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Mediation of Trust Disputes: Risks for Trustees

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Jeremy is an accomplished litigator, specialising in commercial, equity and trust law. He has an ability to quickly grasp complex factual and legal situations and provides incisive, commercially realistic, advice at short notice. He regularly appears before all Courts and specialises in complex dispute resolution.

Jeremy is recognised by Chambers 2016 Asia Pacific and Chambers 2015 Global Directories as being an "up and coming" practitioner in the field of Dispute Resolution. He is quoted as "an excellent young lawyer who has a sharp intellect, and is a good tactician and a very good communicator. His approach in court is courteous and disarming. The Global directory quotes that he is "fast acquiring an enviable reputation", with an impressed client enthusing that he is "probably the most outstanding young lawyer I have ever met."

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DISPUTES, SETTLEMENTS AND COMPROMISE: RISKS AND STRATEGIES FOR TRUSTEES

By Jeremy Johnson TEP, Partner, Wynn Williams¹

Introduction

1. The increasing use of trust structures means that trustees face increasing exposure to litigation.² That is true whether the trust is one that is formed for commercial activities, whether it holds liquid assets for beneficiaries or whether, as is increasingly the case in New Zealand, it is used for the purposes of holding the family home. In any of those circumstances there is a risk of litigation. In the case of trusts that own family homes that increase is particularly heightened when regard is given to the rate of separation of couples in modern society.
2. What this means is that trustees increasingly have to deal with and resolve disputes. Often this will be done with the assistance of lawyers but not always; regardless of whether or not lawyers assist it is becoming increasingly clear many trustees and their professional advisors do not fully consider the possible limitation on the ability of trustees to settle disputes.
3. Trustees generally either take an active or a passive role; in other words they either try to actively resolve disputes themselves or they take a passive role and simply sign off on outcomes agreed by other protagonists. This latter situation often occurs in the context of the separation of couples where trustees will often leave it to the parties to try and resolve matters and then simply act in accordance with their directions.
4. The reality is that neither of those options is always available to the trustees. Rather trustees need to clearly identify the nature of the dispute because the nature of the dispute will fundamentally drive what sort of role they can play as well as the duties that they will owe.
5. The purpose of this paper is to consider:
 - a. the classification of trustee disputes;
 - b. restrictions on the ability of trustees to settle disputes; and
 - c. the best way for trustees to handle these disputes –including practical suggestions for trustees and suggested reform of the Trustee Act 1956 and the High Court Rules to better facilitate the voluntary resolution of disputes.
6. What is clear is that the voluntary resolution of disputes for trustees is more complex than most realise. Accordingly trustees should always work methodically through the categorisation of disputes set out in this paper and stop to consider very carefully their duties when they are about to enter into a voluntary settlement.
7. Further, trustees seeking assistance from the courts will find the procedures cumbersome and expensive. There are some simple reforms that would facilitate

¹ This paper has been prepared for presentation at the 2016 STEP Australasian Conference. I am grateful for the help of Courtney Holmes, summer clerk.

² There are an estimated 300,000 to 500,000 trusts in New Zealand the vast majority of which will own real property of some description - Law Commission *Review of the Law of Trusts: a Trusts Act for New Zealand* (NZLC R130, 2013) at [5] of the Summary.

trustees engaged in mediations and negotiations to assist them in settling disputes within the limits of their trustee duties.

The classification of trustee disputes

8. The nature of trust disputes will reflect the nature and activities of the trust in question. For example if a trust is used for the purposes of commercial activity and trading then a trustee might find itself in a dispute with a commercial counter party.
9. With more passive trusts disputes can arise in circumstances where there is a challenge to the terms of the trust. For example, a creditor may challenge the disposition of the settlor's property into the trust or there may be a challenge under family protection legislation.³
10. Challenges to the existence of the trust often arise in situations where there is the separation of a couple and a relationship property dispute. In New Zealand, these disputes often arise in the context of either challenges to the existence of the trust as a whole usually by alleging that the trust itself is something of a sham.⁴
11. Challenges can also come via the provisions found in the Property (Relationships) Act 1976 (**PRA**). Of particular relevance are Sections 44 and 44C of the PRA. Section 44 allows one party to claim against trustees who are holding trust assets where it is alleged those trust assets were settled on the trust for the purposes of defeating a claim under the PRA.
12. What that means is that the claimant must establish first that, but for the existence of the trust structure, the property in question would have been relationship property for the purposes of the PRA and thus liable to be divided between the separating couple 50/50 (all things being equal).⁵
13. They then must establish that the property in question was settled on the trust for the purposes of defeating such a claim. While there must be an actual intention to defeat claims the intention can exist prior to there actually being a valid claim.⁶ Even if somebody settles property on a trust prior to the commencement of the relationship if that property would have then become relationship property then a valid claim could be brought.
14. This sort of situation is most likely to arise in the context of a claim relating to the family home. Say, for example, if somebody owns a home and settles it on a trust for the purposes of protecting that home from future relationship property claims, then enters into a relationship at which point that home would have become the family home under the PRA but for the trust structure, then a successful claim could potentially be brought under Section 44.
15. In contrast Section 44C allows the Court to order either the trustees of a trust or the other spouse to make a payment out of income of the trust or a payment out of other property in the event that the claimant's claim to property is defeated because of

³ In New Zealand the Family Protection Act 1955 is the relevant piece of legislation while in New South Wales it is the Succession Act 2006, in Victoria it is Part IV of the Administration and Probate Act 1958, and in England it is the Inheritance (Provisions for Family and Dependents) Act 1975.

⁴ For example, this was the argument in *Clayton v Clayton* [2015] NZCA 30 (CA) - the decision of the Supreme Court of New Zealand is still pending.

⁵ There are a variety of exceptions contained in the PRA to the regime of equal sharing; the most relevant exceptions provided for are at Sections 13 and 15 of the PRA.

⁶ See *S M W v M C* [2013] NZHC 396, [2014] NZFLR 71 at [62]; *Gray v Gray* [2013] NZHC 2890.

the existence of the trust structure. There is a requirement that the property in question be relationship property at the time of the disposition.⁷

16. The key point here is that the remedies available under Section 44C are less extensive and immediate than those available under Section 44 but the threshold is lower. In particular there is no need in a New Zealand context for there to be an intention to defeat a claim for relief to be available under section 44C.⁸ Rather it simply needs to be the effect of the trust structure.
17. Finally there are claims that involve claims by beneficiaries against trustees when they perceive their rights as having been adversely affected. So, for example, there can be claims relating to alleged mis-management of trust funds or claims where beneficiaries feel that they have been disadvantaged by the actions of the trustees.
18. It is a fair question to ask, given the wide variety of disputes that trustees might find themselves involved in, how they can be appropriately categorised. Thankfully this issue has been considered by the Courts and in particular by the Chancery Division of the High Court of England and Wales.⁹
19. In *Alsop Wilkinson v Neary*¹⁰ Mr Justice Lightman provided a useful categorisation that has been widely accepted in academic circles and has also been referenced in relation to trustee costs in New Zealand.¹¹ In his categorisation Mr Justice Lightman was following the lead of Kekewich J in *Re Buckton*.¹²
20. Mr Neary was a partner in the firm of Alsop Wilkinson who stole over £1M from the firm and the client's trust account. The firm took responsibility for paying back clients who had lost their funds and then sought to pursue Mr Neary for the amounts owing to him. Judgment was successfully obtained but then there was a need to have it enforced.
21. Mr Neary transferred wealth into a trust; this case involved applications to set aside transfers to two trusts under Section 43 of the Insolvency Act 1986 (England and Wales). That provision is similar to the provisions in the Property Law Act 2007 in New Zealand which allows for settlements of property to be set aside when they are undertaken with the intention and effect of defeating creditors' interests.
22. The trustees of the two trusts were unsure as to whether or not they should defend the action. They sought what are now known as prospective cost orders.¹³
23. In deciding whether or not the trustees should actively defend the proceedings Lightman J set out a three-fold categorisation of proceedings:

⁷ In contrast to section 44 – see for example *Nation v Nation* [2005] 3 NZLR 46, (2004) 23 FRNZ 783 (CA).

⁸ *B v B* [2015] NZFC 611

⁹ For an excellent article that considers some of the issues raised in this paper together with additional issues relating to costs, please see Graham, T & Akko T (2008, April) *Mediation: Important Preliminary Questions: Trustees Duties and Trust Disputes and Trustees Powers of Compromise*. T & T 14 (3) 163 to 171.

¹⁰ *Alsop Wilkinson v Neary* [1995] 1 All ER 431

¹¹ See, for example, *Woodward v Smith* [2014] NZHC 4-7, [2014] 3 NZLR 525 (HC).

¹² *Re Buckton* [1907] 2 Ch 406 (Ch) at 413–417.

¹³ These are also available in New Zealand; see, for example, the Judgment of Kos J in *Woodward v Smith* above, n11.

(1) The first bracket which I shall call a "trust dispute" is a dispute as to the trusts on which they hold the subject matter for the settlement. This may be "friendly" litigation involving e.g. the true construction of the trust instrument or some other question arising in the course of the administration of the trust; or "hostile" litigation e.g. a challenge in whole or in part to the validity of the settlement by the settlor on grounds of undue influence or by a trustee in bankruptcy or creditor of the settlor, in which case the claim is that the trustees hold the trust funds as trustees for the settlor, the trustee and bankruptcy or creditor in place of or in addition to the beneficiary specified in the settlement. The line between friendly and hostile litigation, which is relevant to the instance of costs, is not always easy to draw.

(2) The second bracket which I shall call a "beneficiaries dispute" is a dispute with one or more of the beneficiaries as to the propriety of any action which the trustees have taken or admitted to take or may or may not take in the future. This may take the form of proceedings by a beneficiary alleging breach of trust by the trustees or in seeking removal of the trustees and/or breach of trust.

(3) The third bracket which I shall call a "third party dispute" is a dispute with persons, otherwise in the capacity of beneficiary, in respect of rights and liabilities e.g. in a contract or tort assumed by the trustees as such in the course of administration of the trust.

24. In summary, disputes involving trustees can be categorised as follows:
 - a. Trust disputes which are either:
 - i. friendly; or
 - ii. hostile;
 - b. Beneficiary disputes which are by their very nature hostile; and
 - c. Third party disputes which are not hostile and where the trustee's right to be indemnified out of trust assets will be in operation.
25. Writing extra-judicially Lightman J has acknowledged that these categorisations, while useful, were not definitive and did not cover all cases and that the categorisations were not necessarily mutually exclusive.¹⁴
26. Indeed, the fact these categories are not closed has recently been recognised in England in the case of *Singapore Airlines Limited v Buck Consultants Limited*.¹⁵
27. That case involved consideration of the sub-categories relating to trust disputes identified by Lightman J in *Alsop Wilkinson v Neary*. Those three sub-categories for costs have been identified as:¹⁶
 - a. where the trustee applies to court for the determination of an issue as to the construction of the trust instrument or an issue which arises in the administration of the trust its costs (and the costs of the beneficiaries) are incurred for the benefit of the trust and all parties are entitled to an indemnity of the trust estate;

¹⁴ *Costs Orders for trustees: some thoughts of Alsop Wilkinson v Neary* 20 (3) Trust Law International, 2006.

¹⁵ *Singapore Airlines Limited v Buck Consultants Limited* [2011] EWHC 59 (Ch); [2011] EWCA Civ 1542 (CA)

¹⁶ In *Re Buckton* above n12.

- b. where the application is made by a beneficiary, as opposed to the trustee, but the substance of the application is the same as above then the same costs rule will apply;
 - c. where an application is hostile in which case the trustee may sometimes have a limited role to play before withdrawing to allow the parties to fight their own battles, the trustee is entitled to its indemnity but the beneficiaries may be categorised as hostile litigants and will be at risk of adverse costs orders between each other.
28. *Singapore Airlines Limited v Buck Consultants Limited* involved a question of the Singapore Airlines Limited Pension Scheme. Singapore Airlines Limited had retained Buck Consultants Limited as a pension benefits consultant to provide advice on the documentation of the scheme. Eventually Singapore Airlines Limited and the trustee of the scheme began proceedings in negligence against Buck Consultants Limited in relation to the work done. As part of that litigation preliminary questions on the construction of the rules of the trust were determined. Buck Consultants Limited was largely successful on those issues.
29. The judge at first instance ordered Singapore Airlines Limited to pay Buck Consultants Limited costs on a standard basis but he also ordered that Buck Consultants Limited be indemnified out of the trust fund for the balance of its costs.
30. On appeal Lady Justice Arden for the Court of Appeal found that Buck Consultant Limited's costs should not have been categorised as a "friendly" trust dispute. However, Her Honour also recognised that the proceeding was not purely hostile; there was a benefit to the scheme from questions of the interpretation of the rules being resolved. Accordingly, the Court found that "*the categories of proceedings [for costs in trusts disputes] enumerated in Re Buckton should not be regarded as closed... and that there is ...room for further category when the issue of construction has been pursued, not simply by a beneficiary, but also by a third party for its own separate interests*".¹⁷
31. Accordingly the Court of Appeal gave a 50% indemnity from the trust fund for the defence costs of Buck Consultants Limited with the remainder having to be paid by Buck Consultants Limited itself.
32. The Singapore Airlines Limited case highlights the dynamic nature of the categorisation of proceedings involving trustees. However the broad categorisation adopted in *Alsop* is still the best one and that is particularly the case when trustees have to analyse what role they should play in any dispute and what their duties are when it comes to the settlement of the dispute.

Restrictions on the ability of trustees to settle disputes

33. Having considered the categorisation of trust disputes, it is worth turning to consider the question of where the ability of trustees to settle disputes comes from and what duties they have when disputes come to voluntary settlement.
34. There has long been statutory provision allowing for trustees to settle disputes. In New Zealand the Trustee Act 1956 allows for this at Section 20(g) where it says:
- The trustee may, if and as he thinks fit, -*

¹⁷ *Singapore Airlines Limited v Buck Consultants Limited* [2011] EWCA Civ 1542 (CA) at [75]

(g) *compromise, compound, abandon, submit to arbitration, or otherwise settle any debt, account, claim, or thing whatever relating to the trust or to the trust property, -*

and for any of those purposes may enter into, give, execute, and do such agreements instruments of composition or arrangement, releases, and other things as to him seem expedient, without being responsible for any loss occasioned by any act or things so done by him in good faith.

35. This is similar to Section 15 of the Trustee Act 1925 which is the equivalent statutory provision in England and Wales. The key difference between the two is that rather than the limitation of liability being for acts or things done in good faith in the English provisions it is instead a limitation of liability on acts or things done in discharge of the duty of care set out in Section 11 of the Trustee Act 2000.
36. Section 11 of the Trustee Act 2000 says:-
Whenever the duty under this sub-section applies to a trustee, he must exercise such care and skill as is reasonable in the circumstances, having regard in particular –
(a) *to any special knowledge or experience that he has or holds himself out as having, and*
(b) *if he acts as trustee in the course of a business or profession, to any special knowledge or experience that it is reasonable to expect of a person acting in the course of that kind of business or profession".*
37. This change has effect of imposing on English trustees a slightly higher standard of duty being one of non-negligence as opposed to just one of good faith.
38. Similar provisions exist in Australia. For example, Section 49 of the Trustee Act 1925 in New South Wales gives trustees the ability to compromise, command, compound, ban and submit to arbitration or otherwise settle claims. Section 19 of the Trustee Act 1958 in Victoria is similar.
39. While these statutory provisions provide clarity for trustees that they do have the power to settle disputes it is not the end of the matter. Trustees must give careful consideration to the nature of the dispute in question, what their duties and responsibilities are given the nature of that dispute, and what limitations there are on their ability to settle.

Third Party Disputes

40. The role of the trustee in third party disputes is relatively straightforward. These disputes will arise in the course of the administration of a trust and will be in the ordinary course of the trustees' duties. Accordingly the role of the trustee will be to act in the best interests of the trust.
41. There are no particular complications in relation to these types of disputes; rather it is the sort of situation where a trustee could easily settle the dispute, pay for it out of trust funds and the trustee would be able to rely on his or her indemnity in order to claim reimbursement of any costs incurred in handling the matter.
42. An example of a case that involved a claim that arose in the course of administration of a trust is *Ludwig v The Public Trustee*¹⁸. In that case, a beneficiary of an estate

¹⁸ (2006) 68 NZSWLR 69

sued a trustee of the estate in negligence for agreeing to compromise a claim brought by a car rental company.

43. The claim was brought because, as too often happens, the deceased had rented a car, he had been shot at, the car was set alight and written off (with the deceased inside) and the rental company complained of a breach of the terms of bailment. One of the key questions that had to be answered in this context was of course whether or not the deceased had been engaging in a criminal enterprise when these terrible events happened to him.
44. The Public Trustee sought legal advice about the strength of the claim and was advised to compromise it and it did so. Notwithstanding that legal advice, the beneficiary sued the trustee in negligence for agreeing that compromise.
45. In the New South Wales Supreme Court, Campbell J held that where litigation against a deceased's estate has been settled in accordance with legal advice it is in many circumstances an adequate demonstration that the administrator has acted properly.
46. However, that comment was made with a caveat as at paragraph [33] the Judge said:

There can be circumstances where a matter is so important that it could be an appropriate exercise of discretion to seek a second opinion. There can be circumstances where the advice given is the sort of advice which, to an ordinary prudent businessman conducting similar affairs of his own (or if the administrator is a professional administrator) to an ordinarily skilled and experienced professional administrator, ought to seem suspect. In such situations, seeking another opinion is required in the proper exercise of the administrator's discretion.

47. However the Judge did exonerate the Public Trustee in that case particularly given the small size of the claim and the small size of the estate; given those economic factors, the Judge thought that it was a prudent step for the trustee to have taken particularly relying on legal advice.
48. What is also worth noting is the Judge's treatment of the question of good faith. At paragraph [35] the Judge said:

Further, I infer that in doing so the Public Trustee acted in good faith. I infer this from the Public Trustee seeking advice, obtaining advice that seemed sensible, and acting in accordance with it. Thus, even if its actions in settling the Fasemo claim, on the sort of minute examination which is possible in a Court, being shown to have been lacking, would, by reason of section 49(3) have had no liability for it.

49. Accordingly where the only duty a trustee has in relation to settling a claim is to act in good faith and advice is sought and it seems at first brush sensible, then a trustee that acts on that advice will likely be immune from an allegation of acting with a lack of good faith. Further there is no obligation on the part of the trustee to consult with beneficiaries of the trust before settling the claim.

Trust Disputes

50. The role of trustees and their ability to settle trust disputes is more nuanced than for third party disputes. That is because of the sometimes hostile nature of them.
51. Dealing with the first category recognised in *Alsop & Wilkinson v Neary*, which are friendly trust disputes, those sorts of cases usually involve genuine questions of ambiguity in relation to beneficial entitlements in the trust deed or the administrative powers of the trustee as set out in the trust deed.
52. In those sorts of cases there is not so much a dispute between competing interests as to a degree of uncertainty as to what is within the scope of the trustees' powers. In those cases, there are two comments that can be made:-
 - a. Trustees are able to play a full and active role in the dispute and have their costs paid accordingly. In fact that is probably more economically efficient as if the issues are clarified by trustees and the costs are paid for out of the trust fund then it saves beneficiaries having to undertake that work at additional expense.
 - b. There are not really questions of settlement that arise. In disputes such as this because there are not competing interests per se and there is no risk of "loss". If there is a genuine question of ambiguity that needs to be resolved then it is in the interests of everyone to have those questions resolved. Accordingly most responsible trustees would consider settling the matter. This rationale was effectively recognised in *Singapore Airlines Limited*¹⁹ when the Court of Appeal recognised that there were genuine questions in relation to the construction of the rules of that pension fund that needed to be answered.
53. Matters become more complex in circumstances where the trust dispute is hostile in nature. Those sorts of trust dispute cases will often involve a claim against a trust where there is an attempt to disturb the settlement of property on that trust.
54. It is probably worthwhile categorising these types of cases into three distinct categories:-
 - a. Disputes involving claims against trust assets on the basis of intention to defeat creditors or generally at common law or equity;
 - b. Claims that arise out of failed relationships; and
 - c. Claims that arise pursuant to family protection legislation.
55. In terms of general claims the position, as recognised in *Alsop & Wilkinson*, is that trustees do not have a duty to defend the trust from external claims to trust assets. Rather it is better for the trustee to get out of the way in order to allow the main protagonists to fight it out. Lightman J said:

In a case where a dispute is between rival claimants to a beneficial interest in the subject matter of the trust, rather the duty of the trustee is to remain neutral and (in the absence of any court direction to the contrary and substantially has happened in Mary's case) offer to submit to the Court's directions leaving it to the rivals to fight their battles. If this stance is adopted, in respect of the costs necessary and properly incurred, e.g. in serving a defence, the submission to the Court's directions, in making discovery, the trustees will be entitled to an indemnity and lien. If the trustee

¹⁹ Above n17

does actively defend the trust and succeed, for example, in challenging a claim by the settlor to set aside undue influence, he may be entitled to his costs out of the trust, for he has preserved the interests of the beneficiaries under the trust (consider *re Holden XP Official Receiver* (1987) 20 QBD 43). But if he fails, then in particular in the case of hostile litigation, although in an exceptional case the Court may consider that the trustee should have his costs (see *Bullock v Lloyds Bank Limited* [1954] 3 All ER 726, [1955] Ch 317), ordinarily the trustee will not be entitled to any indemnity, for he has incurred expenditure and liabilities in an unsuccessful effort to prefer one class of beneficiaries (e.g. the express beneficiaries specified in the trust instrument) over another (e.g. the trustees in bankruptcy or creditors) and so has acted unreasonably and otherwise for the benefit of the trust estate.

56. It is that last part of Lightman J's comments that captures the rationale for why trustees need to step back and not defend claims brought by outsiders. That is because if the claim succeeds then the trustee, who holds the legal title, will then be found to hold the beneficial title for the claimant. In that case the trustee will have acted clearly against the interests of one of the beneficiaries by attempting to keep them out of their rightful estate. That basic principle emphasises why it is that trustees should usually leave matters to beneficiaries.
57. The question then arises as to how the trustees should act in circumstances where there is a settlement that is agreed to between the major protagonists. After all trustees who are keeping out of the dispute and submitting to the Court's directions do not want to simply submit to whatever it is the parties want to have happen and circumstances where doing so may well lead to a claim against them by other beneficiaries.
58. The answer to this question depends on two things. First what it is that the settlement requires of the trustee and, second, the nature of the trust and the terms of the trust deed.
59. Turning to the first question which is the nature of what it is that the trustees are required to do the leading authority in this area is *In re Earl of Strafford*.²⁰ This case involved both a High Court decision and a decision of the England and Wales Court of Appeal.
60. In essence the case involved chattels of the Earl of Strafford which were left on a long succession of life interests. The complication arose because the Earl's wife, the Countess of Strafford, bequeathed some similar chattels to certain people (the Third and Fourth Defendants, her daughters) absolutely. Both the Earl and Countess of Strafford died in 1951.
61. The First Defendant, who was the son of the Third Defendant and the nephew of the Fourth Defendant, contended that some of the chattels bequeathed to the Third and Fourth Defendants were not the property of the testatrix but of the testator and they should be held on trusts under the testator's Will.
62. The Third and Fourth Defendants offered to compromise the claim on terms that the trustees should not pursue the claim to the disputed chattels some of which they had either sold or given away and, subject to the Third Defendant retaining her life interest in certain items, the remaining chattels should be divided as to one-fifth to the Third and Fourth Defendants absolutely and as to the remaining fourth-fifths to the trustees to hold on the trust of the testator's Will.

²⁰ *In re: Earl of Strafford* [1978] 3 WLR 223.

63. As part of this compromise the Third and Fourth Defendants' would disclaim any interest under the testator's Will which meant that they would surrender their life interest in the four-fifths which accelerated the First Defendant's life interest from third to first place.
64. The First Defendant contested the validity of this compromise which the trustees had agreed to. The key point of contention was the validity of the proposed acceleration in the First Defendant's life interest. The First Defendant effectively argued that the trustees cannot, under the guise of compromising the dispute, bring about a variation of the trusts affecting the property that they hold; this applies also to the Court when a trustee surrendered their discretion to the Court: "statute apart, the Court has no power to sanction the variation of trusts save in the very limited circumstances recognised by *Chapman v Chapman* [1954] AC 429."²¹
65. In considering this issue, Sir Robert Megarry VC, made a number of pertinent conversations regarding the exercise of the power to compromise under Section 15 of the Trustee Act 1925.
66. First he said that the trustee in exercising that power, like all other powers, must act in good faith in the interests of all concerned, without preferring one beneficiary to another.²² He further went on to observe in response to an argument that a compromise in this case provided unequal benefits, with the First Defendant benefiting more than the later life interest following:
- A compromise which, on the best estimate available, confers unequal financial benefits may nevertheless be a good compromise which ought to be accepted if it is likely to resolve long standing family disputes and promote family peace. A beneficiary who benefits least in money may benefit most in the value that he or she places on peace of mind.*
67. Second there was a submission that when settling disputes trustees need to engage in wide consultation with all beneficiaries and effectively should only settle disputes if all beneficiaries agree. That principle was not rejected. Rather what was recognised was that trustees do have a discretion and the power to settle disputes; while consultation with beneficiaries can be desirable it is not necessary for all beneficiaries to consent before a trustee compromises a claim. If that were the case then the power of compromise would effectively be undermined and the trustee would be reduced to simply a cipher of the beneficiaries.
68. Finally, in relation to the key argument which related to the ability of the Court to effectively vary beneficial interests, it was held that concern was misplaced. It was noted that section 15 did not contain any language that restricted the power of the trustee to compromise.
69. While there may be restrictions in the mode of exercising the powers this was not a case where there was such a restriction. The key rationale for that was that the beneficiaries had the ability to voluntarily surrender their interests in the estate; there was no change in beneficial interests as a result of variation of the terms of the trust

²¹ *In re: Earl of Strafford* [1980] 1 CH 28 at 32 p Sir Robert Megarry VC. *Chapman v Chapman* was a case that limited the Court's ability to vary trusts to circumstances where all of the possible beneficiaries were of majority and consented. This restriction has been removed by statutory power given by the Trustee Act 1956 in New Zealand (and similar statutes overseas) where the Court can approve variations to trusts on behalf of infant and unborn beneficiaries.

²² *Ibid* at 33.

when all that occurred was a voluntary surrender of their interest by some of the beneficiaries.

70. This decision was upheld by the Court of Appeal. Lord Justice Buckley for the Court held, consistently with Sir Robert Megarry VC, that there was nothing in the language of section 15 which would restrict the scope of the power to compromise. Further it was held the compromise did not conflict in any way with any established principle of law as a voluntary surrender of a beneficial interest does not constitute a variation of the trust.
71. Likewise it was held deciding to abandon claims against potential trust assets is not a variation of a trust²³:

If the assets of a trust include a claim against some person, be he a stranger to the trust or a beneficiary under the trust, that claim is an asset of the trust. The trustees may enforce the claim, sell it, compromise it or compound it, or (if it be worthless, abandon it). In any case but the last the fruit of enforcing, selling or compromising the claim will replace the claim as an asset of the trust. None of these transactions involves any variation of the trust of the beneficial interests under that; there is merely a change in the composition of the trust fund. If the trustees compromise the claim at an unduly low level, they may be liable for breach of trust, but no variation of the trusts is involved.

72. Accordingly in circumstances where the compromise involves a change to the composition of the trust fund, then so long as the main protagonists are in agreement and the settlement seems reasonable to the trustees, then they should be able to proceed without too much concern.
73. However where the compromise does involve a variation to beneficial interests (say replacing beneficiary x with beneficiary y) then that is not something the trustees could ordinarily agree to and the sanction of the court should be sought. The only circumstances in which the trustee might be able to agree such an outcome without court sanction would be if the trust deed included the power to add and remove beneficiaries and the clear consent of the affected beneficiaries had been obtained.
74. On a related note one matter that trustees need to consider is the nature of the trust and the question of who the beneficiaries are. In circumstances where there is a wide discretionary trust (as is most common these days) with a number of minor, unborn and unascertained beneficiaries the trustees need to proceed particularly carefully. While there may be two main protagonists who have settled the matter, the trustee needs to be certain that settlement is in fact in the interests of all beneficiaries of the trust. That much is clear from *In re: Earl of Stafford*.
75. In cases where there is a wide class of beneficiaries, trustees need to be mindful of potential risks of future actions if they settle the case on terms that are potentially disadvantageous to those beneficiaries. If the dispute in question already involves court proceedings then the best way for the trustees to minimise their risk would be to ask the beneficiaries to have the settlement by the way of orders of the court. In that case the court can effectively exercise the trustee's power for them which will immunise the trustees from future claims.
76. This leads on to consideration of the second category which is where the dispute arises in the context of the breakdown of a relationship. This is a particularly

²³ Ibid at page 48

common occurrence in New Zealand where the rate of ownership of family homes in trust structures is particularly high.

77. What often happens is that the trustees of the trust (which are usually the couple and a third party) simply agree to a division of the family home between the couple. This is usually problematic given that most of these trusts are wide discretionary trusts and the couple's children and remoter issue are likely to be discretionary beneficiaries.
78. In cases like this trustees must tread a fine line. On the one hand there is the injunction against active participation in the proceedings pursuant to *Alsop Wilkinson v Neary*. On the other trustees are not there to simply act as rubber stamps when two protagonists cut a deal between themselves. That raises a question as to what it is trustees should do in these circumstances.
79. Although very few settlements of relationship property matters have been challenged on the grounds of breach of trust, there is the potential for this to occur in the future. That is particularly likely to be the case where there are substantial sums at stake and where children beneficiaries end up estranged from either one or both of their parents.
80. In these sorts of cases trustees must be careful to:
 - a. ensure that any settlement does not involve a variation of trusts without consent of the Court (or without the trustee receiving clear legal advice that they possess the power to vary the trust);
 - b. ensure that any settlement protects the interests of minor unborn or unascertained discretionary beneficiaries (by, for example, resettlement of trust property onto two new trusts with the same terms); or
 - c. take steps to ensure that any settlement is ultimately implemented or ordered by the Court and in circumstances where the interests of unborn or unascertained or minor beneficiaries are suitably represented before the Court.
81. In the case of deciding whether or not a settlement is in the interests of unascertained unborn or minor beneficiaries it is worth bearing in mind the comment made by Sir Robert Megarry VC in *In re: Earl of Strafford* regarding the fact that settlements that may not be fully financially beneficial to certain classes of beneficiaries can be entered into for the sake of family harmony and family peace. This is an important principle in this area and one that does need to be borne in mind.
82. Finally there is the last category of cases which are cases involving claims against estates pursuant to family protection (or provision) legislation. Claims against wills pursuant to family protection legislation present particular problems. There is a generally accepted duty on the part of trustees of estates to try and uphold the Will. However this needs to be balanced against the injunction against trustees participating in trust disputes in circumstances where there are effectively two beneficiary protagonists.
83. The difficulties in this area are nicely illustrated by the Victorian case of *Hodge v Depasquale*.²⁴ The basic facts of the case are that Giuseppe Depasquale died leaving his second wife, Rosa, and three daughters Eleanora, Pia and Norina. Rosa,

²⁴ *Hodge v Depasquale* [2014] VSC 413

Eleanora and Pia each received specific bequests in varying amounts. Norina received the residue of the Estate up to \$500,000. Any surplus over \$500,000 was to be divided equally between Rosa, Eleanora, Pia and Norina. Rosa was the executor and trustee appointed under the Will.

84. Pia brought family provision proceedings seeking a greater payment to her than otherwise provided for by the Will. Although served with the proceedings Norina did not participate in them. Importantly she did not participate in a mediation of Pia's family provision claim. At mediation the proceeding was settled with Rosa, as trustee, agreeing to pay Pia a further \$250,000. That payment came from the residue of the Estate and effectively came from Norina.
85. Norina then sued Rosa on the basis that she did not have the power to compromise the family provision proceedings and that either Rosa or Pia should have to repay to the Estate the \$250,000 that was paid out to Pia.
86. One of the key questions considered by McMillan J in the case was whether the power to compromise contained in the Victorian Trustee Act 1958 extended to the settlement of family provision claims.
87. Her Honour held that the power to compromise did not extend to the compromise of proceedings under the Victorian equivalent of the Family Protection Act.
88. At paragraph [59] of the judgment it was noted:²⁵

The statutory power of compromise contained in Section 19 was first enacted in the United Kingdom in 1860 in in Victoria in 1864, and has been modified only slightly since first enacted. It supplanted a power "invariably inserted in well-drawn wills". The enactment of the provisions empowering trustees to compromise claims predated the introduction of the testator's family maintenance legislation, which was first enacted in New Zealand in 1900, and in Victoria in 1906. The words of the section seem, on their face, applicable to the compromise of a claim under that regime.

89. However, after considering the authorities, Her Honour then went on to note:²⁶

A claim for further provision is not a claim that the estate owes the claimants debt or liability. The effect of an order under Part 4 is not to recognise a debt or liability; it is in the form of a further legacy, normally a pecuniary legacy. It alters the beneficial entitlements under the trust. Legacies similarly are not debts or expenses of the estate. Beneficiaries cannot bring an action in debt to recover a legacy they must instead bring an administration suit or the modern form thereof.

There is clear authority that, at common law, a trustee may not unilaterally vary or re-arrange the terms of the trust and that a Court may do so only in very limited circumstances.

90. Following the rationale in *In re: Earl of Strafford* the Court then went on to say that because of the nature of the claim it fell outside the power to compromise and that Court sanction was inevitably required (although Court sanction would normally be granted on a consent basis).
91. Accordingly it was held that Rosa had acted outside the scope of her power in agreeing to the settlement. Further the Court concluded that Pia was not liable to

²⁵ Ibid at paragraph [59]

²⁶ Ibid at paragraphs [69] – [70]

repay the additional \$250,000 received and that Rosa was personally liable because she was acting in a position of conflict when she settled the dispute as both executor and a beneficiary.

92. This case demonstrates the risks that trustees can face in family protection proceedings; the reality is that the decision in Victoria will ultimately apply in New Zealand as well given that there are insufficient differences in the relevant statutes to warrant a different approach.
93. What this means is that trustees should always seek the sanction of the Court to any settlements under family protection legislation. This also has the benefit of closing off claims from any beneficiaries who do not participate in any process that leads to the settlement as they will have been required to have been served at the very outset of the proceeding and will be bound by whatever it is that the Court chooses to order.

Beneficiary Disputes

94. The position of trustees in the context of beneficiary disputes is abundantly clear: they cannot rely on their indemnity without a pre-existing order of the Court and, when it comes to compromising, they can compromise the claim only if it involves the use of their own assets to meet it.
95. This principle is well illustrated by the recent New South Wales Supreme Court case of *Sheanhan v Thompson (No 2)*.²⁷ This was a relatively complex proceeding. However, in essence, this was a claim by new trustees against previous trustees concerning two trusts known as the PILT Trust and Baltarna Trust.
96. The previous trustees had been sued by Mr Crossman who complained that certain assets of the PILT Trust had been taken by those trustees and used for their own purposes illegitimately. Two settlement deeds were entered into; one of which was called the contempt deed and the other was the main deed.
97. The contempt deed settled a claim that the trustees had acted in contempt of Court by failing to adhere to the terms of an injunction granted against them (they had). The main deed settled the entire proceeding.
98. The primary payment of funds was pursuant to the contempt deed rather the main deed; perhaps this was a sign that the trustees, when entering into this arrangement, thought that it might be vulnerable to attack.
99. In any event, the previous trustees of the Baltarna Trust had agreed to pay a sum of \$600,000.00 to Mr Crossman in July 2009 and another \$1.6m that was to be paid by a later date. This money was ultimately paid out of trust funds.
100. In this proceeding the new trustees sought repayment of those amounts into the trust fund; they sought payment from Mr Crossman and associated entities who had received the funds; or they sought reimbursement from the previous trustees.
101. One of the primary issues in the proceeding was whether the settlement by the previous trustees and the payment of trust money was a breach of trust. One key factual aspect of this case was that Mr Crossman was only a potential beneficiary of the trust in question and his interest clearly ranked behind the interests of another third party.
102. In considering the key issue, which was whether or not the payments in question were a breach of trust, Rein J said at paragraph [67]:

²⁷ *Sheanhan v Thompson (No 2)* [2015] NSWSC 871

To the extent that Nominees used PILT Trust assets to pay money to Crossman the payments were in breach of trust because the payments were not made to the beneficiaries of the PILT Trust and not made for a purpose of the PILT Trust but made solely for the benefit of Crossman, Nominees, Seller and Londish.²⁸ Dr Bell contended that although there was a trust structure it was still a commercial matter (T316.50). I do not view that as offering any assistance to Crossman. If those engaged in commerce utilise trust structures within which to carry out their dealings, then the obligations imposed on trustees and those dealing with them are carried with that structure.

Whilst it is true that there was a power given to nominees to settle and compromise legal proceedings and execute documents in respect thereto ... that power and the protection of clause 23.19 was subject to the trustees' obligations and the provisions of the deed and was not to be used for an ulterior purpose.

103. What this case highlights is that, notwithstanding complex facts, the principles in this area are simple. If a trustee is faced with a claim for breach of trust it cannot use trust assets in order to settle it. It is simply not within the scope of the trustee's powers to do so. The fact the parties may be commercially sophisticated does not matter.
104. This is supported by the very terms of the statutory power to settle claims which have a clear limitation, namely one of good faith. It is clearly a breach of good faith to act in a situation of conflict of interest by resolving a claim against a trustee for which the trustee might be personally liable with trust funds.
105. Of course the potential liability of the trustee in having settled the claim in that way may be slightly mitigated by being able to recover the funds that were paid out which is what was allowed in *Sheanhan v Thompson*.²⁹
106. If trustees were to try and use trust assets to settle the claims against them in this way, then they should only do so with the sanction of the Court; however it is questionable whether or not the Court would have the jurisdiction to sanction such an action.
107. That is because the Court intervenes in circumstances where the trustees surrender their discretions to the Court; settling a claim brought against a trustee for breach of trust does not involve the exercise of any discretion properly arising in the administration of the trust. In that sort of case it is hard to see where the Court's jurisdiction would come from.
108. This highlights the need for trustees to have suitable insurances in place when they take on trust appointments so that if they are sued for breach of trust they are protected. Alternatively, trustees should attempt to ensure that they have appropriately robust indemnity clauses limiting their liability for their actions.

Solutions for trustees: practical and theoretical

109. Given the complexities in this area there are ways in which trustees can navigate this landscape quite simply. Further there are also changes which could be made in order to assist trustees in settling disputes.

²⁸ Nominees, Seller and Londish were all parties involved in the transactions.

²⁹ This is similar to what happened in *Church Property Trustees v Attorney General* [2015] NZHC 1843

110. In terms of practical advice what is it that trustees can do to minimise their risk and protect themselves when settling disputes? First the trustee should very carefully assess the nature of the dispute and decide what their duties are.
111. If it is a dispute where trustees should step out then they should adhere to that and not be tempted (and not be egged on by their legal advisers) to take an active role. If they want to do so then they should ask for the Court's sanction prior to doing so.
112. Second when it comes to settlements trustees should be mindful of the need for settlements to be structured in ways that will not involve variations of beneficial interests given that that is a clear line that trustees cannot cross. So, for example, in the context of a relationship property proceeding, where claims are brought against trust properties by former spouses, rather than simply agreeing to a split of assets between the two, settlements could be structured:
 - a. with resettlement into two new trusts on the same terms but with the spouses themselves only being beneficiaries of one of those two trusts; or
 - b. one spouse purchasing the other's interest in the trust structure.
113. Those solutions mean that the trustees will be in a position where they can legitimately compromise the claim. As *In re: Earl of Strafford* observed, it is not so much the fact of the compromise but the implementation of it that can lead to difficulties.
114. Third, trustees should always seek proper advice from their lawyers before deciding whether or not to agree to any compromise. As highlighted in *Ludwig v Public Trustee* where the obligation is simply one of good faith then taking sensible advice and following it will meet that criteria.
115. In an English context where the obligation is really one to take care trustees may need to be more discerning in terms of the advice they receive and a second opinion should be sought more readily than where the trustee's duty is just one of good faith.
116. Fourth, trustees should, wherever possible, have their decisions sanctioned by the Court and should never agree to a settlement of matters involving a considerable change to the composition of the trust fund where there are minor, unborn or unascertained beneficiaries. Those cases are the most obvious circumstance where a trustee should seek orders from the court approving the settlement.
117. Likewise in circumstances where the trustees consider that the decision as to whether or not to agree to the settlement is on a "knife edge" then guidance from the court should be sought.
118. However some of this advice may not be that practical; seeking advice from the court or orders from the court in circumstances where trustees want to compromise disputes is not always straightforward. For example if the proceeding in question involves relationship property and it is within the jurisdiction of the Family Court then the ability of the court to sanction a settlement that involves variation of terms of trusts is considerably more limited than in the High Court. A separate proceeding seeking approval for the settlement may need to be launched. That is also the case where court proceedings themselves may not necessarily have yet been filed or where the parties are not in fact having to attend Court but are submitting to an arbitral process.³⁰

³⁰ If the parties are going through an arbitral process, then the arbitrator can in fact make all the orders that the High Court can; given the procedural flexibility allowed in arbitration, it in fact may be a

119. There are some changes that could be made that could help trustees in this area. First, the Trustee Act 1956 (for New Zealand) could be amended to make the categorisation of trust disputes and the ability of trustees to compromise disputes much clearer.
120. Although there will always be questions as to whether a dispute falls within one category or another, statutory recognition of the *Alsop Wilkinson* categories would no doubt be of considerable assistance.
121. In particular it would be of practical assistance to trustees who could turn to the Trustee Act 1956 to find out what their obligations are; it would also enable Parliament to have in one place not just principles relating to trustees' costs but also the principles relating to when court approval of settlements is required.
122. Further to that procedural changes could be made to the High Court Rules allowing for a swift summary jurisdiction whereby trustees could put the terms for a proposed settlement of a dispute before the court together with short affidavits for the court to then determine the issue on the papers.
123. The Rules would need to make provision for:
 - a. appropriate assurances to be given to the court that all beneficiaries of age who were concerned with the dispute had been served;
 - b. assurances that the arguments for and against a dispute have been properly put to the court; and
 - c. drawing the court's attention to the size of the trust fund and the total size of the claim.
124. Such a procedure would allow the court to quickly assess whether a compromise was reasonable and to decide whether there was any genuine argument to be had. In the event there was a genuine argument then the matter could proceed to a full hearing. However that should be unlikely; the power of trustees (in New Zealand and most of Australia) to compromise is only limited by considerations of good faith and jurisdictional questions; given that, it would be hoped that a vast majority of cases would be able to be dealt with by a summary procedure.
125. If such reforms were made then trustees would be in a much better position when it came to settling disputes; to the extent there were circumstances where trustees needed the consent of the court in order to proceed safely then that could be swiftly obtained, but not in circumstances where there were genuine reasons to argue about the trustees' course of action. Such a summary procedure would no doubt encourage the early resolution of disputes.³¹

Conclusion

126. As the number of trusts grow so does the potential for trustees to become embroiled in disputes. The vast majority of disputes put before the courts are ultimately settled

viable and swift alternative to get the orders needed without all of the attendant cost and procedural delays that can occur in High Court litigation.

³¹ Which also makes sense in the context of compulsory mediations as part of the court process such as in NSW – "*Executors/Trustees and Mandatory Mediations*" – Paper presented by Justice Bergin, Chief Judge in Equity, NSW Supreme Court to the Society of Trust and Estate Practitioners in the Banco Court of the Supreme Court of New South Wales, 25 November 2009.

before trial; there is no real reason why that should not happen simply because a dispute involves trusts and trustees.

127. However there needs to be recognition that there are complexities in this area. Trustees do not have carte blanche to agree to compromises. Rather, their power to do so is limited by:
 - a. the nature of the dispute;
 - b. the nature of the compromise; and
 - c. the nature of the beneficial interests.
128. It is important that trustees consider each of these three questions before entering into compromises. Further court procedure and process should be changed so that when court intervention is required trustees, and the disputing parties, can get that assistance and settle their dispute swiftly and at low cost.