



LAW·COMMISSION
TE·AKA·MATUA·O·TE·TURE

Report 79

Some Problems in the
Law of Trusts

April 2002
Wellington, New Zealand

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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17 April 2002

Dear Minister

I am pleased to present to you Report 79 of the Law Commission *Some Problems in the Law of Trusts*, which we submit to you under section 16 of the Law Commission Act 1985.

Yours sincerely

J Bruce Robertson
President

The Hon Margaret Wilson
Minister Responsible for the
Law Commission
Parliament Buildings
Wellington

Introduction

IN THIS REPORT the Law Commission discusses nine current trust law problems and makes recommendations thereon. The report was preceded by a discussion paper, *Some Problems in the Law of Trusts* (NZLC PP48). The Commission was assisted at various stages of the project by KR Ayers, Helmore Ayers, Solicitors, Christchurch; Professor JK Maxton, School of Law, University of Auckland; and WM Patterson, Minter, Ellison, Rudd, Watts, Lawyers, Auckland, and is grateful for their help to these three people and to the individuals and groups listed in appendix A who made submissions on the discussion paper. The Commissioner having the carriage of this project was DF Dugdale.

Some problems in the law of trusts

TRUSTEE'S POWERS OF DELEGATION

1 **I**N OUR PRELIMINARY PAPER we said this:

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

5 It is generally accepted that the present law is defective in two respects in particular. First, the line between ministerial and other functions is less than hard-edged. Secondly, and more importantly, "[t]rusteeship is an increasingly specialised task that often requires professional skills that trustees may not have".¹ So the prohibition of the delegation of fiduciary discretions can inhibit rather than promote the conscientious discharge of the obligations of trusteeship. In New Zealand of course this is particularly so as a consequence of the more sophisticated investment regime resulting from the 1988 enactment of a new Part II of the Trustee Act 1956.

None of the submissions on the preliminary paper challenged the contents of these two paragraphs. Nor was there any disagreement with our proposal that the appropriate reform was to authorise trustees to delegate to agents their powers to administer the trust, including powers of investment and management but excluding powers to appoint trustees or to decide how the capital or income of the trust is to be distributed. A recommendation to this effect

¹ The Law Commission *Trustees' Powers and Duties* (Law Com No 260) (London, The Stationery Office), para 4.6. (The Scottish Law Commission was a party to one part of the report, but we will not be referring to that part.)

by the (English) Law Commission² was adopted by section 11 of the Trustee Act 2000 (UK), and our preliminary paper proposed a formula based on sections 11(1) and (2) of that statute adapted in some minor respects.

- 2 Our concluded view does not differ in substance from the proposal in our preliminary paper, but the draft we now put forward deals with certain matters of detail not addressed earlier.
- 3 We recommend that section 29 of the Trustee Act 1956 be replaced by the following provision:

29.(1) The trustees of a trust may authorise any person to exercise any or all of their delegable functions as their agent.

(2) The trustees' delegable functions consist of any function other than—

- (a) any function relating to whether or in what way any assets of the trust should be distributed, used, possessed or otherwise beneficially enjoyed;
- (b) any power to decide whether any fees or other payment due to be made out of the trust funds should be made out of income or capital;
- (c) any power to decide whether payments received by the trustees should be appropriated to income or capital;
- (d) any power to appoint a person to be a trustee of the trust;
- (e) any right to apply to the Court conferred by this Act; or
- (f) any power conferred by any other enactment or the trust instrument which permits the trustees to delegate any of their functions.

(3) "Functions" in this section includes powers and duties.

- 4 By way of annotation of this draft we record:
 - It reproduces sections 11(1) and (2) of the United Kingdom statute, minus references to charitable trusts and to persons appointed to act as nominee or custodian, plus the words following "distributed" in the proposed section 29(2)(a), and the whole of the proposed sections 29(2)(c) and (e).
 - The proposed section 29(2)(c) is the converse of, and is inserted for the same reasons as, section 29(2)(b).
 - Although the proposed section 29(2)(e) perhaps states what is obvious, following consultation, it seemed to us that its absence could be a source of avoidable uncertainty.

² Above n 1, para 4.9.

- The existing provisions of the Trustee Act 1956 sections 2(3)–(5) make it unnecessary to replicate sections 26 and 27 of the United Kingdom statute (which have the effect that the trust instrument prevails where inconsistent with the new provision and that the new provision applies to existing trusts).
- We considered a provision comparable with the United Kingdom section 22, which spells out the trustees' obligation to keep delegation arrangements under review, but decided that such a provision would do no more than state what the law is in any event.
- Because its terms seem to have caused some difficulty to persons making submissions, we note that the function of the proposed section 29(2)(f) is to prohibit subdelegation.³
- It should perhaps be made clear that what we are discussing is collective delegation by all the trustees. The separate matter of delegation by an individual trustee is already provided for by the Trustee Act 1956 section 31.

EXCULPATING TRUSTEES

- 5 It is common for trust deeds to include clauses protecting trustees from liability for breaches of trust. It is clear that if the trustee has prepared the document, as will often be the case in practice where there is a commercial or professional trustee, any ambiguity will be construed against the trustee, and that such a trustee is likely to be under a fiduciary obligation (breach of which will preclude reliance on the exculpatory clause) to draw the clause to the attention of the settlor and explain its effect.⁴
- 6 It is equally clear that a trustee has certain basic obligations that are essential to the very concept of a trust so that any attempt to relieve the trustee from the consequences of breaching such obligations is of no effect. There are academic statements (relying on a series of Scottish cases decided by the House of Lords) that one of these basic obligations is not to be guilty of gross negligence,

³ Above n 1. Annotation of clause 11(2)(d) of the draft statute, 103.

⁴ The matter is expressed in the Restatement in these terms:

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

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

liability for which cannot, therefore, be excluded.⁵ In *Armitage v Nurse*⁶ the English Court of Appeal rejected the view that the Scottish cases laid down any such general rule. It held that they did no more than construe particular clauses. Millett LJ for the Court of Appeal said this:

I accept the submission made on behalf of [the beneficiary seeking a remedy for breaches of trust] that there is an irreducible core of obligations owed by the trustees to the beneficiaries and enforceable by them which is fundamental to the concept of a trust. If the beneficiaries have no rights enforceable against the trustees there are no trusts. But I do not accept the further submission that these core obligations include the duties of skill and care, prudence and diligence. The duty of the trustees to perform the trusts honestly and in good faith for the benefit of the beneficiaries is the minimum necessary to give substance to the trusts, but in my opinion it is sufficient.⁷

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

At the same time, it must be acknowledged that the view is widely held that these clauses have gone too far, and that trustees who charge for their services and who, as professional men, would not dream of excluding liability for ordinary professional negligence should not be able to rely on a trustee exemption clause excluding liability for gross negligence.⁸

8 In New Zealand, section 13D(1) of the Trustee Act 1956 (part of the new Part II creating a more modern investment regime enacted in 1988) accepts the possibility of valid exculpation provisions. The Superannuation Schemes Act 1989 section 8(b) is a provision (expressed in a lamentably roundabout way) that, by disapplying section 13(D)(1) to superannuation schemes, appears, in respect of such schemes, to make provisions exculpating negligent trustees of no effect.⁹

⁵ Paul Matthews “The Efficacy of Trustee Exemption Clauses in English Law” [1989] Conv 42. The decision of the Alberta Surrogate Court in *Re Poche* (1984) 6 DLR (4th) 40 is to the same effect. In the one New Zealand case on the topic the Court of Appeal avoided this trap (*Robertson v Howden* (1892) 10 NZLR 609).

⁶ *Armitage v Nurse* [1998] Ch 241.

⁷ *Armitage v Nurse*, above n 6, 253–254.

⁸ *Armitage v Nurse*, above n 6, 256

⁹ The existence of this provision provides one answer to the suggestion that restricting the effectiveness of exculpation provisions would result in “trustee chill”, a refusal by professionals to take on trusteeships.

9 It is sensible to consider the extent to which the law should give effect to provisions excluding trustees' liability along with the Trustee Act 1956 section 73, which is in the following terms:

73 Power to relieve trustee from personal liability

If it appears to the Court that a trustee, whether appointed by the Court or otherwise, is or may be personally liable for any breach of trust, whether the transaction alleged to be a breach of trust occurred before or after the commencement of this Act, but 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 he committed the breach, then the Court may relieve him either wholly or partly from personal liability for the same.

The ancestor of this section was the Judicial Trustees Act 1896 (UK) section 3, passed to give effect to the recommendations of a Select Committee on Trust Administration. The Committee accepted that the existing rules of law placed an excessive burden on trustees, particularly in respect of technical breaches, and recommended the excusing power as a consequence. As well as in New Zealand, the English measure has been copied in all the provinces of Canada except Prince Edward Island, and in all Australian states.

10 The options would seem to be:

- to leave the law as it stands; or
- to make all exculpatory provisions ineffective; or
- to debar professional trustees from relying on exculpatory provisions; or
- to confer on courts a discretion whether or not to override exculpatory provisions.

11 The solution proposed by the Ontario Law Reform Commission (which has not been acted upon by the Ontario legislature) was that clauses exculpatory trustees, both professional and lay, should be deprived of effect with reliance being placed in hard cases on the equivalent of our Trustee Act 1956 section 73. This solution is founded on the observation of the Commission that "a professional trustee should be carrying insurance, and a non-professional trustee who is sufficiently unsure of his competence to require such safeguards should not accept the office".¹⁰ But, this view overlooks the fact that many trustees are appointed not

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

because of their professional expertise but because of such factors as closeness to the family and the testator's or the settlor's confidence in the reliability of their judgment in such matters as the exercise of the powers of appointment.

- 12 Reported cases on section 73 and its equivalents in other jurisdictions suggest that, in deciding whether a trustee "ought fairly to be excused", a higher standard of care is imposed on professional trustees.

I am of opinion that a higher duty of care is plainly due from someone like a trust corporation which carries on a specialised business of trust management. A trust corporation holds itself out in its advertising literature as being above ordinary mortals. With a specialist staff of trained trust officers and managers, with ready access to financial information and professional advice, dealing with and solving trust problems day after day, the trust corporation holds itself out, and rightly, as capable of providing an expertise which it would be unrealistic to expect and unjust to demand from the ordinary prudent man or woman who accepts, probably unpaid and sometimes reluctantly from a sense of family duty, the burdens of a trusteeship.¹¹

So, in practice, the Ontario solution does not exclude differentiation between professional and lay trustees.

- 13 The solution proposed by the British Columbia Law Institute's Committee on the Modernisation of the Trustee Act gives the court the right in particular cases to override exculpating provisions. The section they propose (which rolls together the proposed reform and the equivalent of our section 73) is in the following terms:

- 96.(1) If it appears to the court that a trustee, however appointed, is or may be personally liable for a breach of trust, whenever the transaction alleged to be a breach of trust occurred, but
- (a) has acted honestly and reasonably, and
 - (b) 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,
- then the court may relieve the trustee either wholly or partly from that personal liability.
- (2) Without limiting subsection (1) and subject to subsection (3) an exemption clause in a trust instrument is effective according to its terms to relieve a trustee of liability for a breach of trust.
- (3) Where it appears to the court that the conduct of a trustee
- (a) would constitute a breach of trust, and

¹¹ *Bartlett v Barclays Trust Co (No 1)* [1980] 1 Ch 515, 534, Brightman J.

- (b) has been so unreasonable, irresponsible or incompetent that, in fairness to the beneficiary, the trustee ought not to be excused
the court may declare that
 - (c) any exemption clause contained in the trust instrument is ineffective in relation to the breach of trust, and
 - (d) the liability of the trustee for breach of trust be determined as if the trust instrument did not contain the clause.
- (4) In this section, “exemption clause” means a provision of a trust instrument that excludes or restricts liability including
- (a) making the liability or its enforcement subject to restrictive or onerous conditions,
 - (b) excluding or restricting any right or remedy in respect of the liability, or subjecting a person to any prejudice in consequence of that person pursuing any such right or remedy, or
 - (c) excluding or restricting rules of evidence or procedure or which purports to negative a duty that, in the absence of such provision, would otherwise lie on the trustee.
- (5) This section applies whether or not the trust was created before it came into force.¹²

14 In our view, the best solution is to debar from relying on exculpating provisions those who act as trustees for reward. It is to the professional that such strictures as those expressed by Millett LJ and quoted in paragraph 7 are directed. The issue is whether losses should be borne by trustees or beneficiaries. It is appropriate in 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. We recommend that there be added to section 73 a new subsection (2) to the following effect:

- (2) A provision of a trust instrument purporting to exonerate a trustee who acts as such for reward from liability for failure to exercise the degree of care, diligence and skill required by law, shall have no effect.

It is our intention that such provision should apply only to future breaches.

¹² *Report on Exculpation Clauses in Trust Instruments* (2002). At the time of our preparing this report the British Columbia report of which we have been provided a copy in manuscript form had yet to be printed and published, so that we are unable to provide the usual bibliographical details.

The coming into effect of such new provision should be delayed for 12 months from Royal Assent to enable existing professional trustees protected by an exculpation provision either to insure or resign.

- 15 An obvious drafting device to limit the effectiveness of a statutory provision striking down a clause relieving a trustee from liability would be to achieve the same result by drafting the provision not in exculpatory terms, but as a limitation of the duties of the trustee.¹³ We recommend that there be added to section 73 a further new subsection (3) to the following effect:

(3) Subject to section 49 (relating to advisory trustees) and section 50 (relating to custodian trustees) a provision in the instrument creating a trust limiting the degree of care, diligence and skill required of a trustee, shall, in the case of a trustee who acts as such for reward, be of no effect.

- 16 Finally, attention is required to the untidy position demonstrated by the case of *Morris v Templeton*.¹⁴ Only the High Court has jurisdiction to exercise the powers under section 73, but a district court has power to deal with a claim by a beneficiary against a trustee for redress for breach. What if the trustee, against whom such a claim is brought, wishes to invoke section 73? It is obviously not sensible to have two bites at the one set of facts and the way to avoid this is to add a further subsection (4) to section 73 to the following effect:

(4) If, in a claim brought in the District Court against a trustee claiming redress for any breach of trust, the trustee, by his statement of defence, seeks relief under this section, the District Court shall remove the proceedings to the High Court for determination whereupon the action will be disposed of as if an order had been made for the transfer of proceedings to the High Court pursuant to the District Courts Act 1947 section 45(2)(a).

THE REMUNERATION OF TRUSTEES

- 17 The historical position was that a trustee undertook his duties in a spirit of selflessness without any expectation of, or entitlement to, remuneration or reward. In New Zealand today a trustee is entitled to remuneration:

¹³ It seems that such a limitation will be given effect to (*Wilkins v Hogg* (1861) 3 Giff 115, 66 ER 346; *Hayim v Citibank* [1987] AC 730 (PC)), provided that it falls short of being repugnant to any trust relationship.

¹⁴ *Morris v Templeton* (2000) 14 PRNZ 397 (CA).

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

18 In its discussion paper, the Commission drew attention to the Trustee Act 2000 (UK) section 29 that makes it easier, in the absence of an appropriate charging provision, for a trustee to be remunerated for professional services without the need for a court order.¹⁵ On consultation, little enthusiasm was shown for the adoption of this provision in New Zealand. In practice there is almost always an adequate charging provision in the trust instrument.

19 There was, however, general support for the proposition that we should stop pretending that charging provisions in wills are legacies. We recommend that there be enacted, as part of the Administration Act 1969 (perhaps as section 68A), the following:

Any payment to which an administrator is entitled in respect of services is to be treated as remuneration for services (and not as a gift) for the purposes of:

- (a) section 15 of the Wills Act 1837 (gifts to an attesting witness to be void), and
- (b) section 37 of this Act (specific bequests to abate where estate insufficient).

The model for this proposed provision is the Trustee Act 2000 (UK) section 28(4).

PROTECTORS

20 The term “protector” is not a legal term of art. It is commonly used today to describe a person (including a group of persons or a corporation) who is not a trustee or beneficiary and on whom the trust instrument by its terms confers determinative powers that, but for such terms, would be trustee powers. Some description other than “protector” may be employed. Although trust instruments have, under different descriptions, made provision for protectors for some hundreds of years, there has been a recent substantial increase in provision for protectors, beginning with off-shore trusts

¹⁵ New Zealand Law Commission *Some Problems in the Law of Trusts* NZLC PP48 (Wellington, 2002), para 14.

and spreading to trusts with no off-shore element.¹⁶ Commonly, such provisions empower protectors to direct or veto the exercise by the trustees of their powers, or to choose or veto the trustees' choice of beneficiaries of the trust. They may confer other powers.

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

22 In our preliminary paper we noted the tentative view of the Commission that the existing law is sufficiently robust to solve most, but not all, of the obvious problems.

- Our hearts, it is suggested, need not bleed unduly if there are occasions when, as a result of the appointment of a protector, a purported trust is denied that classification. Being too clever by half always carries its risks.
- Where the provision under consideration in effect confers on the protector a dispositive power, a mandate to dispose of property not his own, it seems sufficiently probable that a court would treat the protector as the donee of a power of appointment (and so subject to the restrictions we refer to later in paragraph 31) to make legislative interference unnecessary.
- Where, on the other hand, the provision under consideration confers on the protector a power other than a dispositive power, it seems reasonably clear that a court would, despite the terminology of the instrument, classify the protector as a trustee or subject to fiduciary or contractual obligations sufficient for the protection of the beneficiaries.

Nothing put to us by way of submission suggests that this tentative view is other than correct. As an example of the correctness of the third of these propositions we would cite *Imperial Group Pension Trust Ltd v Imperial Tobacco Ltd*¹⁷ a pension scheme case where the

¹⁶ Professor Walters, whose essay "The Protector: New Wine in Old Bottles" in AJ Oakley (ed) *Trends in Contemporary Trust Law* (Clarendon Press, Oxford, 1996), 63 discusses the topic at length, points out that protectors received no mention in the fourteenth edition of *Underhill and Hayton* published in 1987 and appeared, for the first time, in the fifteenth edition in 1995.

¹⁷ *Imperial Group Pension Trust Ltd v Imperial Tobacco Ltd* [1991] 1 WLR 589 followed in *British Coal Corp v British Coal Staff Superannuation Scheme Trustees Ltd* [1995] 1 All ER 912, 928.

protector whose consent to certain benefit increases was needed was the employer of the beneficiaries, and where it was held that the employer's consent power might not be exercised in breach of the obligation of good faith implied in the employment contract.

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

- (c) Where any advice or direction is tendered or given by the advisory trustee, the responsible trustee may follow the same and act thereon, and shall not be liable for anything done or omitted by him by reason of his following that advice or direction.
- (d) In any case where the responsible trustee is of opinion that such advice or direction conflicts with the trusts or any rule of law, or exposes him to any liability, or is otherwise objectionable, he may apply to the Court for directions in the matter, and the decision and order therein shall be final and shall bind the responsible trustee and the advisory trustee, and the Court may make such order as to costs as appears proper:

Provided that nothing in this paragraph shall make it necessary for the responsible trustee to apply to the Court for any such directions.

This seems wrong in principle. A responsible trustee should not be permitted simply to shrug off the fact that advice or direction from an advisory trustee (or protector) is objectionable.

24 In our view, the existing section 49(3)(c) and (d) should be replaced by the following:

- (c) In any case where the responsible trustee knows or ought to know that such advice or direction conflicts with the trusts or any rule of law, or exposes him to any liability he must apply to the Court for directions in the matter, and the decision and order therein shall be final and shall bind the responsible trustee and the advisory trustee, and the Court may make such order as to costs as appears proper.
- (d) Subject to paragraph (c) where any advice or direction is tendered or given by the advisory trustee, the responsible trustee may follow the same and act thereon, and shall not be liable for anything

done or omitted by him by reason of his following that advice or direction.

The words “or is otherwise objectionable” forming part of the present section 49(3)(d) seem to us too imprecise to be suited to the mandatory provision we propose.

This should be followed by a new section to the following effect:

- 49A(1) In this section a protector is a person who, by virtue of the provisions of a trust instrument, may give to the trustee a direction which the trustee is obliged to follow or whose consent to the exercise by the trustee of a power is necessary.
- (2) In any case where the responsible trustee knows or ought to know that such direction or refusal or failure so to consent conflicts with the trusts or any rule of law or exposes him to any liability, he must apply to the Court for directions in the matter, and the decision and order therein shall be final and shall bind the responsible trustee and the protector, and the Court may make such order as to costs as appears proper.

No doubt such provision would infringe settlor autonomy by defeating the intention of the settlor to relieve the trustee of what would otherwise be some part of the trustee’s responsibilities. But it is well settled that such autonomy falls short of permitting arrangements inconsistent with the trust relationship being established. Relegation of a trustee to a puppet role is sufficiently inconsistent with the fundamentals of a trust to justify the imposition of the statutory obligation we propose.

TRUSTEES’ POWERS TO INSURE

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

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

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

- (1) A trustee may insure any property which is subject to the trust against risks of loss or damage due to any event and upon such terms (including terms requiring replacement by the insurer) as he thinks fits and may also insure against any risk or liability against which it would be prudent for a person to insure if he were acting for himself.
- (2) Subject to the express provisions of the instrument creating the trust the trustee may apportion the cost of premiums between income and capital as he thinks fit.
- (2A) Nothing in this section authorises a trustee to apply any asset of the trust in payment of a premium under a policy of insurance indemnifying the trustee against the trustee's personal liability for breach of the trustee's obligations as trustee.

No opposition to this proposal was received and we now advance it as a firm recommendation.

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

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

We agree with the view of the English Law Commission that trustees should be under no general obligation to insure.¹⁸ There can be circumstances where a cost-benefit analysis justifies a decision not to insure. The absence of a blanket obligation does not preclude trustee liability in the event of failure to insure in circumstances in which the prudence of so doing is clear.

TRADING TRUSTS

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

¹⁸ Above n 1, para 6.8.

This is especially so when persons dealing with the trustee of such a trust do not realise that a trust is involved at all, or that the trustee has no beneficial interest in the assets which he apparently owns. The problems are exacerbated when the trustee is a company of negligible paid-up capital ...¹⁹

There are also risks to beneficiaries whose only recourse in the event of the failure of the business is against an assetless trustee. We were told by some who made submissions that they have yet to encounter trading trusts or problems resulting from their use. This is understandable because use of trading in trusts in New Zealand is not yet widespread, though it has begun. The very purpose of the Law Commission's recommendations is to prevent the occurrence in New Zealand of difficulties of the type that have been encountered in Australia before they actually happen.

- 28 We recommend that, for the protection of beneficiaries, there should be imposed on the directors of the trust company the same obligations to beneficiaries to which they would have been subject if they personally had been the trustees. As to creditors, it seems to us that the best solution is to put it beyond doubt that the trustees' entitlement to indemnity out of the assets of the trust may not be excluded and to impose on the trading company the same obligation, in relation to distributions to beneficiaries of the trust, to satisfy a solvency test as is imposed in relation to dividends and other distributions by the Companies Act 1993.
- 29 We recommend that there be inserted in a suitable place in the Trustee Act 1956 a new section along the following lines:

Trading Trusts

- (1) In this section "trading trust" means a corporation (not being a trustee corporation or a Board incorporated under Part II of the Charitable Trusts Act 1957) which in the capacity of trustee of a trust carries on any trade or business; and "distribution" has the same meaning as is provided by the Companies Act 1993 section 2(1).
- (2) The directors of a trading trust will have the same obligation to the beneficiaries of the trust as they would have had if they and not the corporation had been the trustees of such trust.
- (3) No contract or arrangement purporting to reduce or remove the entitlement of the trading trust to be indemnified out of the assets of the trust shall be of any effect.

¹⁹ RP Meagher and WMC Gummow *Jacob's Law of Trusts in Australia* (Butterworths, Sydney, 6th ed 1997), 69.

- (4) A trading trust may make a distribution to a beneficiary of the trust only if the same requirements as are prescribed by the Companies Act 1993 section 52 (relating to the solvency test) have been satisfied, and in the event of a breach of this provision, the directors and officers of the trading trust will be under the same criminal liability and the same personal liability to make repayment as are directors of a company under the Companies Act 1993 sections 52(5) and 56.

CHALLENGING THE EXERCISE OF POWERS OF APPOINTMENT

- 30 It is common for trust instruments to confer on trustees the power to allocate (appoint) capital and income among potential beneficiaries. The reasons for the popularity of this device include the difficulty that a settlor may have in determining future needs of beneficiaries in advance, and the fact that the device enables the distribution of income that incurs the least tax. Although it is common, for the reasons stated, to confer dispositive powers on trustees, the law as to powers of appointment is properly to be classified as part not of trust law but of property law. However, it is convenient to include the subject matter of this part in the present paper.
- 31 There are well-settled rules determining when the exercise of a power is invalid, as it will be if it offends the rule against perpetuities, or exceeds the scope of the power (by annexing unauthorised conditions, for example), or if the method of execution is defective in a way that defeats the intention of the donor of the power, or if there is a fraud on a power. “Fraud” in this context does not imply moral turpitude. There is a fraud on the power if the purpose of the appointment is to effect some object that is beyond the purpose and intent with which the power was created. The question discussed in this part of the paper is whether the exercise of a power of appointment should be open to challenge on grounds other than the ones indicated in this paragraph. As the law now stands, if the power has been exercised following proper consideration (as distinct from capriciously) in good faith and without improper motive there is no ground on which a court can interfere.²⁰
- 32 One practical problem standing in the way of challenges on the grounds discussed in the previous paragraph is the rule that there is no obligation on the donee of the power to disclose the grounds

²⁰ A useful illustrative case is *Karger v Paul* [1984] VR 161.

for the appointment decision.²¹ “A court does not presume impropriety.”²²

This right to refuse to give reasons is, as a general rule, the haven for trustees, personal representatives, tenants for life and company directors, and their security is reinforced by the general unwillingness of the courts to draw adverse inferences from a refusal to give reasons. ... Despite the large number of cases in which decisions have been challenged it would seem to be more than coincidental that only in a very few cases has an aggrieved beneficiary managed to prove misconduct in the face of a wall of silence erected by his fiduciary.²³

Robert Walker J has observed that:

If a decision taken by trustees is directly attacked in legal proceedings, the trustees may be compelled either legally (through discovery or subpoena) or practically (in order to avoid adverse inferences being drawn) to disclose the substance of the reasons for their decision.²⁴

But this may not assist a plaintiff in formulating a claim. As Kirby P observed in *Hartigan Nominees Pty Ltd v Rydge*:²⁵

There are professional limitations upon the pleading of fraud and misconduct. They may not be alleged without a proper foundation in fact.

In the same case, Mahoney JA observed:

A beneficiary may support a case by discovery but may not use the process to ascertain whether a case exists.²⁶

33 It must not be overlooked that the appointor may not necessarily have acted with *deliberate* unfairness. The power may have been exercised, or any exercise of the power may have been refused on the basis of a belief (as to a beneficiary’s circumstances, for example) that was mistaken.

34 In *Maciejewski v Telstra Super Pty Ltd*, a claim for workers’ compensation brought by a beneficiary against the trustee of a superannuation scheme, Young J in the New South Wales Supreme Court was prepared in an *extempore* judgment in an ill-presented case to arrive at the robust conclusion that:

²¹ *Re Londonderry’s Settlement* [1965] Ch 918.

²² *Richard Brady Franks Ltd v Price* (1937) 58 CLR 112, 135, Latham CJ.

²³ PD Finn *Fiduciary Obligations* (The Law Book Company Limited, Sydney, 1977), 42.

²⁴ *Scott v National Trust* [1998] 2 All ER 705, 719.

²⁵ *Hartigan Nominees Pty Ltd v Rydge* (1992) 29 NSWLR 405, 419.

²⁶ Above n 25, 437.

... whilst trustees do not have to give reasons in a case where a plaintiff puts forward a prima facie case that the trustee's discretion has miscarried, the absence of reasons and the absence of any evidence before the Court as to what happened, will tend to make that prima facie case a virtual certainty.²⁷

But, even if this is correct, it is not clear that all situations will lend themselves to such an approach. The sympathy attracted by an Aussie battler²⁸ seeking her worker's compensation entitlement, as Miss Maciejewski was doing, will not necessarily be extended to some ne'er-do-well snivelling that he has got his hands on a smaller slice than he had hoped of his deceased grandfather's millions. *Maciejewski* is probably best understood as an example of the distinction between traditional trusts and those conferring benefits on employees. The distinction has been described by Sir Nicholas Browne-Wilkinson VC in these terms:

The traditional trust is one under which the settlor, by way of bounty, transfers property to trustees to be administered for the beneficiaries as objects of his bounty. Normally, there is no legal relationship between the parties apart from the trust. The beneficiaries have given no consideration for what they receive. The settlor, as donor, can impose such limits on his bounty as he chooses, including imposing a requirement that the consent of himself or some other person shall be required to the exercise of the powers.

As the Court of Appeal have pointed out in *Mihlenstedt v Barclays Bank International Ltd* [1989] IRLR 522 a pension scheme is quite different. Pension benefits are part of the consideration which an employee receives in return for the rendering of his services. In many cases, including the present, membership of the pension scheme is a requirement of the employment. In contributory schemes, such as this, the employee is himself bound to pay his or her contributions. Beneficiaries of the scheme, the members, far from being volunteers have given valuable consideration. The company employer is not conferring a bounty. In my judgment, the scheme is established against the background of such employment and falls to be interpreted against that background.²⁹

35 There should be noted, in relation to the broad question of when the exercise of a trustee's discretion is open to challenge, an

²⁷ *Maciejewski v Telstra Super Pty Ltd* (1998) 44 NSWLR 601, 604.

²⁸ In Australian English *Aussie battler* is a precise term used as a commendatory description of an Australian of humble station who struggles against life's misfortunes to survive or perhaps to better his or her lot.

²⁹ *Imperial Group Pension Trust Ltd v Imperial Tobacco Ltd*, above n 17, 597. Cited with approval in *Re UEB Industries Ltd Pension Plan* [1992] 1 NZLR 294, 298 (CA).

inclination to look by way of analogy to the rules developed to justify judicial interference in administrative actions. The position should not be overstated. Tipping J fluttered the dovescotes with an *obiter* first instance suggestion that there should be a power of review founded on *Wednesbury* style unreasonableness. (“It is in my view time for private law to catch up with public law in this respect.”)³⁰ Support for this view has been expressed by Salmon J.³¹ Fisher J has agreed that trust law tests of perversity or caprice “may have much in common with ‘unreasonableness’ in an administrative law context”.³² Wild J in *Blair v Vallely*³³ adopted Tipping J’s exposition, but by consent. None of these cases confront the settled English view of the legal position expressed in such a case as *Dundee General Hospitals Board of Management v Walker*³⁴ or the acceptance by all the members of the Australian High Court of the extent of a trustee’s duty in *Attorney-General v Brackler*.³⁵ Robert Walker J in *Scott v National Trust* observed:

So I am inclined to think that legitimate expectation may have some part to play in trust law as well as in judicial review cases.³⁶

All this falls well short of an acceptance that challenges to the exercise of trustees’ discretions are to be determined by an application of public law principles. The most that can be said is that a court, called upon to determine an allegation of perversity or caprice in decision making by trustees, may find itself grappling with intellectual problems comparable with those that arise in the public law context.

36 It is against that background that the view is sometimes expressed that the courts should have a supervisory power. Hardingham and Baxt for example,³⁷ point, by way of analogy, to the Trustee Act

³⁰ *Craddock v Crowhen* (1995) 1 NZSC 40331, 40337.

³¹ *Brackstone v Whitney & Brackstone* (1998) HC, Auckland, M983/97, Judgment 12 May 1998.

³² *Wrightson Ltd v Fletcher Challenge Nominees Ltd* (1998) HC, Auckland, CP129/96, Judgment 12 May 1998. The issue was not discussed in these terms at later stages of the litigation.

³³ *Blair v Vallely* (1999) HC, Wanganui, CP8/98, Judgment 23 April 1999.

³⁴ *Dundee General Hospitals Board of Management v Walker* [1952] 1 All ER 896 (HL).

³⁵ *Attorney-General v Brackler* (1999) 197 CLR 83.

³⁶ *Scott v National Trust*, above n 24, 718.

³⁷ IJ Hardingham and R Baxt *Discretionary Trusts* (Butterworths, Sydney, 1984, 2nd ed), para 515.

1956 section 68 that gives a right to apply to the High Court to an interested party aggrieved by the exercise by a trustee “of any power conferred by this Act”. (The wording of this provision as it stands makes it of no assistance to a potential appointee who has been passed over, because such a disappointed person is neither “beneficially interested in any trust property” nor bases any claim on a statutory power.)

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

38 In our preliminary paper we said:

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

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

If there is a response it may or may not provide grounds for a challenge to the appointment.

This proposal did not attract support. The opposing argument was neatly stated by one submitter in these terms:

If a settlor wishes to give a discretionary power of appointment to someone else – whether a trustee or some other nominated person – there should be no greater reason for requiring reasons for a decision to be given than if the settlor had reserved to him or herself the power to make the same decision. To give persons contingently entitled a right to reasons seems almost inevitably to invite litigation.

Our concluded view is that we should not recommend any statutory change to the law.

TRUSTEES' OBLIGATION TO PROFFER INFORMATION

- 39 The law as it stands, as part of the fundamental requirement of accountability, imposes on trustees certain obligations to proffer information to beneficiaries. Our preliminary paper was concerned with one small aspect of this broad set of obligations. The law is at present uncertain as to whether, when a beneficiary has a right either of his own accord (where he is a sole beneficiary) or in consort with all the other beneficiaries, to put an end to the trust and call for a transfer of the trust property, the trustee is under an obligation to notify the beneficiary of this entitlement.³⁸ The risk of beneficiaries being unaware of such rights is not a fanciful one. Until recent tax law changes it was common for trustees to allocate income among beneficiaries who were minors, with the beneficiaries having no knowledge of what was occurring. On obtaining majority the beneficiary is entitled to call for payment of the accumulated allocations. In real life, trustees often take the paternal view that it is better not to disclose to a 20-year-old an entitlement to a substantial sum in case it is dissipated.
- 40 We recommend that the uncertainty of the present law be brought to an end by statute. Prescriptive detail is not required. There should be inserted into the Trustee Act 1956 a section along the following lines:

If a beneficiary having an interest vested in possession is entitled either alone or in conjunction with other beneficiaries vested in possession to call for the transfer of trust property to such beneficiary or beneficiaries the trustee must notify the beneficiary of such entitlement.

The recommendation is confined to beneficiaries with vested interests because, although an entire class of contingent beneficiaries may combine to put an end to a trust, the size of the class may make such a rule as we propose impractical.

CONFLICT OF LAWS

- 41 In our preliminary paper we pointed out that the United Kingdom, by the Recognition of Trusts Act 1987, had given the provisions of the 1984 Hague Convention on Private International Law the force of law in the United Kingdom. We proposed that a similar

³⁸ Authorities on the definition of the boundaries of a trustee's duty are *Hawksley v May* [1956] 1 QB 304, *Miller v Stapleton* [1996] 2 All ER 449 and the unreported judgment of Collins J referred to at page 463 of the latter case.

course be adopted by New Zealand. We took care to draw this proposal to the attention of the Inland Revenue Department in case such a law change, by assisting the obfuscating processes of tax avoidance or in any other way, changed the odds in the war between the Department and the tax avoidance industry, but have had no objection from the Department. We now formally recommend the adoption of the 1984 Hague Convention on Private International Law by New Zealand.

APPENDIX A

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