New Zealand

Trusts and Asset Planning Guide

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Beddoe and prospective costs orders in a trust context

A prospective (or pre-emptive) costs order sought by a beneficiary wishing to bring substantive proceedings for breach of trust and removal of the trustees was considered recently by the *High Court in Woodward v Smith* (2014) 3 NZTR ¶24-009. However, before considering that case, it is proposed to set out a background to *Beddoe* and prospective costs orders in a trust context. While these orders have a common aim, they have important differences.

Overview

There are two aspects to such orders:

(a) That the applicant's own costs are paid out of the trust fund on an indemnity basis regardless of result.

(b) That the applicant is not liable to pay the costs of any other party, in effect an immunity or other party costs order, *Woodward* at [28].

Either or both types of order may be sought by the applicant.

Contents

NZ Trusts & Asset Planning Guide

There are special costs rules relating to trusts and a *Beddoe* order can provide specific protection for the trust litigant before commencing or defending the main or substantive proceedings. *Beddoe* orders are generally limited to trustees, unless the beneficiary making an application comes within *Buckton* category 2 (see "**The three Buckton categories**" further below). Generally, a beneficiary engaging in hostile litigation would need to make a prospective costs application and seek to come within its narrow parameters. Prospective costs orders are unusual, *Re Biddencare Ltd* [1994] 2 BCLC 160 and exceptional circumstances to justify such an order, particularly an immunity order, will need to be made out, *Woodward* at [50].

However, the Courts will more readily make a Beddoe order and have set out the circumstances in which they will generally do so, subject to the overriding exercise of the Court's discretion. It was noted *In re Buckton* [1907] 2 Ch 406 at 414 that in making such applications the Court acted on the principle that:

> "the trustees are entitled to the fullest possible protection the Court can give them".

This is in recognition that the duties and responsibilities of being a trustee can be onerous:

> "A trustee is entitled as of right to full indemnity out of his trust estate against all his costs, charges and expenses properly incurred . . . and in all cases of doubt, costs incurred by a trustee ought to be borne by the trust estate and not by him personally. The words 'property incurred' . . . are equivalent to 'not improperly incurred', *Re Beddoe* at p 558.
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> "Trustees are not expected to do any of the work on their own expense . . . that necessarily means that such costs and expenses are properly incurred . . . they are entitled to be paid back all they have paid out" *Re Grimthorpe* [1958] Ch 615."

This entitlement a trustee has to reimbursement is long-standing, *Worrall v Harford* (1802) 8 Ves. Jr 4 at p 8. The underlying principle is well established — without the certainty of the right of reimbursement for expenses reasonably [and not improperly] incurred, no one would be a trustee.

Balancing different interests

In considering a Beddoe application the Court will need to consider and balance a number of different factors and interests. These may include:

- A trustee's right to be indemnified for all expenses reasonably [and not improperly] incurred in the execution of the trust (s 38(2) of the Trustee Act 1956 and as part of the Court's inherent jurisdiction).
- The general principle (subject to the Court's discretion) that costs follows the event and that the loser pays, High Court Rules 14.1.
- The trust estate exists for the benefit of the beneficiaries. If the Court makes an order it is the beneficiaries who ultimately pay for the litigation.

- That it would be unjust for a successful claimant to establish his claim only to have had the trust fund reduced by the payment of the costs resisting that claim, *Re Biddencare Ltd*.

- The Court's supervisory role in the administration of trusts, that trusts are properly executed.

The refusal of the court to make a *Beddoe* or prospective costs order in no way fetters the subsequent discretion of the judge as to costs of the substantive hearing, *Weth v Attorney-General* [2001] EWCA Civ 263 at [53].

Re Beddoe

The name *Beddoe* comes from the case *In re Beddoe; Downes v Cottam* [1893] 1 Ch 547 (CA). The court proceedings concerned a trustee who acting under the wrong advice of his solicitor refused to give up certain title deeds. Proceedings were brought against the trustee. The Court of Appeal held that the trustee, not having shown reasonable cause for defending the action was not entitled to retain out of the trust estate his costs, other than what he would have incurred had he applied to the Court for leave to defend the proceedings. While the legal position was not initially clear to the trustee, once it became so, the trustee acted rashly and very unreasonably and should not have continued to resist the proceedings.

The case establishes several other important points:

- A trustee who, without the sanction of the Court, commences an action or defends an action unsuccessfully, does so at his own risk as regards costs, even if he acts on Counsel's opinion, unless under very exceptional circumstances.

- While a trustee is entitled to full indemnity out of the trust estate against all costs, charges and expenses properly incurred ie not improperly incurred, if a trustee brings or defends an action unsuccessfully and without leave [of the Court], it is for him to show that the costs were properly incurred pp 557–558.

- That generally, especially with a small and easily dissipated fund, all litigation should be avoided, unless there is such a chance of success so as to make it desirable in the interests of the estate that the necessary risk should be incurred. If the trustee is doubtful as to prosecuting or defending a lawsuit, he should ask the Court, p 564.

The judgment does note that the opinion of a Judge of the Chancery Division could at that time be obtained by trustees with "ease and comparatively small expense" pp 558, 562. Unfortunately that appears to be no longer the case, "The assumption in *In re Beddoe* that trustees can always obtain the directions of the court at modest expense is, I am afraid, simply wrong in modern times", *Breakspear v Ackland* [2009] Ch 32 (Ch) at [10].

The three *Buckton* categories

In re Buckton; *Buckton v Buckton* [1907] 2 Ch 406 concerned proceedings as to the interpretation of a will and to confirm entitlement under a testamentary trust. The Court held that while the proceedings were in the form of adverse litigation, the substance was a "friendly" proceeding to determine benefical interest for the benefit of all including the trustees and so the costs of all parties were to come from the estate. With the view of establishing some uniformity, the judgment set out three categories of litigation and whether the Court would in general principle grant the applicant (usually but not exclusively the trustee), an order that the applicant's costs be met from the trust estate. These categories were:

(1) The trustees ask the Court to construe the trust instrument for their guidance in order to ascertain the interests of the beneficiaries, or to ask to have a question determined regarding the administration of the trust. The costs of all parties would be necessarily incurred for the benefit of the estate and paid out of the estate.

(2) Differing in form from (1) but not in substance from (1), the application is made by some of the beneficiaries regarding the construction or administration of the trust and which would have justified an application by the trustees. The application is necessary for the administration of the trust and the costs of all parties are necessarily incurred for the benefit of the estate as a whole.

(3) The third class of cases differ in form and substance from (1) and in substance from (2) but not in form. Here application is made by a beneficiary, who makes a claim adverse to other beneficiaries in which circumstance being adverse litigation. The unsuccessful party bears the costs of all the parties, pp 414–415.

Woodward at [23] commenting on this class or category noted:

> "The third category, however, is where a beneficiary is making a 'hostile claim' against the trustees, or another beneficiary. The claim may still involve a point of construction, or administration. It will often involve a claim to a beneficial interest or entitlement to a part of the trust fund. In the third category, involving a hostile claim against trustees or another beneficiary, the usual principles as to costs apply. Ordinarily they will follow the event".

The cases have acknowledged that the categories can overlap, it can be difficult to discriminate between categories and the line between friendly and hostile litigation is not easy to draw, *Alsop Wilkinson v Neary* [1996] 1 WLR 1220 at 1225. Where prospective costs are important to a claimant beneficiary, may affect how the case is run. In Woodward, at [43], the Court noted that as questions of construction of the trust deed were involved the case may have come within Buckton category 2:

> "Were the case run differently, with construction issues severed for prior determination, it might be possible to look at that part of the case as a *Buckton* category 2 case. But merged altogether, it is not. The claim is plainly a hostile one . . .. Issues of construction here could not displace the essential character of the litigation".

Prospective or pre-emptive costs

The court may make a prospective costs order in hostile litigation regarding the ultimate incidence of costs. The principle considerations will be:

(1) The strength of the party's case

(2) The likely order as to costs at the trial

(3) The justice of the application, and

(4) Any special circumstances, *In re Biddencare Ltd, Alsop Wilkinson v Neary*.

Prospective costs order and special circumstances

A prospective or pre-emptive costs order is not limited to the law of trusts. Such an order may be made by the Judge hearing the main (ie substantive) case. Because of the general principle that costs follow the event, any prospective costs application by, for example, a beneficiary in hostile proceedings, needs to possess special circumstances. Such orders are made rarely. Cases where those special circumstances have been made out include:

Re Westdock Realisations Ltd [1988] BCLC 354

The case concerned the beneficial entitlement to £1.1m surplus held by the receiver of two companies — the company liquidators or a government agency which had given guarantees of the companies' indebtedness. The liquidators lacked the funds to contest the case and they sought an indemnity order that their costs be met from the surplus funds. The case involved hostile litigation and did not involve the interests of a large class of persons. However, the special factors were that:

- the point to be decided arose in a number of other cases
- unless a "test case" was litigated, the government agency would take the fund by default, the liquidators not having the funds to contest the issue, and
- the government agency's claim was subrogated to the bank's security and far from straight forward.

The Court made a limited order, that the liquidators should apply after completion of pleading and discovery for directions as to whether the liquidators had a substantial chance of success and should therefore continue with the proceedings. The Court noted that "unless satisfied that after trial a judge would be likely to make an order that the costs of all parties are to come out of the fund, it cannot in general be right to make such an order at this stage", p 359 (e). It was also noted that "the liquidator's lack of resources by itself was not sufficient ground for making any special order as to costs in this case", p 360 (g).

McDonald v Horne [1995] 1 All ER 961 (CA)

Members of a pension scheme issued proceedings against their employers, the fund trustees, concerning the administration of the scheme and to compel the trustees to account. The scheme members could not afford to pay for the litigation. The Court

referred to the *Buckton* trust litigation categories, but noted that while there were issues of construction, the overriding character of the litigation was hostile. While a prospective costs order would not normally be made, the Court of Appeal held that the members proceeding was analogous to a derivative action by a minority shareholder [who is bringing proceedings which will benefit company]. The distinctive aspect of the derivative proceedings in this case was; the limited interest of the beneficiary in the whole pension fund, that the members had made contributions and the commerical nature of the fund.

While there was a need for caution in making such orders this did not mean the judge or master should undertake a close examination of the merits of the dispute. The question was whether the plaintiffs had shown a sufficient case for further investigation. Following this, caution should take the form of choosing the most economical form of investigation. This will not necessarily involve authorising a full trial or even full pleadings and discovery, p 974.

Re X (Trust) [2012] JRC 171; [2013] WTLR 731

Two principal beneficiaries, A and B of a discretionary trust, brought proceedings concerning losses totalling nearly £100m and a breach of trust claim in respect of those losses. They applied to the court for a direction that they could bring the claim at the expense of the trust fund. Counsel's opinion obtained by A and B concluded that the claims made against the trustees should be prosecuted. Trust distributions had funded the applicants' litigation costs to date, and while the trustees ''remained neutral'', they stopped making distributions, alleging the litigation if it became known would damage the trust's assets, a substantial shareholding in a public company.

The court considered that the claim was akin to a derivative action in that if the applicants were successful, the trustees would be charged to replenish the trust fund, rather than pay damages to the applicants. It was also considered that the Court had the inherent jurisdiction to make the order in standard *Beddoe* form because although the applicants were beneficiaries they were in effect bringing the claim as trustees for the benefit of the trust and it was very much like a derivative action [*although it should be noted they were the principal beneficiaries — Editor*]. In terms of the *Alsop Wilkinson* categories this was regarded as a third party dispute, the beneficiaries acting like trustees and the trustees being in effect the third party. The substantial size of the trust fund was noted as was the fact that the applicants were the main principal beneficiaries of the trust and so the risk of the litigation would be borne by the right parties. While the line between authorising the beneficiary to sue at the expense of the trust and authorising the trustee to defend at the expense of the trust would not always to clear to see, in the present case ''it was clear the trustee was defending itself and not the trust'', p 740 (E). The Court observed that:

> ''The court's inherent jurisdiction to supervise the administration of a trust is self-evidently a jurisdiction which the court should exercise in the best interests of the trust. There is no logical reason why that exercise of jurisdiction should not

> extend in an appropriate case, to making an order that the costs of legal actions against the trustee be met out of the trust fund . . . in the exercise of a discretion of this nature, the court will clearly have to have regard to all the circumstances, and may have to balance the interests of different beneficiaries was well as the interest of beneficiaries as trustees", p 739 (F).

However, the court in *Woodward* had several difficulties with the decision:

- The primary focus was on directions and indemnity funding, there was little discussion of the immunity aspect of the orders.
- It was considered there was no attempt at a *Buckton* based classification.
- The decision was founded on the proposition that the beneficiary applicants were acting on a derivative basis.
- The case was special in that there appeared to be a deliberate tactical behaviour by the defendants to stifle the proceedings. "A consideration which might create a special case for the making of a prospective costs order", *Woodward* at [38].

A prospective costs order was sought in New Zealand by three discretionary beneficiaries, that decisions made by trustees were contrary to a memorandum of wishes and unfairly favoured another beneficiary. They sought funding from the trust for what was an indemnity application, *Finlayson v Young* (2009) 2 NZTR ¶19-021.

The court concluded:

- For indemnity and pre-emptive awards, there are two streams of authority — one relates to public interest litigation, the other is private trust litigation. There was no public interest in this case. It was a private dispute between beneficiaries and between certain beneficiaries and the trust. *Re Buckton* identified three classes of trust litigation. In a claim by a beneficiary, which was adverse to other beneficiaries and was essentially hostile litigation, the usual principles were to be applied to any question of costs.
  - *McDonald v Horn* [1995] 1 All ER 961 (CA) focused on the applicable rule in England (RSC Ord 62, r 3(3)). This rule, which is comparable to the New Zealand HCR 14.1, is that the unsuccessful party should pay costs. This was an obstacle to any pre-emptive costs order between adverse parties in ordinary litigation. The present case involved hostile litigation. There was no material distinction between the way in which the English and New Zealand principles were applied.
- While the court was prepared to accept that the plaintiffs had a case that was at least arguable, that their conduct in the proceeding had been reasonable and that they were of modest means, the authorities treat pre-emptive costs awards as very exceptional indeed. This litigation was private, and it was hostile trust litigation. The trial judge would have no choice but to award costs of any kind at the conclusion of the case.

The application for prospective costs failed.

Beneficiary may be subsequently awarded costs on conclusion of the main hearing

Where beneficiaries, for example, are unable to show special circumstances, this does not necessarily mean that they would not be awarded costs from the trust fund on the conclusion of the main or substantive hearing, even if they were unsuccessful at that hearing. The matter was considered in *Morris v Sumpter* (HC Auckland CIV 2004-404-3060 20 July 2005, Allan J). The case concerned a trust settled by a husband and wife and the wife had subsequently died. The wife's children brought proceedings as beneficiaries for the removal of the husband as trustee. The issue was whether the irregularities in the administration of the trust and the husband's failure to account warranted his removal as a trustee. The court declined to remove the husband as a trustee, but appointed a solicitor and accountant as additional trustees.[1] In the costs judgment of 20 July although the Court had declined to remove the husband trustee, it held that the proceedings were a ''bona fide application by parties who were entitled to seek the Court's assistance in regularising the affairs of a trust, which was plainly in need of the Court's intervention . . . the plaintiffs' application was well justified and served to benefit the trust''. The court held the beneficiaries were entitled to the costs sought, from the assets of the trust.

Friendly or hostile litigation?

The trustee's costs in relation to a friendly trust dispute are invariably payable out of the trust assets. With a hostile trust dispute, however, an indemnity may not be available and a Beddoes application may be a warranted safeguard. Pankhurst J in *Kain v Hutton* (2001) 1 NZTR ¶11-011 (3 Oct 2001) at [12]–[14] referred to *Alsop Wilkinson v Neary* and the three kinds of dispute in which trustees may be involved.

> ''. . . First is what is called 'a trust dispute'. That is a dispute as to the trusts on which trustees hold the assets of the trust. Sometimes this may be 'friendly' litigation where the construction of the trust instrument or some other question arising in the course of administration of the trust is at stake. However, a so called 'trust dispute' may also be hostile litigation where, for example, there is a challenge by a creditor or other third party to the settlement of property by which the trust was created. It is acknowledged in the cases that the line between friendly and hostile litigation may not be easy to draw. *The trustee's costs in relation to a friendly trust dispute are invariably payable out of the trust assets. With a hostile trust dispute, however, an indemnity may not be available and a Beddoes application may be a warranted safeguard.*
>
> Second is a 'beneficiary's dispute'. That is a case in which a beneficiary (or beneficiaries) challenge the propriety of action taken or not taken by the trustees as the case may be. Hence there may be allegations of breach of trust and the relief

sought may extend to removal of the trustees or perhaps a claim for damages for such breach. In my view the authorities demonstrate that the right of trustees to be indemnified for their costs out of the trust assets in such cases is dependent upon the outcome, or put another way, the merits of the case. Moreover, since a beneficiary's dispute is obviously hostile litigation costs follow the event, that is will be awarded against the beneficiaries or the trustees in terms of the outcome.

The third category is 'a third party dispute'. That is a dispute where claimants, not being beneficiaries, sue the trustees (typically in contract or tort) in relation to some act of the trustees in the course of their administration of the trust. In relation to this category (quoting from *Alsop Wilkinson*):

'Trustees (express and constructive) are entitled to an indemnity against all costs, expenses and liabilities properly incurred in administering the trust and have a lien on the trust assets to secure such indemnity. Trustees have a duty to protect and preserve the trust estate for the benefit of the beneficiaries and accordingly to represent the trust in a third party dispute. Accordingly their right to an indemnity and lien extends in the case of a third party dispute to the costs of proceedings properly brought or defended for the benefit of the trust estate . . . and to avoid the risk of a challenge to their entitlement to the indemnity, (a beneficiary dispute), *trustees are well advised to seek court authorization before they sue or defend*.'"

A trustee defending his removal

A trustee who is concerned that his or her removal had been exercised contrary to the best interests of the beneficiaries should apply to the Court for directions, whether the purported removal was valid. A trustee who unsuccessfully runs a case challenging his or her removal without Court sanction may be deprived of the normal indemnity and personally exposed to costs to the successful party, *Carmine v Ritchie (No 2)* (2012) 3 NZTR ¶22-025.

An alternative possibility for the trustee on inappropriate removal, may be to pay the trust fund into court, *Clifton v Clifton* (2004) 1 NZTR ¶14-018.

The form of the Beddoe application

Alsop Wilkinson (a firm) v Neary concerned hostile litigation against the settlor (a partner in the plaintiff firm of solicitors) and the trustees, challenging the validity of settlements made during the period when misappropriations had been taking place. The trustees sought directions as to whether to defend the proceedings and for a prospective costs order. The court considered that where the dispute is between rival claimants to a beneficial interest in the subject matter of the trust, the duty of the trustee was to remain neutral;[2] submit to the court's directions leaving it to rivals to fight their battles. The trustees would be entitled to an indemnity and lien in respect

of costs necessarily and properly incurred in this stance. In regard to the *Beddoe* application in that case the court considered the application to be fundamentally flawed:

(a) The application was not part of separate proceedings. The purpose of the application was to inform the judge (hearing the *Beddoe* application, not the substantive hearing) as to the strengths and weaknesses of the trustees' case and the course to be taken eg in respect of a possible compromise. "It would be quite inappropriate for all this to be revealed to the court which has to try the case or the other parties to the litigation."

(b) The necessary parties were not before the court. In the *Beddoe* application the beneficiaries are to be given the opportunity to make representations to the court before the order is made.

The *Beddoe* application will normally need to be made right at the beginning before the trustees take part in substantive proceeding and its cost being normally met from the trust fund:

> "The trustees should make the application before they sue or embark upon the defence of a claim. Their right to an indemnity will usually extend to the cost of the Beddoes application itself', *Kain v Hutton* (2001) 1 NZTR ¶11-011 at [15].

Kain v Hutton concerned hostile litigation between some beneficiaries and trustees.

The applicant trustees made a late *Beddoe* application as a part of the proceedings and sought a direction that they "actively defend such allegation made against them personally" and be protected in regard to their costs. With the litigation well under way, the application was declined.

While the trustees are required to disclose the strengths and weaknesses of their case, this is not a "mini-trial" and the court should avoid being side-tracked into unhelpful mini-investigations, *In re a Settlement* [2001] JRC 109. Rather the court's role is in an administrative capacity, *Re Eaton Dec'd* [1964] 1 WLR 1269 (Ch). The *Beddoe* application would include the beneficiaries, but where the party to the main proceeding included beneficiaries it would be quite inappropriate for all of the information made available to the court to be available to the other parties, *Alsop Wilkinson*. The issue is considered further below.

What needs to be disclosed to the court in a Beddoe application?

In *Alsop Wilkinson*, "So long as the trustees make full disclosure of the strengths and weaknesses of their case, if the trustees act as authorized by the court their entitlement to an indemnity and lien is secure. However, ten years later the level and degree of disclosure to the court in support of *Beddoe* application appears considerably greater and should the trustees fall short in this area, then the protection offered by

the Beddoe order could well be put at risk. Lindsay J in *Professional Trustees of 2 Trusts v A* [2007] EWHC 1922 (Ch) at [22] considered that "full disclosure of the strengths and weaknesses of his case" to be:

> "in all cases the only kind of disclosure which may be appropriate if protection conferred on the trustee by a *Beddoe* order is to be absolute".

What if the trustee made "insufficient inquiry regarding the weaknesses of his case, or he makes material factual mistakes which do not come to the notice of the judge who hears the Beddoe application", asks Lindsay J? If, for example, it transpires that the picture which the trustee painted before the Judge in order to get the *Beddoe* relief was materially inaccurate and that the inaccuracy was the trustee's fault:

> "the trustee could, in my judgment, and without inconsistency with *McDonald v Horn* find himself vulnerable in costs. In that sense the *Beddoe* hearing, strictly speaking determines nothing relevant", *Professional Trustees of 2 Trusts v A* at [25].

The concern raised in *Professional Trustees of 2 Trusts* was that if there is a lack of full disclosure then the efficacy of the Beddoe order can be put at risk and therefore trustees should err "if at all, if only for their own sake, on the side of disclosure", *Professional Trustees of 2 Trusts v A* at [33].

Trustees 1-4 v The Attorney-General [2014] SC (Bda) 24 Comm (26 Feb 2014) on the issue of what should be disclosed to the court referred to *Lewin on Trusts*, 18th Ed para 21-117 which although in the context of the English Civil Procedure Rules, suggested that the *Beddoe* application should be supported by evidence including:

- "instructions to and advice from an appropriately qualified lawyer as to the prospects of success and other relevant matters including a cost estimate for the main action, facts concerning the means of the opposing party and a draft of any proposed statement of case and existing pleadings;
- the value of trust assets, the significance of the main action to the trust and why the court's directions are needed;
- whether any relevant Pre-Action Protocol has been followed and whether the trustees have proposed, undertaken or propose to undertake alternative dispute resolution, and if not why not;
- what if any consultation there has been with the beneficiaries and with what result;
- the strengths and weaknesses of the position of the trustees in relation to the substantive action.

Full disclosure is essential otherwise the *Beddoe* application will not afford the trustees full an defective protection", *Professional Trustees of 2 Trusts* at [12].

What needs to be disclosed to the other party in a Beddoe application?

Beddoe relief can be tailored to fit with the situation before the court, *Re Eaton Dec'd, Professional Trustees of 2 Trusts v A*. Therefore, the application and what is to be disclosed to other parties should keep that in mind.

In re Moritz Dec'd [1960] 1 Ch 251 concerned proceedings by a trustee against a beneficiary. On the application for directions the Court declined to make available the exhibits referred to in the affidavits. When that case was decided, judicial practice was that the other parties were not part of the *Beddoe* hearing:

> "While it is proper and indeed necessary to join the parties against whom the proposed relief is sought, those parties [in that case two beneficiaries] should not be present in Chambers when the matter is debated", p 255.

However, four years later, Wilberforce J (as he then was) in *Re Eaton* (1964) considered that while the practice that the other party [in that case a beneficiary] could not be in chambers when the matter was debated, put to the trustees that some further information in addition to the information already supplied, could be provided to the other party, adapting the existing practice to do justice in the particular circumstances of the case.

In *Professional Trustees of 2 Trusts v A* while noting the advantage of disclosure, the court also recognised that "in hostile trust proceedings brought by trustees against a defendant beneficiary . . . the defendant should not be better able to overcome legal professional privilege that if he were not a beneficiary" at [34].

In regard to specific matters, it was considered that if disclosure of a valuation "might seriously affect or restrict the Trustees' role in negotiating a compromise, I would regard the Trustees as properly able to withhold it at this stage . . .. As for counsels' opinions, subject to appropriate redaction where the Trustees' position on compromises, strategy or tactics might be materially and unfairly weakened or when the opinion, if disclosed, might prompt the assertion against the Trustees of a fact otherwise unlikely to be asserted, or if there are any other topics, disclosure of which would be likely materially and unfairly to weaken the obtaining by the Trustees of the relief which they seek in the main substantive proceedings, the Trustees should incline in favour of disclosure, if only to avoid the whole Beddoe procedure later becoming from their point of view, pointless for want of adequate disclosure", *Professional Trustees of 2 Trusts v A* at [39]–[40].

Conclusion

Prospective costs orders

Woodward v Smith summarised the principles governing prospective costs orders in favour of beneficiaries. Such orders may:

- Involve either or both indemnity (the applicant's own costs) and immunity (any liability to meet costs of other parties).
- Routinely be made in categories 1 and 2 of *Buckton.*
- Also routinely be granted in cases within category 3 of *Buckton*, where plaintiff's participation is truly derivative.

- In any other case within category 3 of *Buckton,* the making a prospective costs order will be quite exceptional, the norm being to allow costs to be resolved by the trial judge. Only in very exceptional cases with regard to; the strength of the party's case, likely costs order at trial, the justice of the application and any special circumstances, will a prospective costs order be made.
- Each aspect — indemnity and immunity of a potential order must be considered. Some cases may justify one or the other, and very exceptionally, both.

Beddoe applications and orders

Beddoe applications:

- Generally (but not exclusively) will be made by trustees. The *Beddoe* order will be particularly relevant where the trustees are involved in hostile litigation.
- Need to be made promptly, in separate proceedings before commencing or defending the main hearing.
- The order sought may be for indemnity, immunity or both.
- In making the application for what may be protracted proceedings, whether the order sought be limited to a certain point such as discovery and pleadings before further review by the court as to whether the trust should fund the next stage in the litigation as in *Re Westdock Realisations Ltd*.
- Where those proceeding include issues as to the construction or administration of the trust, whether it is possible to run the proceedings in two parts as *Woodward* indicates.
- Be by way of full disclosure to the court, including the strengths and weaknesses of the trustees' case and other matters that are appropriate to enable the court to make an informed decision, so that the efficacy of the *Beddoe* order that is made is not subsequently undermined by inadequate disclosure.
- It will be necessary to consider the extent to which information made available to the court is disclosed to the other party. More recent court cases appear to favour fuller disclosure.

Footnotes:

1 The main hearing is reported at *Morris v Sumpter* (2005) 1 NZTR ¶15-002

2 See also *Re Schroder's Wills Trusts* (2003) 1 NZTR ¶13-015

Prospective costs application by beneficiary

In *Woodward v Smith* (2014) 3 NZTR ¶24-009 the plaintiff, a discretionary beneficiary, sought a prospective or pre-emptive costs order to protect him should he fail in bringing proceedings against the trustees, alleging breach of the unfair dealing rules and the duty to act in good faith. (It was alleged the trustees had made substantial interest free loans from the subject trust to another trust or commercial interests of which the trustees were beneficiaries.)

The judgment considered the *Re Buckton* categories of trust litigation for indemnity and immunity costs and whether being hostile litigation (even though there was a strong prospect of success), costs should follow event. There were no special circumstances, as in *Re Westdock Realisations Ltd* or *McDonald v Horn*. It was a *Buckton* category 3 type case and the exceptional circumstances necessary to justify a prospective costs order (immunity) "have simply not been made out. It follows that the application for such orders will be dismissed", [50].

Court of Appeal imposing constructive trust on express trust

High Court and background

Bulletin March 2014 considered the High Court decision *Murrell v Hamilton* (2013) 3 NZTR ¶23-015. The Court of Appeal recently reversed this decision. The case concerned a constructive trust claim against a home property owned by a family trust, established in 1991, the discretionary beneficiaries of which included the respondent, Mr Hamilton, and his children. In 2002, the appellant, Ms Murrell, and respondent commenced living together in a de facto relationship that lasted seven years. Ms Murrell asserted that during the relationship that she and Mr Hamilton had discussions between them that led her to believe they were working together for their mutual benefit. Mr Hamilton denied this. The Court preferred Ms Murrell's evidence and that she had made a modest contribution to the development of the property.

The High Court found Ms Murrell's contribution to the home to be 15%. However, the Court considered that her constructive claim was against property that was owned by the trust throughout. There was no basis for the view that the trustees (Mr Hamilton and his solicitor, Mr Mirkin) particularly the latter, had stimulated her expectations in such circumstances that it would be unconscionable of them to deny her claim. Ms Murrell's claim was dismissed.

Court of Appeal

The Court of Appeal, *Murrell v Hamilton* (2014) 3 NZTR ¶24-012, viewed the evidence very differently from the High Court. It considered that there was no reason in principle why a constructive trust claim should not succeed in respect of a property owned by a trust, *Prime v Hardie* (2002) 1 NZTR ¶12-008 and that in this appeal the focus was on whether the trustees should reasonably expect to yield the claimant an interest based on the principles in *Lankow v Rose* [1995] 1 NZLR 277 (CA) at 294. However, the Court of Appeal then went on to note that while Mr Mirkin in his evidence in chief was forth coming about his meticulous attention to the affairs of many trusts, the reality with the trust in this case was quite different. The Court considered that Mr Mirkin abjured his trustee responsibilities in favour of Mr Hamilton, leaving everything to do with the construction of the house and development of the section to Mr Hamilton. He allowed Mr Hamilton to bind the

trustees to contracts relating to the construction of the house and implicitly accepted the trust was liable to pay under the contracts. Mr Hamilton's actions were treated as actions binding on both trustees. In that factual situation it would be unconscionable for the trustees to deny Ms Murrell's claim based on the expectation stimulated by Mr Hamilton on behalf of the trust [CA26]–[CA28].

As both trustees must be taken to have stimulated,Ms Murrell's reasonable expectation it would be unconscionable for the two trustees to deny her claim. The Court made the point that this claim did not take away from the beneficiaries of the trust something to which they are entitled, rather it meant a part of the value of the trust's property which should not accrue to the trust does not accrue to it. Allowing the claim averts the unjust enrichment that would otherwise result to the trust. The Court concluded that this was a straight forward application of *Lankow v Rose* principles. The trust was not a sham and did not require consideration of alter ego trust (as the High Court had).

Greenpeace — political purposes (more than ancillary) may be charitable

The Court of Appeal decision, *Re Greenpeace of New Zealand Incorporated* was considered in *Bulletin* March 2013. The Supreme Court in a 3:2 decision of 6 August 2014, *Re Greenpeace of New Zealand Incorporated* (2014) 3 NZTR ¶24-013; [2014] NZSC 105 has held that political purposes, being more than ancillary may be charitable. While the decision marks a significant shift in purposes that may be charitable, the basis of that assessment is to be firmly founded on the spirit and entendment of the preamble of the Statute of Charitable Uses Act 1601 (UK) 43 Eliz I c 4.

In regard to illegal activities, while breaches of the law not deliberately undertaken or coordinated by the entity are unlikely to amount to a purpose and even isolated breaches even if sanctioned by the entity may not amount to a disqualifying purpose, the submission by Greenpeace that only serious offending such as would permit sanction under the legislation on a one-off basis was not accepted by the Court. The issues considered and the approach adopted by the Court are also relevant to charitable trusts.

Background

Greenpeace of New Zealand Incorporated (Greenpeace) was incorporated in New Zealand under the Incorporated Societies Act 1908 and had previously held charitable status. The Charities Commission (now the Charities Board) declined Greenpeace's registration as a charitable entity under the Charities Act 2005 (the Act) on the ground that two of its objects were not charitable, the promotion of disarmament and peace and promotion of legislation, policies which further Greenpeace's other objects. The Commission followed *Molloy v Commissioner of Inland Revenue* [1981] 1 NZLR 688 (CA) which held that; political purposes which were more than ancillary purposes could not be charitable and an entity which had a

primary purpose which was illegal or contrary to public policy could not be charitable because an illegal purpose could not be for the benefit of the public. The High Court upheld that decision, *Re Greenpeace New Zealand Inc* [2011] 2 NZLR 815.

Greenpeace appealed. The Court of Appeal ([2013] 3 NZTR ¶22-030; [2013] 1 NZLR 339 (CA)) set aside the decision of the Commission declining to register Greenpeace as a charity, but affirmed the exclusion of political purpose. Foreshadowed amendments to Greenpeace's objects avoided the political purpose exclusion. Promoting nuclear disarmament and eliminating weapons of mass destruction was held to be for the public benefit and the political advocacy object was expressed to be limited to being ancillary to other charitable purpose [CA84]. The application for registration was referred to the chief executive of the Department of Internal Affairs and Charities Board to be reconsidered.

Greenpeace appealed to the Supreme Court challenging; that objects which are "political" are non-charitable unless merely "ancillary" to charitable objects, relying on the Australian decision in *Aid/Watch Inc v Commissioner of Taxation* (2010) 241 CLR 538 (HCA) and that illegal purposes or activities, if ancillary or minor do not disqualify an entity from registration as charitable.

Supreme Court, majority decision (Elias CJ, McGrath and Glazebrook JJ)

The main points from the judgment were:

"Charitable purpose" and how it is to be assessed

The judgment noted that legislation has retained the concepts of charity developed in the case law. Objects have been accepted to be charitable if they advance the public benefit in a way that is analogous to the cases that have built on the 1601 preamble. To be within the "spirit and intendment" of the preamble, "one must find something charitable in the same sense as the recited purposes are charitable", *Re Strakosch (dec'd)* [1949] Ch 529 (CA) at 537. *Commrs for Special Purposes of the Income Tax Act v Pemsel* [1891] AC 531 drawing on a much older decision, *Morice v Bishop of Durham* (1805) 32 ER 947 had organised the fourfold classification, (now expressed in s 5(1) of the Act). The fourth category, "other purposes beneficial to the community" was not set in stone.

It was also noted that while the cases have generally insisted with regard to the first three heads that they must also be for the benefit of the public, public benefit under these heads may be presumed until the contrary is shown. At this point the Supreme Court disagreed with the Court of Appeal. It considered that the proper approach is by way of analogy to objects already held to be charitable and that this was assumed under the Charities Act and so disagreed with the approach preferred in the Court of Appeal, which was that benefit to the public presumptively establishes the purpose as charitable.

Development of "political" exception to charitable purpose

The development of the exception that "political" purposes could not be a charitable purpose and its application in New Zealand was also considered. Generally, the Courts have held that it is difficult to conclude where public benefit lies when an entity promotes or advocates its own cause because the Court has no means of judging whether a proposed change in the law will be for the public benefit where the political purpose — a change in the law — was the main object not subsidiary to other charitable purposes. The view that had been taken in New Zealand was that the principal purpose must be charitable but that the subsidiary non-charitable purpose does not change the charitable character of an entity. The political purpose exclusion in New Zealand excludes non-ancillary advocacy for or promotion of political ends, even those charitable in themselves, *Molloy v C of IR*.

Section 5(3) of the Charities Act

Under s 5(3) of the Charities Act the inclusion of a non-charitable purpose, does not prevent registration as a charity if it is "merely ancillary (secondary, subordinate or incidental) to a charitable purpose of the trust" and not an independent purpose. It was considered that s 5(3) provided latitude for non-charitable purposes if no more than ancillary and "advocacy" being given only as an illustration. The Supreme Court considered the Court of Appeal was in error in the view that s 5(3) enacts a general prohibition on advocacy unless it is ancillary to a charitable purpose.

Charitable purpose and "political" purpose are not mutually exclusive

The Court concluded that the development of a standalone doctrine of exclusion of political purpose had not been necessary nor beneficial, particularly in modern participatory democracy and that to hold that promotion of change in law cannot be charitable, was not reconcilable with the view that the law of charities responds to change in social conditions. Reference was made to the Australian High Court decision, *Aid/Watch v Commissioner of Taxation* (2010) 241 CLR 538 (HCA) in which the majority Judges rejected an absolute exclusion of political purpose as a standalone doctrine. A strict exclusion risked rigidity in an area of law which should be responsive to the way society works. Just as the promotion of the abolition of slavery has been regarded as charitable, today advocacy for human rights or protection of the environment and promotion of amenities that make communities pleasant may have come to be regarded as charitable purposes in themselves. Advocacy including through participation in political and legal processes, may be charitable even if not ancillary to more tangible charity.

The Supreme Court considered that the better approach was that an object which entails advocacy for change in the law is one facet of whether a purpose advances the public benefit within the spirit and intendment of the preamble of the 1601 Statute. The advances of causes will often be non-charitable, but that does not justify a rule that all non-ancillary advocacy is non-charitable. Charitable and political purposes are not mutually exclusive. It was therefore unable to agree with the Court of Appeal, that views generally acceptable may be charitable while those which are

highly controversial, are not. Unpopularity of causes otherwise charitable should not affect their charitable status. Charitable purpose depends on consideration of the end that is advocated, the means promoted to achieve that end and the manner in which the cause is promoted in order to assess whether the purpose is of public benefit within the spirit and intendment of the 1601 Statute.

Promotion of nuclear disarmament — is it charitable?

On the specific issue of whether the promotion of nuclear disarmament was charitable, it was considered that the Court of Appeal's conclusion that nuclear disarmament and elimination of weapons of mass destruction (based on the view that the promotion of peace is a charitable purpose) was suspect and that the emphasis on the lack of controversy in New Zealand about the ends of nuclear disarmament seemed misplaced. The majority judges considered that it was no answer to point to the international and domestic framework for nuclear disarmament. Where the charity promotes an abstraction, the focus in assessing charitable purpose must be on how such abstraction is to be furthered. The Court of Appeal had wrongly treated lack of controversy as determinative as to whether the promotion of these ends was charitable. Rather, it was considered necessary to focus on the manner of promotion. The promotion of a standalone object, if not ancillary, must itself be an object of public benefit as used by the authorities to qualify as a charitable purpose. Such public benefit may be found in advocacy or other expressive conduct, but such a finding depends on the wide context including public participation. The charitable status of the purposes of Greenpeace had not been considered on the correct basis. If it is concluded that the object of promoting nuclear disarmament is not shown to be charitable, then whether the activities undertaken by Greenpeace are no more than ancillary to its charitable purposes will require further assessment by the Board and for the reconsideration of the application.

Illegal activities

While illegal activities may point to an absence of charitable purpose, a charity with an illegal purpose will not be "established and maintained exclusively for charitable purposes". However, breaches of the law not deliberately undertaken or coordinated by the entity are unlikely to amount to a purpose and even isolated breaches even if sanctioned by the entity may not amount to a disqualifying purpose. However, the submission by Greenpeace that only serious offending such as would permit sanction under the legislation on a one-off basis was not accepted by the Court.

Conclusion

- "Charitable purpose" is not established where objects are of benefit to the community unless the benefit is charitable within the common law. A single test of public benefit is insufficient, rather the traditional method of analogy to objects already held to be charitable was preferred.
- Charitable and political purposes are not mutually exclusive, if the political purpose is itself charitable (as the law recognises) because of public benefit. A "political purpose" exclusion should no longer be applied in New Zealand.

- Section 5(3) provides that non-charitable purposes do not affect charitable status if no more than ancillary and includes "advocacy" as an example. The promotion of a cause will not be charitable if the end promoted or the means of promotion in itself cannot be said to be within the charitable sense of public benefit, even if an end may be seen as general public benefit (such as the promotion of peace). The manner of promotion of the purpose must be considered.
- Illegal activity may disqualify an entity from registration, although such activity would not justify removal from the charities register.

Dissenting judgment (William Young and Arnold JJ)

The dissenting judgment agreed with the majority in regard to illegal activity. The main dissent was in regard to advocacy as a charitable purpose. It was considered that the focus in the 1601 preamble was on the performance of activities that provide tangible benefit. Political advocacy encompasses promotion or opposition to existing or proposed legislation, and attempts to change or support government policy. Charitable status is not lost provided such activities are subsidiary or incidental to an institution's charitable purposes. It was noted that if advocacy in support of a charitable purpose is not charitable unless merely ancillary (s 5(3)), then how could political advocacy ever be charitable in itself? The worth of Greenpeace's advocacy of causes was not easily determined by the courts and an inquiry into which may lie outside the proper scope of the judicial role.

Removal of settlor/trustee

Powell v Powell (2014) 3 NZTR ¶24-011 sets out the process of inquiry the Court undertakes and the questions it asks itself in the exercise of its discretion under s 51 of the Trustee Act 1956 and its inherent jurisdiction as to whether the trust has been properly executed and whether the removal of a trustee is required. The case concerned an application and cross application made by two trustees, father (trustee/settlor) and son (trustee/beneficiary) for the removal of each other.

Background

The plaintiff, Mr John Powell (Mr Powell), was the father of the defendant, Mr Daniel Powell (Daniel). Mr Powell instigated a discretionary family trust, for the benefit of Daniel, any spouse, children or grandchildren Daniel may have. It was Mr Powell's intention that Daniel who was now adult would be responsible for growing the investments of the trust.

Mr Powell was a successful businessman and the trust received shares in a company, which owned a commercial property in Christchurch. Daniel returned from overseas in 1999, became a trustee with his father of the trust and using his own funds subscribed for a significant shareholding in the company becoming a director in that company. Daniel married and his wife worked for one of Mr Powell's other

companies and later in 2008 began receiving a salary from the Company. Daniel was paid by the trust, which charged the Company a management fee. The trust made modest distributions to Daniel's family.

Relations broke down between Daniel and his parents in 2011, a key factor that concerned Mr Powell was the salary paid to Daniel's wife for little or no work, although this was an arrangement the Court accepted Mr Powell had agreed to three years earlier. Mr Powell refused distribution requests for medical treatment for Daniel's wife's serious cancer and children's school fees, although these had been previously paid by the Trust. He also resisted paying Trust PAYE and ACC cheques resulting in the Trust incurring late payment penalties of $6,000.

In 2012, Mr Powell's solicitors wrote to Daniel as trustee of the trust with concerns about the trust and that payments should not be made to him by the trust until the matters were resolved, effectively stopping his income. This was followed by Daniel assaulting his father, criminal charges being laid including intentional damage and assault with intent to use a weapon. Daniel was ultimately discharged without conviction. Mr Powell made various allegations against Daniel's as a trustee. The trust was deadlocked. Both parties sought to remove the other as trustee and an independent trustee appointed in that person's place under s 51 of the Trustee Act.

The Court exercise of its discretion, removal of a trustee and appointment of replacement

The Court went through a number of steps in regard to the exercise of its discretion to remove a trustee and appoint a replacement. These were:

The facts determine how the Court's discretion will be exercised. The Court noted that the facts were hotly contested but that it is the factual circumstances of the case which will determine how the Court's discretion should be exercised. The Court is required to "look carefully into the circumstances of the case" (*Letterstedt v Broers* (1884) 9 App Cas 371 (PC) at 387).

The proper execution of the trust is the test. The Court's principal duty is "to see that trusts are properly executed" (*Letterstedt v Broers* at 386). While s 51 includes misconduct, a trustee does not need to have committed a breach of trust in order to be removed, *Powell*.

The Court will not remove a trustee lightly. The Court will not remove a trustee lightly and is reluctant to do so where there are other avenues to remedy the preceived risk. Where the trustees, being separated spouses are deadlocked, the Court may remove both spouses.

The perceived intention of the settlor. The Court will have regard to the perceived intention of the settlor and that the Court should intervene to the minimum extent.

A trustee must be neutral between beneficiaries and promote the terms of the trust. The Court in appointing trustees, will give consideration to:

- the settlor's intentions
- neutrality between beneficiaries, and
- promotion of the terms of the trust, *Mendelssohn v Centrepoint Community Growth Trust* [1999] 2 NZLR 88 (CA).

Is the complained of action likely to be perpetuated in the future? A relevent factor raised in *Powell v Powell* at [65] was whether the complained of action was likely to be perpetuated in the future. In *Powell* the father's complaint was the salary paid to the Daniel's wife for little or no work. The Court noted "this reflects a decision made by the trustees in a period where Daniel and his father were working together and were more relaxed in the way they viewed systems . . .. if a payment to Hayley is to be continued, it will need to be put on a more robust and defensible footing".

Had the complained of action previously been agreed to? In *Powell v Powell*, the trustee father queried the policy of his trustee son setting the management fee despite the father's previous acceptance of this being done as the most tax effective way possible. The Court observed that the trustee father was now objecting "because he sought to maximise the grounds of complaint he had against Daniel".

Is a trustee actively deadlocking the trust? The father in his capacity as trustee actively created the deadlock by threatening to stop his son's Daniel's salary from the trust (which charged a management fee to the company), refusing to pay PAYE and ACC cheques (incurring penalties of $6,000 and refusing to make distributions formally made eg to pay for Daniel's wife cancer treatment.

Reference was made to *Ward v Ward* (2007) 2 NZTR ¶17-021 where Heath J commenting on the exercise by the Court of its powers under s 51 of the Trustee Act and the misconduct of a trustee (and whether this warranted his removal) said:

> "A refusal to exercise powers as a trustee consistent with the fiduciary obligations owed to beneficiaries and in accordance with the terms of the trust is likely to be regarded as misconduct for the purpose of s 51".

The possibility of future deadlocks. An issue the court needs to consider is the possibility of future deadlocks. In *Powell v Powell* in deciding whether Daniel should remain a trustee the Court considered the possibility of future deadlocks if an independent trustee replaced the father who was actively deadlocking the trust. The Court considered there was minimal risk of future deadlocks.

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Whether the trustee understands his/her obligations. In determining the future proper exercution of the trust the Court needs to consider whether a trustee understands his or her obligations. An issue raised was whether Daniel could properly consider a distribution to his sister or her children (also beneficiaries). The Court considered that if he would reject such a request out of hand, that would be a compelling reason for him to be removed as a trustee. The Court considered that Daniel seemed to be able to articulate his obligations as a trustee and that with the moderating influence of an independent trustee he would be perfectly able to consider the needs of his sister and her family.

In regard to the father, the Court was satisfied that Mr John Powell had sufficient animosity towards Daniel that he could not fairly and impartially consider Daniel or his wife for assistance and it would inappropriate for him to remain a trustee. While Mr John Powell had business skills, these alone did not justify him staying on as trustee when his primary duty was to act fairly and impartially for all the beneficiaries. The court noted that Daniel may have personal flaws but he had business accumen and all parties were content to leave him as a director of the company. The benefit of the independent trustee working with Daniel was noted, "The independence and rigour of a professional trustee working alongside Daniel" would be sufficient oversight.