfactory basis for this? Are there other ways in which the current legislation could be made simpler and more efficient?

### Appointment of first trustees: acceptance and disclaimer

- Q35 Should the common law rules relating to acceptance and disclaimer (rejection) of the office of trustee be set out in legislation? If so, should a time limit be imposed, with the effect that a person would be deemed to have disclaimed the office if he or she has not indicated his or her acceptance within a certain period of time?

### Custodian trustees

- Q36 How commonly are custodian trustees appointed under section 50, and for what purpose? Are there any problems with the operation of section 50?

### Administrative powers

- Q37 Should trusts legislation confer on a trustee the same administrative powers in relation to trust property that the trustee would have if the trustee were the absolute owner of the property?
- Q38 Would it be desirable for trusts legislation to list the administrative powers of trustees, possibly in a schedule, in clear terms? What powers should such legislation contain?

### Power to appoint agents

- Q39 Should trust legislation allow trustees to appoint agents to perform their administrative functions along the lines of the proposed new sections 29 and 29A of the Trustee Amendment Bill 2007?
- Q40 Do you agree with the changes recommended by the select committee?

### Power to delegate

- Q41 Are there any problems with section 31 of the Trustee Act 1956 that require attention? Is the section used in practice?
- Q42 Should section 31 be expanded to allow a trustee to delegate all trusts, powers, and discretions?
- Q43 What safeguards, if any, should there be in relation to such a power of delegation?
- Q44 Should a trustee be required to give written notice to co-trustees and any person with power to appoint trustees or, in the absence of such persons, to all adult beneficiaries with vested interests and the guardian of any minor and the manager of any incapacitated persons?
- Q45 Should the trustee be required to exercise reasonable care in making such a delegation?
- Q46 Should the trustee remain liable for the default of the delegate?
- Q47 Should a trustee be able to delegate to a sole co-trustee?
- Q48 Should a sole trustee be able to delegate? To whom should notice of the delegation be given in such a case: to adult beneficiaries with a vested interest in the trust property and any guardian or manager of an incapacitated person?
- Q49 Are there any other matters regarding delegation of trustees’ powers, duties, and discretions that should be addressed?

### Investment powers

- Q50 Are the current powers of investment in Part 2 of the Act adequate? In what respects, if any, do they require change?
- Q51 Should trust legislation allow trustees to follow a total return investment policy?
- Q52 Should trust legislation allow trustees to invest trust assets without regard to whether the return is of an income or capital nature? Should trustees still be required to maintain a fair balance between income and capital beneficiaries and ensure a reasonable level of income is obtained?
- Q53 Should trust legislation provide that trustees may, if authorised by the trust instrument, invest on a percentage trust? Should there be a requirement to value the trust assets on a regular basis and, if so, how often and on what basis should the period be set? What percentage is appropriate and how should it be set?
- Q54 Should trust legislation provide that trustees may, if authorised by the trust instrument, allocate or apportion receipts and outgoings between income and capital accounts without regard to the legal categorisation of those receipts and outgoings (a discretionary allocation trust)?

### Apportionment of outgoings between capital and income

- Q55 Should trusts legislation allow trustees to apportion expenses between income and capital accounts or charge an outgoing to one or the other? Should the power be subject to the trustee being satisfied that doing so is just and equitable, in accordance with normal business practice, and in the best interests of beneficiaries?
- Q56 Should trusts legislation allow trustees to transfer funds between capital and income to recover expenditure previously charged to one or the other?
- Q57 Should trusts legislation enable a trustee to deduct an amount from income derived from trust property subject to depreciation and add the amount to capital?

### Delegation of investment decision-making

- Q58 Should trust legislation allow trustees to delegate their duties and powers in relation to investment of trust property? What safeguards, if any, should there be in relation to such delegation? Should the legislation prescribe the classes of organisation or people that can be delegated investment decision-making (such as financial advisers, banks etc)?
- Q59 Should a trustee remain liable for the actions and decisions of a person to whom the duties and functions of investment have been delegated? Could a trustee be liable if the decision to appoint an investment manager was not made in good faith or the trustee failed to monitor the investment manager's performance?
- Q60 Are there any other matters relating to trustee investment that should be considered?



## Business related powers

- Q61 Should trusts legislation confer power on trustees of all trusts, whether estate or inter vivos trusts, to carry on business? If so, what ancillary powers might also be desirable?
- Q62 Is it necessary to retain an express power to acquire shares in co-operative companies (section 33)?
- Q63 If the power to carry on business were to remain limited to estate trusts, should any changes be made to section 32 of the Act?
- Q64 Should trustees continue to have express power to convert a business into a company? Is section 33 adequate for this purpose?
- Q65 Should the powers in section 42A (establishment of capital reserve), section 42B (application of capital of business to income beneficiary), section 42C (exercising powers under section 42A and 42B), and section 42D (adoption of accounting periods) continue?
- Q66 Are there any other matters relating to these provisions that require attention?

## Liability for actions of a co-trustee

- Q67 Are there any issues or problems with section 38 of the Trustee Act? How can this provision be improved?

## Power to appoint advisory trustees

- Q68 Are any changes needed to section 49?
- Q69 Do you agree with the changes to the section proposed by the Law Commission and included in the Trustee Amendment Bill?
- Q70 Do you agree with the position recommended by the select committee that the responsible trustee should not be under an obligation to apply to the court but should still be liable for following the advice of an advisory trustee if the responsible trustee would have been liable for the action he or she took in the absence of any such advice?

## Power to apply trust property for maintenance, education, and advancement

- Q71 Are there problems with the operation of sections 40, 41, and 41A of the Act?
- Q72 Do the terms maintenance, education, advancement, and benefit provide trustees with sufficient guidance? Is more specificity required in this regard? Would examples help?
- Q73 Is it appropriate to retain the requirement in section 40 to accumulate income for an infant beneficiary until he or she reaches 20 or marries or enters into a civil union under that age? Is 20 still an appropriate age or should it be reduced to 18?

- Q74 Should the monetary limits in section 41 be removed or made subject to a legislative mechanism that ensures continuous updating?
- Q75 Would the provisions benefit from being rewritten in more accessible language?

#### Applications for directions

- Q76 Does section 66 of the Trustee Act 1956 operate satisfactorily?
- Q77 Is the scope of the section clear or would there be benefit in incorporating some of the key common law principles in a new provision?



