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The Duties, Office and Powers of a Trustee - Review of the Law of Trusts, Fourth Issues Paper

The New Zealand Law Society (Law Society) welcomes the opportunity to respond to the questions posed in the fourth issues paper in the review of trust law in New Zealand, *The Duties, Office and Powers of a Trustee* (Issues Paper). This submission has been prepared with assistance from the Trust Law Review Working Group, formed by the Law Society's Property and Family Law Sections.

Chapter 1 – Trustees' Duties

Q1 Have the duties of trustees been correctly identified? Are there any other duties that should be included?

We agree with the Butler List, and have no other duties to add.

Q2 Should trust legislation contain a list of trustees' duties?

Yes.

Q3 How should such duties be expressed? Should they be stated in general terms like the duties of directors in the Companies Act 1993 or in greater detail?

The duties of trustees should be stated in general terms, like the duties of company directors. It would be appropriate if they were set out as at paragraph 1.22 of the Issues Paper.

Q4 Which duties should be treated as irreducible core duties that cannot be excluded?

Referencing the Butler List, the following should be core duties:

- (a) to make acquaintance with the trust's terms;
- (b) to adhere to the trust's terms;
- (c) to act in the beneficiaries' best interests;

- (d) to be active;
- (e) to pay correct beneficiaries;
- (f) to keep proper accounts and give information as required.

The remaining duties in the list should be able to be varied or excluded:

- (a) to maintain impartiality;
- (b) not to profit from the trusteeship;
- (c) to act gratuitously;
- (d) to invest;
- (e) not to delegate;
- (f) to act unanimously.

Q5 Should trust legislation contain a list of beneficiaries' rights?

No. The overarching right of beneficiaries is to require performance of the trust by the trustee in terms of the deed and any additional requirements of the legislation.

Q6 Is any reform of the trustees' duties listed in this chapter desirable?

No, provided that the wording of the trustees' duties is not inconsistent with the operation of the contemporary discretionary family trust, and that it is not retrospective.

Q7 Should provision be made in new trust legislation for trustees to act by majority? If so, what safeguards, if any, should be provided to protect the position of a dissenting trustee? Should a dissenting trustee have continuing obligations to assist in giving effect to a decision by a majority of trustees?

The Law Society does not think that there should be legislative provision for trustees to act by majority. It is a matter of choice for the settlor, or lawyers drafting trust deeds for the consideration of their clients, to provide for a decision made by a majority of trustees. There are other mechanisms to avoid a deadlock, such as referral to a Queen's Counsel for an opinion, or for a decision to be made by an independent person engaged for a specific purpose. Such choices should be left to settlors and their advisors. The default requirement for trustees to act unanimously is an important safeguard. It will generally force a trustee or beneficiary in a trust, where the trustees are deadlocked, to go to the High Court. This will usually be appropriate.

Chapter 2 – The Duty to Inform

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

The current law regarding access to trust information in authorities like *Schmidt v Rosewood Trust Ltd* and *Foreman v Kingstone* is only partially satisfactory. These authorities identify the nature and importance of a trustee's duty to inform beneficiaries about the existence of a trust and its activities. Although they will produce clear disclosure outcomes in many situations, uncertainty still exists in this area which is likely to cause ongoing problems in practice for both trustees and beneficiaries.

Some problems remain in this context (particularly under discretionary trusts) because:

- (a) many trustees (particularly of discretionary trusts) are unaware of or ignore the information disclosure obligations that they have under existing trust law;
- (b) information disclosure to beneficiaries is often sporadic, limited, or made only to selected or preferred beneficiaries;
- (c) it is uncertain to what extent a settlor, by express confidentiality mechanisms, can eliminate a trustee's information disclosure obligations;
- (d) it is unclear at what age disclosure of information should be made to a beneficiary of the trust (particularly in the case of, say, a teenager or young adult);
- (e) it is unclear whether information should be provided to a parent or guardian of a minor and, if so, at what time;
- (f) it is unclear whether the disclosure rules apply equally to all trusts, irrespective of their assets – i.e. is there a materiality rule for less substantial trusts?

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

The uncertainties and deficiencies in the existing trust law rules (as declared in cases like *Re McGuire*) in this area would not support, without more, their enactment in new legislation (option one).

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

Specific legislative guidance in this area is desirable because trustees need to be aware of their legal obligations (and many are not or are confused) and beneficiaries need to be aware of their rights (and many are not or are confused). The rules in this context for fixed (and contingent) trusts and discretionary trusts are not the same and it is often unclear what type of trust one is seeking disclosure from.

Legislative clarity is a better mechanism than requiring disputed information disclosure situations to be addressed by the High Court. Such proceedings are often highly contentious and do not lead to productive trust “solutions”. They can also be expensive and time-consuming. An application to the court should be available to compel the production of recognised “trust information” as a last resort.

For many trusts in New Zealand (for which the family home is the single asset) the need for extensive information requirements would be difficult to justify. In these cases, however, beneficiaries should still receive information at some point about the existence of the trust and their status as a beneficiary of the trust.

The extent of disclosure in any particular case might have to recognise express confidentiality and other mechanisms contained in the trust deed and memorandum of wishes (although this may be able to be covered by a discretion reserved in the trustee).

Given the inherent nature of trusts as “private” arrangements, there must be some ability for trustees in certain circumstances to say no to disclosure if they believe that disclosure is not in the best interests of the trust as a whole.

The concept of a “qualifying beneficiary” as proposed in British Columbia has much to recommend it because it could potentially deal with the class of beneficiaries to whom information was required to be provided and at what age and stage in their lives (for example, it could deal with the position of teenagers and minors and persons who had indicated they did not want to receive information).

Qualifying beneficiaries should have a right to be told of the existence of the trust and to request information from trustees. This right should be prospective, and should apply to trusts from the commencement date of any proposed new trust legislation.

Qualifying beneficiaries:

- should have legal capacity and be over the age of 20;
- be beneficiaries who the trustees reasonably believe have or may in future have a real prospect of receiving benefits under the trust (an objective test).

See also the response to question 15.

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

Information that should always be disclosed

The following core information should always be disclosed:

- (a) the existence of the trust;
- (b) the names of the trustees;
- (c) the status of a person as a beneficiary; and
- (d) the beneficiary's right to request further information.

Further information

Beneficiaries should be able to request further information at their own cost. Such further information may include:

- (a) a copy of the trust deed,
- (b) the financial statements of the trust (or advice that there are no financial statements);
- (c) particulars of distributions of capital and income.

The further information would be important for some beneficiaries. Many trusts would be inactive on a yearly basis, with little worthwhile information to report. If there are accounts, and a beneficiary requests them, they must be disclosed. See also the response to question 14.

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

- *significant investment or management strategies;*
- *significant transactions or possible transactions under consideration;*
- *plans for distribution on termination or partial termination;*

- *resettlement proposals; and*
- *information known to be of particular significance to a beneficiary?*

See the responses to questions 11 and 15.

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

There is a case for disclosure of limited information to qualifying beneficiaries (subject to the trustee's discretion) without those beneficiaries having to request it. Information beyond the limited list (again subject to the trustee's discretion) should be made available to qualifying beneficiaries on request.

See the responses to questions 11 and 15.

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

A settlor should not be able to prevent disclosure of trust information in a blanket way in all circumstances. A confidentiality mechanism might apply where disclosure would not be in the best interests of the trust and the beneficiaries as a whole, or even in respect of a particular beneficiary.

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

The Law Society prefers an analysis of qualifying and non-qualifying beneficiaries as described in its response to question 10. The focus should be on the type and content of information that should be disclosed and then to provide a general legislative guideline (consistent with the general law) about a beneficiary's entitlement to that information.

Any proposed new trusts legislation should provide:

- Definitions of qualifying and non-qualifying beneficiaries.

A qualifying beneficiary would be a beneficiary who:

- (i) has legal capacity and is over the age of 20; and
- (ii) who the trustees reasonably believe has or may in future have real prospects of receiving benefits under the trust from the trustees (an objective test).

A non-qualifying beneficiary is one who the trustees reasonably believe should not be given information about the trust because:

- (i) it is not in the best interests of the beneficiary to do so; or
- (ii) it is not in the best interests of the trust to do so.

- (b) The trust instrument may expressly limit the trustee's duty to give information to one or more, but not all beneficiaries.
- (c) The trust instrument may expressly require a trustee to give information to a beneficiary under these provisions.
- (d) If a beneficiary is a qualifying beneficiary the trustees must make reasonable efforts to ensure the beneficiary is notified or is otherwise aware that:
 - (i) the beneficiary is a beneficiary of the trust;
 - (ii) the beneficiary may request and on payment of the trustee's costs receive a copy of the trust deed (and any documents amending it) and a copy of the financial statements for the trust's financial period ending immediately before the request; and
 - (iii) the beneficiary may request other information from the trustees which the trustees may, at their discretion, decide whether to supply to the beneficiary (on payment of the trustee's costs).
- (e) Any beneficiary should be allowed to apply to the court for an order that the trustees supply information about the trust (and the new provisions are without prejudice to the court's jurisdiction to grant such an order).
- (f) The provisions should apply to wills made and *inter vivos* trusts formed after the commencement date of any new trust legislation.

The scope of s68 of the Trustee Act 1956 should also be expanded. Currently this section allows a trustee to be called to explain and give information to the court about the exercise of

powers under the Trustee Act. This is restricted to Trustee Act powers (and possibly where an equivalent power in the trust deed has been exercised). This should be expanded to include all powers (i.e. including those under the trust deed).

This has been the position in Queensland for some time, and it has not led to the ‘floodgates’ being opened for claims. The reason for this is that the courts in Queensland have held the line on the difference between a review of a trustee’s decision, versus actually interfering with the trustee’s decision. The courts in Queensland, and elsewhere, are reluctant to interfere with a trustee’s decision unless it is unlawful. If the scope of s68 of the Trustee Act is to be extended, the Commission may wish to include a further provision making it clear that, while the provision allows the court to review a decision, it does not otherwise change the law about when a court may interfere with a trustee decision.

Placing trustees under this potential level of scrutiny should increase the quality of trustee decision-making. More importantly, it would help prevent trustees using the current law as a shelter for bad or unlawful trustee decision-making (which in some cases may have been deliberate). The current law on discovery is not strong enough to deal with this issue effectively.

Chapter 3 – Excluding the Duties of a Trustee

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

The Commission has clearly identified the arguments for and against exemption clauses. It has also identified that, while recommendations for possible changes and regulation of this area of law have been made internationally by comparable organisations to the Commission, these recommendations have been generally cautious and narrow.

When considering possible regulation the main policy drivers internationally have been:

- (a) the type of conduct that can be excluded (i.e. should this go beyond dishonesty);
- (b) notification obligations (if any) and the consent to exemption clauses for key trust participants, like a settlor;
- (c) the extent to which exemption clauses are offensive to core trustee obligations;
- (d) whether a different standard should apply to professional paid trustees than to unpaid and voluntary lay trustees;

- (e) not placing unreasonable legal burdens on trustees of trusts which are not material settlements in asset and other terms.

In weighing up these factors, the Commission will need to keep in mind that the vast majority of trusts in New Zealand are discretionary trusts with minimal assets. Regulation for that class of trusts would be unwarranted, particularly as it is unlikely that exemption clauses are being widely used by trustees to escape liability. The risks for these trusts and trustees might not be insurable.

The position is different for material trusts and professional trustees where potential liability can be insured against, and where the trustee is likely to have greater control over the running of the trust. Such trustees should not readily be able to have a widely drafted exemption clause operating for their benefit.

Jurisdictions such as Jersey and Guernsey, where trusts are invariably substantial asset trusts administered by professional trust companies, have widened the types of conduct that cannot be exempted from liability.

There is probably a case for some regulatory change in this area, but the evidence and international experience suggests that any change should be narrow in its focus.

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

It is unclear whether the current law is too favourable towards trustees. Beneficiaries are probably disadvantaged in two areas:

- (a) in not having full awareness of the existence and meaning of exemption clauses in trust deeds; and
- (b) in the case of a material trust, where the trustee escapes liability under an exemption clause despite conduct that, while not amounting to fraud, is so unreasonable it should not be excused.

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

The fraud (dishonesty) exception is a standard of conduct that is clearly understood in the law. Lesser standards such as “wilful misconduct”, “gross negligence” and “negligence” are more difficult to prove, and are not standards to which the majority of discretionary trusts, with minimal assets and voluntary trustees, should be subject.

Excluding liability for certain trustee misconduct that does not amount to dishonesty could be justified in the case of professional trustees administering material trusts. The key question is whether the standard is a failure to exercise reasonable skill and care, or gross negligence. It is reasonable for trust corporations to be held to the standard of “reasonable skill and care”, given that they will be insured and it is the standard applicable to professional service providers.

This position is most closely aligned to option 6 (dual standard) in the Issues Paper. The additional safeguard of s73 of the Trustee Act in cases of this type could still be relied on to relieve trustees from personal liability in certain circumstances.

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

The court’s discretion under s73 of the Act is an important mechanism to relieve honest trustees, who have acted reasonably, from liability for situations which are beyond their control, particularly in areas such as the investment of trust funds.

Case law on s73 has shown that the New Zealand courts have no problem in distinguishing between liability situations that justify an exercise of the court’s discretion in favour of the trustees and those that do not: see for example *Re Mulligan* [1998] 1 NZLR 481; *Wong v Burt* [2005] 1 NZLR 91 and *Jones v AMP Perpetual Trustee Company NZ Ltd* [1994] 1 NZLR 690.

Impugned trustee conduct is fact-sensitive and does need to be considered by the court to determine whether liability should fairly be imposed. Section 73 works well as that type of mechanism.

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

As noted above, option 6 has much to commend it, as do the notification and acknowledgement mechanisms in option 3.

The Law Society does not favour total prohibition (option 7) for the reasons identified by the Commission. It would also place an unreasonable cost and burden on a trustee or beneficiary to require them to go to court to have the benefit of the exemption clause set aside.

Chapter 4 – Appointment, Retirement and Removal of Trustees

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

Trust legislation should define who cannot be a trustee. The following persons should be prohibited from being appointed or continuing to hold office as a trustee:

(i) Minors

A trustee owes duties to the beneficiaries of the trust and may need to enter into obligations with third parties. If a minor is a trustee it could be prejudicial to the interests of the minor and the beneficiaries. A minor does not have full legal capacity. This causes difficulties with the legal duties owed by the minor to the beneficiaries and third parties. A minor is also less likely to have the acumen desirable in a trustee.

(ii) Corporations in liquidation or being wound up

Trusteeship is inconsistent with the status of the corporation.

(iii) Bankrupts

Bankrupts should not be trustees, unless the court approves of the bankrupt being appointed or continuing to hold office. The Law Society supports the current law under which bankrupts are usually regarded as unsuitable trustees. However, there may be situations where it is in the interests of the beneficiaries for a bankrupt to be appointed or continue to be a trustee – for example, where the bankrupt has a superior knowledge of the trust investments or the beneficiaries and their needs. Any new legislation should allow for a bankrupt to be a trustee in limited circumstances. These circumstances are difficult to define so would need to be determined by the court on a case-by-case basis.

(iv) Persons who have been convicted of a crime involving dishonesty

Unless the court approves of the person being appointed or continuing to hold office, persons who have been convicted of a crime involving dishonesty should not be trustees. Again, there may be situations where it is in the interests of the beneficiaries for a prohibited person to be appointed or continue to be a trustee. The court's approval should be required so that it can decide what is appropriate on a case-by-case basis.

(v) Incapacitated persons

Incapacitated persons should not be trustees. This includes:

- (a) persons who are mentally disordered persons under the Mental Health (Compulsory Assessment and Treatment) Act 1992;
- (b) persons whose estates are subject to a property order under the Protection of Personal and Property Rights Act 1988;
- (c) persons that the court determines are incapable of properly carrying out the office of trustee for the trust in question.

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

Removal by continuing trustees

The legislation should clearly set out the categories of persons who may be removed from office by the continuing trustees. Those categories should be narrow so that continuing trustees cannot use removal or the threat of removal as a bargaining chip in trustee disputes.

The categories of persons who may be removed by continuing trustees should follow the categories of prohibited trustees:

- (a) minors;
- (b) corporations in liquidation or being wound up;
- (c) bankrupts, unless the court approves of the bankrupt being appointed or continuing to hold office as trustee;

- (d) persons who have been convicted of a crime involving dishonesty, unless the court approves of the person being appointed or continuing to hold office as trustee;
- (e) incapacitated persons (as defined in the response to question 21).

Removal by the court

The legislation should also provide that the court may remove a trustee where:

- (a) the trustee is a prohibited trustee (as defined in response to question 21);
- (b) there is a serious deadlock or hostility between some or all of the trustees which results or may result in the trust or the beneficiaries being at risk;
- (c) there is serious hostility between trustees and/or the beneficiaries, which results or may result in the trust or the beneficiaries being at risk;
- (d) the trustee otherwise does not properly carry out its obligations;
- (e) the trustee refuses to carry out its obligations;
- (f) the trustee cannot be found or is unresponsive; and
- (g) on any other grounds the court thinks fit.

Any new legislation should not provide for the removal of a trustee who has been absent for 12 months or more without delegating its powers. A trustee can carry out his or her responsibilities whilst overseas. The real issue is whether the trustee is properly carrying out its obligations, and, as set out above, a failure to do this ought to be a ground for removal.

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

Yes, the legislation should allow the court to appoint new trustees. There needs to be a mechanism for this where either (i) there is no one else available (or willing) to do it, or (ii) the court needs to step in to ensure the trust is properly administered. The new legislation should allow the court to appoint trustees where:

- (a) no other person (appointer) has a power to appoint a trustee under the trust instrument or under the Trustee Act;
- (b) an appointment is necessary to comply with the trust instrument or the general law, and the appointer refuses to carry out an appointment, cannot be found or is unresponsive;
- (c) the court has removed a trustee;
- (d) the appointer's power to appoint new trustees is removed or suspended by the court; or
- (e) the court otherwise determines that it is necessary or expedient to appoint a new trustee.

Q24 Should the principle in Mendelsson v Centre Point Community Growth Trust be incorporated in legislation?

No. The court should be free to adopt and develop the principles upon which it exercises its jurisdiction. In exercising its jurisdiction the court will take into account a range of matters including the settlor's intention as determined from the trust instrument and the best interests of the beneficiaries.

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

High Court jurisdiction with simplified procedure for certain cases and case streaming to specialised Judges

The High Court should continue to have the jurisdiction to appoint trustees. However, there should be a short form procedure for various trust matters and an Associate Judge could preside in respect of many of them. Appointment of trustees could be one of the trust matters dealt with using the short form procedure.

There are insufficient trust matters to warrant a separate Chancery Court, but this should be kept under review given the large number of trusts in New Zealand. In the meantime, it would be sensible to include trust matters in the Associate Judge lists in the same way as bankruptcy and company liquidation matters. There could be specialisation of High Court Judges using a case streaming system for more complex trust matters that are not dealt with by the Associate Judges.

Caveat procedure for trust disputes related to relationship property disputes

We are concerned about the procedural inefficiencies that can arise where relationship property disputes are related to trust disputes. Given the high proportion of homes held within trusts, this is a common situation. Difficulties arise where different courts have jurisdiction over two different but related parts of a dispute. The problem is exacerbated where one party to a relationship holds trustee powers or powers to remove and appoint trustees and exercises the powers inappropriately to the disadvantage of the other partner.

The Law Society has previously commented on the weaknesses in the provisions of the Property (Relationships) Act 1976 in its response to the Commission's earlier Trusts Issues

Papers. From a procedural perspective, the Commission should consider the need for the following features in relationship property or trust legislation:

- (a) A caveat procedure under which an appointer can be prevented from exercising his or her powers to appoint or remove trustees where parties separate, unless the exercise of the powers is approved of by the Family Court and supervised (whether by the Family Court or another person supervised by the Family Court).
- (b) A caveat procedure under which a trustee can be stopped from exercising his or her powers where parties separate unless the exercise of the powers is approved of by the Family Court and supervised (whether by the Family Court or another person supervised by the Family Court).

Family Court jurisdiction and case streaming to specialised judges

Further measures may also be desirable to improve procedures where relationship property disputes and trust disputes are related. These could include:

- (a) A limited jurisdiction for the Family Court to remove trustees and appoint trustees:
 - where parties to a relationship separate and there is a serious deadlock or hostility between some or all of the trustees which results or may result in the trust or the beneficiaries being at risk;
 - where parties to a relationship separate and there is serious hostility between the trustees and/or the beneficiaries, which results or may result in the trust or the beneficiaries being at risk.
- (b) A limited jurisdiction for the Family Court to remove and appoint an appointer or suspend or supervise an appointer's powers to appoint or remove trustees:
 - where parties to a relationship separate and there is a serious deadlock or hostility between the appointer and some or all of the trustees which results or may result in the trust or the beneficiaries being at risk.
 - where parties to a relationship separate and there is serious hostility between the appointer and the beneficiaries, which results or may result in the trust or the beneficiaries being at risk.
 - where parties to a relationship separate and there is serious hostility between two or more appointers which results or may result in the trust or the beneficiaries being at risk.

If the measures in (a) and (b) are adopted, there should be specialisation of Family Court Judges in trust matters using a case streaming system.

- (c) An alternative to these two jurisdiction options is to improve the interface between the Family Court and matters which are dealt with by the High Court under the suggested short form procedure and other procedures.

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

The personal representative of a deceased sole trustee is able to appoint a replacement trustee (and this has been the case for many years), so it is unclear why a liquidator should not also have the power to appoint a new trustee.

However, some complicated questions might arise about the former corporate trustee's right of indemnity against the trust fund. A liquidator could be faced with questions about what property will vest in the new trustee. This could place the liquidator in a difficult position when considering an appointment of a replacement. The Law Society considers that the liquidator should be entitled to seek directions from the court or to ask the court to appoint a replacement trustee.

Replacement of incapacitated trustee

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

The personal representative of a deceased sole trustee is able to appoint a replacement trustee (and this has been the case for a number of years), so it is unclear why the holder of an enduring power of attorney or property manager of a sole trustee who has become mentally incapable should not also be able to do so. An attorney (where the donor has become mentally incapable) or property manager should have the power to appoint a new trustee.

However, this should only apply where there are no other persons entitled to appoint a trustee. For example, where there are two or more trustees, the continuing trustee should be the person who appoints a replacement where the co-trustee has become incapable.

Removal of trustees

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

A settlor should be entitled to specify, regulate, or give guidance on the number of trustees. This should apply regardless of whether the court exercises a power to remove or replace trustees.

The court should ensure that, when it is removing and replacing trustees, the trust will have at least two trustees or a sole trustee corporation as trustee, in the absence of an express requirement or express or implied guidance from the settlor.

The legislation should provide for these principles in the default provisions dealing with trustee removal and appointment:

- (a) where a settlor specifies a number of trustees or an upper limit and a lower limit on the number of trustees, then those requirements should apply;
- (b) where a settlor originally appointed a single trustee, a single trustee will then suffice when a trustee is removed or appointed (unless the settlor includes express requirements to the contrary);
- (c) in the absence of the above, when a trustee is removed or appointed, the court will have a discretion as to the number of trustees but should ensure there will be at least two trustees or a sole trustee corporation. It is not necessary to have an upper limit on the number of trustees.

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

For clarity the legislation should stipulate that where three or more trustees were originally appointed, a trustee can be discharged without a new trustee being appointed, unless the settlor has expressly stated otherwise in the trust instrument. The legislation should adopt the principles outlined in the response to question 28, including the principle that the settlor can impliedly indicate, by originally appointing a sole trustee, that one trustee will suffice. There should not be an argument that, by originally appointing three trustees, three are required.

See also the response to question 22 regarding whether co-trustees should have power under the legislation to remove other trustees.

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

Sections 45 and 46 are necessary. Without them, a trustee would have difficulty retiring and would be liable for costs.

Section 45(2), which is based on the English Trustee Act 1925, should be more clearly drafted. The limitation (of at least two trustees) in s45(3) can be problematic because there is a conflict between that and the principle that a settlor can determine the number of trustees. Section 45(3) should contemplate the possibility that the trust instrument might expressly or impliedly allow only one trustee (which is not a trustee corporation).

Q31 Is section 46 still needed?

Yes. Section 46 is still needed to cater for the possibility of co-trustees or power holders not consenting to a trustee retiring. In the absence of s46, a trustee (if they were able to obtain a court order permitting retirement) would, under case law, be required to pay costs.

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

This issue can be dealt with by way of the simplified procedure suggested above. A retiring trustee should place accounts before the court. This is in the interests of the retiring trustee as their liabilities and indemnity rights against the trust fund need to be investigated.

Removal of appointors and protectors***Q33 Should trust legislation enable the court to remove an appointer or a protector and replace that person with someone else? On what grounds should this be possible?***

In the absence of provisions in the trust instrument, an appointer should be able to be removed and replaced by the court where the appointer is a person in one of the following classes:

- (a) minors;
- (b) corporations in liquidation or being wound up;
- (c) incapacitated persons who are:
 - (i) persons who are mentally disordered persons under the Mental Health (Compulsory Assessment and Treatment) Act 1992
 - (ii) persons whose estates are subject to a property order under the Protection of Personal and Property Rights Act 1988.

Appointers' behaviour can be problematic, particularly in situations where there is conflict between the appointer and the beneficiaries, such as where parties to a relationship separate. Legislation should make provision for this. See the response to question 25.

The legislation should give the court the power to supervise the exercise of an appointer's powers and, where the appointer has breached his or her powers, suspend or supervise the exercise of them. Where the appointer holds the power in a fiduciary capacity, the court should also have the power to remove and replace the appointer.

Vesting of trust property on removal or discharge of trustee

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

Section 47 contains a procedure that can, in principle, be used in non-contentious cases where a trustee is removed by co-trustees on the grounds that the trustee is a prohibited person. Unfortunately s47 is currently of little application because it cannot be used for fairly wide classes of property (such as land under the Land Transfer Act).

A simplified procedure under s47 could be used in the new legislation to facilitate property vesting in continuing or new trustees where a trustee is removed by co-trustees.

In other cases, such as where a trustee has been removed by the court, the current provisions and procedures should be simplified. It is expensive to obtain a vesting order, even in fairly straight-forward situations. In both of these instances, a simplified High Court procedure should be available to be heard before a specialised Associate Judge or High Court Judge in the way previously described.

There are some circumstances where a trustee (particularly a trustee removed under the terms of the trust instrument) may object and wish to ensure that his or her rights of indemnity are better protected. We understand that a trustee has an equitable lien against the trust property which is not dependent on possession. However, there may be circumstances where a removed trustee may wish to object to the vesting of title to trust property in others before proper provision is made for the removed trustee's trust liabilities to be dealt with.

There should be a procedure available to a removed or retiring trustee to ensure that its position is protected.

Appointment of first trustees: acceptance and disclaimer

Q35 Should the common law rules relating to acceptance and disclaimer of office of trustee be set out in legislation?

No. There are many scenarios where disclaimer might occur and it would be too difficult and potentially too restricting for this to be set out in the legislation.

Custodian trustees

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

Custodian trustees are not common in family trusts. This is because the custodian trustee framework does not properly align with the usual investment requirements for family trusts.

It would be preferable for nominees and custodians to be provided for so as to allow modern investment vehicles to be safely used by new and existing *inter vivos* family trusts and testamentary trusts. This is important because many modern investments contemplate legal title being held by a nominee (rather than the trustees) and certain investment decisions, within parameters, being exercised by some kind of manager (rather than the trustees).

Section 50 is used in trusts which hold assets on behalf of Maori and in some investment trusts. It has the advantage that changes in title are not required following a change in managing trustees and trust decisions can be made by a majority of managing trustees.

Section 50 has caused problems in some situations due to inconsistencies between the way investment trusts have operated and the actual wording of s50. However, those problems were due to the way the trusts operated and the drafting of the trust instruments, rather than s50 itself.

Section 50 should be retained. The situation should be catered for where trustees do not wish to appoint a custodian trustee under s50 but wish to use a modern investment vehicle. Provisions to allow title to trust assets to be held by nominees and for trust investments to be managed by others on behalf of trustees should be included in the new trust legislation.

Chapter 5 – Trustees’ Powers

Administrative powers

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

Yes. The current provisions are too complicated and not particularly useful for trustees. The ability of trustees to deal with trust property as if it were vested in the trustee absolutely and for the trustee's own use should be limited to administrative matters. Administrative matters can be defined simply as being transactions relating to the management or disposition of trust property.

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

A schedule providing “opt in” or template administrative powers could be useful.

Power to appoint agents

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

Yes. In practice significant administrative functions are arguably carried out by agents while ostensibly being undertaken by trustees personally. Many administrative functions can be performed more efficiently and with greater transparency with the use of appropriately qualified agents.

However, it is important to clearly distinguish between the appointment of an agent and a trustee delegating trustee powers. Trustee legislation should be aligned with what is happening in the market-place in relation to investment. A trustee should be able to manage trust assets as they would their own assets, including being able to appoint an agent (such as a broker or investment manager) to manage investments for them. Trustee legislation should allow for this. This area of law should be clarified so that trustees can invest in this way with confidence.

Sections 29 and 29A of the Amendment Bill do not clarify this issue. They need to be simplified to clearly distinguish between a trustee's investment powers on the one hand, and other powers on the other (such as dispositive powers, powers to add and remove beneficiaries, powers to determine capital and income, and so on).

Sections 29 and 29A also do not deal with the question of using custodians or nominees to hold title to investments. These arrangements are common and should be dealt with in a modern Trustee Act.

The new trust legislation should state that a trustee may appoint an agent (such as an investment manager) or agents to select, acquire, monitor, manage and dispose of (by sale or exchange) trust assets, and exercise other rights in respect of them, for investment purposes.

The legislation should also stipulate that a trustee may permit title to the investments to be held by a custodian or nominee on behalf of the trustee and impose on the trustee a duty to use reasonable care in:

- (a) selecting the agent or nominee or custodian;
- (b) setting the terms of their engagement;
- (c) approving an investment strategy;
- (d) monitoring what the agent or nominee or custodian is doing.

Q40 Do you agree with the changes recommended by the Select Committee?

We agree with the Select Committee's recommended changes (outlined at paragraph 5.9 of the Issues Paper) – with the exception of the change recommended to make it clear what fees and charges the trustee may pay the agent and what the trustee may be paid for employing the agent and reviewing the arrangement. The circumstances of each trust and agency arrangement will be different and it is difficult to see that a prescriptive set of fees and charges would be workable. It should be made clear that the agent's charges must be reasonable, and that would be a matter which the trustee must consider when appointing and reviewing any agency arrangement. A trustee who is entitled to charge (almost invariably a professional trustee) must charge on a reasonable basis in any event. To go further than that in legislation would potentially add significant complexity.

*Power to delegate****Q41 Are there any problems with Section 31 of the Trustee Act 1956 that require attention? Is the Section used in practice?***

Section 31 is used frequently in practice. The main difficulty with it is the narrowness of its scope, requiring absence from New Zealand or physical incapacity.

As recognised by the Commission, there are other circumstances where it might be desirable for a trustee to delegate his or her trust powers and discretions. One area of difficulty is temporary or permanent mental incapacity, although changes have been suggested in the response to question 27 that may resolve this issue.

Q42 Should Section 31 be expanded to allow trustees to delegate all trust powers and discretions?

Section 31 already allows delegation of all trust powers and discretions. A clear distinction between delegation and agency should continue, as should the ability to delegate all powers within an expanded set of circumstances.

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

The Law Society supports the UK approach in terms of time limitations. It is important to recognise that delegation might occur in two contexts:

- (a) Where the delegation takes effect immediately – for example, the trustee is about to leave New Zealand.
- (b) Where the trustee considers that he or she may be unable to exercise trustee responsibilities at some point in the future because of absence or infirmity. This would apply to most professional trustees. For example, in law firms where partners are professional trustees it is very common for them to use s31 to delegate their trustee powers to one or more of their partners in circumstances where they have no current intention of being out of New Zealand but know that they are likely to be out of New Zealand at some point in the future when a trustee decision is required to be made.

Any time limitation such as 12 months should be expressed as coming into effect only when the deed comes into effect. A professional trustee who enters into an “anticipatory” deed of delegation and who is a trustee of a number of trusts should be able to do so without time limitation. In respect of any one trust, the period where the delegate exercises the powers should not exceed 12 months on any one occasion.

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

Notice should be required to be given to co-trustees and any persons with the power to appoint trustees.

It is most unlikely that there would be an absence of a person with the power to appoint trustees because if there is no person with such a power under the trust instrument then the default provisions of the Act will apply and the remaining trustees have power to appoint.

Notification of beneficiaries, even adult beneficiaries, is considered too onerous – particularly for a professional trustee who is delegating powers because, for example, they are taking a short overseas trip.

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

As the Commission indicates, it is implicit in s31 that reasonable care is required. It is implicit generally in trust law that trustees must take reasonable care in exercising their powers and obligations.

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

The existing provision, which provides that the trustee is not liable to a beneficiary if the trustee proves that the delegate is appointed in good faith and with reasonable care, is appropriate.

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

The Law Society agrees with the British Columbia Committee recommendations set out at paragraphs 5.15 and 5.16 of the Issues Paper.

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

See the response to question 47.

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

No.

Investment powers

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

No comment.

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

No comment.

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

No comment.

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

No comment.

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

No comment.

Apportionment of outgoings between capital and income

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

Yes, trusts legislation should allow trustees to apportion expenses between income and capital accounts or charge an outgoing to one or the other. This should be subject to the trustees being satisfied that doing so is just and equitable and in accordance with normal business practice. Guidance on what constitutes normal business practice in this context would be helpful, for example, a financial reporting standard or other promulgation by the External Reporting Board.

The requirement that the discretion be exercised in the best interests of beneficiaries might cause confusion. Life interest and remainder beneficiaries are all beneficiaries of the trust, and the decisions regarding the application of expenses to income or capital will inevitably result in not being in the best interests of one of those categories of beneficiaries.

Accordingly, this requirement should not be imposed.

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

Yes, trustees should be permitted to transfer funds between capital and income to recover expenditure previously charged to one or the other. However, in the light of our response to question 55, the trustees should only be able to do so if they are satisfied that it is just and equitable and in accordance with normal business practice. If trustees are granted discretion to decide whether to apply an expense to income or capital then trustees should also be permitted to change their minds at a later time.

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

Yes, trustees should be permitted to deduct an amount from income derived from trust property subject to depreciation and add that amount to capital. This would be consistent with the underlying principles of depreciation, which is the provision for gradual wear and tear and reduction in value of the asset. Allowing depreciation to be recovered from income essentially maintains the asset for the capital beneficiaries.

The trustees should only be entitled to deduct an amount from income to provide for depreciation if the trustees are satisfied that this is just and equitable and in accordance with normal business practice. Consistent with the response to question 56, the trustees should also be permitted to reverse (in whole or in part) any deduction made from income to the provision for depreciation in the event that the property is sold for more than its depreciated value.

Delegation of investment decision-making

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

Most modern trust instruments permit delegation, so it would also be appropriate for trust legislation to permit this, subject to the following safeguards:

- (a) a requirement for the appointment of an investment manager to be made in good faith and with reasonable care;
- (b) a mandatory obligation by trustees to review the investment manager's performance periodically;
- (c) a provision allowing a person to seek directions in respect of the investment manager's performance, comparable to s68 of the Trustee Act.

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

Trustees should be liable for any breach of the safeguards outlined in the response to question 58.

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

No.

Business related powers

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

As most modern trust instruments permit the carrying on of business, it would also be appropriate for trust legislation to permit this, subject to the obligation to ensure that the business is carried on in the best interests of the beneficiaries.

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

It is appropriate to retain an express power to acquire shares in co-operative companies. Co-operative companies continue to be an important and necessary investment particularly for trusts involved with farming activities. It would be useful for such a provision to record that the exercise of the power to hold shares in a co-operative company is not the exercise of a power of investment, as such a provision would continue the recognition that trustees may have no alternative but to be a shareholder in the co-operative.

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

It is suggested that a period of longer than two years would be useful to enable a deceased estate to continue carrying on a business. As it currently stands, s32 only permits carrying on of the business for a period of two years, until wound up, or for a longer period if approved by the court.

Given the modern complexities of business transactions and dealings, and the intricacies of some businesses, a five year period may be a more suitable time to enable the business to be managed in the best interests of the beneficiaries without involving the court. Beneficiaries would continue to have protection under such a provision as they could apply for an order from the court if they were concerned about trustees' actions. Likewise, trustees would have the ability to apply to the court for directions if they were concerned about their obligations to beneficiaries.

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

The Law Society supports the Commission's recommendation to retain s33 in trusts legislation subject only to updating the wording. Such a provision provides a trustee with protection from personal liability for business debt arising from the trust carrying on business activities.

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

These provisions should continue in trusts legislation, because they provide trustees with the certainty and ability to make appropriate decisions for the continuation of the business, bearing in mind obligations owed to beneficiaries, and to general solvency provisions relating to carrying on of businesses.

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

No.

Liability for actions of a co-trustee

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

The Law Society is not aware of any problems in practice caused by this section.

Power to appoint advisory trustees

Q68 Are any changes needed to section 49?

There is an issue around the liability of a trustee who follows an advisory trustee's advice, which relates to the circumstances in which advisory trustees exist. From the 1970s through to the mid-1990s there was a common view that it was desirable for a client not to be a trustee in "their" trust, and significant numbers of mirror trusts were created. The device advisers used to ensure that clients felt they retained some sense of involvement in the trust's affairs was to have the client as an advisory trustee in relation to that trust.

If a complete indemnity is provided for responsible trustees in relation to advisory trustees, the question arises as to whether a trust exists at all.

The existing provisions under s49 are, however, adequate.

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

No. Imposing an obligation to apply to the court would be onerous, expensive and time consuming.

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

The Law Society agrees with the proposition that adding a statement to this effect would codify the current position. Unless a provision restricting trustee liability in a specific

situation is intended to override general trustee liability then, as a matter of principle, there is little merit in restating the law in liability restriction provisions.

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

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

Section 40

Section 40(1)(a) says that the “trustee may, at his sole discretion pay ... of the income of that property as may, in all of the circumstances, be reasonable”. We do not believe that this mixing of a subjective decision with an objective decision adds any useful protection to the beneficiary. It probably adds to confusion and difficulty for the trustee. The words “as may, in all of the circumstances, be reasonable” should be deleted.

Section 40(1) requires that where the trustee has notice of another fund it apportions its payment of income for the infant and accumulates the rest. This protection is not necessary and causes difficulty for the trustee, so it should be deleted.

Section 41

There can be problems in identifying who is eligible as an object under s41. Case law needs to be considered carefully to determine that those persons who hold contingent property rights under a double contingency are not eligible as objects. Section 41 should clarify eligibility.

There are also problems with the limits in proviso (a), which are often too low and are excluded by the terms of the trust deed. There are also problems if an advance up to the limit is made. If there is an increase in the value of the rest of the fund, case law needs to be considered to determine that a further “top up” advance is not possible. It would be preferable for the limits to be removed. It is open for settlors or testators to include limits if they wish.

Some of these matters are currently being considered by the Law Commission for England and Wales in Consultation Paper 191, *Intestacy and Family Provision Claims on Death*.¹ (See sections 31 and 32 of the English Trustee Act 1925).

¹ http://www.justice.gov.uk/lawcommission/docs/cp191_Intestacy_Consultation.pdf

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

The Law Society believes these words are sufficiently understood. It is also understood that “benefit” is a wide term and provides trustees with sufficient scope.

There are various issues under s41 relating to the word “benefit” and resettlements. We do not believe this can be dealt with in the legislation and those questions are best left to the courts to resolve.

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

Income should be accumulated for the infant unless it is paid out for the infant's benefit.

However, for the trust to accumulate income and then apply it to capital in s40(2)(b), which overrides the vested entitlement of the infant, is illogical. The section should be reworded to provide for the infant (or his or her estate) to be entitled to vested income which has been accumulated and other interests to be held as an accretion to capital.

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

The monetary limits should be removed. They are routinely removed in practice and create various problems once the limits are reached. See the response to question 71.

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

Yes, the provisions should be rewritten. Currently they are difficult to understand and could be simplified.

Applications for directions

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

The section operates satisfactorily, although see the response to question 15 about the related s68, and the improvements that are needed in respect of it.

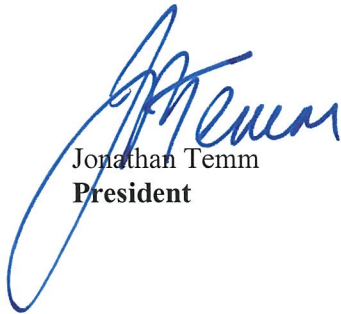
Q77 Is the scope of the section clear or would there be benefit in incorporating some of the key common law principles in a new provision?

The scope of this section is now settled; but there is a case for introducing the common law concepts to the statute, simply so that trustees and others can be aware of the scope of any application for directions, without necessarily having to obtain legal advice.

Conclusion

If you have any queries regarding this submission please contact the Property Law Section manager, Kim Oelofse, by telephone (04) 463 2991 or email (kim.oelofse@lawsociety.org.nz).

Yours sincerely



Jonathan Temm
President