TRUST LAW

Our muddied law of trusts: Part 2

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In my last article (see *LawNews* Issue 19, 2017), I wrote about the Court of Appeal's statement in *Vervoort v Forrest* [2016] 3 NZLR 807 and *Blumenthal v Stewart & Others* [2017] NZFLR 307 that the law of trusts in this country "must bend to the practical realities when one trustee is in absolute control of all trust activities and the other trustees have effectively abdicated their trustee responsibilities".

In other words, the courts are to treat as valid and enforceable a trust that is governed by a dictatorial trustee who keeps his co-trustees in the dark about his actions. This development sets New Zealand apart from other countries whose laws are based on the English law of trusts.

In my last article, I wrote of one consequence of this development – the potential inability for the courts to invoke two mechanisms to invalidate trusts. The first is a determination that a trust is invalid because one of the three certainties is missing. The "certainty" is the requirement that the legal and beneficial interests in an asset have been settled on the trustees. If a dictatorial settlor/trustee always intended to retain control of the asset, that certainty is missing. The second mechanism is the ability to show that a trust is a sham (because the dictatorial settlor/trustee never intended to have a genuine trust in the first place). In that context, I also referred to some recent academic writings which show that our current jurisprudence on the concept of sham has an unsound foundation and its restrictive definition of what constitutes a "sham" may be wrong. The potential loss of powers to regulate trusts is only one of the areas of difficulty that the new development has created.

In this week's article, I will consider another consequence of a ruling that actions of a dictatorial settlor/trustee are binding on co-trustees who are kept in the dark about his actions – namely, the liabilities that the co-trustees face as a consequence of the dictatorial settlor/trustee's actions.

There is a well-established principle in the laws concerning trusts that all trustees are co-equally liable for a trust's losses and liabilities. So, if the actions of a dictatorial settlor/trustee are to be treated as valid and enforceable, it should mean that the "innocent" trustees, who have been kept in the dark about the losses and liabilities that the dictatorial settlor/trustee has caused, are financially liable for those losses and liabilities. This is a very unsatisfactory situation.

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The courts will conventionally try to distinguish the one situation from the other, but it will not be easy for a court to say that the unanimous and dictatorial actions of the settlor/trustee in a *Vervoort* situation are valid and enforceable, while the unanimous and dictatorial conduct of a trustee in a loss-creating situation is invalid and unenforceable.

If the need for unanimity of trustees can be dispensed with in a *Vervoort* situation, it can presumably be dispensed with in a loss-creating situation? What has led the Court of Appeal to go down this path? I suspect it is a belief that many trusts are not in fact "genuine" and that they are, in practice, dominated by one person who can manipulate the trust to do anything that the dominant trustee wants (I say "he" or "his" because in most cases it is the actions of a man and not of a woman). In circumstances where judges consider trusts to be disingenuous, and the trust's assets to be that of its controller, surely the better way is to find a response to declare the trust invalid?

Since the *Vervoort/Blumenthal* developments have occurred at the Court of Appeal level, any changes to the law must also be made at that level or in the Supreme Court. The paths that those courts might go down to reverse the consequences of the unfortunate *Vervoort/Blumenthal* decisions could include:

- declaring that such trusts are not genuine, since the dictatorial settlor/trustee never intended to cede the beneficial interests in a trust asset to the trustees. In making this assessment, his intentions alone are relevant and not the intentions of his co-trustees, and his intentions can be assessed after full consideration has been given to his actions during the course of his trusteeship; or
- a declaration that such trusts are a sham;
- a more proactive and practical law of emerging shams. In this pathway, the courts would say that the trust may have been genuine at the outset, but that its current status is that of a sham.

Some would say the courts should be much more honest in their approach to "trusts" which they consider to be disingenuous. If such trusts are perceived to be "play things" that are controlled by a dictatorial trustee, the proper answer may, in many cases, be to say that the "trust" is like the Emperor who had no clothes – it's not a trust at all.