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TRUSTTalk

AN ASSOCIATION OF INDEPENDENT CHARTERED ACCOUNTANTS

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Echoes heard from half way around the world

New Zealand's connection to the wider world of trust law has never been more apparent than in the recent English case of *MezhProm Bank v Pugachev*. This case concerning whether trusts might be invalid or "sham" trusts has become a major talking point around the trust world.

The case concerned a Russian oligarch who fell out with his former political masters, losing most of his claimed billions, and set up trusts in New Zealand (and elsewhere) aiming to secure his remaining assets around the world. When he was eventually sued by the liquidators of a bank he had owned in Russia, they were naturally keen to get their hands on any assets he still controlled.

The latest decision (of many) followed attempts by Mr Pugachev's former partner and mother of some of his children, beneficiaries of several trusts, to protect their London home, owned by a New Zealand trust. The resulting judgment of Mr Justice Birss has sent shockwaves around the trust world.

Justice Birss discussed the New Zealand Supreme Court's leading decision in *Clayton v Clayton* concerning trusts where the settlor has kept significant control over a trust and its assets. However, rather than relying upon past cases about what might be a sham, Justice Birss adopted a more novel approach.

Put simply, Justice Birss asked the question: what is the true effect of the arrangements behind the trusts? This is almost a pure expression of function over form. So if the "true effect" of the trust structure is that the settlor retains complete control over the trust and its assets, that the trustees will simply do his or her bidding without question, or that the powers of appointment or other mechanisms of control give the settlor powers giving effective control of the assets, then a trust has never actually been created and is invalid. So where the settlor believed their trust structure provided complete protection for their assets, instead creditors may indeed be able to get access to the assets to settle their claims.

While it should be noted that this case was decided in the High Court in England and has not been appealed, nor has it yet been considered in argument by a higher court, yet the underlying finding of the case has been furiously debated around the trust world since so it remains to be seen whether it marks a major change in how trusts are treated. Or will the "true effects" test end up as a curious outlier when the law is considered in future?

Settlors of trusts can take steps regardless to avoid being caught if the "true effects" test is taken to heart by more judges. Whether it may yet have deeper implications for some of the many other uses for trusts, remains to be seen. Very much a case of watch this space.

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Must Trustees follow memoranda of wishes when managing trusts?

It is common practice when settling new trusts for the settlor to execute a memorandum or letter of wishes setting out guidance for the trustees as to how the settlor would like the trust's capital and assets to be dealt with in future (especially after the settlor has died).

This leaves the question that has come before the courts on a number of occasions: how strictly should trustees follow the settlor's wishes? *Mackie Law independent Trustee Limited v Chaplow* provides useful guidance as to how closely trustees should follow letters of wishes.

The trust in question was settled by a Mr Munro who wrote a memorandum of wishes before his death. The main beneficiary of the trust following Mr Munro's death, was his daughter. However, difficulties arose afterwards over how the trustees should follow the wishes, which included a direction that Mr Munro's partner live in the trust property for 3 months after his death (even though she was not a beneficiary of the trust). The wishes also gave guidance regarding provision for the daughter. Relations between the daughter and the trustees deteriorated, but the main underlying issue was the trustees' determination to follow the wishes to the letter.

What the Court found was that the trustees were entitled to consider the wishes as part of their decision-making process and could elect to follow them, but they could not do so if it conflicted with the much more important trust deed.

The trustees were found to be wrong to consider themselves obliged to follow the wishes. The evidence showed they referred to the wishes in their decision-making but not to the actual trust deed itself. As a consequence the trustees were in breach of their obligations under the deed of trust.

The message is simply that while trustees might give consideration to the settlor's wishes, these must always be secondary to the trust deed. In this case the court felt obliged to award costs against the trustees personally, rather than paid out of the trust.

Trust Bill Update

The new Government has picked up the Trusts Bill and included it in the Parliamentary legislative programme for this year. The Bill is now being considered by a Parliamentary Committee and submissions from both experts and the public are being heard. Depending on how the Committee reports back to Parliament, it is expected that the Bill may be passed into law during the second half of 2018.

Trustees act personally!

There is a common misunderstanding that an independent trustee is different from other trustees and has no personal liability unless the trustee commits a breach of trust. This is, for better or worse, a myth.

All trustees act personally, whether they are family members (in a typical family trust) or whether they are "independent trustees". At law there is no difference.

The recent case of *Courtney v Pratley* further dispels the myth. The case also provides some useful guidance on what are known as Beddoe applications – opportunities for trustees to ask the court what they should do and to protect themselves from having costs awarded against themselves should they need to go to court themselves.

The case concerned whether it was necessary for Mr Pratley, the executor / trustee under a will, to take steps to defend a $36,000 claim filed by Mr Steven Courteney for expenses from his father's estate. Steven had been left out of his mother's will and brought a claim challenging the will. The sums involved were not large, but ballooned once legal costs were taken into account.

Mr Pratley's costs as trustee were $8,000 on his own account, plus $29,000 in legal fees and a costs award in favour of Steven of $36,735.80 (making a total of over $73,000 and far outstripping the amount of the claim). Although Mr Pratley, who was a professional and not a member of the family, was appointed on the removal of Steven's brother, at the time the judge commented that there would need to be care in how he carried out this role. However, on appointment Mr Pratley needed to immediately decide whether to defend Steven's claim on account of his father's expenses. He took advice and decided to continue to pursue the brother's defence against Steven's claims.

Under the Trustee Act 1956 a trustee is entitled to "all expenses properly incurred". Equally this means that improperly incurred expenses must be paid by the trustee personally.

While the court was sympathetic to Mr Pratley's position in defending the claim, the court came to the view that the defence was inappropriate for the size of the claim. The claim of $36,000 made litigation clearly uneconomic (as was reflected in the costs of the litigation, which exceeded the amount claimed). The trustee's obligation to protect the assets of the trust had to be measured against erosion of trust property due to litigation and although Steven's brother had been the sole beneficiary of the estate at the time, Mr Pratley needed to properly consider the merits of the claim by Steven and his daughter.

The judge gave some useful advice. She felt that Mr Pratley should have sought what is known as a Beddoe order (which would have determined whether his costs were to be met by the estate). While the Court was clear that no criticism was intended of Mr Pratley, the consequence of not seeking Beddoe guidance was that he was not entitled to his costs in respect of Steven's proceedings.

The message: all trustees act personally and can be personally liable. Even "independent" trustees when there has been no breach of trust. But there are steps, such as Beddoe applications, that all trustees can take to limit personal risk from trust litigation.

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AN ASSOCIATION OF INDEPENDENT CHARTERED ACCOUNTANTS

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