Sharing away trustees powers—New Zealand

Geoffrey Cone

Abstract

New Zealand has some unique provisions in its trust legislation that enable trustee powers to be shared, and for powers that would usually be expected to be exercised by a trustee to be implemented by other persons. In addition, where those powers are exercised the trustee who does not exercise the power can be exonerated. This article looks at the origins of these rules and examines in detail the statutory provisions that contain these rules. The recommendations of the New Zealand Commission for Trust Reform are also considered in this context.

Settlors, often control freaks, and those from civil law countries, are suspicious of absolute control being given to trustees. Partly this stems from the difficulty of grasping the clear line that developed in common law and equity between legal and beneficial interests, and partly from a mistrust, in some countries, of the institutions that protect entrusted interests. In civil law countries, this perception is hard to understand, as wealthy and powerful persons are happy to entrust ownership and power to agents, nominees, or attorneys, without concern, but not to a trustee.

In New Zealand, a series of additions were made to trust law that broke down the unitary control principles usually associated with trustees; the reasons were not so much of control, as to ensure that trustees were not burdened with responsibilities they were not qualified to carry.

This article will consider three variations that achieved this in New Zealand; the Managing Trustee, The Advisory Trustee, and the Investment Manager. In light of the just released recommendation of the New Zealand Law Commission's Review of the Law of Trusts; protectors will also be considered.

The managing trustee

Under Section 50 of the Trustee Act 1956, any company may be appointed to be a custodian trustee of any trust. This can be done at the time of the creation of the trust or by a later appointment. The power of appointment would usually be given to the current trustee. When this is done, the other trustee is called the managing trustee.

On the appointment, the trust property is vested in the custodian trustee as if that trustee were the sole trustee or legal owner. If required, vesting orders may be made by the court. The function of the custodian trustee is to get in and hold the trust property, invest the funds, and dispose of the assets, as the managing trustee, in writing, directs.

The management of the trust property, and the exercise of all powers and discretions not given to other parties, will remain vested in the managing trustee as if there was no custodian trustee. Under Section 50 (2)(e), where there are more than two managing trustees, the custodian trustee must act on the direction of

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the majority. The power of appointment of new trustees lies with the managing trustee.

Therefore, by the appointment of the custodian trustee, the managing trustee is divesting title to the trust fund, while retaining all administrative powers. The degree of the divestment, and the powers retained by the managing trustee may be defined by the trust instrument, or otherwise the Act will apply, under Section 50(2)(b), to give all powers and discretions to the managing trustee. As the law stands at present, the appointment of a new managing trustee need not be disclosed to any person who deals with the custodian trustee.

The custodian trustee will not be liable for any actions taken if taken in accordance with any properly given the direction for any act or default of the managing trustee. However, if the custodian trustee is of the opinion that any direction conflicts with the trust, or the law, or exposes the custodian trustee to any liability, or is otherwise objectionable, the custodian trustee may apply to the court (in practice the New Zealand High Court) for directions (Section 50(2)(b). The court order will bind both the custodian and the managing trustee.

So far as third parties are concerned, Section 50(2)(h) provides that all actions, proceedings, and dealings are with the custodian trustee and no person needs to enquire as to the concurrence of the managing trustee.

Advisory trustee

Section 49 of the act provides that an advisory trustee may be appointed on the creation of the trust or by any person having the power to appoint a new trustee, in respect of the whole or a part of the trust fund. Where the advisory trustee is appointed, the responsible trustee remains the legal owner of the trust property. Section 49(3)(b) states:

> the advisory trustee may advise the responsible trustee on any matter relating to the trusts or the estate, but shall not be a trustee in respect of the trust.

The responsible trustee must, before making any decision, consult the advisory trustee. The scope of this provision is considered below. These matters may be defined in the trust deed or otherwise may concern 'any matter relating to the trust' (Section 49(3)(a)). Having been consulted, the advisory trustee may advise the responsible trustee on that matter. The responsible trustee may follow the advice or ignore it. If the responsible trustee acts on the advice, it will not be liable for any act or omission by reason of its following that advice (Section 49(3)(c)). Where there is more than one advisory trustee and they are not unanimous, the responsible trustee may apply to the court for directions (Section 49(3)(d)), or where the responsible trustee is of the opinion that the advice or direction conflicts with the trusts or any rule of law, or exposes him to any liability, or is otherwise objectionable.

These principles lead to a number of interesting and important points:

(1) *Is the advisory trustee a trustee?*
The advisory trustee is not to be treated as a 'controller' or owner of the trust fund, as a responsible trustee or a managing trustee would be. This arises out of the policy, which led to the enactment of this section, which will be explained below. The advisory trustee solution was devised in order that the advisory trustee (often an overseas person) would be 'consulted' by the responsible trustee but would not have any positive powers. However, the extent of this power is not clearly defined in Section 49 (see point 4 below).

(2) *Does the advisory trustee have 'fiduciary' duties?*
Section 49(3)(b) states that the advisory trustee 'shall not be a trustee in respect of the trust'. If this provision removes any fiduciary duty from the advisory trustee, it provides significant protection to the advisory trustee and the responsible trustee. However, because an advisory trustee is not treated as a trustee, this should not mean that it does not have

duties in another capacity, and this could include a fiduciary duty distinct from that of a trustee, or for the provision of wilfully or negligently misleading advice. In any case, the responsible trustee does not have to take the advisory trustee's advice and would be entitled to ignore it or seek directions.

(3) *A responsible trustee who acts on the wrong advice.* A responsible trustee who acted on wrong advice from an advisory trustee would seem not to be liable. Section 49(3)(c) states that in following the advice or direction of the advisory trustee:

> the responsible trustee shall not be liable for anything done or omitted by him by reason of his following that act or direction.

However, it is possible to imagine situations in which a responsible trustee and advisory trustee effectively conspire to achieve an improper result. This would be rare but clearly could be in breach of the fiduciary duties of the responsible trustee. However, there has been no case in New Zealand where this has been considered. Where a recommendation is made properly on reasonable grounds, and where the responsible trustee follows in good faith a reasonable and considered recommendation of an advisory trustee, then the statutory limits on liability should apply. However, it is conceivable that a responsible trustee could be held accountable for failing to take directions from the court.

(4) *Advice or direction*

Section 49(3)(b) refers to advice by the advisory trustee, but subsections (c), (d), and (e) refer to directions also. It seems possible, therefore, that an advisory trustees powers could be extended in the trust deed to giving directions. This would be consistent with the proposed rules for protectors, considered below.

History of the advisory and managing trustee

The statutory changes that lead to these two offices, and indirectly to that of a protector, began in connection with the Public Trustees Office, early in the 20th century.

The changes were introduced as a result of a Royal Commission undertaken by the Mackenzie Government into the Public Service. The Royal Commission's report made certain criticisms of the quality of the services of the Public Trustee, which appeared to have been operating out of its depth. Those criticisms eventually lead to the formation of a Commission of Enquiry to examine the conduct of the Public Trust Office. The Commission of Enquiry recommended the introduction of the equivalent provisions of the managing and advisory trustee provisions.

The rationale underlying the introduction of these sections was described by the Honourable Mr Herdman, then Minister of the Public Trust Department (later Herdman J) in his presentation of the Public Trust Office Amendment Bill for its first reading before the House on 12 August 1913:

> So the position is this: that the Public Trustee under the will is appointed trustee. The whole property under the will is vested in the Public Trustee, and he becomes the manager of the estate; and he, the Public Trustee, may if he likes – if he finds himself in a difficulty – consult an advisory trustee . . .
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> Supposing a man is very wealthy and is possessed of property of a multifarious character . . . He might conclude that it was desirable in the interests of the property and of the beneficiaries that it should be vested in the Public Trustee; but being large and perhaps complicated, and therefore requiring special handling, he might say, 'I would like to have some other business man to advise the Public Trustee in the event of his meeting with difficulties . . .'
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> Clause 6, dealing with the appointment of custodian trustee, is just the opposite of the provision dealing with the advisory trustee – it is just its antithesis. The

> Public Trustee is appointed a custodian trustee, and he holds the assets and acts under the direction of the other trustees appointed under the will . . .
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> You are providing, in the case of an advisory trustee, that the Public Trustee shall be the owner of the property administered, and that he may take the advice of somebody outside. In the case of a custodian trustee, you are making the Public Trustee the custodian of the whole of the property, but the actual management is undertaken by the ordinary trustees under the will.

A subsequent amendment to Section 4 of the Public Trust Office Amendment Act 1913, contained in Section 37 of the Public Trust Office Amendment Act 1921, introduced the language more or less equivalent to the parts of Section 49 of the Trustee Act, to provide for the exoneration of the responsible trustee where advice is taken from the advising trustee, and the power to apply to court, mentioned above.

These provisions, with the necessary modifications to place the advisory trustee provisions in the context of private trusts, was introduced into the Trustee Act 1908 by Section 7 of the Trustee Amendment Act of 1924.

The Honourable Mr Downie Stewart, then Minister of Customs, explained the rationale behind the introduction of Section 7 in his presentation of the Trustee Amendment Bill for its third reading before the House on 20 October 1924:

> The clause relating to private trustees is copied from the Public Trustee Office Act, under which the Public Trustee has power to appoint advisory trustees to co-operate with him. The scheme is working satisfactorily, and it was thought right that private trustees should have the same right . . . Apparently a number of practitioners have recently been in the habit of appointing advisory trustees, and a question has been raised as to their power to do so in trust deeds.

Clearly by that time, these provisions were being used in private trusts and so it was regarded as right that they should have statutory recognition. There is some suggestion that this was driven in part by the desire of English advisers to use these provisions to administer New Zealand trusts for English families with interests held by trusts in New Zealand, and elsewhere in the far flung Empire of the time. In fact, the writer has seen trusts developed in those times which use these 'remote control' provisions in order to exercise a high degree of control over New Zealand trustees.

There has been to the writer's knowledge, no reported or available unreported case in New Zealand dealing with managing trustees, advisory trustees, or protectors.

This is not to say that these offices are uncommon—to the contrary. The use of these devices became extremely common during the 1950 to the 1990s when estate duties were running at 40 per cent of the dutiable estate on death, and were used to provide indirect control for wealthy settlers who had placed property in trusts. It is perhaps a testimony to draughtsmanship that these provisions have not received attention from the courts.

Protectors

It was proposed in a Bill presented to the New Zealand Parliament in 2007 (the Trustee Amendment Bill 2007) that statutory recognition be given to protectors. Protectors have been accepted as part of New Zealand Trust law for many years, but have not been defined in the Trustee Act.

The Bill has not been passed and is now unlikely to proceed, but it is worth considering it here as the definition reflects New Zealand practice in the use of a Protector. In the Bill, a protector is defined as a person who by virtue of the terms of the trust instrument may give to the trustee either or both of the following:

- a direction the trustee is obliged to follow and
- a consent that permits or is necessary to enable the trustee to exercise a power.

It is thus recognized that a protector has the power to direct actions by the trustee as provided by the trust instrument. There is no limitation in principle to that direction. It follows that a settlor could be

given extensive powers as protector. The result of this is that there would be scope, as in other jurisdictions, to reserve extensive settlor powers.

The Bill proposes that if the trustee receives a direction from, or there is a refusal or failure to give consent by the protector, the trustee must determine whether on reasonable grounds that action or omission conflicts with the trust or law or exposes the trustee to any liability. So, where the protector makes a direction that could be in breach of trust if acted on by the trustee, or is contrary to the law—such as directing the trustee to act in a way that broke the law, for example, by committing a criminal act, then the trustee may consider whether it should act on that direction.

If the trustee does determine that the direction or refusal to give consent contravenes these requirements, then the trustee may apply to the High Court for directions. Such directions will bind both the protector and the trustee.

In fact, this potential legislative recognition may well have been left in the dust of day-to-day practice. It is common now for New Zealand trusts to have extensive and complex protector powers, even to the extent of having committee structures, or special entities to carry out protector functions.

There are, however, still uncertainties. As Garrow and Kelly note regarding protectors:

> the nature of the beast varies according to the way in which the individual trust deed has been drawn up

but, as the learned authors say 'the law has long permitted settlors to keep certain powers for themselves or some person nominated by the settlor'. However, a problem arises in defining the nature of the protector's duties, and, more practically, how a dispute between the protector and the trustee can be resolved.

The New Zealand Law Commission averted to the first problem in 2002, stating that:

> Where the provision under consideration in effect confers on the protector a dispositive power, a mandate to dispose of property not his own, it seems sufficiently probable that a court would treat the protector as a donee of a power of appointment.

In such a case, the power would normally be a fiduciary power. The question must be asked in this context whether it is simpler to appoint an advisory trustee (whose powers may be specifically defined, as long as they fit the statutory model), avoiding any argument that the would-be protector may have obligations akin to that of a trustee. This is argued by the learned authors of Garrow and Kelly, where they state:

> One wonders if in some cases where protectors are now used, advisory trustees might not be more appropriate – and leave less room for doubt given the statutory basis for advisory trustees . . .

This would be particularly important if the provision that the advisory trustee shall not be a trustee in respect of a trust, considered above, limits the liability of the advisory trustee, while absolving the responsible trustee from acting on that advice.

As to the second issue, the Bill attempted to create a mechanism to resolve disputes, by permitting a court application to resolve any uncertainties in relation to a protective act or direction. The Commission made no recommendations as to the incorporation of protectors into New Zealand statute law, presumably meaning that they were content to allow their powers to be regulated by the trust instrument.

Reform

As mentioned above in relation to protectors, an effort was made in the Trustee Act Reform Bill 2007 to revise these rules, and especially to define more completely a responsible trustees powers to apply to the court for directions, and so an application to the court was to be made compulsory. At the same time, it was proposed that the absolution of the responsible trustee who acted on the advice or direction of the advisory trustee be denied. Presumably, it was decided that this was too generous a protection for the responsible trustee, which could be better provided by

compelling that trustee to go to the court for directions. No effort was made to deal with the managing trustee custodial trustee relationship, although as noted there is a similar provision for the custodian trustee to voluntarily apply to court for directions if it was concerned about a direction received from the managing trustee.

After two readings, the Bill was referred back to the Law Commission by a Select Committee for further consideration. Before the Bill was referred back, the Committee recommended amendments to the Bill to give responsible trustees the option (rather than the obligation) to seek the court's direction where a protector or an advisory trustee gave advice or directions which the responsible trustee believed to be in conflict with the trusts or any laws, or exposed the responsible trustee to liability. It was also recommended that there should be no protection for a responsible trustee from actions for breach of trust or for failure to comply with general duties in the law of trusteeship when the responsible trustee follows an advisory trustee's or protector's advice or direction.

The law commission's recommendations

Custodian trustees

The Law Commission did not recommend significant changes to the existing law, noting that the device had worked well and was widely used in the management of Maori land, and in relation to trusts that held overseas property (foreign trusts). The principal changes recommended by the Commission were that the law should be amended to provide that a custodial trustee should only be liable where, on its own initiative, it perpetuates a fraud, or where it fails to act on the managing trustee's instructions, causing loss, or where it causes loss by acting independently of the managing trustee. The Commission also considered that the custodial trustee must be indemnified from the trust fund, and may be appointed only in respect of part of the trust property. Also, natural persons should be allowed to be custodial trustees, and multiple custodial trustees should be permitted.

Advisory trustees

Very little was proposed to change the rules applying to advisory trustees. It was recommended that the word 'trustee' should be removed from the name and that the responsible trustee would still be protected following the advice of the advisor, unless he knew that the advice was unlawful, contrary to the terms of the trust, as was advice no reasonable trustee would have given. Again the Commission noted that the advisory trustee role was widely used especially in the administration of assets by the Maori Trustee.

Protectors

As mentioned, recommendations were made as to the office of the protector.

Investment manager

In 1988, the provisions of the Act dealing with investments were rewritten by the Trustee Amendment Act 1988. The purpose of the changes was to do away with narrow rules that limited trustees to a restricted list of investments, mostly government and local authority stock, and first mortgage investments.

These restrictions could be modified in the trust instrument, but traditional drafting and the existence of the restricted list provided trustees with a powerful incentive to hug the shore of low risk and low return investments.

At a time when inflation was a serious problem for the New Zealand economy (sometimes reaching 20 per cent per annum), these restrictions, real or self imposed, proved a boon for land speculators who could look to trust funds for cheap first mortgages, while their own investments increased so as to dwarf the real value of the trustee's investment. The alternative investments such as Government and local body bonds provided no risk, but nugatory returns. Capital beneficiaries saw their trust funds diminish,

and income beneficiaries found that their payments from their trusts, net of trustee fees, eroding in value every year.

A dramatic example of these problems was provided by re Mulligan (deceased).

Here a forceful life tenant not only outlived many of her step-children but also intimidated the trustees of her husband's estate, to the extent that the funds she invested from the over generous income she received from the trust exceeded by a substantial margin the gains made by the trustee in the capital fund that remained in its hands. She made matters worse by leaving her then large estate to different beneficiaries to those of her husband's relatively diminished estate, sparking proceedings against her late husband's trustee. This resulted in the trustee being held liable to compensate the beneficiaries for the almost non-existent growth in the trust fund.

One has sympathy for the professional trustees in this case who found themselves in this position for reasons not wholly of their own making. In the Mulligan case, the trustees were caught in part because under the terms of the trust, or perhaps over prudence, coupled with a real fear of Mrs Mulligan (who reputedly would storm into the trustees office in her fur coat accompanied by two small yapping dogs, to demand more income from the trust) could not invest in the high growth sectors that were available to the life tenant, and plan against inflation.

The problem had been noticed earlier in 1966, when in *re Murray's Trust*, Woodhouse J, stated in relation to the list of approved investments that:

> Negative safeguards of this sort may preserve the numerical position of the fund in money terms, but something more constructive is required if its effective or real value is to be protected against inflation.

As a consequence of these concerns, the Trustee Act was amended in 1988 to provide, in Section 13A, that a trustee 'may invest any trust funds, in any property', subject to a general duty to invest prudently.

However, the legislation went further, and provided not only that the duty of prudence could be removed by provision in the trust instrument, but also enabled a third party to undertake the investments.

The starting point is Section 13D of the Act, which provides that the trustees' duties to exercise skill and prudence in managing the trust investments are subject to a 'contrary intention' being expressed in the trust deed and 'subject to the term of that instrument'. This section, provided there is careful drafting, enables the normal requirements of case law and statute for the management of trust funds to be excluded in specifically defined cases.

This general principle is underlined by Section 13F, which enables even the 'rules and principles which impose' a duty to act in 'the best interest of present and future beneficiaries', a 'duty to act impartially towards beneficiaries and between different classes of beneficiaries' and 'any duty to take advice' (Section 13D(a)–(c)), shall not apply 'to the extent they are inconsistent with the instrument creating the trust'. Therefore, it is possible for the trust deed to remove or limit the trustees' duties to act impartially and take advice in relation to a power of investment.

Further and most importantly, the power of investment may be exercised in effect by a third party. Section 13G provides that a trustee executing the power of investment shall 'comply with the requirements of the [deed] and act in 'compliance with any direction' with respect to the investment of trust funds. Such a provision, whereby a trustee is obliged to invest as directed by a third party is not unheard of (see *Vestey's (Lord) Executors v IRC*), but in New Zealand, it is now approved by statute.

These provisions open the way for the trust instrument to provide a power of veto or advice, or a power to direct investments, and that will be binding on the trustee, as well as exonerating it from the prudent person test, or for that matter, any responsibility for the investment of the trust fund.

There is some suggestion that this provision was included to permit a protective power that would enable a family business or home to be protected against an unwelcome exercise of a trustee's powers, especially one that was based on a concern as to the prudence of the investment, but the words of Sections

13F and 13G go far beyond that, and, in practice, will apply to much more financially significant cases.

The Act gives no guidance as to the liability of the investment advisor or manager in such a case. It is hard to imagine that a court would not require the power to be exercised with an eye to the benefit of the beneficiaries, but it is strange that this was not provided for in the legislation.

The Law Commission recommended repealing Section 13G and incorporating the same provisions in Section 13D, but otherwise did not seek to alter the principles set out above. However, the Commission did propose that a trustee must act with care, and honesty, in appointing an investment manager, and be responsible for any consequent loss.

Conclusions

In conclusion, it is clear that the Trustee Act permits significant departures from the concept of a trustee having powers, which it must exercise itself and take responsibility for those acts. In the case of the advisory trustee, the managing trustee, and the investment adviser, it seems possible for the principal or responsible trustee who holds the trust fund to limit, or define, liability if it follows the directions of the managing trustee and the investment manager or the advice (or maybe directions) of the advisory trustee. These provisions have been broadly endorsed by the New Zealand Law Commission.

Geoffrey Cone *graduated from University of Otago, New Zealand, with LLB honours and a post graduate diploma in tax and trust law. He commenced practice in 1980 in Auckland, New Zealand, then moved to Christchurch where he was a partner and the Chairman of Partners in a leading law firm. There he practiced in commercial litigation as well as tax and trust advisory work and appeared in the courts at all levels as leading counsel, including the Privy Council. After working in the British West Indies as a litigator for 2 years, he returned to practice in 1997 in Auckland, following which he established his own practice in 1999. His firm, Cone Marshall Limited, is the only New Zealand law firm to specialize exclusively in international trust and tax planning, and it provides trustee and trust management services through its affiliated companies. Email: gcone@conemarshall.com.*