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Clayton v Clayton — Illusory trusts, 16 March 2015

The recent Court of Appeal decision, 26 February 2015, of Clayton v Clayton *(2015) 4 NZTR ¶25-001*; [2015] NZCA 30, covered a number of important, topical trust issues. Although the case involved a relationship property claim and a number of trusts, this Bulletin focuses on the principal trust involved, the Vaughan Road Property Trust (the VRPT), the terms of that trust and how the power to appoint and remove beneficiaries held by the former husband (and ultimately the assets of the trust) came to be regarded as relationship property to which the former wife was held entitled to one-half.

In regard to the VRPT, Mr Clayton was settlor, trustee and one of a number of discretionary beneficiaries. Mr Clayton as trustee and also in his personal capacity, held extensive powers in regard to the trust property including the ability to make himself the sole beneficiary and appoint the trust property to himself. One of the issues for the Court was whether the property of that trust (the trust being validly established), or the general power of appointment (to appoint and remove the trust beneficiaries) were relationship property within the Property (Relationships) Act 1976 (the PRA).

Other issues in regard to the Vaughan Road Property Trust were also considered by the Court of Appeal, including whether:

- a valid trust had in this case been established
- could a valid trust still be illusory
- did wide trustee discretionary powers, and self dealing provisions in trust deed negate the "irreducible core of obligations"
- had the settlor retained powers that were tantamount to ownership of the trust property, or whether by having a high degree of control the trust became a sham, and
- were there any constraints on the trustee in the exercise of these wide powers?

The case also considered; dispositions by the former husband to a number of other trusts and whether those dispositions came within ss 44 and 44C of the PRA and the valuation of business assets in New Zealand and USA. The appeal followed proceedings in the Family Court, an appeal to the High Court and now this appeal.

Background

Mr Clayton had established a substantial timber milling business and also took over an existing business established by his father. Mrs and Mr Clayton had married in 1989. They have two children. They separated in 2006 and the marriage was dissolved in 2009. A number of trusts were established during the marriage or after separation, to hold assets acquired by Mr Clayton. Mrs Clayton claimed one-half of the estimated property pool (most of which was held in trust) being relationship property and valued for her at the time of the Family Court hearing at $28,831,000. Valuers for Mr Clayton valued the assets (on the agreed basis of EBITDA) at considerably less.

The Vaughan Rd Property Trust

The VRPT was declared by Mr Clayton in 1999, for discretionary beneficiaries including himself, Mrs Clayton and their children. The children were also default final beneficiaries. Mr Clayton was the sole trustee. Principal clauses of interest in the trust deed were:

- Clauses 4 and 6 which permitted the trustees to distribute income and capital before the vesting day.
- Clause 11 of the trust deed which provided that the trustees' discretion was unfettered and that the trustees need not act impartially towards beneficiaries "even though the interests of all Beneficiaries are not considered by the Trustees".
- Clause 14 permitted a trustee who was a beneficiary to exercise any power or discretion in his favour and cl 19 permitted a trustee to act notwithstanding a conflict of interest.
- Clause 23 permitted the trustees with the consent of Mr Clayton to "vary, revoke or enlarge" the provisions of the trust deed.

Under the trust deed, the "Principal Family Member" (Mr Clayton) was empowered to appoint and remove beneficiaries and trustees, cls 7 and 17. For the Court of Appeal, the critical clause was cl 7, the power to remove beneficiaries, which could be exercised by Mr Clayton so that he remained the sole beneficiary. In the event of the exercise of that power in his favour, the trust at that point would have ceased to exist (CA [47]).

The Family Court and High Court accepted that there was a genuine intention to establish the VRPT "for legitimate business purposes" (CA [50]), which was for the purpose of separating the land and buildings from the operating assets of Mr Clayton's business and was a valid trust. The Court of Appeal agreed.

Family Court

Both the Family Court and the High Court held that property acquired by Mr Clayton since the marriage was separate property, but under s 9A of the PRA, post-marriage increases in value were relationship property and to be shared equally with Mrs Clayton. The High Court also upheld the Family Court determination as to the value of Mr Clayton's business interests.

In regard to the VRPT the Family Court, while holding that Mr Clayton intended to establish a trust, noted Mr Clayton's role as settlor, sole trustee, discretionary beneficiary with power to revoke the trust and to appoint and remove trustees and beneficiaries. The Family Court considered that he had total control over the trust without need to account to the beneficiaries. The Judge found cls 11 and 19.1(c) of the trust deed negated the "irreducible core of obligations" and the duty to perform the trusts honestly and in good faith (Armitage v Nurse [1998] Ch 241 (CA); [1997] 2 All ER 705 at 713) and so the basic elements of a trust were not met. The Judge also found the power of revocation in cl 23 (the power to vary or revoke trust provisions) to militate against the creation of a trust.

The trust was held to be illusory (MAC v MAC FC Rotorua FAM 2007-063-000652, 2 Dec 2011 at [85]) and the property of the trust for the purposes of the PRA proceedings was held to be the property of Mr Clayton, and that Mrs Clayton was entitled to share equally with him in the net equity of the assets of the trust.

High Court

Both the Family Court and the High Court found that the VRPT was not a sham. The High Court, applying Official Assignee v Wilson *(2008) 2 NZTR ¶18-005*; [2008] 3 NZLR 45 (CA) at [26], noted that a trust will be a sham where there is an intention to have an expressed trust in appearance only. There was nothing to suggest that the Vaughan Trust was a sham. Mr Clayton was held to have intended to create a trust for legitimate business purposes.

While the Family Court and the High Court were both to find the VRPT illusory, they were to do so on different basis. Whether a trust was illusory was to be determined in the light of the trust deed, Financial Markets Authority v Hotchin *(2012) 3 NZTR ¶22-003* at [30]. The High Court disagreed with the approach of the Family Court. It was considered that the trust provisions referred to by the Family Court did not erode the core obligations. Clause 11 allowed the trustee to act; without considering the interests of all beneficiaries and "the obligation to act impartially" towards beneficiaries. It was considered that this did not excuse the trustees from acting honestly and in good faith (the irreducible core). The Court held similarly in regard to cl 19 which allowed a trustee to act without being disqualified. It was considered that this provision did not relieve a trustee of the duty to perform the trusts honestly and in good faith (HC [81]–[82]), Tasarruf Mevduati Sigorta Fonu v Merrill Lynch Bank & Trust Company (Cayman) Limited [2011] UKPC 17; [2012] WLR 1721 (PC) (TMSF v Merrill Lynch). In regard to the power of revocation in cl 23, this was considered to be markedly different from the power of revocation in TMSF v Merrill Lynch being much more limited and being directed to the trust management provisions.

However, there were other provisions in the trust deed such that Mr Clayton retained powers tantamount to ownership of trust property. While the trust deeds in the Hotchin case at [40] contained a prohibition on self-dealing, cl 14.1 in the VRPT deed expressly permitted a trustee who was a beneficiary to exercise any power or discretion in his or her own favour. The VRPT gave Mr Clayton unfettered discretion to distribute income and capital of the trust to himself if he wished and to bring the trust to an end at any time. It was considered that Mr Clayton had retained and through his delegates exercised the powers of ownership. Within a largely conventional framework the deed provided the appearance of separation, but Mr Clayton was able to deal with trust property as if the trust had never been created. Mr Clayton had retained powers tantamount to ownership of the trust property. The VRPT was held to be illusory (HC [83]–[91]). The trust property was held to belong to Mr Clayton, to which Mrs Clayton was entitled to half. Mrs Clayton appealed in regard to dispositions to certain trusts that were not considered to come within ss 44 and 44C of the PRA. Mr Clayton (particularly in regard to the finding of illusory trust with the VRPT) and the trustees of the other trusts appealed and cross-appealed.

Court of Appeal, Clayton v Clayton decision — the Vaughan Rd Property Trust

Settlor, trustee and a beneficiary

The Court of Appeal considered that there was nothing untoward in Mr Clayton being the settlor, trustee and one of the discretionary beneficiaries of the VRPT. A person may be both settlor and trustee of a trust and both trustee and beneficiary, but not sole beneficiary as there would be no trust, Re Heberley [1971] NZLR 325 (CA). If Mr Clayton were to exercise his power of appointment under cl 7 and become sole beneficiary, there would be no trust (the legal and beneficial interests merge or "come home") (CA [46]–[48]).

It was held that the three trust certainties existed. Mr Clayton, as settlor, intended to create a trust for business purposes to separate the land and buildings from the business operation. (The Family Court and the High Court also made the same findings.) There was the initial $10 trust property, and the trust objects — the discretionary beneficiaries — were able to be ascertained.

Wide trustee powers

While the trust deed conferred wide powers on Mr Clayton in his capacity as sole trustee, it was held that this did not and could not eliminate the fiduciary obligations imposed on him at law enforceable by the other discretionary beneficiaries. It was considered that the requirement of the "irreducible core of obligations" to act honestly and in good faith, were present (Millett LJ in Armitage v Nurse at 253):

"there is an irreducible core of obligations owed by the trustees to the beneficiaries and enforceable by them which is fundamental to the concept of a trust".

It was considered that these core obligations were met and that the terms of the trust deed did not erode those core obligations.

Mr Clayton's powers to deal with the trust property, for his own benefit without regard to the interests of other beneficiaries, did not mean he owed no obligations to them or they had no rights enforceable against him as trustee. Discretionary beneficiaries have rights to ensure a trustee properly considers whether a discretion should be exercised in their favour and to compel proper administration of the trust (CA [53]–[54]). Therefore, the exercise by the trustee of his or her discretionary powers may well result in a beneficiary or beneficiaries benefiting, while others do not.

The Court of Appeal did not agree with the High Court, that Mr Clayton's powers as trustee of the VRPT meant he retained powers tantamount to ownership of trust property. Rather Mr Clayton "was obliged by general equitable principles to exercise his powers honestly and in good faith and to account for the trust property, such obligations being enforceable by the other beneficiaries" (CA [55]), to exercise those powers honestly and in good faith and to account for the trust property. Consequently, the VRPT met the legal requirements for a valid, discretionary trust (CA [55]–[56]).

Was the VRPT a sham?

Counsel for Mrs Clayton argued that the existence of the powers of control over the trust assets, conferred on Mr Clayton, meant the trust was a sham. This submission had also been raised and rejected by the High Court. Largely fatal to any finding of "sham" (or "illusory") was the finding by all three Courts that a valid trust had been established. Then there is also the fact that:

"An allegation of sham, being akin to an allegation of fraud, should not be lightly made", Ben Nevis Forestry Ventures Ltd v C of IR (2008) 23 NZTC 21,842; [2008] NZSC 115; [2009] 2 NZLR 289 at [33].
Consequently, there would need to have been strong evidence at trial to find an allegation of sham involving pretence and deceit established. In determining whether a transaction is a sham, the court will:

- focus on the actual intentions of the parties and compare them with the acts done, and
- it is not restricted by the legal form of the transaction, but will focus on the actions and words of the parties, contemporary and subsequent, (reflecting Equity's preference for substance over form).

Where the parties had no intention of creating a trust, there will be no trust. As settlor and trustee of the VRPT, the focus was on Mr Clayton and a subjectively assessed shamming intention was required, Official Assignee v Wilson *(2008) 2 NZTR ¶18-005*; [2008] 3 NZLR 45 (CA) at [50].

The conclusion was that once a valid trust has been established and is not a sham, it cannot be treated as non-existent just because the trustee has wide powers of control over the trust property. The Court of Appeal pointed out that control alone does not invalidate a trust [CA 80] and there is no halfway house between a valid trust and a sham, [although it should be noted a sham can emerge and may affect settlements from that point on].

An illusory trust?

The Family Court and High Court had held that the VRPT was "illusory" but for different reasons. The Family Court held the trust was "illusory" because Mr Clayton had total control without the need to account to the beneficiaries and could revoke the trust. The High Court noted Mr Clayton's power to distribute in his favour and bring the trust to an end at any time and considered that he was able to deal with the trust property as if "the trust had never been created" Clayton v Clayton *(2013) 3 NZTR ¶23-001*; [2013] 3 NZLR 236 (HC) at [90].

The Court of Appeal noted that neither Judge in the Family Court nor High Court referred to any authority that an otherwise genuine trust, that was not a sham, might be declared not to exist because its terms made it illusory.

Secondly, the finding of "illusory" was inconsistent with Mr Clayton's intention to create a valid trust. The trust did not erode Mr Clayton's core obligations as trustee, to act honestly and in good faith and the beneficiaries could enforce those core obligations. It was considered that the distinction between "sham" and "illusory" was not supportable, the terms were synonymous and legal definitions of the two terms overlapped. What the inquiry needed to focus on was not the legal form, but on the settlor's real or true intentions.

Consequently, there was no separate ground for setting aside a valid trust on the ground of "illusory". The Court noted there was no statutory power to do so, (including under the PRA). The Court of Appeal made the important statement: "trusts will normally prevail over relationship property rights" (CA [85]).
Crucial to whether a trust is a sham or not was the finding that Mr Clayton genuinely intended to create a trust when he established the Vaughan Road Property Trust, to separate and distance the underlying assets from the operating assets of his company.

Mr Clayton's general power of appointment

Under cl 7 of the trust deed Mr Clayton could appoint himself the sole beneficiary (entitled to income and capital). Importantly, this power was conferred on him not as trustee, but as the "Principal Family Member", ie a power exercisable personally, not in the holder's capacity as a trustee. Because this general power of appointment was held under the trust deed in Mr Clayton's capacity as "Principal Family Member", the Court of Appeal considered that he owed no fiduciary duties, which he most probably would have done if the power had to be exercised as a trustee of the trust.

Counsel for the trustees argued that the doctrine of fraud on a power would constrain Mr Clayton exercising the general power of appointment. The Court noted that there was little doubt, that one of Mr Clayton's purposes conferring this general power of appointment on himself, was to enable him to become the sole beneficiary of the trust if he wished. However, in terms of the power, it would not have been improper for Mr Clayton to exercise it in this way. No "deliberate defeating" of his own intention would have been involved. It would have been impossible for him to exceed his own mandate and for the Court to restrain him in that way, if he decided to do so (CA [91]–[92]), ie fraud on a power did not apply to restrain Mr Clayton in the exercise of that general power of appointment.

The Court also noted that:

"there is little doubt that one of Mr Clayton's purposes as donor in conferring the general power of appointment on himself as donee was to enable him to become the sole beneficiary of the trust if he wished" (CA [91]).

The effect of finding that one of Mr Clayton's purposes of granting himself (or retaining) the power to in effect appoint the trust property to himself, was the similarity with the power of revocation in TMSF v Merrill Lynch Bank — because the exercise of the power in each case would have the same result — the return of the trust property to the settlor — and both settlors would have had that intention in mind when granting the power to themselves when the trusts were established.

Was Mr Clayton's general power of appointment property?

Was Mr Clayton's right to exercise his general power of appointment, property? The Court concluded that a general power of appointment of this nature may give rise to property rights to the donee of the power and considered that TMSF v Merrill Lynch Bank should be followed in this case.

In TMSF v Merrill Lynch Bank the settlor, Mr Demirel, had established two trusts in the Cayman Islands with assets of over USD24,000,000. Mr Demirel was bankrupt and wanted in Turkey in association with the theft and embezzlement of approximately USD826,000,000 from Banks in Turkey by him, his family and associates. The discretionary beneficiaries of the two trusts were Mr Demirel, his wife and children. The trusts contained a power of revocation, which the settlor Mr Demirel, could exercise. The proceedings were brought by Mr Demirel's receivers and the issue was whether the power of revocation was itself a property right which Mr Demirel could be required to delegate to the receivers in bankruptcy and which they could exercise and hold the trust property for Mr Demirel's creditors. Older, traditional legal thinking was that a power was a personal right and was not property of the donee of the power, unless legislation provided otherwise, (as for example, formerly under s 8 of the Estate and Gift Duties Act 1968).

However, in TMSF, it was noted that even apart from express legislative intervention, general powers have been regarded as giving rise to property rights, referring to Clarkson v Clarkson [1994] BCC 921 (CA) and In re Triffitt's Settlement [1958] Ch 852 at 861, "where there is a completely general power in its widest sense, that is tantamount to ownership". In regard to the case before them, the Privy Council concluded:

"The powers of revocation are such that in equity, in the circumstances of a case such as this, Mr Demirel can be regarded as having rights tantamount to ownership. The interests of justice require that an order be made in order to make effective the judgment of the Cayman court recognising and enforcing the Turkish judgment. There is no invariable rule that a power is distinct from ownership." (PC [60]–[61])

And that:
"To take a distinction between a general power and a limitation in fee, is to grasp at a shadow while the substance escapes" (PC [41], [60]).

The Court of Appeal considered that the approach of the Privy Council in TMSF should be followed in the present case with the general power Mr Clayton held under cl 7 of the trust, being a property right for the purposes of the PRA:

- There was no good reason why the traditional distinction between a power and property, "should be preserved in all contexts and for all purposes" (CA [100]).
- Subject to the terms, nature and context of the power (and any relevant legislation), when the donee of the power is entitled to appoint the power's subject matter to himself, without regard to the interests of others, to regard the donee as the effective owner of that property (ie where the donee has an absolute disposing power this may be recognised as conferring a property right).
- There was no practical distinction between the power of revocation in TMSF and Mr Clayton's power to appoint himself a sole beneficiary of the Vaughan Road Property Trust, as legal and beneficial interests would have merged and there would be no trust, the trust being effectively revoked.

Power of appointment property being relationship property

Was Mr Clayton's right to exercise his general power of appointment, "relationship property" under the PRA when he and Mrs Clayton separated in 2006? "Property" under the PRA includes "any other right or interest". The Court of Appeal considered the power of appointment was within the definition of "property" as defined in s 2 of the Act because it was a "right" and creates an "interest". It was considered that general powers may give rise to property rights apart from legislation.

The value of the right would be the value of the property received if the power was exercised — the net value of the assets of the VRPT as at 31 March 2011 (being the date agreed to by the parties). Mrs Clayton was entitled to an equal share in the value of the trust property. Although the VRPT was accepted as a valid trust, Mr Clayton had failed to remove the value of the assets from the PRA by retaining the right to exercise the general power of appointment under cl 7. This did not invalidate the trust or mean that as trustee Mr Clayton did not hold the trust property for the beneficiaries. The trust was not a sham. Mr Clayton's general power of appointment to appoint and remove beneficiaries, was relationship property.

Claymark Trust

The Claymark Trust was settled by Mr Clayton in 1994. Mr and Mrs Clayton were discretionary beneficiaries and their children final beneficiaries. The trust purchased two properties adjoining the business sawmill in Katikati (to forestall any nuisance complaints from neighbouring lifestyle properties). The Claymark Trust had loans of over $1,416,000 from the VRPT. The Family Court and High Court accepted it was a bona fide business trust established for business purposes and there was no evidence of a disposition of relationship property to support a claim under s 44C of the PRA. The Family Court also declined to make orders under s 182 of the Family Proceedings Act 1980 (FPA). It held that at the time the trust was established in 1994 the parties were aware of the pre-nuptial agreement. Mrs Clayton's share was limited to a share of any debt owing by the trust to Mr Clayton. The High Court agreed.

In the Court of Appeal, Mrs Clayton's claim in regard to this trust was based on s 44C of the PRA and s 182 of the FPA.

Section 44C of the PRA

Like s 44, a successful claim under s 44C of the PRA requires a "disposition" of "relationship property" that has "the effect of defeating" the claim of one of the spouses. The dispositions were distributions from the VRPT and interest free loans from Mr Clayton. As the VRPT was a valid trust, the assets were not relationship property and so the dispositions from the VRPT were not relationship property. While the interest free loans by Mr Clayton to the Claymark Trust during the marriage were probably made from relationship property, they remained Mr Clayton's assets and divisible as relationship property. An order for compensation under s 44C was declined.

Section 182 of the FPA

In regard to the claim under s 182 of the FPA, the Court of appeal considered that the focus of that section was the expectation of the parties, especially the applicant at the time of settlement, Ward v Ward (2009) 2 NZTR ¶19-038; [2010] 2 NZLR 31. The Family Court and the High Court found the expectations of Mr and Mrs Clayton when the Claymark Trust was established, were that it was formed for business purposes and not a means by which Mrs Clayton would acquire an interest or expectation. Mr and Mrs Clayton did not have the necessary expectations and there was no basis for finding that the dissolution of the marriage affected Mrs Clayton's expectations. Mrs Clayton was not entitled to compensation under s 44C of the PRA for dispositions made to that trust, nor was she entitled to provision from the trust under s 182 of the FPA.

Other trusts and full disclosure

Other trusts established by Mr Clayton were formed either during the marriage or during separation. Generally, the trusts were funded in combination by dispositions from Mr Clayton, loans from VRPT or bank loans arranged through the VRPT. The Court also noted that there had been a lack of full and frank disclosure by Mr Clayton and the difficulties Mrs Clayton had encountered in obtaining the relevant information relating to the trusts and Mr Clayton's dispositions of relationship property to them. The Court concluded that in regard to the PRA there was merit in an approach that:

- parties to relationship property proceedings are under an obligation to make full and frank disclosure of all relevant information so the court can make the appropriate orders
- if a party fails to make relevant information available, the court may draw adverse inference that the information would not have assisted that party if it had been disclosed, and
- in drawing inferences for the purpose of making findings of fact, the court may rely on all the information disclosed, its experience in like cases and inherent probabilities from non-disclosure.

In regard to these trusts, the Court noted that a loan may constitute a disposition of property under s 44 of the PRA. The issue was whether the loans were made in order to defeat Mrs Clayton's rights under the PRA. The High Court approach, that it was for Mrs Clayton to establish where the personal advance from Mr Clayton came from, was not accepted.

With one of the trusts, the Court held that at the time Mr Clayton arranged the bank loan through the VRPT, he did not intend to defeat Mrs Clayton's rights under the PRA as he would not have regarded Mrs Clayton as having rights to claim against the VRPT as she was only a discretionary beneficiary with no legal or equitable interest or right in the property of the trust, which could be defeated by the advance to the second trust.

Therefore, while some of the loans to trusts did not come within s 44 and her claim in this regard failed, an the advance from the VRPT to the second trust did not defeat Mrs Clayton's rights because the loans remain an asset of the VRPT to be taken into account in calculating Mrs Clayton's equal share of the assets of the VRPT [through the general power of appointment held by Mr Clayton being relationship property]. The Court concluded, given the absence of information, adverse inferences may be drawn in respect of the source and the intention or purpose of the disposition. With regard to another trust, it was held that it was not open to Mr Clayton to rely on the absence of relevant evidence to avoid an order against him under s 44. The Family Court decision was upheld, but remitted to the High Court to calculate the quantum of Mrs Clayton's interest.

Valuation of business interests

The parties had accepted that the market value of the shares in the business group should be based on capitalisation of earnings. The Family Court held that this included New Zealand and United States interests. Although the latter had no assets that could be subject to a PRA claim, this did not preclude the earnings from the United States business being included in the EBITDA assessment [the method the parties valuing accountants used]. The Family Court found it appropriate to include a control premium where the owner could influence cash flows, as well as a marketability discount. These factors effectively cancelled each other out. The findings of the Family Court and High Court were effectively upheld by the Court of Appeal.

Comments

The intention to establish a trust

What is required to show the intention to create a trust? "The certainty of intention requirement looks only to the intention of the settlor", Petit, Equity and the Law of Trusts 12th Ed, p 48. Where a person declares a trust (as in Clayton), they are declaring that property they formerly held for their personal benefit he or she now makes themselves a trustee of and holds that property for the beneficiaries.

However, in Clayton v Clayton, the Family Court (FC [73]–[74]), the High Court (HC [79]) and the Court of Appeal found that "Mr Clayton, as settlor intended to create a trust for legitimate business purpose", (CA [50], [76]) which was to separate the land and buildings from the business operation. However, this writer does not consider that that is the correct legal test for the intention to establish a trust, it merely evidenced an intention to transfer those assets to some form of legal vehicle to hold those assets.

The definition by Sir Arthur Underhill in Underhill's Law of Trusts and Trustees, 15th ed, 1995, p 3, of a private express trust established to benefit a person or persons (rather than a purpose trust), is helpful here:
"A trust is an equitable obligation, binding a person (who is called a trustee) to deal with property over which he has control (which is called the trust property) for the benefit of persons (who are called the beneficiaries or cestuis que trust) of whom he may himself be one and any one of whom may enforce the obligation." Quoted by Holland J in North v C of IR (1985) 7 NZTC 5,195.

Therefore, the intention to form a trust requires an equitable obligation binding the trustee to deal with the trust property for the benefit of beneficiaries. Important findings of the Court of Appeal were that one of Mr Clayton's purposes conferring the general power of appointment on himself, was to enable him to become the sole beneficiary of the trust if he wished, and secondly, how that power was held — by Mr Clayton as the Principal Family Member — free of any fiduciary obligation. The power of appointment/removal of beneficiaries and how that power was held — free of fiduciary obligation — could have been an important factor in indicating that Mr Clayton never parted with the beneficial interest to create the equitable obligation necessary for the intention to form a trust.

However, such a conclusion required evidence to support such a position and it appears that such evidence was not there for the Court to draw such a conclusion. Rather the Court concluded:

"There was no suggestion that the VRPT was a pretence or that Mr Clayton intended the deed of trust for the VRPT not to create any rights or obligations of a trust nature. Nor was there any suggestion that Mr Clayton was seeking to deceive anyone as to the nature of the trust. He was not cross-examined on this basis …. There would need to have been strong evidence at trial undermining the concurrent findings of the Courts below before an appellate court would find an allegation of sham involving pretence and deceit established" (CA [68]–[69]).

Certainty of intention to establish a trust and the intention to create a sham trust may have elements in common. The view of this writer is that they are different issues, that may overlap and certain evidence may be relevant to either issue.

The intention of the settlor as to whether the trust was illusory or whether Mr Clayton intended to genuinely create a valid enforceable trust, was considered by the Court of Appeal at (CA [78ff]). In the absence of the requisite genuine intention, it was noted that "there will be no trust at all" and this requires an examination of all the relevant evidence relating to the determination of the settlor's real or true intentions:

"the inquiry focuses not on the legal form of the otherwise valid trust deed but on those intentions".
For this writer, the answers given in cross-examination in the trial become highly relevant as to a settlor's real intentions. The issue of certainty of intention to establish a trust precedes an issue such as whether the trust was a sham, although evidence of the former may be relevant to the latter.

Wide powers of control over the trust assets are not the issue. Once the court accepts a valid trust has been created it cannot be ignored, Harrison v Harrison *(2009) 2 NZTR ¶19-005*; [2009] NZFLR 687 (CA) at [26] "it is at least arguable that the Court is bound to observe the constraints of the existing (legal) structure". And if it is not a sham, "the trust should not be able to be treated as non-existent because the trustee has wide powers of control over the trust property" [CA 80]. As the Court noted "Actual control alone does not provide justification for looking through/invalidating a trust", Official Assignee v Wilson at [70].

The trustee powers

The VRPT contained wide trustee powers, many of which are found in family trusts in New Zealand. For the discretionary beneficiaries, if a power to distribute income and/ or capital is exercised, then this will advantage the beneficiaries who benefit and disadvantage the beneficiaries who go without. This was provided for under cl 11 of the trust deed. Subject to the trust instrument, while a trustee must be impartial to different classes of beneficiary, eg between life tenant and remainderman, Re Mulligan (dec'd) [1998] 1 NZLR 481, trustees of a discretionary trust would not necessarily be required to be impartial, but they would generally be required to be neutral between discretionary beneficiaries, Re Schroder's Will Trusts *(2003) 1 NZTR ¶13-015* at [44].

Clause 11.1(a) of the VRPT deed also provided that the trustees could exercise their discretions even though "the interests of all Beneficiaries are not considered by the Trustees". If that clause had been worded somewhat differently so that the beneficiaries did not need to be considered by the trustees in the exercise of their discretion, then there may have been a question whether there was an intention to benefit the beneficiaries. While discretionary beneficiaries have merely a hope or expectation, Johns v Johns *(2004) 1 NZTR ¶14-005*; [2004] 3 NZLR 202 (CA), they do have a right to be considered, Gartside v IRC [1968] AC 553. This is discussed further below.

The irreducible core of obligations

The Family Court considered that the powers given to the trustee in cls 11 and 19.1(c) negated the "irreducible core of obligations" and the duty to perform the trusts honestly and in good faith owed by the trustee to the beneficiaries such that they had nothing to enforce and the trust was illusory. The High Court disagreed (HC [78]–[80]). The Court of Appeal discussed this, noting that the "irreducible core of obligations" (referring to Armitage v Nurse) "are the obligations to act honestly and in good faith".

The "irreducible core of obligations" was in the context of whether a wide exemption clause protected a trustee for breach of trust in the event of the trustee's negligence. This writer would not see the obligations on a trustee to act honestly and in good faith negating or limiting the right of a discretionary beneficiary to be considered "fairly", or "reasonably". Discussing a discretionary beneficiary's rights Lord Wilberforce said:

"… he has a right to be considered as a potential recipient of benefit by the trustees and a right to have his interest protected by a court of equity. Certainly that is so, and when it is said that he has a right to have the trustees exercise their discretion "fairly" or "reasonably" or "properly" that indicates clearly enough that some objective consideration (not stated explicitly in declaring the discretionary trust but latent in it) must be applied by the trustees and that right is more than mere spes [an expectation or hope] … it may be a right with some degree of concreteness or solidity, one which attracts the protection of a court of equity", Gartside v IRC pp 617–618.

Power to remove beneficiaries being relationship property

The power to appoint and remove beneficiaries has often been included in family trusts following the passing of the Estate Abolition Act 1993. However, that power may be held by the trustees, an appointer (as in the case of Mr Clayton), or in the case of a trust settled jointly, the power may be held by the two settlors. In Clayton v Clayton, the power to appoint and remove beneficiaries was held solely by Mr Clayton. However, the Court focused on the manner in which the general power was granted to Mr Clayton (or retained), not in his capacity as trustee, but as the defined "Principal Family Member". The Court considered that this was intentional because the exercise of the power in Mr Clayton's personal capacity was:

- outside the doctrine of "fraud on a power", and
- Mr Clayton would owe no fiduciary obligations to anyone when exercising the power in his own interests, which he otherwise might or would have owed, had the power been held by him as trustee.
- Initially, it may be thought that the power to appoint and remove beneficiaries is dissimilar to the power to revoke the trust, as in TMSF v Merrill Lynch Bank, however the Court of Appeal made the connection in a number of important ways:
- Mr Clayton as donor intended he should be entitled to remove other beneficiaries and appoint himself sole beneficiary, acting exclusively in his own interests.
- A general power to appoint and remove beneficiaries held by a person in a capacity other than as a trustee, may be exercised without consideration of the interests of the removed or appointed beneficiaries.
- The end result of the exercise of the power was the same as the power of revocation as held by Mr Demriel, and there was no practical distinction between the two powers (CA [101]).
- There was no good reason why a general power of appointment that was an "absolute disposing power" not be recognised as conferring a property right" (CA [100]).

It was held that Mr Clayton failed to remove the value of the assets, the subject of that right, from the reach of the PRA (CA [114]).

Beyond the PRA?

However, TMSF concerned whether Mr Demriel had effectively removed the trust property of USD24,000,000 from the reach of his receivers and ultimately his creditors. The Privy Council held he had not successfully done this. Could Clayton v Clayton have wider ramifications and apply in favour of creditors? The Court of Appeal noted that the power of appointment was a "right" and created an "interest" under s 2 of the PRA (CA [111]).

Subpart 6 of the Property Law Act 2007 enables the Court to set aside certain dispositions of property that prejudice creditors. Under s 345(2)(b)–(e) a disposition includes "the creation of a trust, the grant or creation, at law or in equity, of … or other right, estate, or interest in or over property … the exercise of a general power of appointment in favour of a person, other than the donee of the power.

On general principles, applying TMSF there would appear to be no reason why a power granted and held in the manner of the general power of appointment held by Mr Clayton should necessarily keep trust assets from that settlor's receivers and ultimately creditors, but given the specific terms of the Property Law Act, s 345(2)(e) which excludes from the definition of "disposition" the "exercise of a general power of appointment in favour of the donee", there is doubt [at least to this writer] that such a power would go any further than claims under the PRA.

The value of the general power of appointment

The Court of Appeal held that "Mrs Clayton will be entitled to an equal share in the value of that property, being the net value of Mr Clayton's equity in the assets of the VRPT (CA [113]). The valuation of Mr Clayton's business interests were made with allowance made for commercial factors that would influence the market value of the business including a control premium where the owner could influence cash flows and well as a marketability discount. The trust was formed in 1999. It included beneficiaries other than Mr and Mrs Clayton. Mr Clayton may never exercise that power. It would not have been unreasonable to allow a discount to the valuation of their respective interests to allow for that uncertainty.

Challenging the exercise of a trustee's discretion, 16 March 2015

Generally, it is difficult for a discretionary beneficiary to challenge the exercise by a trustee of their discretionary powers. The settlor chose to give the trust property to trustees to hold for the discretionary beneficiaries, he did not give the property direct to the beneficiaries. Secondly, the trust deed gives the discretion to the trustees, not the court and so the court is not a court of appeal from the exercise of the discretions given to the trustee.

The issue was considered recently in Masters v Stewart *(2014) 3 NZTR ¶24-017*. The circumstances in which a court will intervene in the exercise of a trustees's discretionary power is limited. In the exercise of their fiduciary discretion, trustees must act in good faith, responsibly and reasonably. In the Masters case the Court considered that it would only set a decision aside if the trustees considered irrelevant considerations, failed to consider relevant considerations or reached a decision that was perverse or capacious. Trustees must act rationally and in good faith. In New Zealand, the cases have held the trustee must exercise discretionary powers reasonably in the analogous sense of Wednesbury unreasonableness, "beyond the bounds of reason" and where the trustees have given reasons, the court will consider those reasons, Blair v Vallely *(1999) 1 NZTR ¶9-002*. However, Gailey v Gordon *(2003) 1 NZTR ¶13-002*; [2003] 2 NZLR 192 took a more conservative approach requiring bad faith or ultra vires by the trustees, before the court will interfere.

This was contrasted with the United Kingdom which has taken the approach that the court should not interfere unless what has resulted was unauthorised or the trustee took into account irrelevant considerations or failed to take account of relevant considerations, Pitt v Holt [2013] 2 AC 108 endorsing the Abacus Trust Co (Isle of Man) v Burr [2003] 1 All ER 763 interpretation of In re Hastings-Bass (dec'd) [1974] 2 All ER 763. Secondly, the error must be sufficiently serious to amount to a breach of fiduciary duty. If a relevant consideration went unconsidered, the trustees' disposition was voidable, being within the scope of the trustees' powers, not something they had no power to do at all.

In Masters v Stewart, the trustees failed to take into account a relevant consideration when exercising their powers to make a discretionary distribution to beneficiaries, other than the plaintiff, in circumstances where the trustees were at the request of the settlor/advisory trustee "equalising" benefits received from the trust. The trust had been established by Mr Masters, for the benefit of his children (now all adult). The plaintiff, one of the beneficiaries, had benefited from an earlier distribution, but not to the same extent as the value of a later distribution to his sibling beneficiaries. He was found to be approximately $75,000–$100,000 not as well off from the earlier distribution compared to his siblings, (but not as much as he had asserted). The plaintiff had also worked on the property he received in the earlier distribution.

The Court acknowledged that it was not reasonable to suggest that the trustees should have embarked on a substantial valuation exercise (as had been done for the Court proceedings), before making the distribution. However, there was a failure or an inadequacy on the part of the trustees to accurately assess the benefit received by plaintiff, relative to the distributions to the other beneficiaries.

The court noted the plaintiff did not have an entitlement to be treated equally. The trustees had sought to be even-handed and were not rubberstamping the wishes of the father's (who was an advisory trustee). The fact that the decision of the trustees can be impugned and a breach of the trustees' obligation had been established, did not mean that the exercise of their discretion resulted in a breach of duty. A breach of duty was essential, if the Court was to intervene. It was not enough to show trustees had fallen short of the highest standards.

The trustees were directed by the Court to reconsider the appropriation of capital made by them to the other beneficiaries, taking into account an assessment of the plaintiff's earlier contribution to the trust assets over an extended period of time.

Trustee ratification by conduct of earlier acceptance of liability by co-trustee, 16 March 2015

Hansard v Hansard — background

Hansard v Hansard *(2014) 3 NZTR ¶24-014*; [Interim Judgment] [2014] NZCA 433 and Hansard v Hansard *(2014) 3 NZTR ¶24-023*; [Final Judgment] [2014] NZCA 562 concerned whether the appellant trustee, Sharon Hansard, had as trustee of the D & S Trust, ratified by her conduct, and accepted liability for loans, already accepted by her co-trustee (her husband at the time) and which had arisen as a part of restructuring and asset planning in which the trust was involved.

The settlement of the D & S Trust was part of restructuring intergenerational family affairs, with the transfer of assets from M H Publications Ltd (MHP), a company in which David and Sharon were the sole directors and shareholders, so as to protect assets and create an income stream for the D & S Trust. The restructuring required the D & S Trust to assume responsibility for loans of $712,795 owing by MHP to the GG Trust, being monies the GG Trust advanced in 2001–2003 to MHP.

The appellant, Sharon Hansard, had benefited from that restructuring, but following her separation from her husband, her parents-in-law, as the trustees of the GG Trust (the trust that made the loans), called the loans up. The loans had never been properly documented, but had been adopted by way of journal entry by the parties' accountants and were reflected in various entities financial statements for the year ending 31 March 2005. Beneficiary distributions had been made and tax returns filed on the basis that the asset restructuring had taken place. At issue was whether Sharon had by her conduct, ratified as trustee the loans agreed to by her co-trustee, her then husband, with his parents, the trustees of the trust making the loans, $509,863 for assets transferred, (in effect debts owing for assets transferred to the trust of which the appellant was a trustee) and liability for loans of $712,795 taken over by the D & S Trust. The appellant's former husband, as trustee, always accepted liability for the loans.

Interim judgment

The Court of Appeal [Interim Judgment] considered whether Sharon had ratified the decision made by her then husband as co-trustee regarding the loan of $509,863 for the acquisition of assets from the GG Trust and taken responsibility for loans of $712,795, formerly owed by an associated entity (MHP) to the GG Trust.

Trustees of the D & S Trust required to act unanimously

The D & S Trust deed required the trustees to act unanimously in any decisions. This reflected the principle that a trustee may not delegate his functions to another person unless authorised to do so. To bind the trust estate, the particular act must be the act of all of the trustees, Luke v South Kensington Hotel Co (1879) 11 Ch 121 (CA) at 125–126; Rodney Aero Club Inc v Moore [1998] 2 NZLR 192 (HC) at 195. The Court of Appeal held that the evidence in the High Court entitled the Judge to conclude Sharon had a general understanding of the restructuring even if she did not know all the details. However, there was no evidence Sharon was aware of the assets the D & S Trust was to acquire, the debt it would incur or the assumption by the D & S Trust of responsibility for the debt of $712,795 that MHP formerly owed to the GG Trust.

The effect of the transactions being recorded as journal entries

The Court of Appeal noted that although the journal entries gave effect to the transactions, they could not bind any of the parties until they agreed to the underlying transactions and that subsequent actions were sufficient to amount to ratification of those transactions [CA 44].

Did Sharon subsequently ratify the transactions? The debt of $509,863.

The Court of Appeal held:

- All the trustees may ratify what had previously been done by only some of them, referring to Messeena v Carr (1870) LR 9 Eq 260 at 262–263.
- This may include day to day management and prospective approval of a class of decision, Lang v Southen *(2001) 1 NZTR ¶11-009*.
- Subsequent approval of financial statements may not be sufficient to amount to ratification of actions taken without the unanimous approval of the trustees, because in order to ratify a transaction the ratifier must know the essential detail of that act or decision, Niak v MacDonald *(2001) 1 NZTR ¶11-003*; [2001] 3 NZLR 334 (CA).
- More than a passive acquiescence to a decision made by another trustee was required.

The Court of Appeal concluded that Sharon signed the financial statements and permitted the D & S Trust to charge MHP rental in respect of the assets it acquired from the GG Trust. By that conduct she must have known of and subsequently ratified the acquisition of those assets and the resulting debt of $509,863 (CA [50]–[53]).

Did Sharon ratify taking over the debt of $712,795?

In regard to the debt of $712,795, the Court held that the financial statements made plain D & S Trust assumed that liability. The issue was whether the evidence established Sharon understood the nature of the transaction — the trust assuming liability of $712,795. [Note. The final judgment records that a misunderstanding arose at the interim hearing that this liability was more than $400,000 greater than the assets worth $308,000 it received from MHP in return. However, the final judgment notes that the D & S Trust in addition to business assets of $308,000 also acquired a debt of $404,795 from MHP on which interest was paid to that trust].

In the interim judgment, the Court concluded that the proposal involved a substantial disparity in value and the financial statements were of little assistance in this regard. Unless Sharon knew this fact and agreed to it, she could not ratify the earlier decision by David. Consequently the ratification argument of the $712,795 loan failed. The Court sought further submissions from counsel, including whether the respondents as trustees of the GG Trust might be entitled to rely on their claim for relief based on estoppel. The final judgment followed those submissions.

Final judgment

The Court considered that it was not so much that Sharon signed the financial statements and resolutions, but what was of considerable importance was the process by which the financial statements of the entities came to be prepared. In particular, the financial information provided by Sharon and her husband's accountant to the accountant for the respondents (the trustees of the GG Trust) and that in her capacity as trustee and as a director of the company, the appellant must be imputed with the knowledge of her duly authorised agent acting within the scope of his authority. The respondents had relied on the appellant and her husband as trustees, assuming responsibility for the loan and benefiting from that arrangement, and the appellants were therefore liable for that debt in full.

Must subsequent ratification be by all trustees?, 16 March 2015

For private (as compared to charitable and superannuation trusts) the unanimity rule is a corollary of the requirement that trustees cannot delegate and each trustee must exercise their powers and discretions personally, and all trustees must do so (unless the trust instrument or the Court provides otherwise, or there has been a lawful delegation). Two out of three trustees cannot bind the trust estate, Luke v South Kensington Hotel Company (1879) 11 Ch d 121 at 125. To bind the trust estate the particular act must be the act of all the trustees, Rodney Aero Club Inc v Moore [1998] 2 NZLR 192.

A trustee or trustees can ratify an earlier decision. However, does subsequent ratification require all trustees to subsequently agree, or can a trustee subsequently ratify a decision of a co-trustee/s. There is some uncertainty in this area of the law in New Zealand.

In support of the view that subsequent ratification must be by all trustees, Lewin on Trusts, 19th Ed (2015) at para 29-233 states that ratification must be by all trustees. This writer understands that the important point is that, the trustees apply their judgment according to the circumstances as they exist at the time of the exercise. However the difficulty with Lewin's position is that "some latitude … is permitted":

"But some latitude is no doubt to be permitted. If trustees take a decision not by meeting together but by circulating a proposal in writing to which they all assent, the fact that one trustee gives his assent some days or even weeks after another will not in our view vitiate the exercise if there is no reason to think that circumstances have changed in the meantime. A retrospective assent from one trustee, purporting to approve what has already been done by the others without it will not do. But all the trustees may ratify what has been previously done by some only of them".

However, Kekewich J in Gilby v Rush [1906] 1 Ch 11 at 22–23, the case cited in Lewin in support of the view that subsequent ratification must be by all trustees, held that if the consent of the trustees for the purposes of the Settled Land Act was required, then that consent;

"must be a consent at the time; nothing retrospective will do … it must be consent at the time and it must be a consent ad hoc, with reference to the particular transaction, not given without deliberation, not given without reference to what was proposed at that moment; but given with direct responsibility, the knowledge coming home to their minds that they were trustees for the purposes of the Act and that it was incumbent upon them to consider whether their consent ought to be given or not".

To this writer it appears that the case is dealing with a specific situation under specific legislation.

The subsequent ratification by all trustees was the approach preferred in Dever v Knobloch *(2009) 2 NZTR ¶19-042*. At the trustees' deliberative stage, one of the trustees, Mr Billington absented himself from the decision making and did not participate in unanimous action by all the trustees. After the resolutions were made, he committed himself to the formal documentation needed to carry them into effect. The Court referred to the unanimity rule being a corollary of the non-delegation principle, so that, if trustees cannot delegate, they must all perform the duties attendant upon execution of the trust, Rodney Aero Club Inc v Moore.

The Court noted further that there was no suggestion that Mr Billington did not concur with the decision taken. The Court was inclined to the view that formal endorsement of documents following a decision by other trustees, was not sufficient to meet a requirement for substantive participation by all trustees in the important decision to distribute the Trust. An alternative view was that Mr Billington's limited participation was sufficient and whether this meant a possible conflict of interest. Either way, it lead the Court to an assessment as to whether the trustees had an inarguably complete answer.

The New Zealand Court of Appeal in Hansard v Hansard *(2014) 3 NZTR ¶24-014* [Interim Judgment] quoted from the above passage in Lewin on Trusts — that subsequent ratification must be by all trustees. But Messeena v Carr (1870) LR 9 Eq 260 (the authority cited to support that proposition), accepted that subsequent ratification by the other trustee is effective:

"I had some doubts at first whether as the discretion was to be exercised by the two trustees and one only had acted, the discretion had been properly exercised; but I have come to the conclusion that as the other trustee approved and sanctioned what was done by the one who made the payments, no breach of trust was committed", at 262 per Lord Romilly, MR. Hansard v Hansard *(2014) 3 NZTR ¶24-023* [Final Judgment] accepted that the appellant trustee by her subsequent conduct ratified acceptance of the debt accepted by her co-trustee and that she was estopped from denying acceptance of that liability [ie subsequent ratification by the non-consulted trustee].

Further support for the view that subsequent ratification by a trustee of a decision by his or her co-trustees is effective, is found in Halsbury's Laws of England 5th Ed, Trusts & Powers 2013, para 393:

"A subsequent approval by one trustee of the exercise of a discretion by the other seems, however, to be sufficient".

And

Underhill & Hayton, Law of Trusts & Trustees 17th Ed 2007, para 56.1:

"all must join in the execution of the trust … but retrospective assent to the decision of the other trustees by a non-consulted trustee will validate such decision".

Cadman v Visini *(2011) 3 NZTR ¶21-011 (CA)* concerned proceedings brought by two of the three then trustees. The third trustee gave his subsequent consent to court proceedings. (To have issued new proceedings from the three trustees would have been out of time under the Limitation Act.) Rule 4.24 of the High Court Rules specifically allows one trustee to sue on behalf of all trustees where they have the same interest in the subject matter of the proceeding, which it was held they had here. In regard to the subsequent ratification, the Court of Appeal said:

"Mr Wood has now given his express consent to the Cadmans' decision to issue the proceeding. The judgment of Romilly MR in Messeena v Carr is settled authority for the proposition that one trustee can subsequently approve another trustee's exercise of a discretion. Mr Wood's retrospective consent confirms the trustees' unanimous decision to issue the proceeding. The Cadmans have pleaded a breach of a duty of care owed jointly and severally to each owner of the house. Accordingly one or more of the owners is entitled to sue — the others are not required to join as plaintiffs" [17].

In support of the proposition that one trustee can subsequently approve another trustee's exercise of a discretion the Court of Appeal referred to Messeena v Carr (1870) 9 LR Eq 260 at 262–263, Laws of New Zealand Trusts (Reissue 1) (online ed) at [302] and Halsbury's Laws of England (4th ed, reissue, 2007, online ed) vol 48 Trusts at [953].

Comment

At this point in time, the law is not as certain as it could be in this area in New Zealand. Based on the cases that support subsequent ratification by one trustee of a decision by the other trustee/s, this should be adequate, provided there has been no material change in circumstances that would alter the decision of the other trustees. However, the safer approach is for all trustees to subsequently ratify the decision.

Asset planning — severance of a joint tenancy, 16 March 2015

Gateshead Investments Ltd v Harvey [2014] NZCA 361 concerned an appeal from the High Court and whether a joint tenancy had been successfully severed, or whether by virtue of the joint tenancy, the entire property concerned had fallen into the hands of the adjudicated bankrupt and belonged entirely to the bankrupt's creditors. At the centre of the case were Mr and Mrs Harvey, who owned a property at Coatesville near Auckland as joint tenants.

Features of joint tenancy compared to tenants in common

Joint tenancy arises where land is vested in two or more persons without any indication they are to take distinct and separate shares. Each has a right to the whole property, but not to any particular share in it. In contrast, where land is held as tenants in common, each co-owner has a defined share in the property.

A joint tenancy has two key features:

(i) unity of: possession, interest, title and time (that joint tenants have interests in the property that are equal in all respects), and

(ii) The right of survivorship. On the death of a joint tenant, the deceased's interest accrues by law to the survivor or survivors (as the case may be). There is no vesting or transfer of the deceased joint tenant's interest, rather that interest ceases to exist. Where there is one survivor, the survivor becomes the full owner of the whole property.

In contrast, under property ownership by tenants in common, on the death of one owner, that tenant's proportionate share forms part of his or her estate to be distributed in accordance with the deceased's will, or on intestacy under the provisions of the Administration Act 1969.

Severance destroys the right of survivorship. In New Zealand, a joint tenancy may be severed either by law or by equity. A legal severance occurs upon registration of the severance under the Land Transfer Act 1952, (Gateshead v Harvey [9]–[16]).

Mr & Mrs Harvey and their jointly owned property

Mr and Mrs Harvey purchased the property at Coatesville in 2001. The property was registered in their names as joint tenants. Mrs Harvey was involved in three rest home businesses and borrowed money from Gateshead Investments Ltd (the creditors). She personally guaranteed the loans. The businesses defaulted on the loans and on 26 November 2009 the creditors issued summary judgment proceedings which were not defended.

The relationship property agreement and the creditors claims

On 16 December 2009, Mr and Mrs Harvey entered into a relationship property agreement under s 21 of the Property (Relationships) Act 1976 (the PRA). The agreement scheduled the property that was to become separate property as from the date of the agreement. This included the Coatesville property which was shown as Mr Harvey's separate property, while the shares in Mrs Harvey's rest home businesses were listed as her separate property. The agreement also provided that it was to be binding on the parties in all circumstances, including bankruptcy, the taking of property in execution by creditors, separation and death. It was accepted that Mr and Mrs Harvey's intention in entering into the relationship property agreement was to remove the family home completely from the reach of Mrs Harvey's creditors.

In January 2010 the creditors obtained judgment against Mrs Harvey for $1,442,800 plus interest and costs. On 9 February 2010 the creditors registered a charging order against the title of the Coatesville property. The same month Mr Harvey, unaware of the charging order, entered into an agreement to transfer the property to a family trust. Because of the charging order, neither the transfer of the property into Mr Harvey's sole name (under the relationship property agreement) nor the transfer to the family trust, could be registered under the Land Transfer Act. On 5 November 2010 Mr Harvey made a will appointing his son (the respondent in this appeal), his executor. Under the will Mr Harvey devised the property to the family trust, reserving a life interest to Mrs Harvey. Mr Harvey died in February 2011.

The executor registered a notice of claim against the title based on the relationship property agreement and the creditors sealed a sale order in respect of Mrs Harvey's interest. The creditors also sought orders in the High Court declaring the relationship property agreement void, vesting the property in Mrs Harvey by survivorship and removing the notice of claim by the executor. The High Court held the relationship property agreement was void as against the creditors under s 47(1) of the PRA, having been entered into with the intention of defeating those creditors. However, the Court declined to make the other orders sought.

Issue on appeal

On appeal to the Court of Appeal the executor accepted that the relationship property agreement was void under s 47 of the PRA as against the creditors, (ie that Mrs Harvey's interest in the property was still available to her creditors). The issue was whether the creditors obtained not only Mrs Harvey's share in the Coatesville property, but also Mr Harvey's share by virtue of the joint tenancy. There had been no legal severance of the joint tenancy because of the failure to register the relevant transfers. However, had there been an equitable severance of the joint tenancy — in this case severance by mutual agreement or by a course of dealing, sufficient to indicate that the interests of all were mutually treated as constituting a tenancy in common — before Mr Harvey's death?

The Court of Appeal concluded that there was compelling evidence of a mutual intention to sever, Mrs Harvey's intention to assign her half share absolutely to Mr Harvey, and he intended to dispose of his share in the rest home businesses. Such a disposition amounted to a severance in equity of the joint tenancy. That agreement to sever was supported by consideration, and apart from the attempt to defeat creditors, there was nothing in proper. The transfer to Mr Harvey as sole owner (the greater), must be taken to include the lesser (severance of the joint tenancy and transfer of Mrs Harvey's share as tenant in common to Mr Harvey).

Any voiding of the claim under s 47 was only to the "extent necessary to meet the creditor's claim". At the time the relationship property agreement was entered into the creditors only had a claim to Mrs Harvey's half interest. There was no right of claim to the whole property. The purpose of s 47 was not to improve the position of the creditors, only preserve it. The Court held that this accorded with common sense and the justice of the case. If the creditors were to obtain the entire property that would be an undeserved windfall and it would be unjust if the creditors received nothing (CA [60]–[62]). The appeal was dismissed (the creditors effectively entitled to Mrs Harvey half share in the property).

Comment

While the relationship property agreement and the attempt to transfer her half share in the property to Mr Harvey was void as against Mrs Harvey's creditors, the steps Mr Harvey took were effective in equity to sever the joint tenancy, so that his share of the property on his death did not pass automatically to his wife's bankrupt estate and the hands of her creditors.