



# Administration of Trusts

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## 1 General principles – trusts

### 1.1 Trustee' Duties

Trusts such as testamentary trusts and discretionary trusts are typically established within a family group. In the context of a testamentary trust (for example) it is usually a member of a testator's family that is a trustee of the testamentary trust, with the whole of the testator's family able to benefit (including the trustee) under the terms of the testamentary trust.

However, notwithstanding that testamentary / discretionary trusts are established within a family group, the rights and obligations of the parties to a testamentary / discretionary trust relationship are the same as those which apply to other forms of trusts.

As advisors, it is important that those involved in the trust estate understand their rights and obligations. In particular, when determining who in a family group will hold the position of trustee of a testamentary / discretionary trust, regard should be given to the fiduciary nature of the position. For example, the principle of fiduciary duty provides that the fiduciary interest should not be placed in conflict with its own (personal) interest. That is, a fiduciary should not use its position as a fiduciary for the purpose of acquiring a personal advantage. A fiduciary is not permitted to retain any advantage acquired unless the person(s) to whom the duty is owed freely and with full knowledge consent to the acquisition and retention of the advantage (see for example *Bray v Ford* [1896] AC 44 at 51-2 and *Gluckstein v Barnes* [1900] AC 240 at 255). This tension is illustrated in the scenario where a trustee of a testamentary trust is also a beneficiary under the terms of that trust.

The High Court in *Maguire v Makaronis* (1997) 188 CLR 499 at 473 outlined a trustee's fiduciary duties and the remedies which may apply if there is a breach:

*Whilst the trustee is the archetype of a fiduciary, the trust has distinct characteristics. In particular, where a trust is created by will or settlement in traditional form, the trustee holds title to property on behalf of beneficiaries or for charitable purposes. If the trust be still subsisting, the objective of an action to recover loss upon breach of trust is the restoration of the trust fund. The right of the beneficiaries is to have the trust fund reconstituted and duly administered, rather than to recover a specific sum for the sole use and benefit of any beneficiary. Indeed, no one particular beneficiary may have sustained a present and individual loss. This may be so if the trustee is a discretionary trust or no interest vests, either in interest or possession before the termination of a prior interest. Further, the particular breach of which complained is made may be consequent upon failure in observance of one or other of the duties which attend trust administration, such as those to make only authorised investments, and to use due diligence and care in the administration of the trust.*

The court in *Reading v A-G* [1951] AC 507 observed the scenario in which a fiduciary relationship subsists:

*... a fiduciary relationship exists (a) whenever the plaintiff entrusts to the defendant property ... and relies on the defendant to deal with such property for the benefit of the plaintiff or purposes authorized by him, and not otherwise, and (b) whenever the*

*plaintiff entrusts to the defendant a job to be performed ... and relies on the defendant to procure for the plaintiff the best terms available ...*

There are a wide range of duties which a trustee (including trustees of testamentary trusts) have. As a result, only a number are dealt with in this paper, including a trustees:

- Duty to carry out the terms of the trust;
- Duty of care in the management of trust affairs;
- Duty to administer trust affairs impartially;
- Duty to perform trusts honestly and in good faith for the benefit of the beneficiaries.

It is well settled law and uncontroversial to say that a discretionary trust does not have beneficiaries in the traditional sense, whose interests together aggregate the beneficial ownership of the trust property. Instead, there is a class of persons, usually described in wide terms, who are the objects of a power to appoint either income or corpus or both to selected members of the class. The members of the class are *objects of a power*, rather than *beneficiaries* in the strict sense. They do not have a proprietary legal or equitable interest in the trust fund. They have no *beneficial* interest in the trust property, and they are not persons for whose benefit the trust property is held by the trustee; at the highest they are members of a class of persons for the benefit of some one or more of whom the trustee may in due course hold property if it so determines. At best, they are *potential* beneficiaries, not beneficiaries.

An eligible object or potential beneficiary is not entirely without rights in respect of the trust and trustees. He or she has a right in equity to due administration of the trust, and the trustees have a corresponding fiduciary obligation at least to consider whether, and in what way, to exercise their discretionary powers of appointment: per Brereton J in **Fay v Moramba Services Pty Ltd** [2009] NSWSC 1428 at [32] – [33].

## 1.2 Duty to carry out terms of the trust

Trustees are subject to a duty to carry out, and act within the terms of a trust. This is on the basis that a trustee is expected to give effect to a settler / testator's intention as provided in a trust / testamentary instrument. However, it has been held that a trustee is not bound to fulfil the terms of a trust instrument if:

- All beneficiaries (of full legal capacity) direct the trustee to act outside the scope of a trust instrument (*Wharton v Masterman* [1895] AC 186);
- Fulfilling the terms is illegal;
- Statute or a court order provides that the trust instrument cannot be satisfied; or
- A court (either in its inherent jurisdiction or via statute) allows a deviation.

## 1.3 Duty of care in the management of the trust affairs

Equity has developed a standard of care which applies to trustees in the management of trust affairs on behalf of beneficiaries. It was observed by Gummow J in *Breen v Williams* (1996) 186 CLR 71 at 137 that the characteristic that gives rise to this duty of care:

*... is the holding of the legal title to property with duties to deal with it for the benefit of charitable purposes or for one or more persons, at least one of whom is not the sole trustee...*

In such a situation, it was held by Gummow J that:

*... where an express trust has been effectively constituted and under its terms the trustee is obliged to manage a trust business, the trustee is required both to observe the terms of the trust, and in doing so, to exercise the same care as an ordinary, prudent person of business would conduct in the conduct of that business were it his or her own...*

There is case law which stands for the proposition that a trustee's overarching principal is to protect the financial interests of the beneficiaries. This is because trusts are usually established to financially benefit the beneficiaries. As a result, the trustee's duty of care requires it to secure the best financial returns for the trust. In *Cowan v Scargill* [1985] 1 Ch 270, it was held that:

*When the purpose of the trust is to provide financial benefits for the beneficiaries, as is usually the case, the best interests of the beneficiaries are normally their best financial interests. In the case of a power of investment ... the power must be exercised so as to yield the best return for the beneficiaries, and the prospects for the yield of income and capital appreciation both have to be considered in judging the return from the investment.*

Therefore, when a testamentary trust (for example) deals with trust property with respect to a beneficiary (e.g. making a loan to a beneficiary), an issue to determine is whether the trustee is considering the best financial interests of the beneficiaries of the testamentary trust.

A trustee is not compelled to take every conceivable precaution against financial loss. Rather, the trustee is only required to exhibit due care with respect to the trust fund. In *re Speight* (1883) 22 Ch D 727 it was observed that:

*It seems to me that upon general principles a trustee ought to conduct the business of the trust in the same manner that an ordinary prudent man of business would conduct his own, and that beyond that there is no liability or obligation on the trustee. In other words, a trustee is not bound because he is a trustee to conduct business in other than the ordinary and usual way in which similar business is conducted by mankind in transactions of their own. It never could be reasonable to make a trustee adopt, or conduct the business in any other way. If it were, no one would be a trustee at all.*

The standard was expressed as a higher level in *In re Whiteley* (1886) 33 Ch D 347 at 355 – being a prudent person dealing with property which, in equity, is owned by others:

*The duty of a trustee is not to take such care only as a prudent man would take if he had only himself to consider, the duty rather is to take such care as an ordinary prudent man would take if he were needed to make an investment for the benefit of other people for whom he felt morally bound to provide. This is the kind of business the ordinary prudent man is supposed to be engaged in; and unless this is borne in mind the standard of a trustee's duty will be fixed too low.*

As mentioned above, it is usual in the context of a testamentary trust that the beneficiaries also control the testamentary trust (e.g. as trustee). As an example of the stringency of the trustee's duty of care, if a trustee – who is also one of a number of beneficiaries of a trust – overpays the other beneficiaries, then the trustee / beneficiary is not entitled to claim an adjustment. This is notwithstanding that an underpaid beneficiary is entitled to such an adjustment (see *In re Horne* [1905] 1 Ch 76).

#### **1.4 Duty to act impartially**

Whilst administering the affairs of a trust, trustees have a duty to administer the affairs of a trust impartially.<sup>1</sup> The duty prohibits a trustee to (for example) favour one class of beneficiary as compared to another beneficiary (*Whitehouse v Carlton Hotel Pty Ltd* (1987) 162 CLR 285).

An example of a situation where the duty comes into play include where there are successive beneficial interests – for example in the life interest / remainderman context.

It should be noted that the duty to act impartially is not fettered in the event that a trustee exercises a discretionary power to benefit one beneficiary over another, provided that the discretion is not exercised irresponsibly, capriciously or wantonly (*Edge v Pensions Ombudsman* [1998] Ch 512). Indeed, it was observed in *Edge v Pensions Ombudsman* that the duty of impartiality is '*... inapposite where what is in point is a discretionary power to choose between different beneficiaries ...*'. However, it was observed in *Rowds v Bibb* [1900] 2 Ch 107 that '*... a general discretionary power conferred by the trust deed does not override the trustee's duty to be fair and impartial between all the beneficiaries ...*'.

Trustees who breach the duty of impartially are brought to account (see *Nestle v National Westminster Bank Plc* [1994] 1 All ER 118 at 136). It was observed in *Cowan v Scargill* [1984] 2 All ER 750 at 760 that the duty of the trustee is:

*... to exercise their powers in the best interests of the present and future beneficiaries holding the scales impartially between different classes of beneficiaries.*

As an example, it was observed in *Re Pauling's Settlement Trusts; Youngusband v Coutts & Co* [1963] 3 All ER 1 at 8 that before a trustee exercises a power of advancement, a trustee must '*... weigh on one side the benefit of the proposed advance and on the other hand the rights of those who are or may hereafter become interested under the terms of the settlement*'.

#### **1.5 Duty to perform trusts honestly and in good faith for the benefit of beneficiaries**

Both trustees and executors have a duty to perform the trusts honestly, in good faith, and for the benefit of the beneficiaries (see *Reid v Hubbard* [2003] VSC 387). That is, trustees (and executors) need to act without regard to self-interest, and only consider the best interest of the beneficiaries.

The need to act without regard to self-interest may cause a conflict of interest in the event that a trustee is also a beneficiary.

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<sup>1</sup> It should be noted that the duty to act impartially is not a fiduciary duty, but rather only a trustee duty (see *Re Stewart* [2003] 1 NZLR 809 at 816).

An example of a trustee's duty to perform in the best interest of the beneficiaries was provided in *Partridge v Equity Trustees Executors and Agency Co Ltd* (1947) 75 CLR 149. It was held in *Partridge* that a power in a will to postpone the recovery of a debt was inserted for the benefit of the relevant trust estate, and not for the debtor. It was the duty of the trustee to collect the debt. Further, the trustees had the power to consider the financial position of the debtor and grant further time in which the debt could be paid only '... if it was satisfied that the ... [debtor] ... reasonably required such time to pay the debt and that it ... [i.e. further time] ... could be granted without detriment to the estate ...'.

### 1.6 Bankruptcy Act considerations

Under the Bankruptcy Act, there are two main provisions which will allow a trustee in bankruptcy to claim back assets or their value when they are transferred to a trust (or for that matter any other entity, including a spouse).

### 1.7 Undervalue transfers

Section 120 of the Bankruptcy Act is concerned with transfers of assets from a person prior to bankruptcy at less than their market value. It is very much time dependant. Section 120 has been recently amended to alter the time limitations when transfers are made to an associated person.

The rules in section 120 are:

- If the transferor was solvent at the time of the transfer and the transfer was not to a 'related entity' then the trustee in bankruptcy is limited to transfers which occurred within two years before the commencement of the bankruptcy;
- If the transferor was solvent at the time of the transfer but the transfer is to a related entity then the clawback period is four years;
- In any other case the clawback period is five years i.e. where the transferee cannot prove that the transferor was solvent at the time of the transfer.

It should be noted that the commencement of bankruptcy can be up to six months prior to the date a petition is lodged<sup>2</sup>.

The transferee has the burden of proving that the transferor was solvent at the time of the transfer.

A new provision was introduced in 2006<sup>3</sup> that establishes a rebuttable presumption that the transferor was insolvent if it is established that the transferor:

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<sup>2</sup> The bankruptcy commences at the time of the earliest act of bankruptcy committed within the 6 month period preceding the date the petition is lodged: Section 115 *Bankruptcy Act*. For the definition of 'act of bankruptcy' see section 40 *Bankruptcy Act*.

<sup>3</sup> Subsection 120 (3A) *Bankruptcy Act*.

*'(a) had not, in respect of that time, kept such books, accounts and records as are usual and proper in relation to the business carried on by the transferor and as sufficiently disclose the transferor's business transactions and financial position; or*

*(b) having kept such books, accounts and records, has not preserved them.'*

There are two safe harbours:

1. Plan early so that the clawback period will have expired if financial problems arise. The best planning is that which is never needed.
2. Have the transferee pay market value. This, of course, will not immediately reduce the net worth of the transferor. However, if the transferor consumes the value provided by the transferee on living, holidaying, school fees etc, there is nothing for the trustee in bankruptcy to recover. Meeting mortgage expenses of the spouse's home may not be a wise decision. This is discussed below.

As to planning early the proposition is simple, if time starts to run at the earliest opportunity the relevant time period for clawback by a trustee in bankruptcy may have expired when the triggering act of bankruptcy occurs. On the second point the transferee must give at least market value consideration for the transfer of the property. There are no special rules about determining the market value of property for bankruptcy purposes<sup>4</sup>.

The decision of the Federal Magistrate in *Thomas v. Tyler (No 2)*<sup>5</sup> shows that the usual contest between opinions of valuers takes place in this context. It also illustrates another exceptionally important point. If the valuation is not correct and the property is transferred at an undervalue the appropriate order, unless it is an exceptional case<sup>6</sup>, is that the property be reconveyed to the trustee in bankruptcy by the transferee. The transferee is repaid the amount of the undervalued consideration but the critical upshot is that any increase in the value of the property will accrue to the trustee in bankruptcy and not the purchaser.

A tactical reaction to this is that the transferee should purchase the property at its market value (with, in this case the market value determined at the high end of the scale). The transferor would provide vendor finance and then release all of the balance of the debt. The property transferred in that case at an undervalue is the debt which is released. The growth in

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<sup>4</sup> It was relevantly observed in the Explanatory Memorandum to the *Bankruptcy Legislation Amendment Bill 1999* that:

*'The expression 'market value' is intended to refer to the value of the property concerned if it were disposed of to an unrelated purchaser bidding in a market on an ordinary commercial basis for property of the kind disposed of, without any sort of discount or incentive for purchase being offered. The expression is not intended to include a situation where the property was being disposed of at a fire sale, at discounted prices because of some immediate need on the part of the owner to liquidate his or her assets',*

Refer *Victorian Producer's Co-Op Co Ltd v. Kenneth* [1999] NSWSC 155.

<sup>5</sup> [2005] FMCA 342.

<sup>6</sup> cf the observation made by Raphael FM in *Thomas v. Tyler (No 2)* that the decision of Driver FM in *Schmierer v. Horan* [2004] FMCA 16 to cause the transferee to pay the trustee in bankruptcy the shortfall was motivated by a desire to maintain the bankrupt's family in the family home and, in any event, there was a small difference which on the balance of convenience justified the order, as exceptional.

the value of the property originally transferred remains with the transferee as there should be no order for reconveyance of the property.

Of course, there is always the question of whether the property has been truly transferred to the trustee of the trust<sup>7</sup> or the transactions are shams<sup>8</sup>.

### 1.8 Transfers to defeat creditors

The other clawback mechanism available to a trustee in bankruptcy is section 121 of the Bankruptcy Act. This provision is driven by motive and is not time dependent. The High Court found in *Cummin's Case*<sup>9</sup> that transfers of property up to 15 years earlier were void as against his trustee in bankruptcy.

Section 121 provides that a transfer is void if:

- the transferor's main purpose was to prevent the transferred property from becoming divisible among the transferor's creditor (or to hinder or delay that process); and
- the property would probably have become part of the transferor's estate or would probably have been available to creditors if the property had not been transferred.

The transferor is taken to have the required main purpose if it can be reasonably inferred from all the circumstances that the transferor was at the time of the transfer insolvent or about to become insolvent.

There is also the same rebuttable assumption about the failure to keep books, accounts and records, or to preserve them as in section 120<sup>10</sup>.

If the transferee gave at least market value consideration for the transfer and did not know or could not reasonably have inferred that the transferor's main purpose was to defeat his or her creditors and that the transferor was or was about to become insolvent then the transfer is not void.

Again, if the transferee pays market value consideration and is innocent of the transferor's state of mind (and objectively so) then the value paid can be dissipated on consumption<sup>11</sup>.

There is an alternative approach. If it can be demonstrated that the bankrupt would have dissipated value actually transferred by the bankrupt (prior to bankruptcy) that value will not be caught by section 121. This is because it must be shown (by the trustee in bankruptcy) that

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<sup>7</sup> *Ramaldi v. Reeves* [2007] FMCA 408.

<sup>8</sup> *Sharment Pty Ltd v. Official Trustee in Bankruptcy* [1988] FCA 179 and *Hyhonie Holdings Pty Ltd v. Leroy* (2003) NSWSC 624 and (2004) NSWCA 72. In *Sharment* Lockhart J observed that in order to find a sham there needed to be a strong finding. The strength of that finding may have been very recently diluted by the decision of the High Court in *Raftland Pty Ltd v. FC of T* [2008] HCA 21.

<sup>9</sup> (2006) HCA 6.

<sup>10</sup> Subsection 121 (4A) Bankruptcy Act.

<sup>11</sup> For an extreme example of this see *Jessup v. Mountain View Farm* [2002] FCA 312.

the property would probably have become part of the transferor's bankrupt estate available to the creditors.

The main issue of concern with section 121 is whether it strikes at generic asset protection planning. Say a person about to engage in a financially risky enterprise eg. accounting or law, transfers assets to a discretionary trust before commencing business. In those circumstances can section 121 provide the trustee in bankruptcy with a clawback when there are no unsatisfied creditors and none looming?

Sackville J in the Federal Court decision in *Cummin's Case* considered this situation<sup>12</sup> and concluded that:

*'It does not seem to me that Ex Parte Mercer necessarily means that a barrister who transfers assets in order to keep them out of the hands of clients or potential clients, who at some stage in the future might sue for professional negligence, is outside the scope of s121(1)(b) of the Bankruptcy Act should the transfer be subsequently impugned. It must be borne in mind that s121(1)(b) may be satisfied even if the transferor was solvent at the time of the transfer and even if the transferor had no creditors at that time. It seems to me that the answer to the question is likely to depend on the facts of the particular case. I am prepared to assume for the purposes of this case, without deciding, that if all that is known is that a professional person:*

- *transferred the bulk of his or her assets to a family member for no consideration;*
- *has no creditors at the time of the transfer (or retains sufficient to meet all liabilities known at the time);*
- *has not engaged and does not propose to engage in any hazardous financial ventures; and*
- *intends to protect the transferred assets from any actions brought by a client who might in the future sue for professional negligence (there being no such suit in the offing at the time of the transfer;*

*then s121(1)(b) of the Bankruptcy Act does not render the transfer void against the person's trustee in bankruptcy. For the reasons that appear, I do not think that assumption is of assistance to the respondents in the circumstances of the present case.*<sup>13</sup>

It is difficult to gain any confidence from this statement, one way or the other. Perhaps there is a slightly favourable view being expressed. Unfortunately none of the judges in the Full Federal Court or the High Court sought to resolve the issue. The High Court simply concluded that it was good enough to be aware of impending liabilities and did not consider the wider question about general asset protection<sup>14</sup>.

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<sup>12</sup> *Prentice v. Cummins (No 6)* [2002] FCA 1503.

<sup>13</sup> [2002] FCA 1503 at paras. 102-103.

<sup>14</sup> [2006] HCA 6 at paras. 29-33.

The issue is, however, readily resolved for practitioners. When there is no choice but to make the transfer to protect the family home and to keep the family from the poor house it must be done and the consequences (if any) suffered later.

In the context of section 121 motive is everything. It helps, therefore, if the transaction is driven by another significant motive such as commercial (including taxation) or family domestic reason.

In *Florance*<sup>15</sup> the Court was persuaded by the evidence of Mrs Florance, the non-bankrupt spouse and option holder, that she wished to retain the properties in question against her husband's desire to give up legal practice and move to the country, ie. purely 'domestic considerations'.

## 2 The Court's power to remove a trustee

Court has the power to appoint a new trustee in substitution of another (former) trustee via both its inherent jurisdiction, and pursuant to section 70 of the Trustee Act. Section 70 of the Trustee Act provides that:

### **70. New trustees**

- (1) ***The Court may make an order for the appointment of a new trustee or new trustees either in substitution for or in addition to any existing trustee or trustees, or although there is no existing trustee.***
- (2) ***The appointment may be made whenever it is expedient to appoint a new trustee or new trustees, and it is inexpedient difficult or impracticable so to do without the assistance of the Court.***
- (3) *In particular and without prejudice to the generality of any other provision of this section, the Court may make an order for the appointment of a new trustee in substitution for a trustee who is convicted of a serious indictable offence, or is a bankrupt, or being a corporation is in liquidation or is dissolved.*
- (4) *In the case of any trust for a charity the Court may make an order for the appointment of a new trustee on such evidence of the trust as the Court deems sufficient.*
- (5) *This section shall be deemed to authorise the Court to make an order for the reappointment of the continuing trustees alone as new trustees.*
- (6) *An order under this section, and any consequential vesting order or conveyance, shall not operate further or otherwise as a discharge to any former or continuing trustee than an appointment of new trustees under any power for that purpose contained in any instrument would have operated.*

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<sup>15</sup> Re *Florance Ex parte: Andrew v. Florance* [1983] FCA 357.

(8) *Every trustee appointed under this section shall, as well before as after the trust property becomes vested in the trustee, have the same powers authorities and discretions, and may in all respects act as if the trustee had*

(9) *Nothing in this section shall give power to appoint an executor or administrator.*

In the context of the Court's inherent jurisdiction to appoint and remove a trustee, *Letterstedt v Broers and Anor* (1884) 9 App Cas 37 (**'Letterstedt's Case'**) stands for the proposition that the jurisdiction of the Court with respect to the removal of a trustee and substitution of new trustees should be exercised for the welfare of the beneficiaries and the trust estate. Lord Blackburn at 386 in *Letterstedt's Case* observed that:

*It seems to their Lordships that the jurisdiction which a Court of Equity has no difficulty in exercising under the circumstances indicated by Story is **merely ancillary to its principal duty, to see that trusts are properly executed.** This duty is constantly being performed by the substitution of new trustees in the place of original trustees for a variety of reasons in non-contentious cases. ... It must always be borne in mind that trustees **exist for the benefit of those to whom the creator of the trust has given the trust estate.** [emphasis added]*

Further, at 386 in *Letterstedt's Case*, Lord Blackburn observes that 'human infirmity' may be a basis of removing a trustee:

*As soon as all questions of character are as far settled as the nature of the case admits, **if it appears clear that the continuance of the trustee would be detrimental to the execution of the trusts, even if for no other reason than that human infirmity would prevent those beneficially interested, or those who act for them, from working in harmony with the trustee, and if there is no reason to the contrary to the intentions of the framer of the trust to give this trustee a benefit or otherwise, the trustee is always advised by his own counsel to resign, and does so.** If without any reasonable ground, he refuses to do so, it seems to their Lordships that **the Court might think it proper to remove him** ... [emphasis added]*

Lord Blackburn at 387 of *Letterstedt's Case* observes that there is no 'general rule' that needs to be satisfied before a trustee is removed, except the 'broad principle' that the welfare of the beneficiaries is paramount:

*In exercising so delicate a jurisdiction as that of removing trustees, their Lordships do not venture to lay down any general rule beyond **the very broad principle ... that their main guide must be the welfare of the beneficiaries.** Probably it is not possible to lay down any more definite rule in a matter so essentially dependent on details often of great nicety.*[emphasis added]

Similarly, the High Court in *Miller v Cameron & Ors* (1936) 54 CLR 572 (**'Miller v Cameron'**), in determining whether it was proper to remove a trustee, held that the dominant consideration was the welfare of the beneficiaries. In citing *Letterstedt's Case*, Stark J at 579 in *Miller v Cameron* considered the interests of the beneficiaries:

*No general rule can be laid down for the removal of trustees from their office. The only guide is the welfare of beneficiaries, and a trustee may be removed if the Court is satisfied that his continuance in office would be detrimental to their interests.*

Further, Stark J at 579 of *Miller v Cameron* concluded that the trustee needed to be removed for the 'protection of the trust estate': *'In the present case, the order removing the appellant from his office is clearly right, and indeed necessary for the protection of the trust estate.'* Further, Dixon J in *Miller v Cameron* at 580 observes that:

*The jurisdiction to remove a trustee is exercised with a view to the interests of the beneficiaries, the security of the trust property and an efficient and satisfactory execution of the trusts and a faithful and sound exercise of the powers conferred upon the trustee.*

That is, Dixon J held that in determining whether a trustee should be removed, and another trustee substituted in its place, consideration needs to be given to:

- (1) protecting the interests of the beneficiaries;
- (2) security of the trust property;
- (3) efficient and satisfactory execution of the trusts; and
- (4) faithful and sound exercise of the powers conferred upon the trustee.

Dixon J in *Miller v Cameron* at 580 observed that, in deciding on whether to remove a trustee and appoint another in substitution, the considerations to be taken into account are many and varied, with the welfare of the beneficiaries paramount:

*In deciding to remove a trustee the Court forms a judgement based upon considerations, possibly large in number and varied in character, which combine to show that the welfare of the beneficiaries is opposed to his continued occupation in the office.*

Further, Dixon J at 580-1 in *Miller v Cameron* observed of the discretionary nature of an action to remove a trustee:

*Such a judgement must be largely discretionary. A trustee is not removed unless circumstances exist which afford ground upon which the jurisdiction may be exercised. But in a case where enough appears to authorise the Court to act, the delicate question whether it should act and proceed to remove the trustee is one upon which the decision of a primary Judge is entitled to especial weight.*

Turner LJ *In re Tempest* (1866) 1 Ch App 485 (*'In re Tempest'*) at 487 considers that in determining appointments of trustees, *'... the Court acts upon and exercises its discretion ...'*, but that it *'... is not ... a mere arbitrary discretion ...'*. Rather, in exercising the discretion, Turner LJ outlined three *'... rules and principles ... [which] ... may, I think, safely be laid down as applying to all cases of appointments by the Court of new trustees ...'*, being that:

- (1) *'... the Court will have regard to the wishes of the persons by whom the trust has been executed, if expressed in the instrument creating the trust, or clearly to be collected from it ...'* (at 487)

- (2) *'... the Court will not appoint a person to be trustee with a view to the interest of some of the persons interested under the trust, in opposition wither to the wishes of the testator or to the interests of others of the cestuis que trusts ...'* (at 487)
- (3) *'The Court in appointing a trustee will have regard to the question, whether his appointment will promote or impede the execution of the trust, for the very purpose of the appointment is that the trust may be better carried into execution ...'* (at 488)

The test of whether an appointment *'... will promote or impede the execution of the trust ...'* was approved and applied by O'Leary J at 162 in *Robert's Case*.

The decisions in *Letterstedt's Case* and *Miller v Cameron* are concerned with the power to remove or replace a trustee as part of the inherent power of the Court to see that trusts are properly executed, and not pursuant to a power conferred by statute (such as section 70 of the Trustee Act). Ball J in *Crowle Foundation v NSW Trustee & Guardian* [2010] NSWSC 647 (*'Crowle's Case'*) observed at paragraph 33 that:

*The legislative test and the test the court applies in exercising its inherent jurisdiction are expressed in different terms. Section 70 applies wherever it is expedient to appoint a new trustee or new trustees and it is inexpedient, difficult or impracticable to do so without the assistance of the court : subs70(2). On the other hand, the question that must be asked when the court exercises its inherent jurisdiction is what is the best interests of the beneficiaries and the administration of the trusts.*

However, Ball J in *Crowle's Case* at paragraph 34 considered that *'... although the legislative test and the test identified by Dixon J ... [in Miller v Cameron] ... appear to be expressed in different terms, the difference is more apparent than real...'*. His Honour considered that the question of *'what is expedient'* must be referenced to the objects to be achieved by the exercise of the power, which his Honour concluded were those outlined by Dixon J in *Miller v Cameron*. It was observed by Ball J at paragraph 34 of *Crowle's Case* that there *'... is no practical differences between what is expedient to attain those objectives and what the court should in the exercise of its inherent power, do to attain them'*.

I note that Ball J in *Crowle's Case* decided to remove a trustee (either pursuant to section 70 of the Trustee Act or in the exercise of the Court's inherent jurisdiction) on the basis that:

- (1) the change of trustee would be conducive to the efficient administration of the trusts (paragraph 36 and following); and
- (2) there were significant risks of conflicts if the existing trustee were not removed (paragraph 39).

In *John Leslie Kennedy v Glenn Raymond Kennedy* [2011] NSWSC 1619 (*'Kennedy's Case'*), Slattery J exercised the Courts supervisory jurisdiction over a trust pursuant to section 70 of the Trustee Act to appoint a new trustee. His Honour discussed the applicable principles with respect to an application pursuant to section 70 of the Trustee Act by observing at paragraph 16 that:

*The principles that apply for the removal of trustees are well established. An order for the removal of a trustee will be made where it is for the welfare of the trust estate as a whole*

*that the trustee should be removed: Guazzino v Pateson (1918) 18 SR (NSW) 275 of 293. If the Court finds that the trust property will not be safe or that the trust will not be properly executed, in the interest of the beneficiaries the trustee can and should be removed: Wrightson v Cooke (1908) 1 Ch 789 at 803 ...*

I note that the Court has the power pursuant to section 70 of the Trustee Act to replace a trustee by reason of age or infirmity. Indeed, Palmer J in *Saul & Ors v Lin* [2004] NSWSC 307 observed at paragraph 17 that ‘..[i]t is well established that the Court has jurisdiction under s. 70(2) of the Trustee Act to appoint a new trustee in place of a trustee who is incapable by reason of age or infirmity...’.

It should be noted that Bleby J in *Pope v DRP Nominees Pty Ltd* (1999) 74 SASR 78 considered that the Court is not deprived of the statutory power to appoint if there is a power of appointment held by someone else. The test that must be satisfied is whether, in the circumstances, it is expedient for the Court to make an order appointing a new trustee. It was observed by Bleby J at 88 that:

*The Court is certainly not deprived of its power to appoint under s 36 merely because there exists a power of appointment in someone else: Re Fauntleroy (1839) 10 Sim 252; 59 ER 610, followed in Re Foxhall (1847) 2 Ph 281; 41 ER 951. The exercise of the power will depend on a number of other circumstances as to whether it is expedient to do so.*

### **3 Statutory power of appointment**

Section 6 of the Trustee Act provides a statutory power of appointment. Section 6 of the Trustee Act provides that:

- (1) **A new trustee may by registered deed be appointed in place of a trustee, either original or substituted, and whether appointed by the Court or otherwise.**
- (2) *A new trustee may be so appointed in any of the following cases, namely:*
  - (a) *where a trustee is dead,*
  - (b) *where a trustee remains out of New South Wales for more than one year without having properly delegated the execution of the trust,*
  - (c) *where a trustee remains out of New South Wales for more than two years,*
  - (d) *where a trustee desires to be discharged from all or any of the trusts or powers reposed in or conferred on the trustee,*
  - (e) *where a trustee refuses or is unfit to act in such trusts or powers, or is incapable of acting therein, or is a minor,*
  - (f) *where a trustee is removed under a power contained in the instrument creating the trust,*
  - (g) *where a trustee being a corporation is dissolved.*

*Provided that a new trustee may not be appointed on the sole ground that a trustee remains out of New South Wales for more than two years if such trustee has delegated the execution of the trust pursuant to the Trustee and Wills (Emergency Provisions) Act 1940 and such delegation remains in force. [emphasis added]*

That is, subsection 6(1) of the Trustee Act provides that a new trustee may be appointed in place of a trustee, and that such an appointment may be made by a Court. Paragraph 6(2)(e) of the Trustee Act provides that the power in subsection 6(1) of the Trustee Act may be exercised ‘... where a trustee ... is incapable of acting...’ in the position of trustee.

In *Re Watts’ Settlement* (1851) 9 Hare 106, it was observed by Turner V.C. at 108 in relation to a settlement that contained a power of appointing a new trustee in the place of a trustee who should become incapable of acting that: ‘*The disqualification which is referred to in the settlement under which the trustee becomes incapable of acting, has reference to personal incapacity; and ... the absence of ... [a trustee] ... and his situation with regard to his bankruptcy, does not constitute such an incapacity as is there provided for ...*’.

See also the decision of Citty J in *Re Lemann’s Trusts* (1883) 22 Ch. D. 633 (*‘Leman’s Case’*), where regard was given to section 32 of the Trustee Act 1850 (UK) (repealed), which enabled the Court to appoint a new trustee in the place of a trustee who had become ‘*incapable*’ of acting in the trusts.

#### **4 The test of ‘expediency’ contained in subsection 70(2) of the Trustee Act**

Subsection 70(2) of the Trustee Act [see **paragraph 1.2** above] provides that the Court may appoint a trustee if both:

- (1) ‘...it is expedient to appoint a new trustee or trustees ...’; and
- (2) ‘... it is inexpedient, difficult or impracticable ... \*to appoint a new trustee+ ... without the assistance of the Court ...’.

In *Lemann’s Case* at 635, Citty J held that ‘... the Court has held it to be expedient to appoint a new trustee in the place of a trustee who is incapable of acting ...’.

O’Leary J in *Re John Albert Roberts* (1983) 70 FLR 158 (*‘Robert’s Case’*) at 162 defined the term ‘expedient’ in the context of section 27 of the Trustee Act (NT) as: ‘Expedient here, I think, may be taken to mean “conducive to advantage in general, or to a definite purpose; fit, proper, or suitable to the circumstances of the case” ...’.

Further, O’Leary J in *Robert’s Case* at 162 observed that in the context of appointing a new trustee in substitution for an existing one, applying the definition of ‘expedient’ in the context of the test laid down by Dixon J in *Miller v Cameron* ‘... I take it to mean then conducive to, or fit or proper or suitable having regard to, “the interests of the beneficiaries, to the security of the trust property and to an efficient and satisfactory execution of the trusts and faithful and sound exercise of the powers conferred upon the trustee”...’

## 5 General prohibition against appointing a relative or a person with close family ties to the position of trustee

Courts are reluctant to appoint as a trustee of a trust someone who is a beneficiary, or a person with close family ties with the beneficiaries.

O’Leary J in *Robert’s Case* observed at 162 of the ‘... general rule that the court will not appoint a near relative of the cestuis que trust to be trustee ...’. O’Leary J explained the purpose of the rule at 163, by observing that ‘... [t]he rule, in the end, is based on the undesirability of appointing a person as trustee who would be in a position where there would be a conflict between her duty and her interest.’

Further, Palmer J in *Saul & Ors v Lin (No 2)* NSWSC 332 observed at paragraph 9 that:

*In my opinion, the general rule that the Court will not appoint as new trustee persons who have close family ties to the beneficiaries is applied as carefully today as it ever was in the old cases. The reason is obvious – Sir John Romilly MR put it in a nutshell in Wilding v Boulder (1855) 21 Beav 222 (22 ER 845):*

*“I have always observed that the worst breaches of trust are committed by relatives who are unable to resist the opportunities of their cestuis qui trust, when they are nearly related to them.”*

*Human nature has not changed since those words were uttered.*

Slattery J at paragraph 18 of *Kennedy’s Case* observed of the Court’s reluctance to appoint beneficiaries as trustees of a trust that:

*... There should be a new trustee or trustees appointed ... The Court is traditionally reluctant to appoint beneficiaries as trustee of the trust. The reasons for this are set out in the cases: Johnstone v Johnstone (1902) 2 SR (NSW) Eq 90. The reluctance is even stronger where there are close family ties between the trustee and the beneficiaries, unless no suitable other person can be found, or there are special circumstances.*

Slattery J considered that there were ‘special circumstances’ that warranted the appointment of a family member to the position of trustee included that:

- (1) the beneficiaries were part of a small family group;
- (2) the administration of the trust was uncomplicated;
- (3) the trust property was a single piece of unimproved real estate; and
- (4) the family members had in fact acted as trustees.

## 6 Access to trust documents – as of right or judicial consent?

A vexing issue that beneficiaries sometimes face when attempting to inspect trust documents is whether they are entitled to do so. Although commonly encountered – whether in the

context of family disputes involving trust estates or disputes involving widely held managed investment schemes – there is little appellate authority on the matter.

In *Silkman, Dorise Enid v Shakespeare Haney Securities Limited* (ACN 087 437 783) in its capacity *as responsible entity of the Shakespeare Haney Premium Income Fund* (ARSN 106 223 483) (*Silkman*)<sup>1</sup> the the NSW Supreme Court sheds further light on the scope of a beneficiary's entitlement to inspect and obtain trust documents.

In his 11 March 2011 decision, Hammerschlag J found that the limited approach contained in *Schmidt v Rosewood Trust*<sup>2</sup> (the Schmidt approach) is preferred over the more expansive one in *In re Londonderry's Settlement*; *Peat v Walsh*<sup>3</sup> (the Londonderry approach). Based on the Schmidt approach, that is, that a beneficiary does not have a proprietary interest in trust documents, they will not have an automatic right of production and inspection of such documents. Rather, they may only obtain such documents by requesting the court exercise its inherent jurisdiction to intervene in the administration of the trust.

The *Silkman* decision concerned an application by an investor (the plaintiff) in a managed investment scheme, who sought to obtain certain documents from the responsible entity of the scheme (the defendant).

### **6.1 Rejecting the Londonderry approach and applying the Schmidt approach**

The plaintiff relied on the Londonderry approach to argue that it could inspect the trust documents the defendant (as trustee) held as of right, with the right being an equitable proprietary interest of the plaintiff (as beneficiary).<sup>4</sup>

Hammerschlag J observed that the “*underlying idea*” of the Londonderry approach was that trust documents “*are themselves either trust property or are so closely related to trust property that they may be characterised as documents in which a beneficiary has such an interest. ... Gummow J described this right as proprietary in nature although falling short of a full beneficial interest ...*”.<sup>5</sup>

The court outlined the implication if the Londonderry approach were to apply:<sup>6</sup> “*On the Londonderry approach the plaintiff need do no more than establish that the defendant is her trustee and that the documents sought are so-called trust documents. The relief is as of right and does not require the exercise of any judicial discretion in favour of the plaintiff. The plaintiff put that trust documents means documents which evidence or record the nature, condition, and value of the assets of the Scheme, and that all the documents called for by Summons meet these criteria.*”

That is, if the Londonderry approach applied and the documents requested were trust documents, then the plaintiff would be entitled to them as of right. Alternatively, if the Schmidt approach applied, as a trustee has no equitable proprietary interest in documents held subject to a trust, there is no automatic right of production and inspection. Rather, the court may use its inherent jurisdiction to intervene in the administration of a trust. A beneficiary could request an order for production and inspection of documents held by a trustee.<sup>7</sup>

Gzell J in *Avanes v Marshall & Ors* explained the Schmidt approach: <sup>8</sup> *“the Privy Council rejected the proprietary interest theory and adopted the approach that the right to seek disclosure of trust documents was an aspect of the court’s inherent jurisdiction to supervise and, if necessary, to intervene in the administration of trusts. Since that right was not confined to proprietary interests, the object of a discretion or a mere power might also be entitled to protection.”*

Gzell J in *Avanes* considered that the Schmidt approach should be accepted, and that *“the decision should not be regarded as abrogating the trustee’s duty to keep accounts and to be ready to have them passed, nor the trustee’s obligation to grant a beneficiary access to trust accounts. But when it comes to inspection of other documents there should no longer be an entitlement as of right to disclosure of any document. It should be for the court to determine to what extent information should be disclosed”*.<sup>9</sup>

That is, his Honour distinguished between trust accounts and trust documents. It seems that under the Schmidt approach, trustees are obliged to disclose trust accounts, and not trust documents. Further guidance may be needed to distinguish between the two.

In *Silkman*, Hammerschlag J considered that the Schmidt approach should be preferred, as the Londonderry approach had the following jurisprudential difficulties:

- it was difficult to ascribe a workable and principled definition to the term *“trust document”*;
- an object of a discretionary trust who had an interest in the due administration of the trust but who had no proprietary interest in the assets would be (illogically) denied disclosure;
- the only limitation on disclosure was by reference to third parties in maintaining confidentiality, and that such a limitation was arbitrary; and
- reconciling a beneficiary’s entitlement to documents, such as a settlor’s statement of intention or a trust deed, when these instruments are themselves not assets or appurtenant to assets of the trust.

It is submitted that the rejection of a beneficiary’s equitable proprietary interest in trust documents is correct. It has been held that a beneficiary (whether of a unit trust or a discretionary trust) does not have an equitable interest in trust assets.<sup>10</sup> Specifically, while a trustee’s right of indemnity exists, it is difficult for a beneficiary to claim any interest or entitlement in the trust assets. This is because while the right of indemnity subsists, that right may be exercised by the trustee of any trust asset. It is only when the right of indemnity is extinguished will a beneficiary be able to determine the assets of the trust which remain (and to which the beneficiaries may be entitled).

***“The court ... would intervene only if it were shown that the defendant had fallen short of its duty to disclose.”***

## 6.2 Non-application of the Schmidt approach

The court considered that using the Schmidt approach, it would intervene only if it were shown that the defendant had fallen short of its duty to disclose. In this case, the court refused to exercise its discretion because:

- the defendant did not fall short of any disclosure obligations, with the scope of the documents requested by the plaintiff not able to cure that deficiency;
- the purpose of the plaintiff's requests were to assess whether there were actionable breaches of trust by the defendant, and not whether the defendant had fallen short of its failure to provide information; and
- the scope of the documents requested was extremely wide.
- However, the court did observe in obiter that if disclosure could be compelled based on the Schmidt approach, then matters which would not deny production included:
  - the unfettered discretion granted to the defendant in the scheme's constituent documents to invest does not entitle documents to be withheld from production; and
  - any improper purpose attributed to the plaintiff would not erode an entitlement to compel inspection.

## 6.3 Whether the requested documents were trust documents

The plaintiff contended that trust documents, for the purposes of obtaining disclosure from the defendant, included documents which "*evidence or record the nature, condition and value of the trust assets*".<sup>11</sup> It was held that even if the Londonderry approach were accepted, the documents which the plaintiff sought did not meet the plaintiff's definition of trust documents as they related to:

- securities in favour of the defendant referable to investments which were offered but not actually given – this would have allowed access to information on securities, which were never assets of the trust;
- potential defaults on mortgage investments held within the scheme – such information extended beyond trust documents, as they did not directly relate to trust assets; and
- accounts recording advances and repayments – documents which answer this category would extend to primary recordings of every payment and receipt on every mortgage investment. This would be beyond the characterisation of documents which evidence and record the nature, condition and value of trust assets.

While the court did review the requested documents to determine whether those documents fell within the scope of that which evidenced and recorded the nature, condition and value of the trust assets, it did not definitively define the term "*trust documents*".

## 7 The court's discretion to exclude – confidentiality

Hammerschlag J also referred to the SA Supreme Court's decision in *Rouse v IOOF Australia Trustees Limited (Rouse)*,<sup>12</sup> which dealt with a trustee's discretion to refuse inspection of trust documents on the grounds of confidentiality. Such discretion may be exercised if:

- the trustee has reasonable grounds to conclude that the disclosure of trust documents will not be in the best interests of the beneficiaries as a whole; and
- such disclosure will prejudice the ability of the trustee in discharging its obligations under the trust.

Doyle CJ in *Rouse* considered that the exercise of the discretion subject to the following caveat: *“I do not, in what I have said, contemplate the use of that discretion to enable a trustee to deal in a partial or discriminatory manner as between beneficiaries or groups of beneficiaries, except to the extent that the necessary result of a proper exercise of the discretion may be that particular beneficiaries are not give access to a document.”*<sup>13</sup>

As Hammerschlag J considered that the requested documents were not trust documents, the court declined to consider the application of the discretion discussed in *Rouse*.

***“The Schmidt approach is consistent with a beneficiary’s general entitlement to the due administration of a trust estate.”***

The rejection of the Londonderry approach, and in particular the notion that a beneficiary has an equitable proprietary interest in trust documents, is consistent with the view that a beneficiary of a trust does not have a beneficial interest in trust assets. This is particularly so where a trustee’s right of indemnity subsists. Indeed, it is submitted that the Schmidt approach is consistent with a beneficiary’s general entitlement to the due administration of a trust estate.

The application of the Schmidt approach shifts the burden with respect to inspection of trust documents from the trustee to the beneficiary. According to the Londonderry approach, after it is established that a trust document exists (subject to limited exceptions), the trustee is compelled to provide the documents. However, the Schmidt approach requires that in order for trust documents to be produced to a beneficiary, they would need to satisfy the following two conditions:

- (1) The documents need to answer the definition of trust documents, which according to the decision in *Silkman* may include those which evidence or record the nature, value and condition of trust assets; and
- (2) After being identified as trust documents, the documents are required for the proper supervision and administration of the trust.

A vexed issue is which documents answer the definition of trust documents. The court based its decision on the proposition that trust documents included those which record or evidence the nature, condition and value of trust assets, and that such documents must directly relate to specific trust assets. It is not sufficient that the requested documents relate to the operation of the trust.

In the context of the facts in *Silkman*, trust documents may include securities (or investments) actually obtained, and not those which were merely offered. Further, actual defaults on mortgages (or actual bad investments), and not potential defaults (or potential bad investments) would be within the scope of trust documents.

While trust accounts do fall within the scope of trust documents, unlike other trust documents, a beneficiary may be entitled to view accounts as of right. Such an entitlement is based on the trustee's duty to keep accounts, and provide proper disclosure of such accounts to beneficiaries.

As a result (and as opposed to obtaining other trust documents), a beneficiary need not invoke the inherent jurisdiction of the court when seeking disclosure of trust accounts.

However, with respect to trust documents which are not also trust accounts, a beneficiary will need to invoke the inherent jurisdiction of the court in order to access such documents. In doing so, the court must be satisfied that the documents requested are required for the proper supervision and administration of the trust. It means a beneficiary needs to meet a higher standard to access trust documents, as opposed to trust accounts.

Trust accounts may not themselves record or evidence the nature, condition and value of trust assets. For example, trust accounts may not record the value of trust assets, if the accounts are based on historical costs.

Certain documents which are used for the purposes of compiling trust accounts (that is, primary documents) may not themselves be trust accounts. Further, such documents may also not meet the definition of trust documents, as they do not evidence or record the nature, condition or value of trust assets. Rather, they evidence or record transactions. As such documents may not be trust documents, the inherent jurisdiction may not need to be invoked to compel production. That is, particulars with respect to transactions which relate to assets may not themselves be trust documents.

It remains to be seen whether applications for disclosure of trust documents:

- promote fishing expeditions by beneficiaries; or
- in proving that the application is required for the purposes of supervision or administration of a trust, whether the courts will require the beneficiary applicant to satisfy the court that there is a cause of action (such as a breach of trust) before disclosure is granted.

Further, the court observed that a beneficiary's claim for trust documents should be distinguished from both preliminary discovery and discovery in proceedings which have already commenced.

## 8 Trusts and family provision legislation

In New South Wales, the provisions contained in *Succession Act 2006* (NSW) ('**the Succession Act**') regarding family provisions, which replaced the *Family Provision Act 1982* (NSW), seek to limit the freedom of testation to the extent consistent with the purposes of the Act and the Bill. That purpose is to:-

*'enable a court to override the terms of a deceased person's will or the distribution of a deceased person's estate on intestacy if it determines it is necessary to do so to ensure that the family and other dependants of a deceased person are adequately provided for'*<sup>16</sup>.

The conflict between testamentary freedom (often expressed as 'the freedom to leave my property to anyone I like') and the 'community standards' often referred to by judges in deciding family provision cases leads to situations of emotion and stress. The plaintiff cannot understand why he or she has been left out, and the beneficiaries under the will cannot understand why the plaintiff is not happy with his or her lot. Often, the impact of the will can be minimised before death; rarely can it be totally avoided.<sup>17</sup>

An understanding, even if only a general one, of the impact and reach of the Family Provision legislation is important in considering the position of wills in estate and succession planning. For will drafters, there are considerations of inclusion of relatives, for provision of reasons for exclusion, and the advice which can be given as to possible applications by disappointed family members. For succession planners, considerations need to be given to the effectiveness of strategies to remove property from the estate.

### **8.1 Overview of family provision**

Under Chapter 3 of the Succession Act, the Court may make a family provision order in relation to the estate of a deceased person in favour of an eligible person on application by the eligible person to the court (section 59, Succession Act). However, the Court may only make the order if the eligible person has not been adequately provided for by the testator for the person's maintenance, education or advancement in life (section 59, Succession Act).

An eligible person as defined in section 57 of the Succession Act include the spouse, child, former spouse, a person who was wholly or partly dependent on the deceased who is either a grandchild or was a member of the deceased's household, and a person with whom the deceased person was living in a close personal relationship at the time of the deceased person's death.

Under subsection 58(2) of the Succession Act, any applications made under the Succession Act must be made within 12 months from the date of death of the deceased unless otherwise ordered by the court.

### **8.2 Family Provision and Trusts**

Section 63 of the Succession Act contains a list of property that may be used for family provisions orders, which include:

- (1) *A family provision order may be made in relation to the estate of a deceased person.*
- (2) *If the deceased person died leaving a will, the estate of the deceased person includes property that would, on a grant of probate of the will, vest in the executor*

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<sup>16</sup> Explanatory Note, Overview of Bill, Succession Amendment (Family Provision) Bill 2008.

<sup>17</sup> For an entertaining review of this conflict, see Professor Croucher's *Conflicting Narratives in Succession Law* (2007) 14 APLJ 179.

*of the will, or would on a grant of administration with the will annexed, vest in the legal representative appointed under that grant.*

- (3) A family provision order may not be made in relation to property of the estate that has been distributed by the legal representative of the estate in compliance with the requirements of section 93, except as provided by subsection (5).*
- (4) Where property of the estate of a deceased person is held by the legal representative of that estate as trustee for a person or for a charitable or other purpose, the property is to be treated, for the purposes of this Chapter, as not having been distributed unless it is vested in interest in that person or for that purpose.*
- (5) A family provision order may be made in relation to property that is not part of the estate of a deceased person, or that has been distributed, if it is designated as notional estate of the deceased person by an order under Part 3.3.*

As can be seen from subsection 63(4), properties subject to the testamentary trust are properties that may be used for family provisions orders.

Further, Part 3.3 of the Succession Act enables the court to make an order designating property that the deceased disposed of before death as being property that forms part of the deceased's 'notional estate', and the court may make a family provisions order out of this notional estate under subsection 63(5), Succession Act.

The Note to Part 3.3 in the Succession Act summarises the notional estate provision:

*Property may be designated as notional estate if it is property held by, or on trust for, a person by whom property became held (whether or not as trustee), or the object of a trust for which property became held on trust:*

- (a) as a result of a distribution from the estate of a deceased person (see section 79), whether or not the property was the subject of the distribution, or*
- (b) as a result of a relevant property transaction, whether or not the property was the subject of the transaction (see section 80), or*
- (c) as a result of a relevant property transaction entered into by a person by whom property became held, or for whom property became held on trust, as a result of a relevant property transaction or a distribution from the estate of a deceased person (see section 81), whether or not the property was the subject of the relevant property transaction.*

*Property may also be designated as notional estate if it is property:*

- (a) held by the legal representative of the estate of a person by whom property became held as a result of a relevant property transaction or distribution referred to in paragraphs (a)-(c) above and who has since died (known as the "deceased transferee"), or*

(b) *held by, or on trust for, a person by whom property became held, or for the object of a trust for which property became held on trust, as a result of a distribution from the estate of a deceased transferee,*

*whether or not the property was the subject of the relevant property transaction or the distribution from the estate of the deceased person or the deceased transferee (see section 82).*

As a result of the provisions in Part 3.3, properties subject to a testamentary trust may become part of the deceased's notional estate.

In *Kavalee v Burbidge* (1998) 43 NSWLR 422, the New South Wales Court of Appeal held that assets transferred by the deceased in a series of transactions during his lifetime to a foundation established under the laws of Liechtenstein were available to be designated as notional estate. The Court found that instructions could be given from time to time by the deceased to the 'Founder' controlling the foundation, who was legally obliged to implement the instructions of the deceased.

Mason P (with whom Meagher JA agreed) said at 446-7:

*'... I do not see s 22(1)(a) [Now s75(1) of the Succession Act] as confined to acts or omissions that are the operative cause of property becoming held by the deceased's intended donee. To do so would ignore the thrust of this liberal enactment which emphasises its scope with the words "directly or indirectly", "as a result of which" (emphasis added) and "whether or not the property becomes [so] held immediately"... The legislation is clearly intended to operate in a context of human agents where several may have to act in concert and where there is the possibility that one may not co-operate. To paraphrase Mason J in *Fagan v Crimes Compensation Tribunal* (at 673), "the fact that other unconnected events may also have had some relationship to the occurrence is not material if the [act] was a cause, even if not the sole cause"...*

The respondents dispute that it is correct to approach the issue of causation in this way. They support Windeyer J in his conclusion that the relevant act or omission must be the effective cause. We were reminded that the Act interferes with property rights. But the critical issue is the extent of that potential interference. In my view, the choice of a looser test of causation is open. For the reasons given, s 22(1) suggests, and certainly permits, the looser approach to the factual issue of causation that I have adopted. *Schaeffer* (at 318) citing *Wentworth v Wentworth* (Bryson J, 14 June 1991, unreported) identifies:

*"... a purpose of the Legislature that the notional property provisions should extend the powers of the Court to the full range of benefits and advantages controlled by testators. In so far as any question of construction presents a choice, a construction which would promote this purpose is to be preferred: see s 33 of the Interpretation Act 1987."*

*... In any event, s 22(1)(a) extends to omissions. And since, as I have held, the deceased had the legal power to direct the Founder to do his bidding, the failure to exercise this power before death must surely be seen as an operative cause of the by-law remaining in its final form. That by-law "designate[d] as beneficiaries" of the Foundation those persons referred to in the "bequests" section of the memorandum. By omitting to*

*exercise his entitlement to direct the Founder to revoke the by-law, the deceased omitted to do an act as a result of which the bequests stipulated in the by-law came to be paid by the Foundation, which was obliged to obey its terms.'*

Mason P then considered at pages 450-454 whether or not there might be a prescribed transaction due to the deceased's omission to exercise the power to appoint or to dispose of the property of the foundation and:

*'The appellants submit that, during his lifetime, the deceased could have caused the assets of the Gartner Foundation to be dealt with as he pleased. They rely upon the trial judge's finding that the deceased had control of Mr Defago who in turn had control of the Foundation through the capacity to compel the exercise of the full gamut of Founder's rights that were vested in DFC at the time of the deceased's death. I have already indicated that I accept that such control existed.*

*Windeyer J held that s 22(4)(a) [Now s76(2)(a) of the Succession Act] did not apply because:*

- (a) the deceased had no power to appoint or dispose of the property of the Foundation; and*
- (b) the property of the Foundation did not become held by another person as a result of the deceased's omission to exercise the power before his death (in the terms of s 22(4)(a)(i)).*

*The respondents support these propositions. The appellants dispute them and also invoke s 22(4)(a)(ii).*

***(a) Did the deceased have the power to appoint or dispose of the property of the Foundation during his lifetime?***

*Windeyer J answered "no". He did not find it necessary to consider (as I have) whether the deceased had legal rights to compel Mr Defago, and through him the Founder, to do his bidding. And he distinguished between the power of the deceased over the Founder on the one hand, and the power of the Founder over the Foundation on the other...*

...

*In my opinion, the distinction drawn by the learned trial judge (between a power to or dispose of property that was directly exercisable, and one which depended upon compelling Mr Defago to execute various documents) finds no support in this legislative scheme. What I have described as the deceased's legal power to compel Mr Defago, through DFC, to cause the Foundation to deal with its assets as the deceased might stipulate was in effect an entitlement to exercise a power to dispose of the property in the Gartner Foundation. That power existed (albeit indirectly) through the agency of Mr Defago and his firms, SCF and DFC. A "power to ¼ dispose of property" is not a technical term of law. In context it must mean something more than a traditional power of appointment, assuming that the latter concept were limited in any presently relevant way.*

...

*Returning, as I must, to construing s 22(4)(a) in context, and faithful to the purpose of Pt 2, Div 2 of the Act as expounded in Schaeffer (at 318-319). I am satisfied that the deceased had until his death an entitlement to exercise a power to dispose of property which was not in his estate, being the property vested in the Foundation.*

*I accept that there is a vital distinction between de facto control and legal entitlement: see Re Sutton Coldfield Grammar School (1881) 7 App Cas 91; National Companies & Securities Commission v Brierley Investments Ltd (at 287). Section 22(4)(a) requires entitlement. However, entitlement and immediate enjoyment are different. Here the powers of DFC as Founder were at the deceased's disposal as a matter of right, through the rights which the deceased had over Mr Defago. And, if he chose, the deceased was, as a matter of right, able to have the Founder replaced by a Founder that would do the deceased's bidding. Indeed, the deceased could have required DFC to appoint the deceased himself as the Founder. All steps to effect an appointment or disposal of assets as the deceased chose were really administrative once the deceased determined to act.*

*I have no difficulty in conceding that the power to appoint or dispose of the assets of Gartner (through art 6) was vested in the Founder for the time being. Absent a contrary direction from the deceased, the Founder immediately before and after the deceased's death (DFC) was entitled to exercise that power of disposition. But more than one person may have concurrent powers to deal with or dispose of the same item of property...*

**(b) Did the omission to exercise the power before death cause either of the events in s 22(4)(a)(i) or (ii)?**

*I agree generally with Windeyer J on s 22(4)(a)(i). The property of the Foundation remained vested in it before and after the deceased's death. It did not "become held by another person" as a result of the omission to exercise the relevant power and the deceased's death.*

*However, s 22(4)(a)(ii) must also be considered. The death of the deceased F either led to the transmission of the deceased's rights over the Founder according to the law of the deceased's domicile, or it terminated those rights ... If the former, there was obviously "another person" (cf s 22(4)(a)(ii)) who became entitled to exercise the deceased's power of disposition, and this occurred as a result of the deceased's omission to do so and his death.*

*If the latter, the expiry of the deceased's rights left the Founder's powers G intact. Can it be said that as a result of the deceased's omission to exercise his power and of his death, the Founder "continue[d] to be, entitled to exercise the power" (to which it was previously entitled) to dispose of the assets of the Foundation?*

*The respondents are correct in their submission that "the power" referred to in subpar (ii) must be the same power as that which was enjoyed by a deceased before he or she ceased to be entitled to exercise it. But the very fact that the subparagraph contemplates that "another person" may continue to be entitled to exercise the power shows that the provision embraces the situation of two or more persons having a concurrent power to dispose of property with one of those persons (being the deceased) ceasing to exercise it as a result of the prior omission to exercise it and death. ... The Founder's entitlement to*

*exercise the power preceded the deceased's death and continued after it. This satisfied subpar (ii) if it were the case that the deceased's entitlement was non-transmissible.*

*This alone is not sufficient to satisfy s 22(4)(a)(ii). It must also be shown that the continuation of the Founder's power came about "as a result of" the deceased's omission to exercise his concurrent power and of his death. The respondents submit that it is at this point that the appellant's argument breaks down. They submit that there is no link or connection between the continuation of the Founder's powers under the articles of the Foundation and the deceased's omission to dispose of the Foundation's assets (as he could have, through his power over the Founder that I have found to exist) before his death. And the respondents emphasise (correctly) that the same "power" is involved wherever it is mentioned in the paragraph.*

*... I would reject the respondents' argument for the following reasons. If the deceased had exercised the power which he held yet omitted to exercise, then the assets of the Foundation would have been effectively disposed of. For example, the deceased could have directed the Founder to make a by-law whereby the corpus of the Founder's assets (after payment of the "bequests") were paid to one or more of the appellants. That by-law could have been made irrevocable ... The deceased did not procure this during his lifetime. It can therefore be said that his omission to do so before his death was a cause of the assets remaining in the Foundation. The Founder's concurrent powers of disposition (through making by-laws) remained as it stood under the articles. It continued after the deceased's death. The provision does not require that the concurrent powers of disposition should be exercisable in identical ways. That continuation was causally linked to the deceased's omission in that the omission contributed to the continuation of the Founder's power of disposition under the (unamended) articles, and left the Founder with assets at its disposition in the Foundation.*

The decision of *Kavalee* was considered by the New South Wales Supreme Court in *Flinn v Fearn* [1999] NSWSC 1041. In *Flinn*, Master McLaughlin distinguished *Kavalee* and said:

*'23 It must, however, be recognised that the decision in Kavalle v Burbidge was essentially a decision upon its own facts, dealing with the legal rights of a testator in the context of the law of Liechtenstein, and the specific legal powers vested in the testator in that case (see the judgment of Mason P at 451E), which are to be distinguished from the powers vested in the deceased in the instant case. Whereas, in Kavalle v Burbidge there was a legal duty imposed upon Mr Defago, the trustee, to act in accordance with the directions of the testator, in the instant case there was no such legal duty imposed upon the trustee to act in accordance with the directions of the deceased.*

*24 There is no doubt, in the instant case, that the deceased during his lifetime, in his capacity as the Nominator, had the power, to remove the trustee named in the deed and to appoint another trustee of the G & A Fearn Family Trust. It seems to me, however, that that power is very different from the power of de facto control of the trust asserted by the plaintiffs to have reposed in the deceased. Indeed, the entire basis of that assertion of de facto control appears to depend upon assumptions, firstly, that the deceased would be able to find another potential trustee who would be amenable to the dictates of the deceased, and, secondly, that any such entity or person, when appointed trustee, would*

*disregard his duties as a trustee (see Jacobs' Law of Trusts in Australia, 6 ed (1997), 51, paragraph 265; 409, paragraphs 1609ff).*

*25 It was submitted on behalf of the defendant that the deceased held his power in a fiduciary capacity and that he could exercise it only in such a fiduciary capacity. Whether or not that was so, it is abundantly clear that the deceased could not have properly given, and the trustee could not have properly received, a direction that the trustee dispose of the trust property. The most that the deceased could have done was to remove the nominated trustee and to appoint as a new trustee a person or entity whom the deceased might have expected would act in accordance with his direction. (It was suggested on behalf of the plaintiffs that the deceased could even have appointed as such new trustee a company controlled by the plaintiff.)*

*26 Nevertheless, there could be no certainty that either the original trustee or any replacement thereof appointed by the deceased would necessarily have acted in accordance with such a direction by the deceased, since the conduct of the trustee, were he merely to have acted as directed by the deceased, without independently carrying out his duties and exercising his discretion (in the manner described in the foregoing passages from Jacobs), would have constituted on the part of the trustee a clear breach of trust. (If the deceased had appointed as a replacement trustee a company which he himself controlled, it is possible that any disposition of trust property to the deceased by such a trustee would have been in contravention of clause 18(a)(ii) of the deed.)*

*27 It seems to me that a clear distinction must be drawn between, on the one hand, the conduct of the deceased in failing to exercise his powers as the Nominator, and, on the other hand, the conduct of the trustee. It is all very well for the plaintiffs to say that the deceased could have dismissed the trustee and could have appointed a fresh trustee who would be malleable and would act in accordance with the wishes of the deceased. Nevertheless, the essential question is whether the deceased himself entered into a prescribed transaction, not whether the trustee, by his failure to do anything, allowed the property to remain subject to a trust.'*

## **9 Asset protection and trusts: The current state of play following the fall out from the Richstar's case**

The *Richstar Enterprises Case*<sup>18</sup> concerned the collapse of the Westpoint Group. The Australian Securities and Investment Commission ('ASIC') had already obtained orders that receivers be appointed to the property of a number of Westpoint directors and companies controlled by them. The point of these actions was to preserve property of the individuals and companies to prevent it being dissipated pending the ASIC enquiries.

The question before the Court was whether a receiver could be appointed to property held in trust. The relevant provision was section 1323 of the Corporations Act. This section allowed the Court on application by ASIC or an aggrieved person to appoint inter alia a receiver to

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<sup>18</sup> *Australian Securities and Investments Commission: In the matter of Richstar Enterprises Pty Ltd (ACN 099 071 968) v. Carey* (No 6) [2006] FCA 814.

property of a person, who is subject to an investigation being carried out under the ASIC Act or the Corporations Act. 'Property' is defined as meaning:

*'any legal or equitable estate or interest (whether vested or contingent) in real or personal property of any description and includes a thing in action'.<sup>19</sup>*

The Court was satisfied that it could make such an order where the property was held as trustee by the persons being investigated and in relation to superannuation funds where the individuals were members. In each instance it was considered that the individuals subject of investigation had an 'interest' (legal or equitable).

The 'interest' of the individuals in discretionary trusts posed a more difficult question because the objects have nothing more than a right to be considered by the trustee as a potential beneficiary of the trustee's largesse as to income or capital.

French J undertook a detailed (but in the writer's view not exhaustive) review of the case law on the powers of trustees and their controllers. The two most telling observations made by the Court were these:

*'in the ordinary case the beneficiary of a discretionary trust other than perhaps the sole beneficiary of an exhaustive trust, does not have an equitable interest in the trust income or property which would fall within even the most generous definition of 'property' in s9 of the Act and be amenable to control by receivers under s.1323. I distinguish the 'ordinary case' from the case in which the beneficiary effectively controls the trustee's power of selection. Then there is something which is akin to a proprietary interest in the beneficiary.'<sup>20</sup>*

And:

*'I am inclined to think that a beneficiary in such a case ... at arm's length from the trustee, does not have a 'contingent interest' but rather an expectancy or mere possibility of a distribution ... On the other hand, where a discretionary trust is controlled by a trustee who is in truth the alter ego of a beneficiary, then at the very least a contingent interest may be identified because, in the words of Nourse J 'it is as good as certain that the beneficiary will receive the benefits of distributions either of income or capital or both'.<sup>21</sup>*

In a wealth preservation and tax planning context it might well be said that 'it is as good as certain that the beneficiary will not receive the benefits of distributions ...'

The Court Concluded that a Mr Beck who was the sole director and secretary of a corporate trustee of a discretionary trust had an interest in property of the trust (it did not matter that his wife was the Appointor):

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<sup>19</sup> Section 9 Corporations Act.

<sup>20</sup> *Richstar* at para. 25.

<sup>21</sup> *Richstar* at para. 36.

*'Mr Beck is a beneficiary of the Agribusiness Annuity Trust of which Eagle Bluff Nominees Pty Ltd is a trustee. He is the director and secretary of that trustee company. He is the original appointor under the trust and his wife, Anne Beck, the current appointor. The trustee has a wide discretion including the power to prefer one or the other beneficiary to the total exclusion of any other beneficiary. Mr Beck would appear, through his trustee company, to have effective control of the assets of the trust. At the very least he has a contingent interest in the sense used earlier. His interest would appear to amount to effective ownership of the trust property. The property of that trust is, in my opinion, amenable to control by the receivers and s.1323'.<sup>22</sup>*

Does this decision sound the death knell of discretionary trusts as wealth preservation mechanisms?

In this writer's view – no and for two reasons. The first, technical differences between the legislation under consideration in *Richstar* and the Bankruptcy Act. The second reason, a practical one, lack of assured funds on the part of trustees in bankruptcy.

The property of a bankrupt at the time the person became a bankrupt passes to the trustee in bankruptcy.<sup>23</sup> However, property held on trust for another is specifically excluded.<sup>24</sup> In addition, the power of appointment of the trustee is not property which passes to the trustee in bankruptcy.<sup>25</sup>

Division 4A of the Bankruptcy Act specifically contemplates and makes provision for the circumstances where a bankrupt controls a trust.<sup>26</sup> In these circumstances it can be vigorously argued that the Bankruptcy Act recognises that the interest of the bankrupt in a discretionary trust is not attainable by a trustee in bankruptcy. For a somewhat contradictory view see the paper prepared by Justice Branson for the ITSA Bi-Annual Congress 2006.<sup>27</sup>

In any event, if the contingent interest that French J has identified passed to the trustee in bankruptcy – what is the true practical effect. The right as a beneficiary is to be considered and no more. That is not an attractive outcome for a trustee in bankruptcy.

The more practical aspect is that a trustee in bankruptcy personally takes on the risk of litigation. If he or she fails then there is a personal loss. This is a significant deterrent to pursuing cases which have a significant risk of failure.

It is recognized that a trustee in bankruptcy may have access to litigation funding. However, a litigation funder would take a very considered view of the implications of *Richstar* (after having first identified significant assets which might be accessed).

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<sup>22</sup> (2006) FCA814 at para. 41.

<sup>23</sup> Subsection 116(1) Bankruptcy Act.

<sup>24</sup> Paragraph 116(2)(a) Bankruptcy Act.

<sup>25</sup> *Re Burton; ex parte Wily v. Burton* (1994) 126 ALR 557.

<sup>26</sup> Division 4A relates to entities controlled by the bankrupt and 'entity' includes a trust.

<sup>27</sup> 'The Bankrupt, His or Her Spouse and the Family Trust: A consideration of Part VI Division 4A of the Bankruptcy Act.'

In the writer's view the decision is not one which will cause the trust edifice to crumble. However, it may in truly risky environments be wise take French J's structuring message into account. Actions which might be taken are:

- the risk exposed person might be excluded as a direct object of the trust. An indirect benefit might be obtained through another discretionary trust brought into the objects clause through the spouse or children;
- the risk exposed person might be one only of a number of directors of the corporate trustee and the decisions need genuinely to be made jointly;
- the risk exposed person would not be the Appointor or, if an Appointor, is one of a number of such persons and does not have a casting vote. An Appointor stripping clause may also be appropriate.

Careful attention to the trust deed may avoid the implications of the decision in *Richstar*.

## 10 Present entitlements and estate considerations

In the recent NSW Supreme Court decision in *Wood v Inglis* [2009] NSWSC 601, Brereton J considered issues relating to a deceased beneficiary's present entitlements accruing in his loan account. In that case, Dr William Inglis, his wife and children were beneficiaries of a discretionary trust. Before he died, Dr Inglis, along with his wife and one of his children, were the directors of the corporate trustee of his discretionary trust. The trust funds were invested in shares and income was distributed to Dr Inglis and his families by crediting their beneficiary loan accounts, on which they drew for expenditure. The trust accounts were prepared whereby movements in the net value of the investments of the trust were treated on income account and distributed to the beneficiaries.

The issue in *Inglis's case* concerns whether the trustee may lawfully treat and have in fact treated the movement in the investment as income. If that was the case, the question then becomes whether the trustee has in fact made the disputed distributions to Dr Inglis and if so whether the trustee has discharged the obligation arising from the distributions made. The case arose because Dr Inglis left his residue estate, which includes the debt due to him from the Trust on his beneficiary loan account, solely to his wife in his will. Therefore if the distributions have been validly made, then the trust will need to pay the distributions (unless otherwise discharged) to his estate, to which his wife is the only beneficiary. On the other hand, if the distributions were not validly made, then any increase in value in the trust investments would remain in the trust, which Dr Inglis' children may benefit from.

Brereton J first considered the question of whether the trustee could, consistent with the trust deed, lawfully treat movements in the value of investments as income, and distribute it to beneficiaries. After considering the terms of the trust deed, Brereton J held that:

*'14 I do not accept that it cannot be said that a profit has been made (or "incurred", for the purposes of clause 10 of the Trust Deed), just because it has not been realised. Comparison of the value of the assets of an entity at the end of the relevant period with their value at the beginning of that period is one well-recognised means of ascertaining*

*profit [Re Spanish Prospecting Co Limited [1911] 1 Ch 92, 98; QBE Insurance Group v ASIC (1992) 38 FCR 270, 284-5 [53] – [57]].*

...

*16 That conclusion is only reinforced by clause 6(f). I do not accept that the reference in clause 6(f) to “property or moneys held by the Trustee”, coupled with the definition of “property”, means that the reach of the clause does not extend to “unrealised capital gains”; the purpose of the clause is plainly to avoid disputation as to whether receipts, profits and distributions received by the trust are capital or income by empowering the Trustee to make that determination. The effect of treating “unrealised capital gains” as income is that so much of the value of a share (which is expressly within the definition of “property”) as reflects that gain is treated as income. As has already been observed, the proviso contained in clause 6(f) demonstrates that the Trustee may chose to treat as capital in the Trust accounts what is income for income tax purposes (although a specific declaration to that effect is required); likewise it may (and without any such specific declaration) chose to treat as income in the Trust accounts what is capital for income tax purposes. In that context, submissions that “unrealised capital gains” are not income in the ordinary sense of the word are beside the point.*

*17 Accordingly, the Trustee was entitled to treat the movements in the net value of investments as income. Accounts prepared on that basis were nonetheless “proper accounts”. Moreover, even if the “unrealised capital gains” were not income, they could be distributed as capital under clause 5(a), which gave the Trustee a discretion to apply capital in favour of any eligible beneficiary at any time before the Perpetuity Date.’*

Brereton J then went on to held that the trustee did in fact determined to include the unrealised gains as income. His honour found that Dr Inglis was the controlling mind of the corporate trustee, and that he had implied actual authority to make decisions concerning the affairs of the trust. Therefore, the fact that Dr Inglis approved the trust accounts which adopted an accounting methodology which bring to account unrealised capital gains as income was indicative of the trustee determining to include the unrealised gains as income:

*‘66 Even though Mr Tierney’s initial adoption of the “market value” methodology derived from a misapprehension, nonetheless the Company, as trustee of the Trust, by its agent Dr Inglis who had implied actual authority in respect of all affairs of the Trust, accepted the accounts so prepared by Mr Tierney for the purpose of clause 10 of the Trust Deed, and thereby validly determined to treat the increase in market value of investments as income for each of the financial years 1998/9 to 2005/6.’*

Along the same lines, Brereton J also found that Dr Inglis acting on behalf of the corporate trustee has also validly and effectively made the distributions to his beneficiary loan account:

*‘67 There was a valid and effective irrevocable and absolute distribution of the whole of the income shown as such in the annual accounts for each year in question to Dr Inglis, to the extent that it was not validly distributed to William or Mrs Inglis, by default under clause 3(d) if not expressly under clause 3(a).’*

In relation to whether the obligation of the trustee to pay Dr Inglis' deceased estate the amount outstanding in his beneficiary loan account, Brereton J held that the estate has never released the trustee from the debt on its loan account:

*'44 Unilateral resolutions of the Trustee to change the amounts of liabilities recorded in its accounts cannot affect the rights of its creditors. Obligations owed to Dr Inglis in respect of his beneficiary loan account, could only be reversed with the concurrence of his estate. In that light, the essential question is whether the estate has released the debt owed in on Dr Inglis' loan account as at his death. Although much attention was given in the evidence and submissions to factual controversies surrounding the events which ensued after Dr Inglis' death, and the alleged conduct, motives and purposes of the protagonists, little turns on them.'*

It is clear from *Inglis' case* that the issue of unpaid present entitlements must be taken into account in succession planning, as it will form part of the assets of the deceased estate and the executor of the estate will be entitled to call in on the trust to pay the unpaid present entitlements.

## **11 Barnes v Addy (1874) LR9 Ch App 244; (1874) 43 LJ Ch 513**

A third party who participates with knowledge in a dishonest and fraudulent design on the part of a defaulting fiduciary may become accountable as a constructive trustee. The now well settled position as set out in **Barnes v Addy** (1874) LR 9 Ch App 244 at 251-252 where Lord Selborne LC stated:

*"Strangers are not to be made constructive trustees merely because they act as the agents of trustees in transactions within their legal powers, transactions perhaps of which a Court of Equity may disapprove, unless those agents receive and become chargeable with some part of the trust property, or unless they assist with knowledge in a dishonest and fraudulent design on the part of the trustees."*

### **11.1 Elements of the second limb of Barnes v Addy**

The essential elements of the second limb in **Barnes v Addy** may be summarised as <sup>28</sup>:

- (a) The existence of a fiduciary duty;
- (b) A dishonest and fraudulent design by the fiduciary;
- (c) The assistance by the third party in that design;
- (d) With knowledge.

### **11.2 Consul Development Pty Ltd v DPC Estates Pty Ltd**

An agent who is in possession of property which the principal holds on trust for another and who makes, on the instruction of the principal, any disposition of that property which is inconsistent with the trust, is not guilty of a breach of trust, unless he or she was aware, or

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<sup>28</sup> See Jacobs, **Law of Trusts** 6th ed at [1339]

ought to have been aware, that the disposition made by him or her was in breach of trust. In order to successfully rely on the second limb of **Barnes v Addy** there must be a fiduciary, the fiduciary must have breached his or her fiduciary duty and the defendant must have assisted with knowledge in a dishonest and fraudulent design on the part of the fiduciary. These elements are articulated in **Consul Development Pty Ltd v DPC Estates Pty Ltd** (1975) 132 CLR 373.

In **Consul Development** Grey was manager of a company, DPC, controlled by Walton, a solicitor, which carried on the business of acquiring dilapidated properties which could be renovated and sold for a profit. Walton employed Robert Clowes as his clerk. Grey told Clowes about a number of properties which he had recommended for purchase saying that the company had been interested in them, but could not afford them. Clowes' company, Consul Development purchased the properties having reached an agreement with Grey that they would share equally any profits or losses. The solicitor's company claimed that those properties were held on trust for it.

Gibbs J, at page 299, said that Clowes was aware that Grey stood in a fiduciary position; he knew that Walton did not have full knowledge of the transactions and had not assented to them. His Honour then said:

*"If it has been proved that Clowes knew, or that an honest and reasonable man with knowledge of the facts known to Clowes would have thought, that Grey was acting in breach of his fiduciary duty in arranging for Consul to buy the properties to share in the profits, enough will have been established (on the assumption made above) to render Consul accountable to DPC."*

His Honour later said that as on the facts which Clowes believed to exist Grey was not acting in breach of fiduciary duty, Clowes did not knowingly participate in Grey's breach *"he neither actually knew, nor had reason to believe, that Grey was violating his duty, and in the circumstances an honest and reasonable man would not have thought it necessary to enquire further."*

Stephen J, with whom Barwick CJ agreed, said at 407-408 that the plaintiff had not only failed to establish actual knowledge against Clowes but the evidence established that Clowes did not wilfully shut his eyes to the truth. He considered that knowledge does not include constructive notice.

### **11.3 Farah Constructions Pty Ltd v Say-Dee Pty Ltd**

The High Court in **Farah Constructions Pty Ltd v Say-Dee Pty Ltd** (2007) 230 CLR 89 at 141; [2007] HCA 22 in addressing and clarifying the law from **Barnes v Addy** has held that:

- a. *Liability of a third party under the first limb of Barnes v Addy is limited to situations where the defendant has received property;*
- b. *Liability under the first limb of Barnes v Addy is limited to situations where the defendant had knowledge of a breach of trust or, possibly, a breach of fiduciary duty.*

*Although this knowledge may be imputed to a defendant, the circumstances in which an agent's knowledge is imputed to a principal are limited;*

- c. *Liability under the second limb of **Barnes v Addy** requires knowledge of the fraudulent and dishonest design of a trustee or fiduciary. Knowledge for this purpose includes actual knowledge, wilfully shutting one's eyes to the obvious, wilfully and recklessly failing to make such inquiries as an honest and reasonable person would make, and knowledge of circumstances that would indicate the facts to an honest and reasonable person. It probably excludes mere knowledge of circumstances that would put an honest and reasonable person on inquiry.*

Mere knowledge is not be enough, the defendant should have knowingly participated in the breaches of fiduciary duties: **Biala Pty Ltd and Anor V Mallina Holdings Ltd and Anor** (1993) 11 Acsr 785; **Ikeuchi v Liu & Ors [2001]** QSC 054 at [143] – [144]. In **Robb Evans v European Bank Ltd** [2004] NSWCA 82 at[160], Spigelman CJ, with whom Handley and Santow JJA agreed, said:

*" ... it is an essential aspect of accessorial liability for 'knowing receipt' that the act of transfer of the property ... must be in breach of a fiduciary obligation. The claim arises in equity's exclusive jurisdiction ...".*

Liability may be attached in a wider situations such as n **Biala Pty Ltd v Mollina Holdings Ltd** (1993) 11 ACSR 785, 833 per Ipp J, affirmed by the Western Australian Full Court **Dempster v Mollina Holdings Ltd** (1994) 15 ACSR 1 and **Turner v TR Nominees Pty Ltd** (Santow J, 3.11.1995 unreported) where the directors of a trustee type of company carried on its activities for their own or the company's best interests and not for the benefit of the beneficiary.

Equity can be flexible and gives relief in cases analogous to **Barnes v Addy** for example in **Franklin v Giddens** [1978] Qd R 72, 81 a wife who made a profit from a trade in a commodity which she knew her husband had stolen has been held to be accountable.

## **12 Exercising the power of appointment under a trust deed – fraud on power?**

The power to remove or appoint a trustee is a fiduciary power and must be exercised in the interests of the beneficiaries and solely for the furtherance of the purposes of the trust for which it was conferred; it cannot be exercised in the interests of the appointor: see: **Re Burton, Wily v Burton** (1994) 126 ALR 557 at 559; **Jacob's Law of Trusts 7th ed.** 2006 at [1512]; **Hillcrest v Kingsford** [2010] NSWSC 285; **Rayner and Ors v N J Sheaffe Pty Ltd and Ors** [2010] NSWSC 810 at [149]; **Scaffidi v Montevento Holdings** [2011] WASCA 146 at [144]ff]].

It is improper for an appointor to exercise his or her power of appointment for his or her own benefit. Rather the power to remove and appoint a trustee must be exercised for the benefit of the beneficiaries of the Trust.

In the context of an appointor of a trust 'fraud' does not necessarily denote conduct that will be termed 'fraud' at common law. Rather, fraud on a power means that the power has been exercised for a purpose, or with an intention, beyond the scope of or not justified, by the instrument creating the power: see Young et al in **On Equity**, (2009) Lawbook Company at [8.880] and the cases cited therein.

In **Re Burton; Wily v Burton** [1994] FCA 1146; (1994) 126 ALR 557 at 559-560 Davies J held: -

*"When the power is contained in a deed of trust, the donee of the power is even more constrained to act in the interests of the persons for whose benefit the power was conferred. Thus, in Re Skeats' Settlement (1889) 42 Ch D 522, Kay J held that, as a power of appointing new trustee was fiduciary power, the donee of the power may not exercise it so as to appoint himself. At 527, His Lordship said:*

*...the universal rule is that a man should not be judge in his own case; that he should not decide that he is the best possible person, and say that he ought to be the trustee.*

*Naturally no human being can be imagined who would not have some bias one way or the other as to his own personal fitness, and to appoint himself among other people, or excluding them to appoint himself, would certainly be an improper exercise of any power of selection of a fiduciary character such as this is."*

In **Fitzwood Pty Ltd v Unique Goal Pty Ltd** [2001] FCA 1628; (2001) 188 ALR 566 (reversed on other grounds at [2002] FCAFC 285) Finkelstein J held at [98]: -

*"I am prepared to accept that a power of removal of a trustee may be a fiduciary power that must be exercised for the benefit of the beneficiaries and not for the benefit of the donee of the power, at least when the donee is not a beneficiary, although much will depend upon the terms of the trust instrument: Re Skeats' Settlement (1889) 42 Ch D 522 at 526; [1886-90] All ER Rep 989 at 990; Inland Revenue Commissioners v Schroder [1983] STC 480 at 500."*

### **12.1 Austec Wagga Wagga Pty Limited v Rarebreed Wagga Pty Limited**

The issue of a fraud on a power by an appointor was recently considered in **Austec Wagga Wagga Pty Limited v Rarebreed Wagga Pty Limited** [2012] NSWSC 343.

In **Austec** a business was the property of a family trust. Both the business and family trust were managed through a corporate trustee - Austec. The wife was the director of the corporate trustee and the husband was the appointor of the family trust.

The family trust was a discretionary trust and whilst there were a number of objects of the trust, eg husband, wife and children, the husband and wife had been the only objects to receive distributions.

The couple fell into dispute and it became very difficult, if not impossible, for them to continue to work together in the business. The wife, as director of the corporate trustee, appointed an administrator over Austec. The husband on becoming aware of the appointment of an

administrator exercised his power of appointment and removed Austec as corporate trustee of the family trust and replaced it with Rarebreed as corporate trustee.

This removed the control of the business from the administrator and placed it into the hands of the director of Rarebreed.

It was conceded by the husband that whilst the he was not a director of Rarebreed he had an “influence” and provided guidance” to Rarebreed.

An action was brought in the Supreme Court by the administrator of Austec seeking declarations and orders to regain control over the business. The application was essentially that the husband had perpetrated a fraud on a power by appointing Rarebreed as corporate trustee over the family trust.

The court found that the husband has perpetrated a fraud on his power as appointor by removing Austec and appointing Rarebreed on the basis that he had acted to advantage himself and contrary to the power permitted to him under the trust deed.

## 13 The Principles to Apply In Family Court Property Matters

### 13.1 Family Law Act

Pursuant to section 79 of the **Family Law Act** the Family Court has the power to alter the property interest of the parties in their property (referrable to s4(1)(ca)). These interests may include business assets, property inherited by one of the parties, separate investments and pre-maritally owned property: **Carter and Carter** (1981) FLC 91-061.

Section 79(1)(a) of the **Family Law Act** provides:

*“In property settlement proceedings, the court may make such order as it considers appropriate in the case of proceedings with respect to the property of the parties to the marriage or either of them – altering the interests of the parties to the marriage in the property.”*

By virtue of s 4(2) of the **Family Law Act**, the phrase “the parties to the marriage” in s 79(1) includes a reference to a person who was a party to a marriage which has been terminated by a divorce at a time before the court makes orders under s 79(1): See **Kennon v Spry** (2008) 238 CLR 366; 251 ALR 257; 83 ALJR 145; 40 Fam LR 1; [2008] FLC 93-388; [2008] HCA 56 at [94] per Gummow and Hayne JJ.

The word “property” as it is used in s 79 is subject to s 4(1) of the **Family Law Act** which provides:

*“property, in relation to the parties to a marriage or either of them – means property to which those parties are, or that party is, as the case may be, entitled, whether in possession or reversion.”*

The word “*property*” as it appears in s 79 of the Family Law Act has been construed by reference to its ancestry in matrimonial causes statutes and has been given a wide meaning: See **Kennon v Spry** at [54] per French CJ.

### 13.2 The process to be followed in s79 proceedings

The Family court typically takes “*a four step approach*” when dealing property division<sup>29</sup>. The steps are:

- (a) determine the pool of assets and liabilities;
- (b) evaluate each of the parties’ financial and non-financial contributions during the marriage and post separation;
- (c) determine if that contribution figure requires adjustment in light of the relevant s.75(2) factors;
- (d) consider whether the proposed result is just and equitable in all of the circumstances having regard to the actual result in dollar terms.

### 13.3 How the Family Court manages its limitations of power when dealing with property settlement

As the Family court is a court of statutory creation its powers are limited. For example the Family Court does not have powers in respect of the law partnership but it can exercise its powers under s.79 to alter the interests of the parties to the marriage in that part of their property which is represented by their interests in the partnership it would need to be satisfied that there was a partnership and up to what date the partnership subsisted or whether it still subsists: *R v Ross-Jones; Ex parte Beaumont* [1979] HCA 5; (1979) 141 CLR 504 **per Gibbs J at 602**.

The Family court can order accounts of the property of the parties to a marriage with particular reference to an account of their property as partners although it cannot order partnership accounts as such: ***Summitt & Summitt and Ors*** [2009] FamCA 371 at 603.

In order to do justice and equity to the parties, the value of assets which no longer exist may be notionally considered so as to determine what a fair share of the existing pool of assets should be. This often involves a notional consideration of assets, which had been in the possession of one of the parties at some time after separation, but which had been dispersed for that party’s own use.

The inclusion of notional add-backs ought not to be seen as a method of increasing the size of the pool. One cannot make an order adjusting an interest in an asset that does not physically exist at the time of hearing but the Court can factor its value in to the ultimate decision: see ***Milankov and Milankov*** (2002) FLC 93-095, 88,864.

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<sup>29</sup> For example see ***Pastrikos v Pastrikos*** (1980) FLC 90-897, 6 Fam LR 497; ***Lee Steere v Lee Steere*** (1985) FLC 91-626, 10 Fam LR 431; ***Ferraro v Ferraro*** (1993) FLC 92-335, 16 Fam LR 1; ***Davut v Raif*** (1994) FLC 92-503; ***In the Marriage of Hickey*** (2003) FLC 93-143; *C & C* (2005) 33 Fam LR 414. ***Milankov and Milankov*** [2002] FamCA 195; (2002) FLC 93-095 at [112] – [115]

### 13.4 Kennon v Spry (2008) 238 CLR 366

Relevantly the facts with regard to the trust in *Spry* were, in part, as follows:

- (a) the husband was the only person entitled in possession to the assets of the Trust.
- (b) No object of the Trust had any fixed or vested entitlement.
- (c) the husband was, after execution of the 1983 Instrument, left in possession of the assets of the Trust, with the legal title to them, and to the income which they generated, unless and until the husband should decide to apply any of the capital or income to any of the continuing beneficiaries.
- (d) the husband was not obliged to distribute to anyone.
- (e) The default distribution gave male beneficiaries other than the husband no more than a contingent remainder. None had a vested interest subject to divestiture.
- (f) the husband was the sole trustee of a discretionary family trust and the person with the only interest in its assets as well as the holder of a power, inter alia, to appoint them entirely to the wife.

After considering the above factual scenario French CJ held that the “*true character*” of the Spry Trust was a vehicle for the husband and wife and their children to enjoy assets.

### 13.5 Majority judgment

In summary French CJ held that the Trust assets were “*property of a party to the marriage*” because:

- (a) the husband had legal ownership of the Trust assets;
- (b) the husband had power as a trustee to appoint the assets to his spouse; and
- (c) The wife had a right to be considered.

In summary Gummow and Hayne JJ held that for the purposes of s79, the Trust property was the wife’s property because:

- (a) The wife had a right to due administration;
- (b) The husband had a duty as trustee to consider how to exercise the power of distribution;
- (c) The power could have been exercised entirely in favour of the wife.

The Chief Justice, at [59] – [62], held the assets of the Spry Trust could be made the subject of orders under s 79 of the Family Law Act because those assets constituted “*property of the parties to the marriage*” within the meaning of that section.

Where property is held by a party to a marriage under a non-exhaustive discretionary trust with an open class of beneficiaries and there is no obligation to apply the assets or income of the trust to anyone, and where this property has been acquired by or through the efforts of that party or his or her spouse, whether before or during the marriage, the property does not necessarily lose its character as “*property of the parties to the marriage*” just because the party has declared a trust of which he or she is trustee and can, under the terms of that trust, give the property away to other family or extended family members at his or her discretion: see French CJ in *Spry* at [62] – [80].

Aside from the fact that by the execution of the 1983 Instrument the husband excluded himself from the class of beneficial objects of the Trust, the circumstances remarked upon by His Honour were entirely commonplace in the context of discretionary trusts: See **Thurlstone (Aust) Pty Ltd v Andco Nominees Pty Ltd** [1997] NSWSC 517.

### 13.6 Minority Judgment

In summary Heydon J held as follows:

- (a) The objects of a discretionary trust do not have “*property*” in the assets of the trust in the sense in which “*property*” is understood in the general law or in the way in which that word is used in a number of important statutes.
- (b) The word “*property*” as used in s 79 should not be given an extended meaning.
- (c) Even if, contrary to the foregoing, Mrs Spry did have “*property*” rights (eg by virtue of her position as an eligible object of benefaction under the Spry Trust having a right to compel the trustee to duly administer the Spry Trust) within the meaning of s 79, the orders sought by Mrs Spry were directed to gaining access to the assets of the Spry Trust (as opposed to access to the “*property right*” just described) and Mrs Spry had no property in those assets. As such, the “*asset orders*” sought by Mrs Spry did not meet the description “*proceedings with respect to the property of the parties to the marriage or either of them*”.
- (d) The definition of “*property*” in s 4(1) does not contemplate entitlements to property as trustee.
- (e) The Family Court, in making orders under s 79, cannot ignore the existence of trust obligations which limit the rights of a party who owns the property and holds the office of trustee.

Heydon J also considered, albeit in summary form, the application of s 85A of the Family Law Act to the Spry Trust. His Honour rejected the application of that section.

### 13.7 ‘Control’ analysis<sup>30</sup>

Who has control over the assets?

The concept of “*control*” has been addressed in a number of cases in the Full Family Court<sup>31</sup>:

In **Goodwin and Goodwin Alpe** (1991) FLC 92-192, French CJ said at [58]:

*“Prior to the 1983 Deed [the Husband] as sole trustee had the “absolute discretion” to apply all or any part of the income and/or capital of the fund to himself as one of the “beneficiaries”. On the basis of that power, and consistently with authority including the*

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<sup>30</sup> The ‘control’ analysis concept is articulated and argued by Peter Hannan in his article “*Kennon v Spry: An extended reach for s 79?*” (2010) 1 Fam L Rev 18.

<sup>31</sup> see **Stephens v Stephens** [2009] FamCAFC 240 at [37] per May, Boland and O’Ryan JJ; **In the Marriage of Kelly (No 2)** (1981) 7 Fam LR 762; **Ashton and Ashton** [1986] FamCA 20; (1986) FLC 91-777

*decisions of the Full Court referred to above, the assets of the Trust would properly have been regarded as his property as a party to the marriage for the purposes of s 79.*

*The authorities establish that in certain circumstances the assets of a third party, such as a trust, can be treated as the property of a party to the marriage: see also Stein and Stein [1986] FamCA 27; (1986) FLC 91-779; Davidson and Davidson (1991) FLC 92-197; Webster v Webster [1998] FamCA 1517; (1998) FLC 92-832; JEL and DDF (No 2) (2001) FLC 93-083 and Milankov and Milankov [2002] FamCA 195; (2002) FLC 93-095."*

In the **Spry case** at first instance Strickland J found that the husband's level of control over the assets of the trust meant that the assets could be treated as a "*financial resource*"; although his honour treated them as the husband's property.

The High court's decision in **Spry** does not use the word 'control' but the concept is implicit, at least, in the majority judgments.

When one has in mind the purpose of discretionary trusts as developed in the 19<sup>th</sup> century and the purpose of s79 and 16B of the **Family Law Act** it is trite to say that trusts, or at least discretionary 'family trusts', are treated in a fundamentally different way in the Family Law jurisdiction as compared to equity and at least at this stage 'never to twain shall meet'.

### **13.8 Section 85A argument**

The wife raised the s85A argument for the first time in the High Court. Keifel J was the only judge to fully consider the s85A argument.

Section 85A provides:

*"(1) The court may, in proceedings under this Act, make such order as the court considers just and equitable with respect to the application, for the benefit of all or any of the parties to, and the children of, the marriage, of the whole or part of property dealt with by ante-nuptial or post-nuptial settlements made in relation to the marriage.*

*(2) In considering what order (if any) should be made under subsection (1), the court shall take into account the matters referred to in subsection 79(4) so far as they are relevant.*

*(3) A court cannot make an order under this section in respect of matters that are included in a financial agreement."*

Keifel J analysed referred to the report of the Joint Select Committee on the Family Law Act July 1980, volume 1 and at [209] determined that:

*"s 85A was directed to the use of discretionary family trusts and other structures used for holding assets acquired in the course of a marriage, for tax-related and other purposes. Vehicles such as these had been in common use for some time prior to 1983. It is apparent that s 85A was intended to give the Court power to deal with property which could not be the subject of an order under s 79, but which accorded with current conceptions of what was a "settlement" of property in matrimonial law."*

Ultimately her Honour found that s85A provided the Court with the appropriate mechanism to satisfy the payment of the sum ordered by the wife directly out of the trust and stated:

*“The primary judge found that the wife should receive a sum of money, in addition to specific property, representing her contribution to the pool of assets which had been created by the endeavours of the husband and wife. The problem that faced his Honour was how the husband could meet that sum from the assets at his disposal. His Honour’s answer to that question was that it could, and should, come from the Trust property. His Honour found that the wife should be paid out of the Trust, but considered that that result could only be effected by the husband. That was not a correct view, having regard to s 85A(1). Action, on the part of the husband, was not necessary to appropriate so much of the Trust property as was necessary to meet the primary judge’s order. The Court could make an order directly applying that property to her benefit. It did not need to have regard to the status of either the wife or the husband as beneficiaries in order to do so.”* (emphasis added)

Since the **Spry** decision has been handed down (in December 2008) there have been very few cases that have considered s85A and Kiefel J’s minority decision in any depth. As far as I am aware none have involved orders as contemplated by Kiefel J in paragraph [209].

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<sup>1</sup> [2011] NSWSC 148.

<sup>2</sup> [2003] 2 AC 709.

<sup>3</sup> [1965] Ch 918.

<sup>4</sup> Supra n.1 at [17].

<sup>5</sup> Ibid at [18].

<sup>6</sup> Ibid at [19].

<sup>7</sup> Ibid at [20].

<sup>8</sup> [2007] NSWSC 191 at [10].

<sup>9</sup> Ibid at [15].

<sup>10</sup> See for example *CPT Custodian Pty Ltd v Commissioner of State Revenue* [2005] HCA 53 and *Commissioner (Chief) of Stamp Duties v Buckle* (1998) 72 ALJR 243.

<sup>11</sup> Supra n.1 at [29].

<sup>12</sup> [1999] SASC 181.

<sup>13</sup> Ibid at [103].