[2022] NZLJ 87

Can a corporate trustee be used to avoid a requirement for an independent trustee?

Andrew Steele, Barrister, Auckland, on *Legler v Formannoij*

The facts in *Legler v Formannoij* [2021] NZHC 1271 raise interesting legal issues albeit at the possible expense of 'family relations'.

THE FACTS

Mrs F and Mr L were together 28 years (initially in a de facto relationship, then as married spouses). In 2002, Mr L received a substantial inheritance which he settled into two trusts. One trust was intended primarily to benefit Mr L's three, now adult, children from a former marriage and the other, the Kaahu Trust, was intended primarily to benefit Mrs F and Mr L. The proceeding involves only the Kaahu Trust of which, initially at least, Mrs F, Mr L and a professional trustee company were trustees.

Mr L died in 2017 and the trustee company resigned as trustee leaving Mrs F as sole trustee. The trust deed required the appointment of another trustee, so Mrs F used her powers of appointment to appoint a company, Kaahu Trustee Ltd, of which she was sole director, to be sole trustee. The issue before the Court was whether that appointment was lawful.

KEY TRUST DEED CLAUSES

The following clauses of the Kaahu Trust deed were engaged.

Clause 18.1 states:

> Any power or discretion vested in the Trustees may be exercised in favour of a Trustee who is also a Beneficiary by the other Trustee or Trustees.

Clause 26.1 states:

> Unless a corporate body is the sole Trustee:
>
> (a) if at any time there is only one Trustee, no power or discretion conferred on the Trustees by law or by this deed, other than that of appointing a new Trustee, shall be exercised by the surviving Trustee until such time as an additional Trustee has been duly appointed;
>
> (b) the Trustees must always include at least one person who is not a Beneficiary, nor the spouse, parent or child of a Beneficiary or of a Trustee, nor a person who is or has been in any sexual relationship with a Beneficiary or with a Trustee.

Clause 27.1 states:

> Corporate bodies: Any properly empowered corporate body may act as the sole Trustee or as one of two or more corporate Trustees.

Clause 27.2(c) states:

> Provisions applicable when the Trustee is a corporate body:
>
> …
>
> (c) Trustee/Beneficiary: It is expressly declared a corporate Trustee may exercise all the powers and discretions vested in that Trustee by this deed and by law notwithstanding such exercise may in any way directly or indirectly benefit any Beneficiary who has any interest (contingent or otherwise) in that Trustee whether as director, officer, shareholder or otherwise however.

A SUMMATION OF THE SETTLOR'S APPARENT INTENTION

Clause 18.1, albeit awkwardly, effectively bars a trustee from exercising their powers and discretions to benefit themselves. So, where there are two trustees, only the other trustee can benefit their co-trustee.

Clause 26.1 only operates if there is one trustee that is not a company. This is the position Mrs F found herself in. When engaged, cl 26.1 freezes Mrs F's exercise of her trustee powers and discretions until she appoints another trustee. Clause 26.1 stipulates that the new trustee must not be connected (in various ways) to a beneficiary.

The settlor's intention seems clear from these clauses, namely, that a sole individual trustee should be restrained by the presence of an independent mind, that is, someone unconnected with a beneficiary. The mischief being avoided is that of a sole trustee/beneficiary, who is an individual, exercising their trustee powers to benefit themself.

If this was the settlor's intention, then it is undone by cls 27.1 and 27.2 which provide that a company may be a sole trustee and, if it is, then the company may benefit any beneficiary notwithstanding that the beneficiary is a "director, officer, shareholder or otherwise" of the company.

So, on one hand, the Kaahu trust deed comprehensively bars an individual as sole trustee from using their powers to self-benefit, while apparently allowing that same individual to self-benefit provided they do so using a company under their complete control.

THE CHALLENGE

The children challenged Mrs F's appointment of Kaahu Trustee Ltd arguing it was a 'fraud on a power' because it enabled Mrs F to take exclusive control of the trust. In short, they argued that she used her power of appointment to benefit herself.

Justice Downs analysed the doctrine of 'fraud on a power' by reference to the leading cases of *Wong v Burt* [2005] 1 NZLR 91 (CA) and *Kain v Hutton* [2008] NZSC 61, [2008] 3 NZLR 589. The principle was distilled to: a trustee must exercise their powers in accordance with the purposes for which those powers were conferred.

His Honour determined, at [32], that a person appointing a trustee exercises a fiduciary duty, so must exercise the power properly, in good faith, and with regard to the best interests of the beneficiaries as a whole. This reflects the duty now codified in s 94 of the Trusts Act 2019 which states:

> A person with the power to remove or to appoint trustees must exercise any power of removal or appointment —
> (a) honestly and in good faith; and
> (b) for a proper purpose.

"Proper purpose" presumably equates to the common law requirement that the power be exercised "in the best interests of the beneficiaries".

ADVICE TO MRS F

Mrs F was advised that she could avoid appointing a second 'independent' trustee by instead appointing a company as sole trustee. And because the trust deed allowed it, she could control that company by being its sole director. A different, and arguably more risk averse, advisor signalled a concern about whether such a company would satisfy the trust's implied intent that there be 'independent control' of trustee decision-making.

Despite the concern, Mrs F elected to appoint Kaahu Trustee Ltd of which she was sole 'governing' director. Mrs F contemporaneously resigned as a trustee. Several months later, with Mrs F at the helm, the company:

- Removed the children as beneficiaries;
- Distributed trust funds to Mrs F; and
- Appointed Mrs F sole final beneficiary on final vesting day.

THE COURT'S ANALYSIS

According to Downs J, the deed did not "… preclude — nor manifest an intention to preclude — control by a single, corporate trustee with a beneficiary as director". At [46], his Honour stated:

> This means [Mrs F] did not commit a fraud on a power by appointing a corporate trustee subject to her control. Whether viewed as the purpose of simplifying matters in relation to Kaahu — [Mrs F's] testimony — or as one to control Kaahu — [the children's counsel's] contention — [Mrs F] did not act with an improper purpose. [Mrs F] did no more than something envisaged by the deed, indeed, expressly provided for by it.

But does it follow that because the deed envisages the use of a power it cannot therefore be improper? And was what happened in the best interests of the beneficiaries? How are *those* interests served by allowing cls 27.1 and 27.2(c) to circumvent the protections created in cls 18.1 and 26.1(a) and (b).

As for the beneficiaries' 'best interests' — the proof is in the pudding. Once the trustee's powers and discretions were brought under Mrs F's control, she used them to promote her own interests and diminish and or remove the interests of all the other beneficiaries.

His Honour rejected the contention that Mrs F appointed the company to prefer her own interests for six reasons:

1. Mrs F became the sole trustee through circumstance, not exploit.
2. Mrs F initially and genuinely, as opposed to going through the motions, attempted to find another trustee who would act with her.
3. Mrs F sought advice and acted upon it when setting up the corporate trustee.
4. Mrs F was advised of her fiduciary responsibilities as director of the sole company trustee.
5. The children "have been provided for, and each is well off" (at [56]) by the other trust, whereas the Kaahu Trust was "primarily" for Mrs F and Mr L (at [57]).
6. Mrs F was a "careful, fair-minded witness" who impressed His Honour as "sincere" (at [58]). His Honour noted that Mrs F remained of the intention to leave the children property when she died despite the litigation.

These reasons are explored below:

1. Mrs F became the sole trustee through circumstance, not exploit.

Fair enough. Mrs F came to be sole trustee innocently, but the fact remains that she found herself in the position of being obligated to appoint a new trustee and she elected against appointing an independent one who would constitute a restraint against her benefitting herself as beneficiary and in favour of appointing a sole corporate trustee that was the antithesis of such restraint.

2. Mrs F initially and genuinely, as opposed to 'going through the motions', attempted to find another trustee who would act with her.

Mrs F approached two possible 'independent' trustees. A prior lawyer who did not, as part of their practice, act as a trustee and Perpetual Guardian. Apparently, Perpetual Guardian's fees were too high and were not a 'good fit'. There are professional trustees in abundance throughout New Zealand. Mrs F approached two of them. Generously, the Judge held that Mrs F had not 'gone through the motions' of attempting to find an independent trustee. However one views Mrs F's efforts, there is no denying that she consciously chose to stop looking for an independent trustee and instead simply adopted the company 'solution' knowing it gave her complete and unrestrained decision-making authority. That this was also a cheap option and obviated the need for a 'good fit' seems incidental when regard is had to the best interests of the beneficiaries.

3. Mrs F sought advice and acted upon it when setting up the corporate trustee.

Mrs Wong of *Wong v Burt* sought and acted on advice, yet it did not save her decisions from falling foul of the doctrine of 'fraud on a power'.

4. Mrs F was advised of her fiduciary responsibilities as director of the sole company trustee.

The Supreme Court rejected Mr Clayton's argument that his fiduciary obligations to the beneficiaries constrained his ability to exercise his trustee powers in his own favour (see [64] to [67] in *Clayton v Clayton* [2015] NZSC 29). That Mrs F

was appraised of her fiduciary responsibilities is no answer to the potential mischief arising from a lack of independence in trustee decision-making. The point of cls 18.1 and 26.1 is to avoid a sole trustee from benefitting themself rather than properly considering all the objects of the trust. Because Mrs F, via the corporate, is entitled by the trust instrument to benefit herself, the normal constraints on her fiduciary obligations are of no practical significance.

5. The children "have been provided for, and each is well off" by the other trust, whereas the Kaahu Trust was "primarily" for Mrs F and Mr L.

It is difficult to see the relevance of the independent financial position of the children. Even if they had been impecunious, this fact would not have shone light on Mrs F's intention in opting for a sole corporate trustee. Put another way, if Mrs F *had* abused her power of appointment, then the unlawfulness would be unaffected by the children's circumstances.

6. Mrs F was a "careful, fair-minded witness" who impressed His Honour as "sincere". His Honour noted that Mrs F remained of the intention to leave the children property when she died despite the litigation.

If Mrs F says that her intention in appointing a sole corporate had nothing to do with side-stepping the apparent requirement for independence in trustee decision-making, then the Court is entitled to believe her. But Mrs F's stated intention to leave something from the trust to the children, despite the litigation, seems irrelevant to whether or not her appointment decision was lawful. Some may suggest the Court was generous to accept Mrs F's claimed wish about benefitting the children in the future, given that in the present Mrs F had used her new unrestrained power to remove the children as beneficiaries, make a distribution to herself and appoint herself final beneficiary. If Mrs F's actions constitute a 'fraud on the power', then it matters not that the fraud was done with an altruistic intention (as was the case in *Wong v Burt*). The question is whether or not the use of the power accorded with the purpose(s) for which the power was conferred.

MONTEVENTO HOLDINGS PTY LTD V SCAFFIDI

The Court placed weight on the decision of the Australian High Court in *Montevento Holdings Pty Ltd v Scaffidi* [2012] HCA 48, (2012) 246 CLR 325.

In *Montevento* there were similar clauses to cls 18.1, 26.1 and 27.2(c) of the Kaahu Trust deed. At the nub of the Australian High Court's short judgment was the determination that the trust deed drew a clear distinction between individuals and corporations, recognising that a corporation may be a trustee or co-trustee of this trust, while containing no actual or implicit prohibition upon a corporation, even if controlled by a beneficiary, from being such a trustee.

It is noteworthy that the High Court chose to repeat what the court of first instance stated. The primary Judge found that there was no evidentiary basis for concluding that Montevento would jeopardise the welfare of the trust fund or the interests of the beneficiaries

If the evidence had included that Montevento had removed all other beneficiaries, made a distribution to itself and inserted itself as sole final beneficiary, then Court may have taken a different view. In any event, the reference to the subjective intention and conduct of the appointor is reflective of the six-point analysis of Downs J in *Legler v Formannoij*.

The majority of the Court of Appeal, which was overruled by the High Court, saw the prohibition in the trust deed against an appointor, who is a beneficiary, being eligible to be appointed as a trustee, as extending to appointing himself to a position whereby he, nevertheless, exercised those same powers and rights by appointing as trustee a company of which he is the sole director and shareholder.

The Court of Appeal's approach seems a closer fit with the maxim that "equity looks to the substance not the form". As noted by J Heydon, M Leeming and P Turner (eds) *Meagher, Gummow and Lehane's Equity: Doctrines and Remedies* (5th ed, Sydney, LexisNexis, 2015) at [3-145], this is "another wording" of the maxim that "equity looks to the intent, rather than to the form".

A LITERAL INTERPRETATION — FORM OVER SUBSTANCE

The approach taken by the Courts in *Legler v Formannoij*, and more so in *Montevento Holdings Pty Ltd v Scaffidi*, seems to reflect a literal interpretation of the terms of the trust instrument coupled with an adherence to the principle, now embodied in s 15 of the Companies Act 1993, that a company is a legal entity in its own right separate from its shareholders and directors.

Once one ignores who is making the decisions for a company, that is, who dictates what the company does, then the outcome in these cases seems a foregone conclusion. But is there a case for lifting the corporate veil and recognising the obvious, namely that the company is nothing more than a puppet of the governing director?

There can be no doubt that the requirement for an independent trustee in these cases is subverted by the appointor's election to appoint a company which they alone control. It seems irrational to prevent such control falling into the appointor's hands on the one hand, yet allow this to occur under the guise of the corporate veil.

Admittedly, in *Legler v Formannoij* the express provision in cl 27.2(c) allowing directors who are also beneficiaries to receive the benefit of the trustee company's decisions put the Court in a cleft stick in the sense that upholding the apparent intention to avoid self-dealing and requiring independence in decision-making would mean ignoring cl 27.2(c), while enforcing cl 27.2(c) has the effect of undermining the carefully laid out provisions imposing restraints in cls 18.1 and 26.1(a) and (b) to defeat self-dealing and requiring independence in decision-making.

Given that the settlor's apparent intention is conflicting or, arguably, thwarted, it is possible that rectification might have been available to cure the anomalous situation. In *Re Butlin's Settlement Trusts* [1976] Ch 251, Brightman J stated that the court has power to rectify a settlement notwithstanding that it is a voluntary settlement. This is affirmed in *Ash v Singh* [2017] NZHC 2909 and affirmed on appeal in *Singh v Ash* [2018] NZCA 310. The touchstone for relief is to show that the trust deed does not reflect the settlor's intentions. Rectification was not argued, however.

Montevento Holdings Pty Ltd v Scaffidi did not have a clause like cl 27.2(c) and yet the High Court still came to the same conclusion.

The courts do not ignore the concept of separate legal personality, that is, they do not lift the 'corporate veil', unless the circumstances establish that the persons controlling the company have acted fraudulently or where the company is regarded as a sham or where a company is used to avoid an

existing legal duty. In other words, it will be done if the law requires it to be done to identify the real nature of a transaction (see *A-G v Equiticorp Industries Group Ltd (in stat man)* [1996] 1 NZLR 528, (1996) 7 NZCLC 261,064).

While Mrs F may have had 'simplification' of trust administration and cost savings on her mind, presumably she also had the other considerable benefits accruing to, what is effectively, a sole trustee on her mind too.

It is difficult to reconcile His Honour's statement, at [46], that Mrs F did not commit a fraud on a power by appointing a corporate trustee subject to her control even when "*viewed as a means by which she could control the trustee*" (emphasis added). If Mrs F's intention was to appoint a company so she alone could control it and hence control all trustee powers and discretions, then is that in the interests of all the beneficiaries of the trust? Mrs F's subsequent conduct in making a distribution to herself and removing the children as beneficiaries offers a possible answer.

COULD THE KAAHU TRUST DEED HAVE BEEN INTERPRETED DIFFERENTLY?

The Court interpreted cl 27.2(c) as allowing the appointor/beneficiary to be in complete control of the sole company trustee. That is a valid literal interpretation of the clause, but is it a valid contextual one?

The principles applying to the interpretation of contracts also apply to the interpretation of express trusts — see *Powell v Powell* [2015] NZCA 133, [2015] NZAR 1886 at [53]–[55]; *Pryor v Bulley* [2013] NZCA 559, [2015] NZAR 518 at [12] and [85].

The majority decision of the Supreme Court in *Firm PI 1 Ltd v Zurich Australian Insurance Ltd* [2014] NZSC 147, [2015] 1 NZLR 432 (at [60] to [63]) settled the principles applying to the interpretation of contracts and gave guidance on the balance between literal and contextual interpretations.

The Court held that the aim is to ascertain the meaning that the instrument would convey to a reasonable person having all the background knowledge which would reasonably have been available at the time that the trust was settled, and noted that a purposive or contextual interpretation is not dependent on there being an ambiguity in the contractual language in the trust instrument.

In short, the Court will be seeking to identify the manifested intention of the settlor in light of the purposes of the trust and the interests of those who are to benefit from it — see *Jacomb v Jacomb* [2020] NZHC 1764 at [60].

Contextually, how does one reconcile the strongly reinforced requirement in cls 18.1 and 26.1 for independence in decision-making and the bar against self-benefiting from the exercise of the trustee's powers with cl 27.2(c) that ignores those restrictions for a sole company trustee even where that company is under the complete control of a sole individual who would otherwise be hobbled from exercising any trustee powers (other than the power of appointment).

If the touchstone is the purpose of the trust and the interests of those who are to benefit from it, then there is strong argument that, contextually, cl 27.2(c) ought to be interpreted so that the corporate trustee must contain a requirement ensuring independence and a bar on self-benefitting.

Complicating the contextual approach are cls 2.2(a) and (b) in the 'interpretation' section of the deed which say:

> (a) except as otherwise expressly provided by this deed, all powers or discretions vested in the Trustees by any clause shall not in any way be limited or restricted by the interpretation of any other clause;
>
> (b) the interpretation of this deed in cases of doubt is to favour the broadening of the powers and the restricting of the liabilities of the Trustees;

WHAT IF CL 27.2(C) HAD BEEN ABSENT?

I suggest that cl 27.2(c) is unusual and would generally be absent from most trust deeds. It was absent in *Montevento Holdings Pty Ltd v Scaffidi*, which raises the question: would *Montevento* be followed in New Zealand on the same facts?

In *Jacomb v Jacomb* [2020] NZHC 1764, the Court was required to consider the effect of cl 15 which stated:

> THE number of Trustees shall be kept up to at least two (2) (at least one of whom shall at all times be a person or body who/which is not a Discretionary Beneficiary and is not a relative (within the meaning of Section 2 Income Tax Act 1976) of any Discretionary Beneficiary) in number and all decisions or actions of the Trustees pursuant to this Deed shall be valid and effectual if agreed to unanimously by the Trustees or in the case of there being no unanimity by a majority of Trustees, which majority must include at least one such Trustee who/which is not a Discretionary Beneficiary nor a relative of any Discretionary Beneficiary.

The existing two trustee/beneficiaries appointed a corporate trustee of which they were the sole directors and shareholders to be a third trustee and relied on the separate corporate personality of the company to avoid the 'independence' restrictions in cl 15. The Court held that the appointment was invalid with his Honour Cooke J stating at [66]:

> In my view the third defendant could not act as a third trustee whilst it was owned and controlled by the other two trustees. It was incapable of providing a third voice. I doubt that it could perform the role as an additional trustee at all in those circumstances. There is no doubt that a corporate body can be a trustee, but it must be capable of performing the functions and duties of a trustee. For example it must be able to attend meetings and make decisions. Here the third defendant was indistinguishable from Mr and Mrs Jacomb. When it attended meetings of the trustees to make decisions it could only reflect the will of the other two trustees. It could only agree with what they had both decided, and could not break any deadlock if there was disagreement between them. It could certainly not introduce the independence required by cl 15. The agent or representative of a discretionary beneficiary must also be treated as a discretionary beneficiary for the purposes of cl 15.

I suggest that had cl 27.2(c) been absent from the Kaahu Trust deed, Mrs F would have been precluded from exercising the company trustee's powers to benefit herself and the appointment would have been invalid as conflicting with cls 18.1 and 26.1.

POSSIBLE LEARNINGS

If the would-be settlor of a trust sees benefit from independence in trustee decision-making, then they will need to ensure that the kind of prohibitions reflected in cls 18.1 and 26.1 of the Kaahu Trust deed are carried over and made applicable to any sole corporate appointed as trustee.

Settlors may see advantages in an appointor/beneficiary retaining the ability to control a sole company trustee, but there may be risks too. In *Legler v Formannoij*, the Court was clearly influenced by the fact that the appointor was the matriarch of the family and that the trust was settled primarily for her and her husband's benefit. It follows that the merits of the case arguably fell for Mrs F rather than the plaintiffs.

In another case, the court may find an intention to misuse the power of appointment if the merits do not lie with the appointor and the facts in relation to the appointor's intention differ. In litigation, the facts are what the Judge decides them to be. 'Fraud on a power' disputes are heavily fact dependent. Consequently, prediction of the outcome is likely to be an uncertain endeavour. It is much better to have unambiguous clauses in the trust instrument.

'Fraud on a power' disputes are heavily fact dependent. Consequently, prediction of the outcome is likely to be an uncertain endeavour. It is much better to have unambiguous clauses in the trust instrument.

Another less conspicuous concern arises from the fact that if the appointor elects a sole corporate trustee in respect to which they have sole governing authority and that corporate can benefit them as one of the beneficiaries, then they are in the same position as Mr Clayton in *Clayton v Clayton*, that is, the appointor's powers may constitute 'property' for the purposes of the Property (Relationships) Act 1976 and possibly also the Insolvency Act 2006. ❐

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rehabilitation for someone who is a mature adult and who has only recently (but grudgingly) begun to comprehend the gravity of his actions. As for the sympathy the Tribunal felt for Mr Gardner-Hopkins being publicly shamed when so many other predators have not been, it is the very act of striking him off that might have led to more public accountability for predators hidden in plain sight: more complainants might be willing to come forward if there were stronger penalties, and more of those responsible for perpetrating sexual misconduct in the profession would be rooted out.

The Tribunal reveals what is at the core of decision at [69] (emphasis added):

> It is clear to us that his abilities as a lawyer generally, and as an advocate in particular, are such that *it will be beneficial to the public if he were readmitted to the profession in a rehabilitated state as soon as practicable* after the period of suspension expires.

It is unclear why this is a relevant consideration in the context of a disciplinary proceeding, the purpose of which is to protect consumers of legal services and the reputation of the profession. But also, what is beneficial for the public is to have access to lawyers who comply with and respect the law, and lawyers who can focus on their work without fearing for their safety in the workplace. This statement perpetuates the fiction that good advocates are scarce. They are not. It is just that many good advocates and technically competent lawyers — often women — leave the law, are mentally downgraded to "intermediate" status when they are actually highly effective senior lawyers, or take themselves out of the running for leadership positions (see, for example, Gatfield, above). Why would a senior woman lawyer want to lead a toxic organisation and be financially and legally bound up with sexual predators who pose a significant business risk and create emotional labour for other managers? Perpetuating the false narrative that there is scarcity at the top helps keep sexual predators — mostly men — at the apex of the profession and women at the bottom. Failing to hold sexual misconduct to account is one of many mechanisms that subordinates women lawyers, reflecting and confirming the patriarchal nature of the profession (Gatfield, above); Anna Hood "Reflections on the perpetual cycle of discrimination, harassment and assault suffered by New Zealand's women lawyers and how to break it after 122 years: Reviewing Gill Gatfield's *Without Prejudice*" [2018] NZWLJ 249).

Members of the public would understandably have their confidence in the legal profession knocked following this penalty decision, and new or aspiring lawyers would be sceptical that the profession would protect them from sexual misconduct. The penalty decision misunderstands the very severe, extensive and life-long consequences of sexual assault and abuse, the source of the practitioner's behaviour, and the nature and extent of the rehabilitation required. And, the decision ultimately communicates that technically competent lawyers are above the law, while other equally technically competent lawyers — usually women — languish beneath them. In the absence of real consequences for those who abuse and harass their colleagues, little if anything will change in the culture of the legal profession, and the disciplinary process will not be taken seriously as a mechanism for protecting consumers of the profession and the profession's reputation. In addition to all of these dangers, what is most dangerous is that the powerful liability decision in this case makes it seem like positive change is happening when it is not. ❐