NEW ZEALAND LAW SOCIETY

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Trusts Bill

06/03/2018

Submission on the Trusts Bill

Introduction

1. The New Zealand Law Society welcomes the opportunity to consider and comment on the Trusts Bill (Bill).

2. The objective of the Bill is to update the Trustee Act 1956 and the Perpetuities Act 1964, introducing plain language legislation that seeks to balance certainty and accessibility for settlors, trustees and beneficiaries, with flexibility to cater to the wide variety of trusts which operate in New Zealand.

3. These are very desirable goals. However, as this submission seeks to explain, the attempts to codify and define certain precepts of trust law (such as that of the "express trust") may have unintended consequences. A hallmark of trusts law has been the flexibility to evolve to meet unique circumstances via case law. The codification of some concepts in the Bill is likely to stifle this flexibility.

4. Some aspects of the Bill make the legislation more practical, such as the simplification of the mechanics for incoming and outgoing trustees. The Bill also permits the referral of matters to alternative dispute resolution, which could only have been achieved by legislative change.

5. However, other aspects of the Bill will be problematic – in particular, the information disclosure provisions in subpart 3 of the Bill. The clauses relating to the compulsory provision of information to beneficiaries are the most contentious provisions in the Bill. As currently drafted, the requirements will be difficult for trustees to apply in practice, are likely to have adverse impacts on family affairs in relation to family trusts, and are not proportionate to achieving the aim of holding trustees to account.

6. The Law Society also notes that many older trust instruments will not be drafted in a manner that is consistent with the Bill. These older trusts may also not permit amendment of the terms of the trust deed or resettlement, which will cause difficulties for trustees attempting to comply with the new law.

7. The Law Society comments below on the following key issues:

    a. interpretation and relationship between statute and common law/equity;

    b. key definitions;

    c. trustees' duties and the tension between those duties;

    d. the compulsory provision of information to beneficiaries;

    e. review of trustees' decisions; and

    f. the Schedule 3 exemption for specified commercial trusts.

8. Other more detailed drafting comments are set out in the Appendix to this submission.

9. The Law Society does not wish to be heard, but is happy to engage with the select committee or officials on particular issues if further discussion would be of assistance.

Interpretation and relationship between statute and common law/equity

10. The Bill is not intended to be a self-contained code. Therefore, the interface between its provisions, existing case law, and the terms of a particular trust instrument is important. Clause 5(5) of the Bill governs the interface with common law and equity. It states:

> *(5) This Act—*
>
> *(a) is not an exhaustive code of the law relating to express trusts; and*
>
> *(b) is intended to be complemented by the rules of the common law and equity relating to trusts (except where otherwise indicated or where those rules are inconsistent with the provisions of this Act).*

11. Clause 7 of the Bill then provides instruction on how to interpret the Bill in relation to common law and equity:

> ***7 Interpretation of Act***
>
> *(1) This Act—*
>
> *(a) must be interpreted in a way that promotes its purpose and principles; and*
>
> *(b) is not subject to any rule that statutes in derogation of the common law should be strictly construed; but*
>
> *(c) may be interpreted having regard to the common law and equity, but only to the extent that the common law and equity are consistent with—*
>
> *(i) its provisions; and*
>
> *(ii) the promotion of its purpose and principles.*

12. The interplay between the common law, equity and the Bill is restated in two slightly different ways in clause 5(5)(b) and clause 7(1)(c):

    a. Clause 5(5)(b) states that the Bill "*… is intended to be complemented by the rules of the common law and equity* relating *to trusts (except where otherwise indicated or where those rules are inconsistent with the provisions of this Act)*".

    b. However, clause 7(1)(c) states that the Act "*… may be interpreted having regard to the common law and equity, but only to the extent that the common law and equity are consistent with—(i) its provisions; and (ii) the promotion of its purpose and principles*".

13. The two provisions are presumably framed differently (one positively framed and one negatively) because clause 5(5)(b) relates to the preservation of existing substantive rules of common law and equity not modified by the Act, while clause 7(1)(c) is concerned with the interpretation of provisions of the Act with regard to common law and equity. With the current drafting, there is unlikely to be a clear-cut distinction between the two concepts, and

these clauses will potentially result in ambiguities regarding the relationship between the Bill and common law and equity. To address this concern, the Law Society **recommends** that clauses 5(5)(b) and 7(1)(c) be amended as follows:

a. The language in clause 5(5)(b) "*except where otherwise indicated or where those rules are inconsistent with the provisions of this Act*" is unclear. The Law Society **recommends** that clause 5(5)(b) should state: "*is intended to be complemented by the rules of the common law and equity relating to trusts, except where <u>expressly modified by the Act</u>*".

b. Clause 7 should be amended to:

   i. remove sub-paragraph (b): the Law Society considers this clause is unnecessary, as it is clear from sub-paragraph (c) that the Act should be interpreted with regard to the common law and equity;

   ii. remove the following words from sub-paragraph (c): "*but only to the extent that common law and equity are consistent with its provisions and the promotion of its purpose and principles*". This point is sufficiently dealt with in clause 7(1)(a), which states that the Act "*must*" be interpreted in a way that promotes its purpose and principles.

The Law Society accordingly recommends that clause 7 should read:

> ***7 Interpretation of Act***
>
> *(1) This Act—*
>
> *(a) must be interpreted in a way that promotes its purpose and principles; and*
>
> *(b) ~~is not subject to any rule that statutes in derogation of the common law should be strictly construed; but~~*
>
> *(c) <u>subject to paragraph (a),</u> <u>is intended to</u> ~~may~~ be interpreted having regard to the common law and equity. ~~but only to the extent that the common law and equity are consistent with—~~*
>
> *~~(i) its provisions; and~~*
>
> *~~(ii) the promotion of its purpose and principles~~.*

14. Clause 5(6) may also cause difficulties. Clause 5(6) states that "*if there is an inconsistency between* the *provisions of this Act and those of any other enactment, the provisions of that other enactment prevail, unless this Act provides otherwise*". However, many Acts rely on trust concepts in the current Trustee Act 1956 (such as the Income Tax Act, which relies on the definition of "trust"). Clause 5(6) may result in the concept of what is a trust being trumped by definitions in other legislation, which may have unintended effects. The Law Society **recommends** that clause 5(6) be amended to provide that, in relation to trust matters, the Act has primacy unless other legislation expressly states that the provisions of the Act should not apply. The Law Society also **recommends** a consequent review of other legislation relying on trust concepts to determine whether those other statutes require amendment or not.

Key Definitions (clause 9)

15. The definition of "*trustee*" is "*a person who is appointed as trustee of a trust*". This definition focuses on appointment. As a result, the definition does not include a trustee de son tort and a constructive trustee. These types of trustees are potentially within the scope of the Bill via clause 5(2)(b). They are not however "*appointed*". If a person is not classified as a trustee, they will fall outside the scope of important provisions of the Bill. The Law Society **recommends** that the definition state "*a trustee means a person who is trustee of a trust*".

Meaning of an "express trust" (clause 9; Part 2)

16. During the consultation on the proposed reform of trust law, the Law Society submitted that a definition of express trust should not be included. There has been a long-standing debate amongst legal academics about how to define an "*express trust*" but, to date, a satisfactory definition has not been found. Defining the characteristics of an express trust in this manner is likely to stifle the evolution of the trust structure through case law. The Law Society **recommends** that a definition of "express trust" not be prescribed in the Bill.

17. As a separate point, the Law Society **recommends** that clause 13 (characteristics of express trusts) be amended. Clause 13 refers to a trust existing where a trustee "*holds or deals with trust property*". The word "*deals*" suggests that a trust may exist where property is dealt with (such as an agency) rather than "*held*". The word "*deals*" should be deleted, as an essential characteristic of a trust is the holding of property.

Trustees' Duties (Part 3)

18. The trustees' duties set out in Part 3 create a complex interplay between various duties and, in some cases, a potentially serious clash. Some examples of the difficulties are set out below.

Compliance with terms of the trust

19. Clause 23 states that a trustee must act in accordance with the terms of the trust. However, sometimes it will be impossible, difficult, unlawful, or undesirable for a trustee to comply with the terms of a trust. In those situations, a trustee may wish to intentionally breach the terms of the trust and may have the beneficiaries' support in doing so. Alternatively, the trustee may have breached his or her duties but then have reached a settlement with the beneficiaries after the fact.

20. Under the current law, where a trustee cannot comply with the terms of the trust (or considers it undesirable), a trustee may seek the benefit of various protection mechanisms. One protection mechanism is for a trustee to seek the consent of all beneficiaries of the trust under a deed of arrangement. A well-drafted deed of arrangement will contain indemnity provisions for the trustee indemnifying him or her against liability for entering into, and following the deed of arrangement. However, this may be problematic under the Bill. If the deed of arrangement is found to constitute a modification of the terms of the trust, the indemnity could be invalid. This is because clause 38 prohibits indemnities against dishonesty, gross negligence, or wilful misconduct in the "*terms of a trust*".

21. Even if the deed of arrangement is drafted so that it does not constitute modified terms of the trust, there may still be problems. Clause 78(2) states that beneficiaries cannot indemnify a trustee in relation to the exercise or non-exercise of a trustee duty, power, or function involving dishonesty, gross negligence, or wilful misconduct by the trustee. There is no reason why adult beneficiaries, with full knowledge, should not be entitled to indemnify a trustee in those circumstances. The Law Society therefore **recommends** that clause 78 should be amended to allow this.

Hold or deal with trust property and act for the benefit of the beneficiaries

22. Clause 25 states that a trustee must hold or deal with trust property, and otherwise act, for the benefit of the beneficiaries or to further the permitted purpose of the trust. However, there are likely to be circumstances where furthering the purpose of the trust may not be aligned with the interests of one or more of the beneficiaries. This type of clash of duties was considered in the leading case of *Cowan v Scargill.*[1] The authorities have been recently reviewed in *Merchant Navy Ratings Pension Fund Trustees Ltd v Stena Line Ltd,*[2] in which the court confirmed[3] that the duty to act in the best interests of the beneficiaries should not be viewed as a paramount, stand-alone duty separate from the proper purposes principle. The court stated that:

> *It is necessary first to decide what is the purpose of the trust and what benefits were intended to be received by the beneficiaries before being in a position to decide whether a proposed course is for the benefit of the beneficiaries or in their best interests. As a result, I agree with his conclusion that ... to define the trustee's obligation in terms of acting in the best interests of the beneficiaries is to do nothing more than formulate in different words a trustee's obligation to promote the purpose for which the trust was created. …*
>
> *In my judgment, it is clear from* Cowan v Scargill *that the purpose of the trust defines what the best interests are and that they are opposite sides of the same coin.*

23. Two important points can be seen from this – the duty to act in the best interests of beneficiaries is closely linked to duty to act for a proper purpose. Looking at these two duties from that perspective, clashes in these duties will often be able to be avoided. However, there will be occasions where the clash between duties, such as that in clause 23 (to act in accordance with the terms of the trust) and that of clause 25 will need to be resolved by the courts.[4]

24. Two other key examples of a clash between the duties are:

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1 *Cowan v Scargill* [1985] 1 Ch 270. See also *Re O'Donoghue* [1998] 1 NZLR 116 (HC) and *Porter v New Zealand Guardian Trust Co Ltd* (1996) (CP136/91), 7 TCLR 323.

2 *Merchant Navy Ratings Pension Fund Trustees Ltd v Stena Line Ltd* [2015] EWHC 448 (Ch).

3 At [228] – [229].

4 See in *Citibank NA v MBIA Assurance SA* [2007] 1 All ER 475, where the court held that a trustee of a trust relating to debt securities could contract out of its fiduciary duty to act in the best interest of beneficiaries. See also H Dervan *Reviewing the Citibank securitisation case: Did it really challenge the integrity of equity?* (2016) 27 JBFLP 279.

a. The power in a trust deed to add or remove beneficiaries. This is at odds with the duty to act in the interests of beneficiaries who may be harmed by removal or by the addition of further beneficiaries.

b. Where a trust deed contains a term that a particular type of investment must be made or retained. A trustee's investment powers in clauses 54 and 55 of the Bill can be modified or excluded and under clause 5(4) the terms of a trust may impose additional duties on a trustee – such as a duty to invest in a particular investment. However, over time it may become clear that that particular investment (or type of investment) may not be for the benefit of the beneficiaries. At this point, the question arises – is the trustee bound by the terms of the trust to invest in a particular way or should the trustee be bound to act for the benefit of the beneficiaries and invest in a different manner?

   Under the existing Trustee Act 1956 this point is dealt with by section 13F (trustee's duties at law preserved) and section 13G (duty to comply with requirements of trust instrument). Section 13F states that the trustee's duty to exercise powers in the best interests of beneficiaries remains in force except where it is altered or inconsistent with the Trustee Act 1956. Section 13G then states that the trustee must comply with the trust instrument and directions binding on the trustee regarding the investment of trust funds. As a result, there is a clear hierarchy – the terms of the trust prevail. However, this does not deal with the trustee's dilemma of how to avoid what may now be an inappropriate or undesirable investment strategy. The only way to cure this is either to enter into a deed of arrangement with the beneficiaries or to seek directions from the court to change the investment strategy.

25. The Law Society notes these tensions and the fact that there is likely to be a need for recourse to the courts in the more contentious situations to resolve the conflict between duties.

26. The Law Society **recommends** that the following clauses of the Exposure Draft Trusts Bill be reinserted in the Bill, to assist in resolving the difficulties referred to above:

    a. Clause 15(3) of the Exposure Draft Trusts Bill clarified that modification of certain default duties is not inconsistent with the mandatory duties. This was helpful for the avoidance of doubt and the Law Society recommends that this clause be reinserted. However, as originally drafted, clause 15(3) only referred to some duties – the duty to invest prudently, duty not to profit and the duty to act for no reward. If this clause is reinserted, there are a number of other default duties which can be modified and therefore should be included in this list.

    b. Clause 14(2) of the Exposure Draft Trusts Bill: "*The mandatory duty in section 25 (to hold or deal with trust property and otherwise act, for the benefit of the beneficiaries or for the permitted purpose) must be interpreted in the context of the terms of the trust and the purpose of the trust*."

27. Clause 31 of the Bill states that a trustee must not bind or commit trustees to a future exercise or non-exercise of a discretion relating to the distribution of trust property. That does not (fully) represent the current law. The rule against fettering the exercise or non-exercise of discretions is not merely limited to discretions about distributing of property. It applies to discretions generally. The Law Society therefore **recommends** that the words "*relating to the distribution of trust property*" be deleted.

Trustees' obligations to keep and give trust information

28. The most contentious part of the Bill is the requirement to disclose trust information to beneficiaries (clauses 45 – 51). This is a very important area because if beneficiaries cannot obtain information about a trust and their rights, they cannot hold a trustee accountable. However, this needs to be balanced against the practicality of identifying and providing information to beneficiaries. The disclosure of information to beneficiaries can result in complex disputes, as shown in the recent Supreme Court appeal in *Erceg v Erceg* [2017] NZSC 28.

29. The Law Society submits that the information disclosure requirements, as currently drafted, will be difficult for trustees to apply in practice, are likely to have adverse impacts on family affairs in relation to family trusts, and are not proportionate to achieving the objective of holding trustees to account.

30. Clause 45 sets out some important definitions including "*trust information*" and "*representative*" of a beneficiary who lacks capacity:

> ***45 Definitions for purposes of sections 46 to 51***
>
> *In this section and in sections 46 to 51,—*
>
> ***lacks capacity** means, in relation to a beneficiary, a beneficiary who—*
>
> *(a) is a child; or*
>
> *(b) is not competent to manage the beneficiary's own affairs for any reason, including a beneficiary who—*
>
> *(i) is subject to an order appointing a manager under section 31 of the Protection of Personal and Property Rights Act 1988; or*
>
> *(ii) has a trustee corporation managing the person's property under section 32 or 33 of that Act*
>
> ***representative** means the parent, guardian, attorney, or property manager of a beneficiary who lacks capacity*
>
> ***trust information**—*
>
> *(a) means any information—*
>
> *(i) regarding the terms of the trust, the administration of the trust, or the trust property; and*
>
> *(ii) that it is reasonably necessary for the beneficiary to have to enable the trust to be enforced; but*

(b) does not include reasons for trustees' decisions.

31. Clause 46 then sets out the purpose of the trust information provisions, which is to ensure that trustees are kept accountable for complying with trust duties:

> ***46 Purpose and application of sections 47 to 51***
>
> *(1) The purpose of sections 47 to 51 is to ensure that beneficiaries have sufficient information to enable the terms of the trust and the trustees' duties to be enforced against the trustees.*
>
> *(2) Sections 47 to 51 do not apply to charitable trusts or to trusts established for a permitted purpose that do not have beneficiaries.*

32. Clause 47 then sets out a presumption that a trustee must make available some "*basic trust information*" to every beneficiary or representative of a beneficiary unless the trustee reasonably considers otherwise:

> ***47 Presumption that trustee must notify basic trust information***
>
> *(1) There is a presumption that a trustee must make available to every beneficiary or representative of a beneficiary the basic trust information set out in subsection (3).*
>
> *(2) However,—*
>
> *(a) before giving the information, the trustee must consider the factors set out in section 49; and*
>
> *(b) if the trustee reasonably considers (after taking into account those factors) that the information should not be made available to every beneficiary,—*
>
> *(i) the presumption does not apply; and*
>
> *(ii) the trustee may decide to withhold some or all of the basic trust information from 1 or more particular beneficiaries or classes of beneficiaries.*
>
> *(3) The basic trust information is—*
>
> *(a) the fact that a person is a beneficiary of the trust; and*
>
> *(b) the name and contact details of the trustee; and*
>
> *(c) the occurrence of, and details of, each appointment, removal, and retirement of a trustee as it occurs; and*
>
> *(d) the right of the beneficiary to request a copy of the terms of the trust or trust information.*
>
> *(4) A trustee is required to consider at reasonable intervals whether the trustee should be making the basic trust information available under this section.*

33. However, the Bill is not in keeping with the New Zealand Law Commission's suggested approach. The Law Commission's recommendations reflected the law as set out in the Privy

Council decision in *Schmidt v Rosewood Trust Limited*.[5] In that case, the Privy Council recognised that modern discretionary trusts can and often do have a wide class of beneficiaries and that disclosure to all of them will often not be appropriate. The Law Commission's view was that there should be a presumption of disclosure of basic trust information but only to beneficiaries who have a real prospect of receiving a distribution.[6] This would result in the pragmatic outcome that beneficiaries such as children of a settlor would receive the basic trust information but wider family members would normally not. In the Law Society's opinion, this is a balanced outcome which meets the aim of ensuring that trustees are held accountable. This approach was followed in the Exposure Draft Trusts Bill (clauses 41 and 43) using the concept of "*qualifying beneficiary*" with a two-step test:

a. First, the trustee was required to identify "*qualifying beneficiaries*", being those with real prospects of receiving a distribution from the trust.

b. The presumption of disclosure then applied to those qualifying beneficiaries. The trustees then had to decide whether there was a good reason not to disclose basic trust information to the qualifying beneficiaries.

34. This two-step test is sensible: it focuses on the trustees providing information to beneficiaries who have a real interest in receiving the information and on holding the trustees to account.

35. In the Bill, there is a presumption that the trustee "*must make available to every beneficiary or representative of a beneficiary the basic trust information*", and the concept of "*qualifying beneficiary*" has been removed. Instead there are numerous factors set out in clause 49 that the trustee must consider in deciding if the presumption applies:

> ***49*** ***Procedure for deciding whether presumption applies***
>
> *The factors that the trustee must consider (for the purposes of sections 47(2)(a) and 48(2)(a)) are the following:*
>
> *(a)* *the nature of the interests in the trust held by the beneficiary and the other beneficiaries of the trust, including the degree and extent of the beneficiary's interest in the trust and the likelihood of the beneficiary receiving trust property in the future:*
>
> *(b)* *whether the information is subject to personal or commercial confidentiality:*
>
> *(c)* *the expectations and intentions of the settlor at the time of the creation of the trust (if known) as to whether the beneficiaries as a whole and the beneficiary in particular would be given information:*
>
> *(d)* *the age and circumstances of the beneficiary:*
>
> *(e)* *the age and circumstances of the other beneficiaries of the trust:*
>
> *(f)* *the effect on the beneficiary of giving the information:*

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5 *Schmidt v Rosewood Trust Limited* [2003] 2 AC 709.

6 Law Commission, *Review of the Law of Trusts: Preferred Approach*, Issues Paper 31, Chapter 3 http://ip31.publications.lawcom.govt.nz/Chapter+3+-+Trustees+duties/Duty+to+inform

(g) the effect on the trustees, other beneficiaries of the trust, and third parties of giving the information:

(h) in the case of a family trust, the effect of giving the information on—

(i) relationships within the family:

(ii) the relationship between the trustees and some or all of the beneficiaries to the detriment of the beneficiaries as a whole:

(i) in a trust that has a large number of beneficiaries or unascertainable beneficiaries, the practicality of giving information to all beneficiaries or all members of a class of beneficiaries:

(j) the practicality of imposing restrictions and other safeguards on the use of the information (for example, by way of an undertaking, or restricting who may inspect the documents):

(k) the practicality of giving some or all of the information to the beneficiary in redacted form:

(l) if a beneficiary has requested information, the nature and context of the request:

(m) any other factor that the trustee reasonably considers is relevant to determining whether the presumption applies.

36. This approach in the Bill will result in trustees having to consider whether to provide *all* beneficiaries with information. The fact that a beneficiary is unlikely to receive trust property in the future is merely one of the eleven factors set out in clause 49 that the trustee must take into account. This is a complex approach and, in the Law Society's view, is unnecessary to achieving the objective of holding trustees to account.

37. The current provisions are likely to result in trustees disclosing information to all beneficiaries simply to avoid breaching the clause 47 duty (that the trustee must notify basic trust information). This may cause difficulties for family relations as more remote beneficiaries will be provided with information about a trust even though, in reality, they are unlikely to benefit from the trust. The information disclosure process may be impractical and costly for trusts with modest or very modest means.

38. The Law Society **recommends** that the Bill should reinstate the following provisions from the Exposure Draft Trusts Bill, so that there is a presumption of disclosure of basic trust information but only to beneficiaries who have a real prospect of receiving a distribution:

    a. the definition of "*qualifying beneficiary*"– "*a beneficiary who has a reasonable likelihood of receiving trust property under the terms of the trust*"; and

    b. the two-step test set out in the Exposure Draft Trusts Bill, with the factors currently set out in clause 49 of the Bill being taken into account in deciding whether there is a good basis for non-disclosure under step 2.

39. Clause 50 deals with situations where a trustee cannot find any beneficiaries to disclose information to or decides to make no disclosure to any beneficiaries. It is an onerous

provision. The mandatory requirement to apply to the court for directions will be difficult for the following reasons:

a. It sets a standard for disclosure which is too high – clause 50(4)(a) states that "*trust information may be withheld from all beneficiaries only in exceptional circumstances*". There are many reasons information might be withheld. For instance, in the Supreme Court case of *Erceg* the trustees decided not to disclose the information as it would have had unhelpful family implications. The requirement to apply to the court in many of these circumstances will be unnecessary to protect beneficiaries, and difficult and costly.

b. Clause 50 does not cover the situation where a beneficiary is generally aware of the trust but does not wish to receive any trust information or particular trust information.

40. The Law Society **recommends** that clause 50 be redrafted in the following way:

a. The Bill should contain a general right (not a mandatory requirement) for trustees or beneficiaries to seek directions from the court regarding disclosure of information. (The way clause 50 is currently drafted may result in trustees being led to believe that they can <u>*only*</u> apply for directions in the circumstances described by clause 50. This is incorrect.)

b. The Law Society agrees that there is a need for protection where no beneficiaries have been identified, or where the trustee decides to withhold all of the basic trust information from all beneficiaries, to ensure that trustees are held to account. However, the obligation to apply to the court for directions after 12 months is too onerous. Clause 50 should be amended so that an application for directions is only required where the circumstances set out in clause 50(1)(a) and (b)[7] have:

i. applied for 12 months; and

ii. it is reasonably foreseeable that this state of affairs will continue for a further specified period (such as 3 years).

c. Clause 50 does not currently deal with the situation where the trustee considers that some (but not all) information should be provided. This is a gap which should be remedied in the drafting of the general right to apply for directions referred to in paragraph 40a above.

41. The Law Society submits that the amendments set out above would satisfy the consumer protection purpose of clause 50, while removing unduly onerous requirements.

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[7] In the circumstances of clause 50(1)(c) (where a request for trust information is refused), a mandatory requirement to apply to the court for directions is not necessary to hold the trustee to account as the beneficiary obviously knows of the existence of the trust. The beneficiary can then apply to the court for directions as set out above.

Review of trustee's decisions (Part 7)

42. The default position is often that a trustee will not be obliged, under general trust law, to give reasons for the trustee's decisions when exercising powers or discretions. This causes significant problems for a beneficiary wishing to hold a trustee to account. The beneficiary will need to produce evidence about the trustee's reasons to show the trustee has not exercised the power or discretion lawfully. However, the beneficiary is not entitled to disclosure of those reasons unless the beneficiary can show that the trustee has not exercised the power or discretion lawfully. Therefore, the beneficiary is left with a circular problem and a trustee who has acted wrongly may use this as a shield. Clauses 118 and 119 of the Bill are aimed at dealing with this problem.[8]

> ***118 Court may review trustee's act, omission, or decision***
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> *(1) The court may review the act, omission, or decision (including a proposed act, omission, or decision) of a trustee on the ground that the act, omission, or decision was not or is not reasonably open to the trustee in the circumstances.*
>
> *(2) The court may undertake a review on the application only of a beneficiary.*
>
> *(3) The review must be conducted in accordance with section 119.*
>
> *(4) This section and section 119 do not limit or affect—*
>
> *(a) the court's jurisdiction to supervise trusts, including its jurisdiction under the Charitable Trusts Act 1957; or*
>
> *(b) the Attorney-General's powers and duties with respect to charitable trusts, including powers and duties under the Charitable Trusts Act 1957.*
>
> ***119 Procedure for court's review of trustee's act, omission, or decision***
>
> *(1) An applicant for a review under section 118 must produce evidence that raises a genuine and substantial dispute as to whether the act, omission, or decision in question was or is reasonably open to the trustee in the circumstances.*
>
> *(2) If the court is satisfied that the applicant has established a genuine and substantial dispute, the onus is on the trustee to establish that the act, omission, or decision was or is reasonably open to the trustee in the circumstances.*
>
> *(3) If the court, after hearing the trustee, is satisfied on the balance of probabilities that the act, omission, or decision was not or is not reasonably open to the trustee in the circumstances, the court may (but subject to subsection (4))—*
>
> *(a) set aside the act or decision, or direct the trustee to act in the case of an omission:*

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[8] Along with clauses 41 - 50 (trustee obligation to keep and give trust information).

(b) restrain the trustee from acting or deciding in the case of a proposed act or decision, and direct the trustee to act in the case of a proposed omission:

(c) make any other orders that the court considers necessary.

(4) The court must not make an order that affects—

(a) a valid distribution of the trust property that was made before the trustee had notice of the application; or

(b) any right or title acquired by a person in good faith and for value.

43. The provisions contemplate a two-stage process. First, the beneficiary must produce sufficient evidence to the court to show that there is a "*genuine and substantial*" dispute about whether a trustee decision was (or is) "*reasonably open*" to the trustee. The use of the words "*reasonably open*" is aimed at ensuring the existing law around the legal validity of the exercise of a trustee power or discretion is taken into account. So, for example, if the beneficiary can show evidence raising a genuine and substantial dispute about whether a trustee decision is ultra vires then the beneficiary will meet the first limb of the test.

44. Second, if the beneficiary can establish that there is a genuine and substantial dispute about whether a trustee decision was (or is) "*reasonably open*" to the trustee, the onus then passes to the trustee to show the trustee's decision was (or will be) proper. In doing so, the trustee will need to disclose its grounds and reasons for the decision. If the trustee does not show this, then the court may make appropriate orders.

45. It is very important when considering these provisions to draw the distinction between (1) requiring the trustee to show its decision is proper (and therefore disclosure); and (2) intervention.

46. Merely because the court can require the trustee to show its decision is proper does not mean the court should intervene. The court should only intervene where it is shown the trustee has exercised a power unlawfully.

47. The provisions in the Bill which deal with this process require amendment. Clause 119(1) correctly deals with the first step procedure in this regard. It requires that there be a "*genuine and substantial*" dispute about whether a trustee decision was (or is) "*reasonably open*". However, clause 119(2) and (3) then use the "*reasonably open*" or "*not reasonably open*" test to determine whether a trustee's decision is proper. Whether a decision is (or was) reasonably open or not is not the correct test. It is whether it was lawful or not. A decision may be "*reasonably open*" to a trustee but the trustee may still make an error when making it – resulting in the decision being unlawful. The Law Society **recommends** that the provisions should not specify the grounds on which the courts may interfere with a trustee's decision, other than saying the trustee's decision must be unlawful.[9]

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[9] The lawfulness of trustee decisions is a complex area and many of the grounds for intervention overlap. Attempting to specify grounds for intervention in the legislation is too complex and there is potential for unexpected outcomes. The grounds for intervention should be left for the courts to continue to develop.

Schedule 3

48. Schedule 3 provides that certain provisions of the Bill may be modified or excluded if a trust is a "*specified commercial trust*". The provisions which can be modified or excluded are:

    a. clauses 41 – 51, which are the provisions on retaining documents and disclosure of information to trustees;

    b. clauses 63 – 72, exercise of trustee powers and functions by others;

    c. clauses 77 – 79, trustees' indemnities; and

    d. clauses 113 – 115, termination and variation of trusts.

49. This permits a significant carve-out of the duties, safeguards and requirements under the Bill. The key issue is that the way in which the definitions in Schedule 3 are currently drafted may result in a number of mixed purpose trusts exploiting a loop-hole and avoiding obligations under the Bill.

50. The definition of "*specified commercial trust*" in Schedule 3 is:

> *"(a) an express trust*
>
> *(i) that is created for the purpose of facilitating 1 or more commercial transactions; and*
>
> *(ii) every beneficiary of which is a beneficiary as a result of entering into the commercial transaction that the trust is created to facilitate, or as a result of entering into a commercial transaction of the type that the trust is created to facilitate;*
>
> *(b) a wholesale trust; or*
>
> *(c) a security trust."*

51. "*Commercial transaction*" is defined as "*a transaction that all parties enter into in trade*".

52. There are a large number of mixed purpose trusts which would fall within limb (a) of the definition of specified commercial trust. For instance, many ordinary trusts will undertake a mix of private and commercial activities. In that situation, the trust could potentially be a trust "*created for the purpose of facilitating 1 or more commercial transactions*". Therefore, there is a need to ensure that only trusts which truly are commercial are captured in the definition of "*specified commercial trust*".

53. The Law Society **recommends** the following amendments to the definition of "*specified commercial trust*":

> *"(a) an express trust*
>
> *(iii) that is <u>solely</u> created for the purpose of <u>undertaking</u> ~~facilitating~~ 1 or more commercial transactions; and*

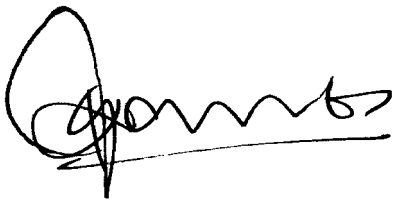
(iv) *every beneficiary <u>of the trust is only</u> ~~which is~~ a beneficiary <u>because the beneficiary acquired an interest in the trust by providing valuable consideration to the trustee or any other person</u>; ~~as a result of entering into the commercial transaction that the trust is created to facilitate, or as a result of entering into a commercial transaction of the type that the trust is created to facilitate~~;*

(b) a wholesale trust; or

(c) a security trust."

54. The Law Society **recommends** the definition of commercial transaction be amended as follows: "*a transaction that <u>the trustee of the trust</u> ~~all parties~~ enter<u>s</u> into in trade*". This change is suggested, to reflect the fact that a beneficiary will not be a party to a transaction – it will be the trustee. The Law Society also does not consider that it matters whether the counter-party is in trade – only whether <u>*the trust/trustee*</u> is entering into the transaction in trade.

55. Many commercial trusts will involve dealing in real property or interests in land. However, that is not currently contemplated in the definition of "*goods*" in Schedule 3. There is no reference to real property or any other interests in land in that definition. In contrast, the definition of "*trade*" contemplates a "*disposition or acquisition of any interest in land*". The Law Society **recommends** that real property and other interests in land be included in the definition of "goods". The select committee could consider using the definition of "*goods*" and "*services*" in the GST Act as a comprehensive definition.



Tim Jones
Vice President

6 March 2018

Appendix: Summary of recommendations

TRUSTS BILL – APPENDIX: Summary of New Zealand Law Society recommendations				
No	**Issue**	**Clause**	**Comment**	**Recommended drafting changes**
1	Application, and relationship of Act with trust terms, common law and equity, and other enactments	5(5)b)	See **paragraphs 10 – 13** above of main submission.	Clause 5(5)(b) should be amended to read: This Act— (a) is not an exhaustive code of the law relating to express trusts; and (b) is intended to be complemented by the rules of the common law and equity relating to trusts <u>except where expressly modified by the Act</u> ~~(except where otherwise indicated or where those rules are inconsistent with the provisions of this Act)~~.
2	Inconsistency with other enactments	5(6)	See **paragraph 14** above. Many Acts rely on trust concepts such as the definition of "*trust*" in the current Trustee Act 1956 (e.g. the Income Tax Act). The Law Society submits that in relation to trust matters, the Trusts Bill should have primacy unless other legislation expressly states that the provisions of the Bill should not apply	
3	Overview of the Act	6(3)	Clause 6(3) of the Bill also refers to express trusts: "*An express trust is one that is deliberately set up by a settlor, as opposed to a trust that arises by operation of*	Clause 6(3) should be amended to read: An express trust is one that is <u>intentionally established</u> ~~deliberately set up~~ by a settlor, as

TRUSTS BILL – APPENDIX: Summary of New Zealand Law Society recommendations				
No	**Issue**	**Clause**	**Comment**	**Recommended drafting changes**
			law or the order of a court." The Law Society submits that the wording should be changed to remove the reference to "*deliberate*" which is not a term generally used in relation to the settlement of trusts (intention is the proper term).	opposed to a trust that arises by operation of law or the order of a court.
4	Interpretation	7(1)(c)	See **paragraph 13** above of the main submission.	Clause 7 should be amended to read: **7 Interpretation of Act** (1) This Act— (a) must be interpreted in a way that promotes its purpose and principles; and ~~(b) is not subject to any rule that statutes in derogation of the common law should be strictly construed; but~~ (c) <u>subject to sub-paragraph (a), is intended to</u> ~~may~~ be interpreted having regard to the common law and equity, ~~but only to the extent that the common law and equity are consistent with—~~ ~~(i) its provisions; and~~ ~~(ii) the promotion of its purpose and principles~~.

TRUSTS BILL – APPENDIX: Summary of New Zealand Law Society recommendations				
No	**Issue**	**Clause**	**Comment**	**Recommended drafting changes**
5	Definition – "trustee"	9	The current definition of "trustee" is focused on appointment. That definition does not capture a trustee de son tort and a constructive trustee. These types of trustees are potentially within the scope of the Bill via clause 5(2)(b)) however they are not "appointed". If a person is not classified as a trustee, they are outside the scope of provisions such as clause 123. (See **paragraph 15**).	The definition in clause 5 should be amended to read: Trustee means a person who is ~~appointed as~~ trustee of a trust.
6	Meaning of an express trust	12-14	The Law Society submits that a definition of express trust should not be included. See above at **paragraph 16**.	
7	Express trust	13	The references to "*dealing with property*" should be removed. See commentary at **paragraph 17** above.	
8	Duration of a trust	16	The existing rules around the maximum duration of a trust are (1) the rule against remoteness of vesting (also known as the rule against perpetuities); (2) the rule against accumulations, and (3) the restrictions on alienation. Under clause 16 of the Trusts Bill the maximum duration of a trust is set at 125 years. The clause excludes from this rule charitable trusts, a trust under a retirement scheme, employee superannuation schemes, and a share purchase scheme. Those trusts	

TRUSTS BILL – APPENDIX: Summary of New Zealand Law Society recommendations				
No	**Issue**	**Clause**	**Comment**	**Recommended drafting changes**
			continue indefinitely. The difficulty with this approach is that there are potentially other trusts of long duration that would have complied with the current rules on maximum duration (rules (1) to (3) above) that are now subject to the strict 125 year rule. A simple example is a fixed trust between companies. There may be some trusts currently in existence which have a longer term than 125 years. While this situation might be rare, the Bill should provide that a court has the power to grant a longer term than 125 years.	
9	Expiry of a trust	18	It is submitted that a definition of the "*expiry of a trust*" should be included. The Law Society is happy to assist in drafting such a clause.	
10	Trustee duties	Part 3: clauses 23, 25, 26	There is a complex interplay between a trustee's various duties and, in some cases, a potentially serious clash – see above at **paragraphs 18 – 26**.	The Law Society recommends that the following language be reinserted from the Exposure Draft Trusts Bill: Clause 14(2): "*The mandatory duty in section 25 (to hold or deal with trust property and otherwise act, for the benefit of the beneficiaries or for the permitted purpose) must be interpreted in the context of the terms of the trust and the purpose of the trust*." The Law Society also recommends that clause 15(3) of the Exposure Draft Trusts Bill be reinserted. That clause clarified that

TRUSTS BILL – APPENDIX: Summary of New Zealand Law Society recommendations				
No	**Issue**	**Clause**	**Comment**	**Recommended drafting changes**
				modification of certain default duties is not inconsistent with the mandatory duties. This was helpful for the avoidance of doubt. However, as originally drafted, clause 15(3) only referred to some duties – the duty to invest prudently, duty not to profit and the duty to act for no reward. If this clause is reinserted, there are a number of other default duties which can be modified and should be included in this list. The Bill uses the terms "*proper purpose*" (clause 26) and "*permitted purpose*" (clause 25) in a way which appears to be interchangeable. If this is the case, the Law Society recommends that one single term should be utilised.
11	Proper purpose	26	This clause should be expressed in the negative as equity acts in the negative.	Clause 26 should be amended so as to read: A trustee must <u>not</u> exercise the trustee's powers <u>as trustee</u> for an <u>improper</u> purpose.
12	General duty of care of trustees	27	This clause sets out the general duty of care for trustees. However, it states that the duty does not apply when exercising a discretion to distribute trust property. It is not clear why this activity is excluded.	
13	Distribution of trust property	31	See the main submission above at **paragraph 27**.	Clause 31 should be amended so as to read: A trustee must not bind or commit trustees to a future exercise or non-exercise of a discretion ~~relating to the distribution of trust property~~.

TRUSTS BILL – APPENDIX: Summary of New Zealand Law Society recommendations				
No	**Issue**	**Clause**	**Comment**	**Recommended drafting changes**
14	Paid advisers & disclosure	40	Clause 40 requires advisers (such as lawyers) who advise on the terms of a trust or draft the terms, to take reasonable steps to ensure the settlor is aware of an exclusion clause[10] or indemnity clause's effect and meaning. The provisions encompass an adviser who acts for a settlor.[11] Failure to comply does not invalidate the clause. However, where the adviser fails to comply with the provision and also happens to be a trustee, the adviser cannot obtain the benefit of the exclusion or indemnity clause. There is no way to fix that by a later disclosure as the clause requires the adviser to take the reasonable steps to ensure the settlor is aware of the exclusion clause or the effect of the indemnity *before the trust is created*. This may prove awkward as it may require the trustee/adviser to resign – even where non-disclosure was an understandable slip. The Law Society recommends that the Bill include a mechanism such as court approval to correct an error by an adviser who is also a trustee provided the settlor and all	

10 This presumably means or includes an 'exemption clause' – the language is different to clause 37. This language needs to be made consistent.

11 The clause is different to the equivalent provision in the Exposure Draft Trusts Bill. Clause 36 of the Exposure Draft Trusts Bill appeared wide enough to include advisers of others, such as advisers to trustees as well.

TRUSTS BILL – APPENDIX: Summary of New Zealand Law Society recommendations				
No	**Issue**	**Clause**	**Comment**	**Recommended drafting changes**
			beneficiaries agree. It is also unclear if this obligation applies to subsequent settlors who settle property sometime after the trust has been created.	
15	Documents to be kept by trustees	41-43	Clauses 41 to 43 require trustees to take reasonable steps to keep trust documents for the duration of their trusteeship. The clauses ought to be amended to clearly allow trustees to rely on others, such as accountants, lawyers, and trust administrators, to "*keep*" trust documents for the trustees.	
16	Representative definition	45	Currently, a trust can be set up where the beneficiaries are not aware of the existence of a trust provided there is a valid mechanism to ensure that trustees will be held accountable. Typically that would involve an accountancy firm undertaking that exercise. The definition of "representative" should be amended to include other types of representative, such as an accounting firm.	
17	**Disclosure of information to beneficiaries**	**Part 3: clauses 45-51**	Trust information is the most contentious part of the Bill. The current Bill is impractical and ought to be amended – see **paragraphs 28 – 41 (esp. paragraph 38)** above.	The Law Society recommends that: a. the definition of "*qualifying beneficiary*" as set out in the Exposure Draft Trusts Bill be reinserted – "*a beneficiary who has a reasonable likelihood of receiving trust property under*

TRUSTS BILL – APPENDIX: Summary of New Zealand Law Society recommendations				
No	**Issue**	**Clause**	**Comment**	**Recommended drafting changes**
				the terms of the trust"; and b. the two-step test set out in the Exposure Draft Trusts Bill be reinstated, with the factors currently set out in clause 49 being taken into account in deciding whether there is a good basis for non-disclosure under step 2.
18	As above	49	Clause 49(c) should be amended so that it includes not just a settlor's intention at the time of the creation of the trust but later expressions of intent which may change with time.	Clause 49(c) should be amended to read: the expectations and intentions of the settlor ~~at the time of the creation of the trust~~ (if known) as to whether the beneficiaries as a whole and the beneficiary in particular would be given information:
19	As above	50	It is onerous to require a mandatory court application under proposed clause 50 if no information is to be given or if no beneficiary can be identified. The Law Society submits that in order to avoid unnecessary applications to the court, there should be a time frame of 3 years. See full submission above at **paragraph 40**.	Clause 50 should be redrafted in the following way: a. The Bill should contain a general right (not a mandatory requirement) for trustees or beneficiaries to seek directions from the court regarding disclosure of information. The Law Society notes that the way clause 50 is currently drafted may result in trustees being led to believe that they can <u>*only*</u> apply for directions in the circumstances described by clause 50. This is incorrect. b. The Law Society agrees that there is a need for protection where no beneficiaries have been identified, or where the trustee decides to withhold all of the basic trust information from all beneficiaries, to ensure that trustees are held to

TRUSTS BILL – APPENDIX: Summary of New Zealand Law Society recommendations				
No	**Issue**	**Clause**	**Comment**	**Recommended drafting changes**
				account. However, the obligation to apply to the court for directions after 12 months will be onerous. Clause 50 should be amended so that an application for directions is only required where the circumstances set out in clause 50(1)(a) and (b)[12] have: i. applied for 12 months; and ii. it is reasonably foreseeable that this state of affairs will continue for a further specified period (such as 3 years).
20	As above	45-51	It is reasonably common for trusts to stipulate certain beneficiaries are not to receive any trust information until certain conditions are satisfied. Clause 49 should require the trustee to consider the express terms of the trust (which is potentially different from the expectation or intention of a settlor set out in clause 49 (c)).	
21	Powers of maintenance &	58-62	Clause 58(6) cannot be modified or excluded. This will mean that any prior interests must prevail and the trustee cannot exercise the power under clause 58 to	

[12] In the circumstances of clause 50(1)(c) (where a request for trust information is refused), a mandatory requirement to apply to the court for directions is not necessary to hold the trustee to account as the beneficiary obviously knows of the existence of the trust. The beneficiary can then apply to the court for directions as set out above.

TRUSTS BILL – APPENDIX: Summary of New Zealand Law Society recommendations				
No	**Issue**	**Clause**	**Comment**	**Recommended drafting changes**
	advancement		deal with another beneficiary's prior interest to the income. The key issues with this are: i. It is unclear why the beneficiary of the prior interest should not be able to consent to the power being exercised. ii. It is unclear whether another beneficiary's interest as an object under a power of appointment or interest as an object under a discretionary trust would count as a sufficient prior "*interest*" under clause 58(6) preventing a trustee using cl 58 to benefit a child. Previous case law suggests that that that type of interest would not be sufficient. This point should be clarified. It is also submitted that the order of clause 58(1) and (2) should be reversed so that sub-clause (2) becomes sub-clause (1).	
22		58 and 60	Both clauses deal with the trustee's power to pay for a child beneficiary's welfare – one dealing with income (clause 58) and the other dealing with capital (clause 60). However, the language used is different. The Law Society submits that these provisions should use consistent language.	

23	Appointment of agents, managers, custodians, and attorneys	63-69	Clause 63 is too restrictive: Clause 63(2)(a) makes it unclear whether a trustee can use a manager for advice. It states *"…a trustee may not …appoint a person to perform … on behalf of the trustee …a function that is, or is related to, the determination of whether, when, or in what way any trust property should be distributed…".* The functions of managers of some investment trusts may be captured by these words and may be wide enough to catch situations where the trustee is still making the decision – albeit based on the manager's advice. The Law Society recommends including a clause which states that a trustee may receive advice from others provided that the trustee exercises his or her own judgement in making the decision to follow or not follow that advice. Clause 63(4) places restrictions on who can be an "*eligible person*" and therefore able to hold title to trust property for the trustee as a nominee/custodian. The provisions allowing appointment of a nominee or custodian cannot be modified other than excluding them entirely (in which case the trustee would then need to hold the trust property personally).	
24	Indemnification of trustees	78	See **paragraphs 19 – 21** of the submission.	

25	Appointment and discharge of trustees	Part 5: cl 88	Clause 88 requires a person holding a power to remove or appoint trustees to exercise the power honestly and in good faith and for a proper purpose. Currently it is possible for this kind of power to be fiduciary or non-fiduciary in nature. Clause 88 seems to mean that neither of those standards will apply – instead the clause 88 standard will apply – regardless of whether the power holder is a trustee or not. Clause 88 cannot be modified or excluded by the terms of the trust instrument. It is not clear why a settlor should not be able to specify a higher (fiduciary) duty or a lower duty (personal power) to suit the circumstances.	
26	Divesting & vesting of trust property	108	Clauses 108 to 111 set out simplified processes for the transfer of trust property from outgoing trustees to replacement and continuing trustees. However, clause 108 states that a trustee is divested of trust property automatically on a change of trustees as soon as a document of removal is signed. The trustee may not be a party to that document, which may cause problems where an outgoing trustee wishes to protect himself or herself by providing for trust property to be retained to cover trust liabilities.[13] Currently, this clause in the Bill cannot be modified. This provision should be changed so that clause 108 can be modified to permit a trustee to retain trust property to cover trust liabilities.	

[13] *Meritus Trust Company Limited v Butterfield Trust* [207] SC (Bda) 82 Civ (13 October 2017).

27	Review of trustee decisions	118-119	Clause 119(2) and (3) should not use the "*reasonably open*" or "*not reasonably open*" test to determine whether a trustee's decision is proper or not. Whether a decision is (or was) reasonably open or not is not the correct test. The test is whether the decision was lawful or not. A decision may be "*reasonably open*" to a trustee but the trustee may still make an error when making it – resulting in the decision being unlawful. The provisions should not actually specify the grounds on which the court may interfere with a trustee's decision other than saying the trustee's decision must be unlawful. See full submissions above at **paragraphs 42 – 46**.	
28	Schedule 3		See above at **paragraphs 47 – 55**.	"specified commercial trust": *"(a) an express trust* *(i) that is solely created for the purpose of undertaking ~~facilitating~~ 1 or more commercial transactions; and* *(ii) every beneficiary of the trust is only ~~which is~~ a beneficiary because the beneficiary acquired an interest in the trust by providing valuable consideration to the trustee or any other person. ~~as a result of entering into the commercial transaction that the trust is created to facilitate, or as a result of entering into a commercial transaction of the type that the trust~~*

				~~*is created to facilitate*~~*;* *(b) a wholesale trust; or* *(c) a security trust."* "commercial transaction" definition: *a transaction that <u>the trustee of the trust</u> ~~all parties~~ enter<u>s</u> into in trade*". Definition of "goods" and "services" – should consider using the definition from the GST Act as a comprehensive definition.
	General drafting notes		The Bill refers to "*beneficiaries*" quite frequently when there may be only one beneficiary. See for example clause 6(6).	