

The “Irreducible Core” of Trusts in New Zealand

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Introduction

This paper seeks to answer a fundamental question in the law of trusts: ‘what constitutes the “irreducible core” of a trust in New Zealand?’ The “irreducible core” will be examined by looking at the minimum duties a trustee must owe to the beneficiaries and the permissible scope of trustee exemption clauses. Since the seminal judgment of Millet LJ in *Armitage v Nurse*,¹ the scope and content of the “irreducible core” has been the subject of considerable attention by legal academics and Law Commissions throughout common law jurisdictions. Until recently, there was little case authority of high standing to suggest anything other than Millet LJ’s conception of the “irreducible core” ought to prevail. Yet, the issue has been re-opened at the highest appellate level courtesy of five separate judgments by the Privy Council in *Spread v Hutcheson*.²

This paper analyses the “irreducible core” through four stages and then considers the possibility of law reform in New Zealand. Chapter I considers the theoretical question of ‘what is a trust?’ I will show how the traditional dichotomy of explaining trusts via either a proprietary or obligational conception ought to be abandoned in favour of a sui generis hybrid theoretical model. This chapter is not presented merely to provide background or give context to the discussion of the “irreducible core”. Rather, it will be shown how a conceptual understanding of trusts is what provides the “irreducible core” with its substantive content.

Chapter II explains the “irreducible core” as a discourse. It argues that the “irreducible core” is a tool that possesses much value for assessing the minimum essence of a trust. Importantly, I will explain how the “irreducible core” can and should be viewed through two lenses: from the perspective of the minimum duties that a trustee must owe and by looking at where to draw the line with trustee exemption clauses.

Chapter III presents a conceptual argument of what ought to make up the substantive content of the “irreducible core”. Here I build upon the theoretical

¹ *Armitage v Nurse* [1998] Ch 241 (CA).

² *Spread Trustee Company Ltd v Sarah Ann Hutcheson and Others* [2011] UKPC 13 [*Spread v Hutcheson*].

understanding of trusts presented in chapter I and suggest how this understanding provides the “irreducible core” with its content. In particular, this chapter shows how the “core” must give meaning to *both* the proprietary and obligational characteristics of a trust. The discussion will focus on whether the trustees’ duty to perform the trust honestly and in good faith for the benefit of the beneficiaries, the duty to account and identify trust property, and the duty of care belong in the “irreducible core”.

Chapter IV considers whether there are good public policy reasons for broadening the “irreducible core” beyond its conceptual roots to make trustees’ liability for gross negligence non-excludable.

Chapter V argues that the current state of the law in New Zealand concerning the “irreducible core” and trustee exemption clauses is such that legislative reform ought to take place.

It is my contention that the “irreducible core” ought to follow its conceptual origins and any step that seeks to abandon these roots, in the name of pragmatic policy concerns, should be viewed with considerable caution.

Chapter I – What is a Trust?

A. Overview

A theoretical understanding of trusts is vital to determining the substantive content of the “irreducible core”.³ Therefore, this chapter addresses the underlying theoretical question of ‘what is a trust?’⁴

The traditional dichotomy of explaining trusts via either a proprietary conception or an obligational conception⁵ has left trusts “abiding in a legal matrix of tension”.⁶ This chapter will describe each theory before demonstrating that neither provides a satisfactory or holistic explanation of ‘what is a trust?’ Consequently, a sui generis hybrid definition will be presented as the most accurate and desirable theoretical account of contemporary trusts.

B. The Proprietary Theory of Trusts

The proprietary theory explains trusts as a mechanism of property⁷ whereby property is transferred from the settlor to the beneficiaries. James Penner,⁸ a notable proponent of the proprietary conception, argues that “fundamental to a trust”⁹ is this structured transfer of property, via the medium of a trustee. On the proprietary theory there are two crucial conditions upon which the existence of a valid trust is contingent:¹⁰

³ Jessica Palmer “Theories of the Trust and What They Might Mean for Beneficiary Rights to Information” (2010) NZ Law Review 541 at 544 observed that “an awareness of these two influential conceptions is certainly most helpful and, I would argue, necessary to ensure that the more particular principles of trust law are, as far as possible, conceptually coherent...” and at 564 Palmer argues that “[n]o particular area of trust law can be adequately analysed without an underlying conception or framework that identifies what the nature of the trust is”.

⁴ All references in this paper to a ‘trust’ should be read as ‘a private express trust’, unless otherwise stated.

⁵ I use the term ‘obligational’ to encompass both ‘obligational’ and ‘contractarian’ conceptions of ‘what is a trust?’

⁶ Charles Rickett “The Classification of Trusts” (1999) 18 NZULR 305 at 309.

⁷ Jessica Palmer, above n 3, at 542.

⁸ James Penner “Exemptions” in P Birks and A Pretto *Breach of Trust* (Hart Publishing, Portland, 2002) 241.

⁹ *Ibid*, at 261.

¹⁰ See generally Patrick Parkinson “Reconceptualising the Express Trust” (2002) 61(3) CLJ 657 at 658; James Penner, above n 8, at 252; Jessica Palmer, above n 3, at 542.

1. There must be a separation of legal ownership (vested in the trustee) from equitable ownership (vested in the beneficiary)¹¹ and
2. There must be identifiable trust property.

The first condition encompasses the important proposition that trust property does not form part of a trustee's estate.¹² In *Harrison v Harrison*¹³ Fogarty J held that "[t]rust is a word used to sum up a relationship where equity will compel a person holding the legal interest in a property to use it for the benefit of someone else".¹⁴ Consequently, the duties owed by a trustee are enforceable at the request of a beneficiary because they are the equitable owner of the property.¹⁵ On a proprietary account, the specific terms of a trust attach to and run with the trust property¹⁶ whilst any obligations that arise in relation to the trust are incidental and give meaning to the original transfer of property.¹⁷ The second condition reflects the certainty of subject matter requirement of a valid trust: "[a] trust without property is like a sea without water".¹⁸

Prima facie, a number of central tenets in trust law lend support to the proprietary understanding of trusts. For example, the rule in *Saunders v Vautier*¹⁹ stipulates that beneficiaries with a vested interest may wind up the relevant trust, if they are of age and sound mind and all in agreement. In *Re Phillips New Zealand Ltd*,²⁰ Baragwanath J approved of the rule in *Saunders v Vautier*²¹ for terminating trusts and applied it to beneficiaries seeking to modify trust terms: "[i]f all beneficiaries are sui juris and consent to an amendment proposed by the trustees it is difficult to visualise a successful challenge to it".²²

¹¹ See generally *B v X* [2011] 2 NZLR 405 (HC) at [87]; *Abdul Hameed Kadija v De Saram* [1946] A.C. 208, 217 where the Privy Council held that "the distinction between the legal and equitable estate is of the essence of the trust".

¹² James Penner, above n 8, at 253.

¹³ *Harrison v Harrison* [2009] WTLR 1319 (HC).

¹⁴ *Ibid*, at 1324.

¹⁵ Anthony Duckworth "Trust Law in the New Millennium: Part III: Fundamentals" (February 2001) *Trusts and Trustees* 9 at 11.

¹⁶ Jessica Palmer, above n 3, at 542.

¹⁷ *Ibid*, at 542.

¹⁸ Patrick Parkinson, above n 10, at 658-659.

¹⁹ *Saunders v Vautier* (1841) Cr. & Ph. 240.

²⁰ *Re Phillips New Zealand Ltd* [1997] 1 NZLR 93 (HC).

²¹ *Saunders v Vautier*, above n 19.

²² *Re Phillips New Zealand Ltd*, above n 20, at 101. See generally Andrew Butler "Variation and Resettlement of Trusts" in Andrew Butler (ed) *Equity and Trusts in New Zealand* (2nd ed, Thomson Reuters, Wellington, 2009) 235 at 238-239 who explains that the power to vary is

His Honour explained that unanimous beneficiaries “together use their possession of the total bundle of proprietary rights”²³ which echoes Penner’s view that the rule in *Saunders v Vautier*²⁴ stands as confirmation that trust property belongs ultimately to the beneficiaries.²⁵ Similarly, Jessica Palmer explains that “[t]his power of the beneficiaries [to vary and/or wind up the trust] specifically defeats both the trustee’s obligations and his ownership and can only be justified as being a facet of the beneficiaries’ equitable proprietary rights”.²⁶ Thus the rule in *Saunders v Vautier*²⁷ demonstrates that the inquiry is about ‘who owns the trust property?’ and not ‘who can enforce the trust obligations?’²⁸

Further support for a proprietary understanding of trusts may be found in the fact a trust will not fail for want of a trustee.²⁹ This may indicate that a trust primarily concerns the transfer of property from a settlor, for the benefit of the beneficiary, and is not dependent on any agreement³⁰ to the arrangement by a prospective trustee.³¹

C. The Obligational Theory of Trusts

The obligational theory contends that trusts ought to be understood as a species of obligation rather than as a form of property ownership.³² This theory does not outright deny the proprietary nature of trusts.³³ Rather, it posits that property rights are conditional upon, and subsequent to, the equitable obligations imposed upon the trustee via the agreement reached between settlor

seen as an extension of the rule in *Saunders v Vautier* but notes that whilst beneficiaries can *permit* the trustees to modify the trust, they cannot *compel* them to modify the trust.

²³ *Re Phillips New Zealand Ltd*, above n 20, at 101.

²⁴ *Saunders v Vautier*, above n 19.

²⁵ James Penner, above n 8, at 255.

²⁶ Jessica Palmer, above n 3, at 546.

²⁷ *Saunders v Vautier*, above n 19.

²⁸ Paul Matthews “The New Trust: Obligations Without Rights?” in AJ Oakley *Trends in Contemporary Trust Law* (Clarendon Press, Oxford, 1996) 1 at 1.

²⁹ See *Re Lysaght* [1996] Ch 191.

³⁰ As will be discussed shortly, the ‘deal’ or ‘agreement’ between a settlor and trustee forms a crucial part of the obligational theory’s conception of trusts.

³¹ Jessica Palmer, above n 3, at 545.

³² Patrick Parkinson, above n 10, at 659.

³³ *Ibid*, at 681-682.

and trustee.³⁴ Charles Rickett has clearly espoused the obligational conception and the role of property within this theory.³⁵

The trust has two facets. First, the trustee owes obligations to the beneficiaries. The trust is an I-THOU relationship. The trust is an in personam doctrine. But, the obligations are referable, of course, to things which have value, to “property”, or an IT, as defined by the general law. Thus, secondly, the I-THOU relationship is mediated through an IT. There cannot be a trust without an IT to which both the trustee and the beneficiary relate in some way. That relating is done through the notion of “ownership”.

Proponents of the obligational theory agree upon the secondary role of property. However, within the obligational camp there is division as to the proper definition of a private express trust. On the one hand, David Hayton argues that an express trust is:³⁶

An equitable obligation binding a person (‘the trustee’) to deal with property owned by him as a trust fund segregated from his private patrimony whether for the benefit of persons (‘the beneficiaries’) of whom he may himself be one, and any of whom has the right to enforce the obligation...

However, Patrick Parkinson, also a prominent proponent of the obligational trust theory, rejects Hayton’s definition. Parkinson instead argues that there need not be segregation of trust property from the private patrimony of the trustee³⁷ and, furthermore, that it is not sufficient for someone merely to have a legal power of enforcement.³⁸ He instead puts forward the following definition:³⁹

³⁴ See *Fortex Group Limited (in receivership and liquidation) v Macintosh* [1998] 3 NZLR 171 (CA) at 172 per Tipping J. His Honour defined an express trust as “one which is deliberately established and one which the trustee deliberately accepts.” The use of this sort of language lends weight towards the trust hinging on the agreement between the settlor and trustee. See generally Patrick Parkinson, above n 10, at 663; Jessica Palmer, above n 3, at 543; John H Langbein “The Contractarian Basis of the Law of Trusts” (1995) 105 Yale LJ 625 at 627; F.W. Maitland (Revised by John Brunyate) *Equity – A Course of Lecture* (2nd ed, Cambridge University Press, Cambridge, 1936) at 29. All of these authors use the language of a ‘deal’ or ‘agreement’ between the trustee and the settlor.

³⁵ Charles Rickett, above n 6, at 308-309.

³⁶ David Hayton “Developing the Obligation Characteristic of a Trust” (2001) 117 LQR 96 at 107 [“Obligation Characteristic”].

³⁷ Patrick Parkinson, above n 10, at 662-663 and 683.

³⁸ *Ibid.*, at 683.

³⁹ *Ibid.*

An express trust is an equitable obligation binding a person (“the trustee”) to deal with identifiable property to which he or she has legal title for the benefit of others to whom he or she is in some way accountable. Such obligations may either be for the benefit of persons who have proprietary rights in equity, of whom he or she may be one, or for the furtherance of a sufficiently certain purpose which can be enforced by someone intended to have a right of enforcement under the terms of the trust...

Lord Millet’s seminal judgement in *Armitage v Nurse*⁴⁰ spoke of “...an irreducible core of obligations owed by the trustees to the beneficiaries and enforceable by them which is fundamental to the concept of a trust.”⁴¹ Jessica Palmer argues that Lord Millet’s judgment is the “most well known development in support of the obligational model...[as it is] expounded in terms of obligations owed by the trustee to the beneficiary, rather than by reference to the property held by the trustee for the beneficiary”.⁴²

D. The Sui Generis Hybrid Theory of Trusts

With both theories described, it will now be argued that neither provides a complete theoretical explanation of the private express trust.⁴³ The position of discretionary beneficiaries, the certainty of subject matter requirement, and private purpose trusts will all be canvassed to illustrate the incomplete explanatory power of the individual theories. Upon completion of the said discussion, a hybrid theory will be presented as providing the most accurate and desirable conceptual account of the contemporary private express trust.

⁴⁰ *Armitage v Nurse*, above n 1.

⁴¹ *Ibid*, at 253.

⁴² Jessica Palmer, above n 3, at 551.

⁴³ See *ibid*, at 552. Palmer has argued that “...rather than one conception being a more accurate reflection of the law of trusts than the other, both are highlighting different, but nevertheless necessary, features of the express trust”; F.W. Maitland, above n 34, at 23 who concedes that the trust seems “to be a little of both” – it is neither entirely about personal rights nor rights *in rem*.

1. *Discretionary Beneficiaries and the Separation of the Legal and Equitable Estate*

The proprietary conception of trusts places considerable emphasis on the contemporaneous existence of the legal and equitable estate in the trust property, vested in the trustee and beneficiaries respectively. This proposition may explain the rule in *Saunders v Vautier*,⁴⁴ as it can be argued the rule is a manifestation of the beneficiaries' rights as equitable owner of the trust property.

There is a problem with this line of reasoning. The obligational theorist may ask: "[m]ust there be a symmetry between the legal and equitable estates?"⁴⁵ To answer this question in the negative, the obligational conception considers the position of discretionary beneficiaries.

Discretionary beneficiaries do not gain a property interest, but only a mere hope or expectation that the trust will be exercised in their favour.⁴⁶ Parkinson argues that the rule in *Saunders v Vautier*⁴⁷ can only work for discretionary trusts if there is a fixed class of beneficiaries and the trustees have discretion to make distributions among that class.⁴⁸ In such a case,⁴⁹ Parkinson explains that the beneficiaries should be regarded as collectively holding the equitable estate. This is distinguishable from a situation where there is a really wide class of beneficiaries or, for example, where there is power to nominate charities and no list can be drawn up. In these situations, the rule in *Saunders v Vautier*⁵⁰ does not apply.⁵¹

⁴⁴ *Saunders v Vautier*, above n 19.

⁴⁵ Patrick Parkinson, above n 10, at 659.

⁴⁶ *Johns v Johns* [2004] 3 NZLR 202 (CA) at [31] per Tipping J citing *Hunt v Muollo* [2003] 2 NZLR 322 (CA) at 325. His Honour explained the position of discretionary beneficiaries as possessing "...no more than a mere expectancy. It is simply an expectation or hope...that the trustee's discretion may be exercised in the beneficiary's favour...The position, as stated, is supported by high authority: see *Gartside v Inland Revenue Commissioners* [1968] AC 553 at p 607 per Lord Reid and at p 615 per Lord Wilberforce. An ordinary discretionary beneficiary has no interest, legal or equitable, in the assets of the trust: see *Queensland Trustees Ltd v Commissioner of Stamp Duties* (1952) 88 CLR 54 at pp 62-65...It is only on the making of a distribution to the discretionary beneficiary that the beneficiary obtains any interest in property, and then only to the extent of the distribution."

⁴⁷ *Saunders v Vautier*, above n 19.

⁴⁸ Patrick Parkinson, above n 10, at 661.

⁴⁹ See *Re Smith, Public Trustee v Aspinall* [1928] Ch 915.

⁵⁰ *Saunders v Vautier*, above n 19.

⁵¹ Patrick Parkinson, above n 10, at 661.

Alternatively, the obligational theory might seek to explain the theoretical position of discretionary beneficiaries in both situations. In *Schmidt v Rosewood*⁵² the Privy Council cited Kirby P in *Hartigan Nominees Pty Ltd v Rydge* for the proposition that:⁵³

No matter how wide the trustee's discretion in the administration and application of a discretionary trust fund...the trustee is still a trustee.

This statement reminds us that discretionary beneficiaries have a “right”⁵⁴ to be considered. This “right” exists because trustees owe duties to beneficiaries that do not hinge upon them possessing an equitable property interest.⁵⁵ For example, a trustee must act honestly and in good faith in the best interests of the beneficiaries.⁵⁶ It is these obligations that mean a trustee must *consider* whether the beneficiaries of a discretionary trust or power should have the discretion carried out in their favour.⁵⁷

What this discussion demonstrates is that neither theory is able to holistically explain the position of discretionary beneficiaries. Thus perhaps a hybrid conception is needed whereby the proprietary theory accounts for beneficiaries and their enforcement of trusts⁵⁸ in cases where there are no discretionary beneficiaries or where the class of discretionary beneficiaries is fixed, and the obligational theory is better able to explain the rights of beneficiaries in situations where the beneficiaries have no proprietary interests.

⁵² *Schmidt v Rosewood* [2003] 2 AC 709 (PC).

⁵³ *Ibid*, at 724 per Lord Walker of Gestingthorpe citing *Hartigan Nominees Pty Ltd v Rydge* (1992) 29 NSWLR 405 at 416.

⁵⁴ Andrew Butler “The Trust Concept, Classification and Interpretation” in Andrew Butler (ed) *Equity and Trusts in New Zealand* (2nd ed, Thomson Reuters, Wellington, 2009) 43 at 51 citing *Gartside v Inland Revenue Commissioners*, above n 46.

⁵⁵ Chapter III discusses what duties must be owed in order for the “irreducible core” to be present.

⁵⁶ *Armitage v Nurse*, above n 1, at 253H. See also *Re the Esteem Settlement; Abacus (CI) Ltd and Grupo Torras SA v Sheikh Fahad Mohammed Al-Sabah* [2004] WTLR 1 at [122] for a discussion of the duty of good faith owed to discretionary beneficiaries.

⁵⁷ *McPhail v Doulton* [1971] AC 424 (HL) at 449, 457; *Re Gulbenkian's Settlement* [1970] 1 AC 508 (HL) at 518.

⁵⁸ In the sense of exercising their power to terminate or modify a trust under the rule in *Saunders v Vautier*, above n 19.

2. *Certainty of Subject Matter*

A trust requires certainty of subject matter: there must be some property over which the trust is vested. However, there is much debate as to the true nature of this requirement. In *Hunter v Moss*,⁵⁹ the English Court of Appeal held there to be a valid trust declared over 50 out of 950 shares in a company, despite the settlor not specifying which particular 50 shares were intended to be the subject of the trust. Parkinson treats *Hunter v Moss*⁶⁰ as showing:⁶¹

It is enough that the trust *obligation* is defined with sufficient clarity that a court can decide, in the event of dispute, how much money or property is held on trust or should be devoted to the purposes of the trust. That is, the requirement of certainty of subject-matter is, on closer analysis, a requirement of certainty of obligation.

Upon this basis Parkinson contends that you do not need identifiable trust property at all.⁶² Rather, what is required is “an identifiable subject matter within which the trust property may be identified”.⁶³

However, as Palmer⁶⁴ observes, it is still necessary for there to be *some* trust property over which the trust may attach. Whether this is a requirement of specific trust property, trust property able to be ascertained from a larger mass (such as in *Hunter v Moss*⁶⁵), or couched in terms of sufficiently clear obligations so as to allow identification of the trust property, it does not undermine the premise that there must be *some* form of property over which the trust operates.⁶⁶ Thus the debate is not in fact over whether a trust needs

⁵⁹ *Hunter v Moss* [1994] 1 WLR 425 (CA).

⁶⁰ *Ibid.*

⁶¹ Patrick Parkinson, above n 10, at 664.

⁶² *Ibid.* However, Patrick Parkinson, above n 10, at 666 who admits that the decision in *Hunter v Moss*, above n 62, has been “much criticised” and whilst followed in England, its application has been rejected in Australia (See Gummow J in *Herdegen v Federal Commission of Taxation* (1988) 84 ALR 271, 279). See also David Hayton “Uncertainty of Subject-Matter of Trusts” (1994) 110 LQR 335 who described the case as wrongly decided. In Hayton’s opinion this was because the settlor had not set aside a specific parcel of 50 shares and thus had not yet divested himself of any beneficial interest in those specific shares.

⁶³ *Ibid.*

⁶⁴ Jessica Palmer, above n 3, at 548.

⁶⁵ *Hunter v Moss*, above n 59.

⁶⁶ Jessica Palmer, above n 3, at 548.

property, but how one defines the certainty of subject matter requirement, which turns on the theory adopted.

3. *Certainty of Objects and Private Purpose Trusts*

In *Re Recher's Will Trusts*,⁶⁷ Brightman J held “[a] trust for non-charitable purposes, as distinct from a trust for individuals, is clearly void because there is no beneficiary”.⁶⁸ Thus, “the long struggle in English law to legitimate any non-charitable purpose trusts...”⁶⁹ has been met with considerable objection and limited success. Prima facie, the rejection of private purpose trusts appears to stem from the proprietary conception of trusts⁷⁰ as there must be a beneficiary to enforce the trust.

The obligational theory may accept that the rule is a manifestation of the proprietary understanding but point to recent developments in the law of trusts that may indicate a shift away from the doctrine.⁷¹ In *McPhail v Doulton*, Lord Wilberforce held, on behalf of the majority of the House of Lords:⁷²

[T]hat the test for the validity of trust powers ought to be similar to that accepted by this House in *Re Gulbenkian's Settlement Trusts*⁷³ for powers, namely that the trust is valid if it can be said with certainty that any given individual is or is not a member of the class.

Both Penner⁷⁴ and Palmer⁷⁵ acknowledge that *McPhail v Doulton*⁷⁶ represents a movement away from a proprietary understanding of trusts and, as Palmer explains, is a step “...towards a less demanding view that the trust exists as

⁶⁷ *In Re Recher's Will Trusts* [1972] Ch. 526. See generally, *Morice v Bishop of Durham* (1805) 10 Ves. 522; *Leahy v Attorney General of New South Wales* [1959] AC 457 (PC); *Re Endacott* [1960] Ch. 232 (CA).

⁶⁸ *In Re Recher's Will Trusts*, above n 70, at 538.

⁶⁹ Jessica Palmer, above n 3, at 548.

⁷⁰ *Ibid.*, at 548.

⁷¹ See generally John H Langbein, above n 34, at 645. Langbein states that the proprietary conception of a trust is “...dependent upon historical circumstances that no longer pertain”.

⁷² *McPhail v Doulton*, above n 57, at 456 per Lord Wilberforce.

⁷³ *Re Gulbenkian*, above n 57.

⁷⁴ James Penner, above n 8, at 255.

⁷⁵ Jessica Palmer, above n 3, at 546-547.

⁷⁶ *McPhail v Doulton*, above n 57.

long as the trustee owes the trust obligation to someone”.⁷⁷ This serves to dilute the proprietary conception as the court takes a more liberal stance on how clearly defined beneficiaries must be.

Cases subsequent to *McPhail v Doulton*⁷⁸ may represent an even greater relaxation of a strict proprietary understanding of trusts. Paul Matthews has spoken of “quasi-exceptions”,⁷⁹ whilst Jessica Palmer describes “isolated cases”,⁸⁰ which may go against the rule prohibiting private purpose trusts. Certain readings of *In Re Denley’s Trust Deed*⁸¹ (“*Re Denley*”) and *Barclays Bank Ltd v Quistclose Investments Ltd*⁸² (“*Quistclose*”) lend support to a dilution of the rule against private purpose trusts.

In *Re Denley*, Goff J (as he then was) held:⁸³

Where, then, the trust, though expressed as a purpose, is directly or indirectly for the benefit of an individual or individuals, it seems to me that it is in general outside the mischief of the beneficiary principle.

Under the trust in *Re Denley*,⁸⁴ the primary beneficiaries, to receive enjoyment of the sports ground over which the trust was settled, were the current employees of the company. Parkinson⁸⁵ contends that whilst the present employees in *Re Denley*⁸⁶ had an interest that allowed them to enforce the trust, it was not such that they could vary and/or wind up the trust in line with the rule in *Saunders v Vautier*.⁸⁷ This is because the trust deed contemplated that future employees “might also be permitted to use the sports ground at the discretion of the trustees thus one could not say there was any identifiable

⁷⁷ Jessica Palmer, above n 3, at 547. However, Palmer suggests that whether these developments work against the proprietary theory depends on how one interprets the certainty of objects rule. If it is primarily about enforcement and not the separation of the legal and equitable interest then these developments may not provide much of an erosion to the proprietary theory.

⁷⁸ *McPhail v Doulton*, above n 57.

⁷⁹ Paul Matthews, above n 28, at 3.

⁸⁰ Jessica Palmer, above n 3, at 548.

⁸¹ *In Re Denley’s Trust Deed* [1969] 1 Ch 373 [“*Re Denley*”].

⁸² *Barclays Bank v Quistclose Investments* [1970] AC 567 (HL) [“*Quistclose*”].

⁸³ *Re Denley*, above n 81, at 383G-384A.

⁸⁴ *Re Denley*, above n 81.

⁸⁵ Patrick Parkinson, above n 10, at 662.

⁸⁶ *Re Denley*, above n 81.

⁸⁷ *Saunders v Vautier*, above n 19.

group in which the beneficial estate was vested”.⁸⁸ With regards to enforceability, the position of a current employee in *Re Denley*⁸⁹ can be described as follows:⁹⁰

He is not an equitable owner, yet he clearly has standing to bring an action against the trustee to compel the trustee to administer the trust property. In other words, this is a type of trust in which the trustee has obligations enforceable by beneficiaries, but the beneficiaries are not equitable owners.

*Quistclose*⁹¹ may be read as a case where there was a private purpose trust.⁹² Quistclose (“Q”) made a loan to a company, Rolls Razor (“RR”), solely for the purpose of RR paying dividends owed to their shareholders.⁹³ After Q made the loan, and before RR made payment to its shareholders, RR entered liquidation.⁹⁴ Lord Wilberforce held:⁹⁵

That arrangements of this character for the payment of a person’s creditors⁹⁶ by a third person give rise to a relationship of a fiduciary character or trust in favour, as a primary trust, of the creditors, and secondly, if the primary trust fails, of the third person...

Thus, there was a primary trust in favour of the creditors to be paid on the specified date. The obligational theory might explain the primary trust in *Quistclose*⁹⁷ as a private purpose trust – the purpose being to pay dividends to the creditors. The creditors might be viewed as ‘indirect beneficiaries’ (like the

⁸⁸ Patrick Parkinson, above n 10, at 662.

⁸⁹ *Re Denley*, above n 81.

⁹⁰ Anthony Duckworth, above n 15, at 13.

⁹¹ *Quistclose*, above n 82.

⁹² See Peter J Millet “The Quistclose Trust: Who Can Enforce It?” (1985) 101 LQR 269 who surveys a range of possible ways in which *Quistclose* can be interpreted; contrast William Swadling “Orthodoxy” in William Swadling (ed) *The Quistclose Trust: Critical Essays* (Hart Publishing, Portland, 2004) 9 where the author firmly rejects the existence of a private purpose trust in *Quistclose* stating, at 9, that the case cannot be squared with orthodox principles of trust law.

⁹³ The loan document stipulated that the payment was “for the purpose of [RR] paying the final dividend due on July 24 next.”

⁹⁴ See *Quistclose*, above n 82, at 578-580 per Lord Wilberforce for a summary of the facts.

⁹⁵ *Ibid*, at 580 per Lord Wilberforce.

⁹⁶ When the dividend payment was approved, it made RR a debtor in respect of the net amount owed to its shareholders. Reference to the ‘creditors’ is to the aforementioned ‘shareholders’ of RR. They are now ‘creditors’ because RR has entered liquidation and owed the dividend as a debt.

⁹⁷ *Quistclose*, above n 82.

current employees in *Re Denley*⁹⁸), and thus there was someone with standing to enforce the trust and to meet the certainty of objects requirement.

The creditors, as beneficiaries, may have had the right to enforce the obligations of the trustee (borrower) to ensure the money was paid to them, in accordance with the purpose. If the company went insolvent they could not claim a proprietary right in the money. This is because the purpose of the trust was to pay dividends, not to set up and give beneficial ownership of the money to the creditors to enable them to get the value of their dividends. In this situation the lender would have a proprietary claim.⁹⁹

However, this is not the only way *Quistclose*¹⁰⁰ has been interpreted and is by no means an uncontroversial reading of the case.¹⁰¹ Importantly, what the discussion demonstrates is that there is some uncertainty regarding how the law treats private purpose trusts which may be result of the courts trying, perhaps by sleight of hand, to liberalise the strict enforcement rules inherent in the proprietary conception of private express trusts. What is apparent is that neither the proprietary nor the obligational conception of trusts provides a complete or satisfactory theoretical explanation of the rules, and exceptions, concerning private purpose trusts and the beneficiary principle.

4. *The Proposed Sui Generis Hybrid Theory*

The traditional dichotomy of understanding a trust as either proprietary or obligational ought to be abandoned in favour of a hybrid conception. I propose that a private express trust ought to be conceptually defined as follows. A trusts

⁹⁸ *Re Denley*, above n 81. Contrast William Swadling, above n 92, at 28-29 who is critical of the decision in *Re Denley* and furthermore rejects that *Quistclose* could fit into the “exception” to the beneficiary principle created by Goff J in that case. A further problem with drawing an analogy between the creditors in *Quistclose* and the ‘indirect beneficiaries’ in *Re Denley* is that, unlike in *Re Denley*, it was known in *Quistclose* who *all* the beneficiaries of the purported trust were.

⁹⁹ This reading of *Quistclose* is apparent in two subsequent cases. See *Re Northern Developments Ltd*, unreported, 6 Oct. 1978, Megarry V-C; *Carreras Rothmans v Freeman Matthews Treasure* [1985] 1 All ER 155 at 166.

¹⁰⁰ *Quistclose*, above n 85.

¹⁰¹ See *Twinsectra v Yardley* [2002] 2 AC 164 (HL) [“*Twinsectra*”] per Lord Millet and Lord Hoffmann; *Potter v Potter* [2003] 3 NZLR 145 (CA) per Fisher J; Paul Matthews, above n 28, at 16; William Swadling, above n 92.

is a relationship between trustees and beneficiaries.¹⁰² The relationship is defined by two essential requirements. First, there must be trust property¹⁰³ via which the relationship is mediated.¹⁰⁴ The trust property must be legally owned by the trustee, separate from his or her personal estate¹⁰⁵ and held for the benefit of another (the beneficiary). Secondly, there must be binding obligations that are agreed upon between the settlor and the trustee¹⁰⁶ which are enforceable by sufficiently defined beneficiaries. Which obligations are enforceable, and the extent to which they are so, will depend on the nature of the beneficiaries' interest: as fixed, vested or discretionary. These obligations dictate how the relationship is to be governed. The proprietary and obligational aspects of a trust present two sides of the same coin. Without trust property, it is illusory to speak of there being a trust. Likewise, without the minimum core of obligations there is no trust.

E. Conclusion

The view I advocate ought not to be considered a radical departure from the existing body of authority on point. The New Zealand Law Commission has recently observed that neither theory provides a complete conceptual understanding of trusts.¹⁰⁷ Furthermore, Jessica Palmer has lent her support towards a hybrid understanding of the trust,¹⁰⁸ although Palmer considers a trust to be “fundamentally proprietary”.¹⁰⁹ It is also apparent that proponents of an obligational theory, such as Parkinson,¹¹⁰ Hayton¹¹¹ and Rickett¹¹² do not deny the proprietary nature of a trust, rather they argue that trusts are primarily obligational and the property rights of the beneficiary flow from that.

¹⁰² Including the *Re Denley* sense of ‘indirect beneficiaries’ who are able to enforce the trust.

¹⁰³ This includes ‘trust property’ in a strict sense, in the *Hunter v Moss* sense, and how Parkinson defines it.

¹⁰⁴ Charles Rickett, above n 6, at 308-309 uses the term “mediated” to explain the role of trust property in trust arrangements.

¹⁰⁵ Unless the trustee is also a beneficiary.

¹⁰⁶ Or in the case of a declaratory trust: obligations imposed by the settlor upon his or herself as the trustee.

¹⁰⁷ Law Commission (New Zealand) *The Duties, Office and Powers of a Trustee – Review of the Law of Trusts Fourth Issues Paper* (NZLC, IP26, 2011) at 8.

¹⁰⁸ Jessica Palmer, above n 3, 552-553 and 564.

¹⁰⁹ *Ibid*, at 552.

¹¹⁰ Patrick Parkinson, above n 10.

¹¹¹ David Hayton “Obligation Characteristic”, above n 36.

¹¹² Charles Rickett, above n 6.

What my argument rejects is the need to adopt a ‘chicken or the egg’ analysis to the conceptual makings of trusts. It is not a matter of saying that obligations are consequent on trust property, or vice versa, but a matter of recognising that *both* the property and obligational requirement of a trust go to its very core and without either there is no trust of which to speak.

What this paper will make clear is that the “irreducible core” must gain its substantive content from both the obligational and proprietary origins of the trust concept.

Chapter II – The “Irreducible Core” Discourse

A. Overview

This chapter will explain how “irreducible core” operates as a discourse. Two arguments will be presented. First, I will explain how the “irreducible core” possesses considerable pragmatic value as a tool for assessing the minimum validity of trusts.¹¹³ Secondly, I will demonstrate how the “irreducible core” should be understood by reference to *both* the minimum duties trustees must owe and the standards of trustee fault that are unable to be excluded.

B. The Practical Value of the “Irreducible Core”

This section explains how the “irreducible core” is a useful tool for determining the minimum validity of trusts.

The “irreducible core” is a relatively recent import into the law of trusts.¹¹⁴ In *Armitage v Nurse*,¹¹⁵ Millet LJ spoke of an “irreducible core of obligations owed by the trustees to the beneficiaries and enforceable by them which is fundamental to the concept of a trust”.¹¹⁶ After defining the content of the “irreducible core”,¹¹⁷ Millet LJ went on to state that it is the “...minimum necessary to give substance to the trust”.¹¹⁸ Thus to Millet LJ, the “irreducible core” was framed as the minimum obligations that trustees must owe to beneficiaries for there to be a valid trust.

¹¹³ David Fox “Non-excludable Trustee Duties” (2011) 17(1) *Trusts and Trustees* 17 at 17 describes the irreducible core as a tool for testing the “minimum functionality” of a trust.

¹¹⁴ It is difficult to pinpoint the precise moment when the “irreducible core” emerged as a tool for assessing the validity of legal devices. In the mid-Twentieth century, K.W. Wedderburn argued that there was a core of primary obligations owed under a contract, which could not validly be excluded by an exemption clause. See K.W. Wedderburn “Contract-Exemption Clauses-Fundamental Breach-Main Objects of Contract” (1957) *Cambridge L.J.* 16; K.W. Wedderburn “Contract-Exceptions Clause-Fundamental Breach-Agents” (1960) *Cambridge L.J.* 11. Wedderburn’s discussion is in the context of the then developing notion of ‘fundamental breach’ of contract. David Hayton “The Irreducible Core Content of Trusteeship” in AJ Oakley *Trends in Contemporary Trust Law* (Clarendon Press, Oxford, 1996) 47 [“Irreducible Core Content”] suggested the “irreducible core” to have considerable merit in the trust context. However, the idea of the “irreducible core” only began to receive considerable attention after the seminal, yet controversial, judgment of Millet LJ in *Armitage v Nurse*, above n 1.

¹¹⁵ *Armitage v Nurse*, above n 1.

¹¹⁶ *Ibid*, at 253.

¹¹⁷ What makes up the content of the “irreducible core” is discussed in chapter III.

¹¹⁸ *Armitage v Nurse*, above n 1, 253H-254A.

David Hayton, who first spoke of the “irreducible core” as possessing value in the trust context, described it as setting the limits of a settlor’s free will¹¹⁹ or, as others have called it, ‘settlor autonomy’.¹²⁰ It defines the point where the property arrangement that purports to be a ‘trust’ is in fact repugnant¹²¹ to the very concept it is trying to utilise. In other words, a trust is “illusory”¹²² when the “irreducible core” is absent. The usefulness of the “irreducible core” as a concept highlights the tension between preserving the trust as a flexible mechanism¹²³ of property transfer on the one hand, and “ensuring the trust concept is not rendered an empty shell without meaningful interest for the beneficiaries...”¹²⁴ on the other.

There are three possible consequences of finding the “irreducible core” absent in a given trust. First, the trust in its entirety may be held invalid and a resulting trust back to the settlor declared as the remedy.¹²⁵ A second consequence is that a trustee may be unable to rely on a clause that contravenes the “irreducible core”. Subsequently the trust could be modified to remove the clause.¹²⁶ A third possible consequence of finding the “irreducible core” to be absent is that there is a failed trust and the property is thereby gifted to the trustee.¹²⁷

¹¹⁹ David Hayton “Irreducible Core Content”, above n 114, at 48-49.

¹²⁰ See generally Law Reform Commission (Ireland) *Trust Law: General Proposals* (LRC 92, 2008) at 76-77; Andrew Butler and DJ Flinn “A Modern Law of Trusts: What is the Least That We Can Expect of a Trustee? Exclusion of Trustee Duties and Exemption of Trustee Liability” (2010) NZ Law Review 459, 459 and 499; David Fox, above n 113, at 17 states “[h]ow far can the settlor go in excluding the default trustee duties commonly recognised in general law before the institution he purports to create is no longer recognisable as a trust?”

¹²¹ Nicholas J McBride “Trustees’ Exemption Clauses” (1998) 57 CLJ 33 at 34.

¹²² John H. Langbein “Mandatory Rules in the Law of Trusts” (2004) 98(3) Northwest U L Rev 1105 at 1124. See also Malcolm Cope “A Comparative Evaluation of Developments in Equitable Relief for Breach of Fiduciary Duty and Breach of Trust” (2006) 6(1) QUTLJ 118 at 157; David Fox, above n 113, at 17 states “[t]he apparent trust created by the settlor would be unreal”; *BQ and others v DQ and others* [2011] WTLR 373 [*“BQ v DQ”*].

¹²³ See Law Commission for England and Wales *Trustee Exemption Clauses* (Law Com No 301, 2006) at [1.17].

¹²⁴ Andrew Butler and DJ Flinn, above n 120, at 460.

¹²⁵ See generally David Hayton “English Fiduciary Standards of Trust Law” (1999) 32 Vand J Transnat’l L 555 at 595-596.

¹²⁶ This is how the plaintiff sought to use the “irreducible core” in *Armitage v Nurse*, above n 1. See also *Midland Bank Trustee (Jersey) Ltd v Federated Pension Services Ltd* [1996] PLR 179 at [146]-[147].

¹²⁷ As is the case with a precatory trust. See *In re Adams & Kensington Vestry* (1884) 27 Ch D 394 (CA).

The choice between these outcomes will depend on how the “irreducible core” issue arises in a given case. For example, assume that *Mrs A* settled the (fictitious) *ABC Trust*. It has two beneficiaries (*Mr X* and *Mrs Y*) and a sole trustee (*Mr Z*). The *ABC Trust* deed contains a provision stating ‘the trustee will not be liable for any losses flowing from any fraudulent breach of trust’.¹²⁸ *Mr X* brings a claim, seeking to challenge a fraudulent disposition made by *Mr Z* to *Mrs Y*. In this case, *Mr X* may not want to have the trust as a whole invalidated (as he may be entitled to dispositions of some sort). Thus *Mr X* would be better off to seek to disallow the trustee from relying on the clause that is contrary to the “irreducible core”, thereby making *Mr Z* personally liable. Assume now that no transfer has been made to *Mrs Y*, and that *Mr X* is entitled to the bulk of *Mrs A*’s estate under her will (or under the intestacy rules¹²⁹). In this instance *Mr X* would frame his claim in terms of the clause impeaching the “irreducible core” and invalidating the trust as a whole.

One might ask why the law should encourage a situation in which one of the possible remedies, achieved through unwinding or unravelling the purported trust structure, is at times very hard to implement and potentially may present more difficulties than it solves. Recent case law on ‘sham trusts’¹³⁰ highlights the complex issues presented¹³¹ by seeking to unwind trusts. One might understandably feel inclined to err on the side of caution in supporting a concept that, when breached, may pull apart a trust.¹³² Nevertheless, the overriding consideration is that a conceptual understanding of trusts fills the “irreducible core”. Whilst trusts are a flexible construct of the court’s equitable jurisdiction, they should be kept within some reasonable limits and not be permitted to abandon their conceptual roots. Thus when one holds the “irreducible core” to be absent, a trust does not exist in the given circumstances

¹²⁸ Assume for now that a clause of this sort would be contrary to the “irreducible core”. Whether a clause like this would in fact be contrary to the “irreducible core” is discussed in chapter III.

¹²⁹ Administration Act 1969, Part 3.

¹³⁰ See *Official Assignee v Sanctuary Propvest Ltd* HC Auckland CIV-2009-404-852, 11 June 2009; *Harrison v Harrison*, above n 13; *BQ v DQ*, above n 122.

¹³¹ For instance, transactions may have taken place in reliance on the trust’s validity.

¹³² In *Official Assignee v Wilson & Clyma* [2008] 3 NZLR 45 at 52 where the Court of Appeal emphasised the court’s reluctance to unwind trusts: “A court will only look behind a transaction’s ostensible validity if there is good reason to do so, and “good reason” is a higher threshold, since a premium is placed on commercial certainty”.

because to hold otherwise would be contrary to the fundamental conceptual tenets underlying the trust as a concept.¹³³

C. *The “Irreducible Core” and Trustee Exemption Clauses*

The “irreducible core” can be defined from two commensurate points of view: by looking at the minimum duties that must be owed by a trustee and by looking at the standard of fault for which trustee liability cannot be excluded.¹³⁴ James Penner¹³⁵ is critical of Millet LJ’s¹³⁶ explanation of the practical utility served by the “irreducible core”. Penner’s argument is that the “irreducible core” of duties has been reduced to a duty not to commit a certain type of breach.¹³⁷ Penner argues that the “core” should instead be defined according to some minimum or essential kind of duty owed.¹³⁸ Whilst these concerns serve an important reminder on the one hand, they are overstated on the other.¹³⁹

The important reminder is that certain duties must lie at the “irreducible core” and are a crucial point of focus. However, this by no means renders the standard of fault (the trustee exemption clause side of the coin) unhelpful or subordinate. K.W. Wedderburn, in explaining the link between exclusion clauses and the primary obligations owed under contract, demonstrates the interrelationship between the duties owed and the standard of fault that is excludable.¹⁴⁰ He explains how exclusion clauses are not just about exclusion, they importantly also serve to define the primary obligations owed under a contract. This is because if the primary obligations are discharged there is no

¹³³ See David Fox, above n 113, at 17 where the author states “[w]ithout this core of basic duties, the institution which the settlor has created by vesting assets in the so-called trust could not function as a trust, as that institution is generally understood in the legal system that has to decide the question”.

¹³⁴ *Ibid*, at 18.

¹³⁵ James Penner, above n 8. See also Robert Flannigan “The Core Nature and Fiduciary Accountability” (2009) NZ Law Review 375 at 395-397.

¹³⁶ *Armitage v Nurse*, above n 1.

¹³⁷ *Ibid*, at 251 Penner argues that “[p]ersonal liability to make up for a breach of duty is conceptually a different thing from having that duty in the first place”.

¹³⁸ James Penner, above n 8, at 250.

¹³⁹ The discussion at hand is merely looking at the issue Penner has taken with allowing the standard of trustee fault which is non-excludable to define the “irreducible core”. This is not an analysis of Penner’s argument that Millet LJ misconstrued the “irreducible core” by ignoring the proprietary origins of a trust (see chapter III).

¹⁴⁰ K.W. Wedderburn, above n 114.

duty and there can be no breach without a duty.¹⁴¹ Justice Oliver Wendell Holmes' extra-judicial jurisprudential writings, about the 'bad man'¹⁴² and the law, can be used to further demonstrate why the "irreducible core" should be viewed through both lenses.¹⁴³ Holmes writes "[a legal] theory is apt to get the cart before the horse, and to consider the...duty as something existing apart from and independent of the consequences of its breach".¹⁴⁴ Holmes then asks us to consider what a legal duty means to the 'bad man'. He states that to the 'bad man' a legal duty is "[m]ainly, and in the first place, a prophecy that if he does certain things he will be subjected to disagreeable consequences".¹⁴⁵ In the context of discussing the "irreducible core", Holmes' jurisprudence serves to remind us that the duty owed and the type of conduct that will lead to its breach must be taken together with the former giving meaning to the latter and, importantly, vice versa. Both perspectives define the substantive content of the "irreducible core".

D. Conclusion

This chapter set out two important arguments. It demonstrated how the "irreducible core" is a useful tool for determining the minimum validity of a trust. It then showed how the "irreducible core" should be understood by reference to *both* the minimum duties owed and the standard of trustee fault that is unable to be excluded.

¹⁴¹ K.W. Wedderburn (1960), above n 114, at 13 discussing *Sze Hai Tong Bank Ltd v Rambler Cycle Co Ltd* [1959] AC 576.

¹⁴² In the trust context let us, for argument's sake, consider the 'bad man' to be a trustee contemplating an action that would constitute a breach of trust.

¹⁴³ Oliver Wendell Holmes "The Path of the Law" (1897) 10 Harv L Rev 457. Holmes at 459 states: "[i]f you want to know the law and nothing else, you must look at it as a bad man, who cares only for the material consequences which such knowledge enables him to predict".

¹⁴⁴ *Ibid*, at 458.

¹⁴⁵ *Ibid*, at 461.

Chapter III – The Substantive Content of the “Irreducible Core”

A. Overview

This chapter explains, from a conceptual point of view, what makes up the substantive content of the “irreducible core”.

The argument in this chapter will be presented in three parts. First, it will be argued that the trustees’ duty to perform the trust honestly and in good faith for the benefit of the beneficiaries must lie at the “irreducible core”.¹⁴⁶ It will be shown what each of these duties entails and the correlative trustee conduct for which an exemption clause could not validly exclude liability. Secondly, it will be argued that the trustees’ duty to account to the beneficiaries and duty to identify trust property should form part of the “irreducible core”. Thirdly, it will be argued that the trustees’ duty of reasonable care and skill should not form part of the “irreducible core”.

B. *The Trustees’ Duty to Perform the Trust Honestly and in Good Faith for the Benefit of the Beneficiaries*

The duty to perform the trust honestly and in good faith for the benefit of the beneficiaries must lie at the “irreducible core” of a trust. In *Armitage v Nurse* Millet LJ defined the “irreducible core” of a trust:¹⁴⁷

...[T]here is an irreducible core of obligations owed by the trustees to the beneficiaries and enforceable by them which is fundamental to the concept of a trust. If the beneficiaries have no rights enforceable against the trustees there are no trusts. But I do not accept...that these core obligations include the duties of skill and care, prudence and diligence. The duty of the trustees to perform the trusts honestly and in good faith for the benefit of the beneficiaries is the minimum necessary to give substance to the trusts, but in my opinion it is sufficient.

¹⁴⁶ *Armitage v Nurse*, above n 1, at 253H.

¹⁴⁷ *Ibid.*

The duty of the trustees to perform the trust honestly and in good faith for the benefit of the beneficiaries should undoubtedly fill the “irreducible core”.¹⁴⁸ Without this duty, there is simply no ‘trust’.¹⁴⁹ The tripartite portions of this “irreducible” duty should to be read conjunctively but the terms are not synonymous. Each duty will be explained in turn.

1. *Good Faith*

The trustees’ duty of good faith should be viewed as the broadest of the three duties. Despite the importance of good faith and its use in many areas of the law there is a distinct lack of clarity as to how it should be defined. Jane Stapleton¹⁵⁰ provides a non-exhaustive¹⁵¹ explanation for what ‘good faith’ entails. Stapleton explains that good faith comprises of standards, obligations and considerations that seek to temper the deliberate pursuit of self-interest in situations where the conscience is bound.¹⁵² She describes honesty as part of the duty of good faith and that good faith necessitates not acting contrary to an undertaking or exploiting a vulnerable party.¹⁵³ The broad definition, that this paper will shortly advocate, of ‘actual fraud’ and the argument in favour of making ‘equitable fraud’ non-excludable are in part justified by the need to give meaningful substance to the duty of good faith. Stapleton’s reference to not pursuing self-interest shows how good faith overlaps significantly with, or may in fact encompass, the fiduciary duties of loyalty¹⁵⁴ and not to be in a position of conflict.¹⁵⁵ The duty of good faith can be breached by conduct that amounts to less than dishonesty and bad faith.¹⁵⁶

¹⁴⁸ See *Walker v Stones* [2001] QB 902; *Foreman v Kingstone* [2004] 1 NZLR 841 (HC) at [71] where Potter J held that “[t]he statement quoted [from *Armitage v Nurse*] nevertheless reflects the basic principle that trustees have fundamental obligations to beneficiaries which arise simply because there is a trust.”

¹⁴⁹ See Andrew Butler and DJ Flinn, above n 120, at 466; David Hayton “Irreducible Core Content”, above n 114, at 58; David A. Steele “Exculpatory Clauses in Trust Instruments” (1995) 14 ETJ 216, at 219, and Law Reform Commission (Ireland), above n 120, at 79.

¹⁵⁰ Jane Stapleton “Good Faith in Private Law” (1999) 52 Current Legal Problems 1.

¹⁵¹ *Ibid*, at 9.

¹⁵² *Ibid*, at 7.

¹⁵³ *Ibid*, at 7-8.

¹⁵⁴ See generally *Bristol and West Building Society v Mothew* [1998] Ch 1 (CA) [“*Mothew*”] at 14-16.

¹⁵⁵ Paul D. Finn *Fiduciary Obligations* (Law Book Company, Sydney, 1977) at 48 refers to the duty not to put oneself in a position of conflicting interest as part of the “duty of good faith”. See also *Boardman v Phipps* [1966] 3 All ER 721 (HL).

¹⁵⁶ See *CIR v Scott* [1998] NZFLR 49 (FC) at 62. Judge Inglis QC considered the meaning of the phrase “otherwise than in good faith” under section 201(2) of the Child Support Act 1991.

2. *Honesty and Dishonesty*

Whilst the duty to act honestly may be part of the duty of good faith, there is considerable debate as to what represents the trustee exemption clause side of this “irreducible” duty. There is general agreement that fraud and dishonesty are non-excludable. Butler and Flinn explain that “[f]raud and equity are...enemies”¹⁵⁷ whilst David Hayton argues that to allow exemption of liability for ‘actual fraud’ would “empty the area of obligation so as to leave no room for any obligation”.¹⁵⁸ Even the most ardent obligational trust theorists, drawing upon the contractarian analogy, explicitly acknowledge there must be some minimum “core” of obligations owed.¹⁵⁹ What is less clear is first, how ‘actual fraud’ should be defined in this context and secondly, whether other types of fraud are non-excludable.

(a) *Actual Fraud*

At the heart of the dispute over how to define ‘actual fraud’ in this context is whether it ought to be measured against an objective or subjective yardstick.¹⁶⁰ There is divergent case law on point, reflecting the complexity of the issue at hand.

In *Nocton v Lord Ashburton*,¹⁶¹ cited with approval by Millet LJ in *Armitage v Nurse*,¹⁶² Lord Dunedin stated “if based on fraud, then, in accordance with the decision in *Derry v Peek*¹⁶³ ...the fraud proved must be actual fraud, a mens rea, an intention to deceive.” Upon this footing, Millet LJ explicitly states that

He commented that “it is not necessary for the Court to be satisfied that Mrs Scott acted in bad faith: all it is necessary to show is that she acted otherwise than in good faith. There is a subtle but significant distinction”.

¹⁵⁷ Andrew Butler and DJ Flinn, above n 120, at 480. See also Paul Matthews “The Efficacy of Trustee Exemption Clauses in English Law” (1989) Conv 42 at 47; and Steele, above n 149, at 219.

¹⁵⁸ David Hayton “Irreducible Core Content”, above n 114, at 57

¹⁵⁹ See John H Langbein, above n 34, at 650-651.

¹⁶⁰ See generally Andrew Butler and DJ Flinn, above n 120, at 481-482; *Spread v Hutcheson*, above n 2, at [107]-[108], [112] where Lord Mance declined to comment on the suitability of the objective test in the trustee exemption clause context.

¹⁶¹ *Nocton v Lord Ashburton* [1914] AC 932 at 963 per Lord Dunedin.

¹⁶² *Armitage v Nurse*, above n 1, at 250E.

¹⁶³ *Derry v Peek* (1889) 14 App Cas 337.

*Derry v Peek*¹⁶⁴ establishes that nothing short of a fraudulent intention in the strict sense will suffice for a case of actual, as opposed to equitable, fraud.¹⁶⁵

In *Armitage v Nurse*, Millet LJ held the meaning of ‘actual fraud’, in clause 15, to be “plain and unambiguous”¹⁶⁶ and further that it “simply meant dishonesty”.¹⁶⁷ His honour elaborated that ‘dishonesty’ entails:¹⁶⁸

...[A]t minimum an intention on the part of the trustee to pursue a particular course of action, either knowing that it is contrary to the interests of the beneficiaries or being recklessly indifferent whether it is contrary to their interests of not.

And furthermore:¹⁶⁹

...[C]lause 15 exempts the trustee from liability for loss or damage to the trust property no matter how indolent, imprudent, lacking in diligence, negligent or wilful he may have been, so long as he has not acted dishonestly.

Lord Millet’s references to ‘intention’ and ‘mens rea’ make it clear that the focus of his form of ‘actual fraud’ is on a trustee’s subjective intent.¹⁷⁰ Consequently, an exemption clause could validly relieve a trustee for liability stemming from *any* conduct, provided the trustee held an honest belief that their actions were carried out honestly and in good faith for the benefit of the beneficiaries, no matter how objectively ill-founded or absurd such a belief might in fact be. It will be argued that this approach too narrowly defines

¹⁶⁴ *Derry v Peek*, above 163.

¹⁶⁵ *Armitage v Nurse*, above n 1, at 250F-G.

¹⁶⁶ *Ibid*, at 250C-D.

¹⁶⁷ *Ibid*, at 251D.

¹⁶⁸ *Ibid*, at 251E.

¹⁶⁹ *Ibid*, at 251F-G.

¹⁷⁰ Compare *Walker v Stones*, above n 148, where Sir Christopher Slade interpreted Millet LJ’s construction of ‘actual fraud’ as not purely subjective. With respect to Sir Christopher Slade, the subjective connotations in *Armitage v Nurse* seem plain and clear in light of the citation of, and reliance upon, *Derry v Peek*, above n 163, and *Nocton v Lord Ashburton*, above n 161, and the subsequent mention of ‘intention’. My interpretation of Millet LJ is evident in David Hayton, Paul Matthews, and Charles Mitchell (eds) *Underhill and Hayton – Law of Trusts and Trustees* (18th ed, LexisNexis, London, 2010) at 780 [“*Underhill and Hayton*”] where the authors describe the primarily objective approach from *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378 (PC) [“*Royal Brunei v Tan*”] per Lord Nicholls and *Armitage v Nurse* as “competing views”.

‘actual fraud’ and dilutes the “irreducible” duty to act honestly and in good faith for the benefit of the beneficiaries.

In *Walker v Stones*¹⁷¹ the English Court of Appeal addressed the meaning of ‘fraud’ in the trustee exemption clause context. Sir Christopher Slade stated that the *Armitage v Nurse*¹⁷² definition of ‘actual fraud’ was not envisaged to relieve a solicitor-trustee from liability where their:¹⁷³

[P]erception of the interests of the beneficiaries was so unreasonable that no reasonable solicitor-trustee could have held such a belief. Indeed, in [Sir Christopher Slade’s] opinion such a construction of the clause could well render it inconsistent with the very existence of an effective trust.

Leaving aside for now the express reference to solicitor-trustees¹⁷⁴ and the issue of whether *Walker v Stones*¹⁷⁵ presents a strained interpretation of *Armitage v Nurse*,¹⁷⁶ it will be argued that Sir Christopher Slade’s primarily objective approach to defining dishonesty possesses considerable merit and should be adopted.

Recent case law on the meaning of dishonesty in the ‘dishonest assistance’ context provides a useful comparator for the discussion at hand. In *Westpac New Zealand Ltd v MAP & Associates Ltd*¹⁷⁷ (“*Westpac v MAP*”) the Court of Appeal clarified the state of the law on ‘dishonest assistance’ in New Zealand. Arnold J¹⁷⁸ treated *Barlow Clowes International Ltd (in liq) v Eurotrust International Ltd*¹⁷⁹ as high authority for closing the door on the point left open by the then leading New Zealand case, *US International Marketing Ltd v*

¹⁷¹ *Walker v Stones*, above n 148.

¹⁷² *Armitage v Nurse*, above n 1.

¹⁷³ *Ibid*, at 941D-E.

¹⁷⁴ See *Underhill and Hayton*, above n 170, at 780-781 where the authors accept without qualm that the objective standard put forward in *Walker v Stones* applies to both lay and professional trustees.

¹⁷⁵ *Walker v Stones*, above n 148.

¹⁷⁶ *Ibid*. See discussion, above n 171.

¹⁷⁷ *Westpac New Zealand Ltd v MAP & Associates Ltd* [2011] 2 NZLR 90 (CA) [“*Westpac v MAP (CA)*”].

¹⁷⁸ On behalf of the unanimous Court of Appeal

¹⁷⁹ *Barlow Clowes International Ltd (in liq) v Eurotrust International Ltd* [2006] 1 WLR 1476 (PC) [“*Barlow Clowes*”].

National Bank of New Zealand Ltd,¹⁸⁰ as to whether to adopt the majority approach from *Twinsectra Ltd v Yardley*.¹⁸¹ In adopting¹⁸² *Barlow Clowes*,¹⁸³ Arnold J held:¹⁸⁴

[A] bank will be liable for dishonest assistance where it has actual knowledge of the circumstances of the transaction [the subjective element] such as to render its participation contrary to normally acceptable standards of honest conduct [the objective element].

*Westpac v MAP*¹⁸⁵ was appealed to the Supreme Court¹⁸⁶ on a narrow issue.¹⁸⁷ Nevertheless, in obiter dicta Tipping J¹⁸⁸ agreed with the judgment of *Barlow Clowes* on this point, stating that:¹⁸⁹

If by ordinary standards a defendant's mental state would be described as dishonest, it is irrelevant that the defendant has different standards and does not appreciate that his conduct, by ordinary standards, would be regarded as dishonest.

These recent pronouncements concerning 'dishonest assistance' provide useful guidance to determining how fraud and dishonesty should be assessed in the trustee exemption clause context. I shall now explain why the courts should apply a primarily objective test.¹⁹⁰

¹⁸⁰ *US International Marketing Ltd v National Bank of New Zealand Ltd* [2004] 1 NZLR 589 (CA) at [9]-[10] per Tipping J, at [78] per Glazebrook J [*"US International Marketing"*].

¹⁸¹ *Twinsectra*, above n 101, per Lord Hoffmann that the dishonest assister must subjectively appreciate what constitutes the objective standard against which their conduct was to be assessed. Contrast the dissenting judgment of Lord Millet.

¹⁸² *Westpac v MAP (CA)*, above n 177, at [45] citing *Barlow Clowes*, above n 179, at [15].

¹⁸³ *Barlow Clowes*, above n 179.

¹⁸⁴ *Westpac v MAP (CA)*, above n 177, at [46].

¹⁸⁵ *Ibid.*

¹⁸⁶ *Westpac New Zealand Ltd v Map & Associates Ltd* [2011] NZSC 89 [*"Westpac v MAP (SC)"*].

¹⁸⁷ *Ibid.*, at [10]. The issue on appeal was not "to consider in any detail all the ingredients of the cause of action now known as dishonest assistance." Rather, "whether it is necessary for the bank to establish all the ingredients of the cause of action in order to have a defence to a prima facie breach of mandate or whether, as Westpac contends, some lesser standard suffices, based on reasonable belief, suspicion or concern that it would be dishonestly assisting a breach of trust".

¹⁸⁸ Notably, Tipping J left the point open in *US International Marketing*, above n 180, so his obiter dicta approval of this approach in *Westpac v MAP (SC)*, above n 186, stands as strong authority for the proposition that he now considers it to be the correct approach.

¹⁸⁹ *Westpac v MAP (SC)*, above n 186, at [26].

¹⁹⁰ See Andrew Butler and DJ Flinn, above n 120, at 483 who describe the standard of dishonesty as "at root an objective test of dishonesty with a subjective limb".

In *Walker v Stones*, Sir Christopher Slade stated on a number of occasions that he could see no grounds for applying a different test in the trustee exemption clause context to that applied for dishonest assistance.¹⁹¹ In *Royal Brunei v Tan*, Lord Nicholls, after discussing the subjective component of dishonesty, explained that:¹⁹²

[The] subjective characteristics of honesty do not mean that individuals are free to set their own standards of honesty in particular circumstances. The standard of what constitutes honest conduct is not subjective. Honesty is not an optional scale, with higher or lower values according to the moral standards of each individual. If a person knowingly appropriates another's property, he will not escape a finding of dishonesty simply because he sees nothing wrong in such behaviour. In most situations there is little difficulty in identifying how an honest person would behave...[For example,] [u]nless there is a very good and compelling reason, an honest person does not participate in a transaction if he knows it involves a misapplication of trust assets to the detriment of the beneficiaries.

Lord Nicholls' statement clearly demonstrates how a subjective approach would dilute the honesty and good faith requirement. Importantly, under a primarily objective approach, the focus is still on the trustee's conscience albeit assessed against an objective standard of reasonableness.

The primarily objective approach to fraud should apply to both lay and professional trustees. Sir Christopher Slade explicitly restricted the judgment of *Walker v Stone* to solicitor-trustees.¹⁹³ He explained this was for two reasons. First, the facts were limited to solicitor-trustees and secondly, he accepted that "...the test of honesty may vary from case to case, depending on, among other things, the role and calling of the trustee".¹⁹⁴ This second concern

¹⁹¹ *Walker v Stones*, above n 148, at 939, 941. See also Andrew Butler and DJ Flinn, above n 120, at 488 "there is...considerable advantage in attempting to establish a workable test for dishonesty that can apply in a range of different circumstances".

¹⁹² *Royal Brunei v Tan*, above n 170, at 389 cited with approval in *Walker v Stones*, above n 148, at 939. See also Jane Stapleton, above n 150, at 9-11 where she explains how honesty is socially constructed. If honesty is a social construct then it ought to be tested against an objective standard.

¹⁹³ *Walker v Stones*, above n 148, at 939.

¹⁹⁴ *Ibid.*

was brought on by the presence of the majority approach from *Twinsectra*.¹⁹⁵ Since then, *Twinsectra*¹⁹⁶ has been overruled¹⁹⁷ by *Barlow Clowes*¹⁹⁸ in favour of an objective yardstick against which to measure a dishonest assister's conduct. This primarily objective standard takes into account the relevant circumstances, thus allaying Sir Christopher Slade's concern about the standard varying from case to case.¹⁹⁹

In conclusion, 'actual fraud' should take on the meaning posited by *Walker v Stones*²⁰⁰ and the 'dishonest assistance' cases. It would be a peculiar situation if strangers to a trust were subject to a stricter standard of dishonesty than trustees. This peculiarity flows from taking a subjective approach. 'Actual fraud' should thus be defined as 'a deliberate or recklessly indifferent breach of trust, even if committed in the genuine belief that the course taken was in the interests of the beneficiaries if such a belief was so unreasonable, taking into account the relevant circumstances,²⁰¹ that no reasonable trustee of the actual trustee's type could have held that belief.'

(b) Equitable Fraud

This section considers whether trustee liability for 'equitable fraud' should be non-excludable. It posits a definition of 'equitable fraud' and subsequently argues that it should be non-excludable.

¹⁹⁵ *Twinsectra*, above n 101.

¹⁹⁶ *Ibid.*

¹⁹⁷ *Barlow Clowes*, above n 179, at [15] the Privy Council explained they were clarifying "an element of ambiguity" as to the meaning of *Twinsectra* and not overruling it. However, most commentators treat *Barlow Clowes* as having overruled *Twinsectra*. See Jessica Palmer "Twinsectra: overruled or clarified?" [2005] NZLJ 410.

¹⁹⁸ *Barlow Clowes*, above n 179.

¹⁹⁹ See "*Underhill and Hayton*", above n 170, at 780-781 where the authors accept without qualm that the objective standard put forward in *Walker v Stones* applies to both lay and professional trustees.

²⁰⁰ *Walker v Stones*, above n 148.

²⁰¹ The reference to 'circumstances' is to ensure that factors such as the trustee's experience, pressure from beneficiaries, whether they relied upon legal advice and so on will be factored in to the question of 'reasonableness'. This is particularly important in the context of lay-trustees and will ensure that equity's flexibility and operation on the conscience is upheld by the approach to 'actual fraud' as formulated above.

Whether ‘equitable fraud’ can be excluded by a trustee exemption clause is an unresolved matter.²⁰² A preliminary problem is finding a consistent definition for ‘equitable fraud’. For example, in *Armitage v Nurse*, counsel for the plaintiff argued that ‘dishonesty’ is not the only badge of fraud and “[a]s to equitable fraud, the court has a discretion...to ...set aside contracts, instruments or transactions where there has been unconscionable conduct”.²⁰³ Millet LJ, in rejecting the argument that clause 15 excluded equitable fraud, explained that equitable fraud covers breach of a fiduciary duty, undue influence, abuse of confidence, unconscionable bargains and fraud on powers. He stated further that all except fraud on powers “involve some dealing by the fiduciary with his principal and the risk that the fiduciary may have exploited his position to his own advantage”.²⁰⁴ G E Dal Pont, writing in the Australian context, has argued strongly in favour of the non-excludability of ‘equitable fraud’.²⁰⁵ He defines it as not requiring proof of an intention to deceive or recklessness²⁰⁶ but an inquiry into “whether what has happened, in the context in which it has happened, appears to the judicial conscience as so unconscientious that it should not be allowed to stand.”²⁰⁷

In *Wilden v Green*,²⁰⁸ the Supreme Court of Western Australia determined the appropriate meaning of an exemption clause that excluded trustee liability for losses flowing from any breach of duty “unless it shall be provided to have been committed, made or omitted in personal conscious fraudulent bad

²⁰² Law Commission For England and Wales *Fiduciary Duties and Regulatory Rules, A Summary* (Law Com. No. 124, 1992) at [3.3.41] states it is not clear if equitable fraud can be excluded by a trustee exemption clause.

²⁰³ *Armitage v Nurse*, above n 1, at 246A-D citing *Torrance v Bolton* (1873) L.R. 8 Ch. App. Cas. 118, 124-125 where the Court of Equity set aside a contract for the sale and purchase of land which, in the circumstances, was ‘unconscientious’. See also *Nocton v Lord Ashburton*, above n 161, at 953 per Viscount Haldane L.C. “[i]n Chancery, the term ‘fraud’ thus came to be used to describe what fell short of deceit, but imported breach of a duty to which equity had attached its sanction”; *Earl of Aylesford v Morris* (1873) LR 8 Ch. App 484, 490-491 per Lord Selborne L.C. gives the following as examples of the types of ‘circumstances’ that are relevant to whether there has been ‘equitable fraud’: imbalances in the relative bargaining power of parties to a transaction, vulnerability, extortion, and abuse of position.

²⁰⁴ *Armitage v Nurse*, above n 1, at 253A.

²⁰⁵ G E Dal Pont “The Exclusion of Liability for Trustee Fraud” (1998) 6(1) APLJ 41.

²⁰⁶ Thus distinguishing it from the type of ‘actual fraud’ advocated by Millet LJ.

²⁰⁷ G E Dal Pont, above n 205, at 51 citing *Logue v Shoalhaven Shire Council* [1979] 1 NSWLR 537 at 555, 559-561 per Mahoney JA [“Logue”]. Dal Pont also argues (citing *Logue* at 553) “[w]hat is involved is, in substance, a situation or conduct evidencing a want or probity of a nature sufficient to invoke the intervention of a court of conscience.”

²⁰⁸ *Wilden v Green* [2009] WASC 38.

faith”.²⁰⁹ The trial judge purported to follow *Armitage v Nurse*,²¹⁰ stating that the trustee could not rely on the clause for unconscientious conduct amounting to equitable fraud “because it would be an act of bad faith to fail to comply with an obligation which is enforced by a court of equity”.²¹¹ The Supreme Court of Western Australia rejected the trial judge’s approach.²¹² In doing so the Court explicitly held that “[e]quitable fraud is not part of the irreducible core of obligations identified in *Armitage [v Nurse]*”.²¹³ Notably, neither *Walker v Stones*²¹⁴ nor the ‘dishonest assistance’ cases were cited to the court by counsel in *Wilden v Green*²¹⁵ nor mentioned in the judgment.

With respect, *Wilden v Green*²¹⁶ too narrowly construes the “irreducible core” and its determination that ‘equitable fraud’ is excludable open to serious doubt. In order to give meaning to the “irreducible” duties of honesty and good faith, equitable fraud should be non-excludable. The trial judge aptly demonstrated how ‘equitable fraud’ and the duties of good faith and honesty overlap. To act in a way that is unconscionable may amount to bad faith or, at least, to conduct that is *otherwise* than in good faith. By making ‘equitable fraud’ non-excludable, one is recognising that the duty of good faith, which is wider than the duty of honesty, must too be given sufficient meaning.

Another possible objection to holding ‘equitable fraud’ to be non-excludable is that it is underpinned by the “very slippery”²¹⁷ notion of unconscionability. The concept of unconscionability has been described by Charles Rickett as the “angel of darkness dressed like an angel of light”.²¹⁸ However, such concerns are overstated. Whilst unconscionability must not be treated as some sort of

²⁰⁹ *Wilden v Green*, above n 208, at [27].

²¹⁰ *Armitage v Nurse*, above n 1.

²¹¹ *Wilden v Green*, above n 208, at [157].

²¹² *Ibid*, at [157]-[158], [162]-[164]. For example at [162] the court held “[t]he trial judge erred in concluding that any failure to comply with an obligation enforced by a court of equity constitutes bad faith. Bad faith connotes conscious wrongdoing that is knowingly or recklessly inconsistent with the interests of the beneficiaries”.

²¹³ *Ibid*, at [163] citing *Armitage v Nurse*, above n 1, at 250, 252 and 253.

²¹⁴ *Walker v Stones*, above n 148.

²¹⁵ *Wilden v Green*, above n 208.

²¹⁶ *Ibid*.

²¹⁷ Charles Rickett “Unconscionability and Commercial Law” 24 UQLJ 73 at 74.

²¹⁸ *Ibid*, at 83.

equitable trump card,²¹⁹ it nevertheless can, and does, have meritorious application: provided it is imported on a principled and reasoned basis.

A number of commentators argue that liability for ‘equitable fraud’ should be non-excludable.²²⁰ Dal Pont²²¹ advances three principled reasons why ‘equitable fraud’ is contrary to the “irreducible core” and thus should be non-excludable. First, he argues that the non-excludability of ‘equitable fraud’ is:²²²

Consistent with equitable principle, namely that equity’s intervention is premised on proof of conduct which, even though not consciously dishonest or reckless, nonetheless offends conscience.

It is clear that equity’s focus is on the trustee’s conscience. In *Westdeutsche Landesbank v Islington L.B.C.*, Lord Browne-Wilkinson espoused that:²²³

[E]quity operates on the conscience of the legal owner. In the case of a trust, the conscience of the legal owner requires him to carry out the purposes for which the property was vested in him.

In light of the position of discretionary beneficiaries, who only have a mere hope or expectation,²²⁴ it is the exercise of the trustee’s good conscience in *considering* how to exercise their discretion that determines the fate the beneficiaries’ interest. Thus it makes sense to prohibit exclusion of trustee conduct that pricks the courts’, and thereby societies’, conscience.²²⁵

Dal Pont’s second argument is about the role of fiduciary duties more generally. He argues that making equitable fraud non-excludable is consistent

²¹⁹ Compare *Pennington v Waine* [2002] 4 All ER 215 (CA) per Lady Justice Arden.

²²⁰ See Malcolm Cope, above n 122; G E Dal Pont, above n 205, Colin Feasby “Fiduciary Obligations and Exculpatory Clauses” (1998) 38 *Alta L Rev.* 923.

²²¹ G E Dal Pont, above n 205.

²²² *Ibid*, at 51.

²²³ *Westdeutsche Landesbank v Islington L.B.C* [1996] AC 669 at 705, per Lord Browne-Wilkinson.

²²⁴ See *Johns v Johns*, above n 46.

²²⁵ See Jane Stapleton, above n 150, at 9-11. Stapleton argues that honesty (which forms part of her overarching duty of good faith) is socially constructed and should be tested against society’s moral expectations. See generally *Schmidt v Rosewood*, above n 52, where the Privy Council relied on the inherent jurisdiction of the court to govern trusts as a creature of equity as one of the cornerstones in their judgment concerning the right of discretionary beneficiaries to trust documents (information). *Schmidt v Rosewood* was followed in New Zealand by *Foreman v Kingstone*, above n 148.

with the deterrent objective of fiduciary law.²²⁶ It is contentious whether fiduciary duties serve a prescriptive or proscriptive role,²²⁷ but nevertheless, Dal Pont explains that “[t]rustees who know that their conduct is measured by the barometer of equitable fraud are unlikely to chance deliberate breaches of trust, and are also prone to adopt special care in the management of trust’s affairs”.²²⁸ Similarly, in my opinion it would serve as an incentive for trustees, if in doubt about the validity of their actions, to seek the directions of the court under s66 of the Trustee Act 1956.

His third argument rejects claims that ‘equitable fraud’ is essentially equated with the trustee’s duty of care. The distinction is clear. Equitable fraud connotes conduct that offends the judicial conscience as so unconscientious that it should not be allowed to stand, which can be distinguished from innocent and careless breaches of trust.²²⁹

It has been demonstrated that there is a principled basis upon which to make ‘equitable fraud’ non-excludable. As Dal Pont concludes, to make equitable fraud non-excludable would “be to emphasise the serious obligations cast on a trustee, deter trustees from deliberate breaches of trust, and as a result, protect beneficiaries from abuses of trustee power”.²³⁰ Making equitable fraud non-excludable gives a heightened meaning to *both* the duty to perform the trust honestly and the broader duty to act in good faith. If the “irreducible core” is a useful concept, which this paper argues it is, and the good faith and honesty requirement lies at “irreducible core”, which it has been argued it must do, then to give suitable meaning to this part of the “irreducible core” it would be repugnant to allow the exclusion of liability for ‘equitable fraud’.

²²⁶ G E Dal Pont, above n 205, at 51.

²²⁷ See *Wilden v Green*, above n 208, at [165] citing *Breen v Williams* (1996) 186 CLR 71 where the High Court of Australia said that fiduciary obligations are proscriptive. Gaudron and McHugh JJ at 133 held: “[t]he Canadian cases also reveal a tendency to view fiduciary obligations as both proscriptive and prescriptive. However, Australian courts only recognise proscriptive fiduciary duties...In this country, fiduciary obligations arise because a person has come under an obligation to act in another’s interests. As a result, equity imposes on the fiduciary proscriptive obligations - not to obtain any unauthorised benefit from the relationship and not to be in a position of conflict. If these obligations are breached, the fiduciary must account for any profits and make good any losses arising from the breach. But the law of this country does not otherwise impose positive legal duties on the fiduciary to act in the interests of the person to whom the duty is owed”.

²²⁸ G E Dal Pont, above n 205, at 51.

²²⁹ *Ibid.*

²³⁰ *Ibid.*, at 52.

(c) *Wilful Default and Recklessness*

This section will define what is meant by ‘wilful default’ and ‘recklessness’ and argue why both should be non-excludable.

The courts have interpreted ‘wilful default’ in two ways. In *Armitage v Nurse*, Millet LJ explained the first sense in which ‘wilful default’ has been understood:²³¹

A trustee is said to be accountable on the footing of wilful default when he is accountable not only for money which he has in fact received but also for money which he could with reasonable diligence have received. It is sufficient that the trustee has been guilty of a want of ordinary prudence.

This approach prevailed until the case of *Re Vickery* where Maugham J held ‘wilful default’ to mean a trustee was:²³²

[C]onscious that, in doing the act which is complained of or in omitting to do the act which it is said he ought to have done, he is committing a breach of his duty, or is recklessly careless whether it is a breach of duty or not.

Dal Pont explains the difficult choice between the two: to define ‘wilful default’ more narrowly, in the *Re Vickery*²³³ sense, sees it essentially collapse into ‘fraud’, whereas to define it more broadly takes it very close to negligence and “is perhaps to afford trustees insufficient protection from inadvertent breaches of trust”.²³⁴

In *Spread v Hutcheson*, Lord Clarke²³⁵ agreed with *Armitage v Nurse*²³⁶ that a trust deed cannot exclude liability for ‘wilful default’ in the *Re Vickery*²³⁷

²³¹ *Armitage v Nurse*, above n 1, at 252C-D citing *In re Chapman; Cocks v Chapman* [1896] 2 Ch 763.

²³² *Re Vickery* [1931] 1 Ch 572 at 583.

²³³ *Ibid.*

²³⁴ G E Dal Pont, above n 205, at 48-49.

²³⁵ *Spread v Hutcheson*, above n 2, at [55] per Lord Clarke citing *Lewis v Great Western Railway* (1877) 3 QBD 195, at 206 per Bramwell LJ where ‘wilful default’ was defined as “misconduct to which the will is a party, something opposed to accident or negligence; the misconduct, not the conduct, must be wilful.” See also John Mowbray (ed) *Lewin on Trusts* (18th ed, Sweet & Maxwell, London, 2008) at 1610 who simply states that “willful default” equates with consciousness that the act or omission is a breach of duty or that the trustee is

sense. Both Lord Clarke²³⁸ and Millet LJ²³⁹ preferred the *Re Vickery*²⁴⁰ meaning on the basis that the wider meaning purported to make liability for negligent acts by trustees non-excludable. It is argued later in this chapter that the duty of care should not form part of the “irreducible core”. But, for present purposes, what is noticeable is that the *Re Vickery*²⁴¹ interpretation of ‘wilful default’ appears to be consumed by the meaning this paper has given to ‘actual fraud’.²⁴²

Trustee liability for ‘recklessness’ should also be non-excludable. ‘Recklessness’ is a “positive, affirmative, intentional, ‘could-not-care-less’ attitude taken by a defendant deliberately indifferent to his responsibilities”.²⁴³ This too ought to be subsumed under the primarily objective test for ‘dishonesty’ outlined above,²⁴⁴ as it involves some consciousness of wrongdoing. To allow the exclusion of trustee liability for ‘wilful default’ and ‘recklessness’ would thus be repugnant to the “irreducible core” duty to act honestly and in good faith for the benefit of the beneficiaries.

3. *For the Benefit of the Beneficiaries*

The “irreducible” duty to perform the trust in the best interests of the beneficiaries must be read in light of the duty to act honestly and in good faith. There is also some overlap with the duty not to be in a position of conflict, as a trustee should put the beneficiaries’ interests above and before their own. Some scepticism exists as to whether the duty to act in the best interests of the beneficiaries is defeated in modern discretionary trusts. For example, Lionel Smith explains that a trustee cannot, in some discretionary trusts, be subject to an obligation that his or her power be exercised in the best interests of the trust

reckless as to the breach and does not extend to negligent breach. Contrast Paul Matthews, above n 157, at 45 explains that almost all commentators think that the pre-*Re Vickery* meaning is preferable.

²³⁶ *Armitage v Nurse*, above n 1.

²³⁷ *Re Vickery*, above n 232.

²³⁸ *Spread v Hutcheson*, above n 2.

²³⁹ *Armitage v Nurse*, above n 1.

²⁴⁰ *Re Vickery*, above n 232.

²⁴¹ *Ibid.*

²⁴² See generally G E Dal Pont, above n 205, at 48-49.

²⁴³ David Hayton “Irreducible Core Content”, above n 114, at 59.

²⁴⁴ *Armitage v Nurse*, above n 1, at 251E; and *Re Vickery*, above n 232, at 583 Maugham J posits being “recklessly careless” as part of the definition of ‘wilful default’.

beneficiaries, because the exercise of the power will defeat the interests of one or more of the beneficiaries.²⁴⁵

However, this argument is overcome by positing an “irreducible core” of duties that must be owed. This paper has argued that the duty to act honestly and in good faith for the benefit of the beneficiaries makes up part of that “core”. Read conjunctively, it becomes clear that in a discretionary trust situation the trustee *must* consider the exercise of their discretion honestly and in good faith. In this sense, the interest of discretionary beneficiaries lies not in being the recipient of a disposition but in their entitlement to any interest being considered honestly and in good faith by the trustees.²⁴⁶

C. The Trustees’ Duties to Account and the Duty to Identify Trust Property

This section defines the trustees’ duty to account and explains why it must lie at the “irreducible core” of a trust. Likewise, it will be argued that this duty necessarily entails, or at least is mutually reinforced by, the duty of trustees to identify trust property.

The meaning of the duty to account is well accepted. David Hayton explains that “...trustees are bound to account to the trust beneficiaries for what they have done with the trust property, whether in their administrative, managerial role or in their distributive, dispositive role”.²⁴⁷

There is general agreement that the duty to account should belong in the “irreducible core”.²⁴⁸ In *Foreman v Kingston*,²⁴⁹ Potter J emphasised the

²⁴⁵ Lionel Smith “Mistaking the Trust” (2010) 40 HKLJ 787 at 789.

²⁴⁶ See *Re the Esteem Settlement*, above n 56, at [122] “[t]his exercise [of a trustee’s discretion] must be carried out in good faith in the sense that the trustees must not only be open to the possibility of deciding not to give effect to a request put to them but also be quite prepared to do so if of the opinion that this is the right course”.

²⁴⁷ David Hayton “Irreducible Core Content”, above n 114, at 48. See also *Re Murphy’s Settlements* [1999] WLR 282 (Ch) at 293.

²⁴⁸ David Hayton “Irreducible Core Content”, above n 114, at 49. See also Law Reform Committee (Ireland), above n 120, at 80 where they expressly adopt this passage from Hayton; David Hayton, “Obligation Characteristic”, above n 36, at 105; *Underhill and Hayton*, above n 170, at 872; and Andrew Butler and DJ Flinn, above n 120, at 475; Terence Tan Zhong Wei “The Irreducible Core Content of Modern Trust Law” (2009) 15(6) *Trusts & Trustees* 477, at 479.

fundamental importance of the duty to account. Her Honour held:²⁵⁰

[W]hen a trust is established, obligations and correlative rights are created. Otherwise there is no trust. The fundamental duty of the trustees is to be accountable to all beneficiaries.

And furthermore:²⁵¹

Beneficiaries are entitled to receive information which will enable them to ensure the accountability of the trustees in terms of the trust deed. They are entitled to have the trust property properly managed and to have the trustees account for their management. They are entitled to receive trust accounts...

In *Armitage v Nurse*,²⁵² Millet LJ did not expressly mention the duty to account when putting forward his version of his “irreducible core”. Nevertheless, a number of commentators have argued²⁵³ or assumed²⁵⁴ that the statement “[i]f the beneficiaries have no rights enforceable against the trustees there are no trusts”²⁵⁵ meant Millet LJ considered the duty to account to lie at the “irreducible core”.

The duty to account corresponds with the certainty of subject matter requirement of trusts.²⁵⁶ Butler and Flinn thereby argue in favour of a duty to identify trust property also lying at the “irreducible core”.²⁵⁷ This overlaps considerably with a duty to account, because inherent in the notion of trustees having to account to the beneficiaries about their management of property is that the trustees must be able to identify what the property is. The place of the duties to account and identify trust property as lying at the “core” is reinforced when considered from the perspective of third parties and property ownership. As Penner has argued, the “core” duties must give effect to the idea that the

²⁴⁹ *Foreman v Kingston*, above n 148.

²⁵⁰ *Ibid*, at [93]

²⁵¹ *Ibid*, at [97]. See also at [73] citing *Spellson v George* (1987) 11 NSWLR 300 at [69].

²⁵² *Armitage v Nurse*, above n 1.

²⁵³ David Hayton “Obligation Characteristic”, above n 36, at 105.

²⁵⁴ Donovan W.M. Waters, *Waters' Law of Trusts in Canada*, (3rd ed, Thomson Carswell, Toronto, 2005) at 1070; A.J. Oakley (ed) *Parker and Mellows: The Modern Law of Trusts* (9th ed, Sweet & Maxwell, London, 2008) at 894.

²⁵⁵ *Armitage v Nurse*, above n 1, at 253H.

²⁵⁶ Andrew Butler and DJ Flinn, above n 120, at 475.

²⁵⁷ *Ibid*.

trust property is not the trustee's own.²⁵⁸ Thus, by including the duty to account and duty to identify trust property at the "irreducible core", one is furthering a key rationale behind the proprietary nature of the trust.

Although the duty to account is expressed as a duty and ostensibly falls on the obligational side of the trust conception, it primarily represents a manifestation of the proprietary understanding of trusts: "arising from the notion that property held by a trustee beneficially belongs to the beneficiary".²⁵⁹ Yet there is an overlap between the duty to account and the duty to act honestly and in good faith for the benefit of the beneficiaries. As Palmer has observed.²⁶⁰

If the core duties are only those to preserve and account for the property, it is not necessary in order for beneficiaries to enforce this duty to have access to trust documents other than the accounts. Access to trust accounts will be sufficient. However, the core duties fundamental to the trust extend beyond merely the requirement to account for the property, and include obligations on the trustee to act honestly and in good faith. The beneficiary must in turn have rights that enable her to require due performance by the trustee of his duties.

The duty of good faith and honesty may in certain situations elevate what is required of the trustees' duty to account. At the same time, the duty to account gives meaning and substance to the duty of good faith and honesty. This shows that the duty to account is not *purely* proprietary in origin as it also contains an obligational element. The trustee may be required to account for how they have carried out the duties of good faith and honesty, for their management of the property, for distributions made and possibly made to account for the exercise of all their duties owed under the trust instrument. What is specifically required of the duty to account will vary depending on the nature of the beneficiaries' interest.²⁶¹

²⁵⁸ James Penner, above n 8.

²⁵⁹ Law Commission (New Zealand), above n 107, at [1.11]; see also David Fox, above n 113, at 19.

²⁶⁰ Jessica Palmer, above n 3, at 559.

²⁶¹ Such a discussion is outside the scope of this paper. A particularly contentious issue is the right of discretionary beneficiaries to information. For a useful starting point see *Foreman v Kingstone*, above n 148; *Schmidt v Rosewood*, above n 52; and Jessica Palmer, above n 3.

D. *The Trustees' Duty of Care and Skill, Prudence and Diligence*

This section will consider whether the trustees' duty of care and skill, prudence and diligence (the "duty of care") forms part of the "irreducible core". In particular, the nature of fiduciary duties will be examined. It will be argued that because the duty of care is not a fiduciary duty and does not necessarily flow from the proprietary or obligational elements of a trust, it should not belong at the "irreducible core". Therefore, on a conceptual understanding of trusts, trustee liability for both ordinary and gross negligence can be validly excluded.

1. *The Nature of Fiduciary Duties*

In *Bristol and West Building Society v Mothew*²⁶² ("Mothew"), the English Court of Appeal delivered an authoritative statement on the nature of fiduciary duties and the nature of the trustees' duty of care. Millet LJ²⁶³ held "...it is obvious that not every breach by a fiduciary is a breach of a fiduciary duty".²⁶⁴ This statement is uncontroversial.²⁶⁵ It is clear that trustees, and other fiduciaries, can owe duties that are not fiduciary in nature. But does the trustees' duty of care fall under the non-fiduciary category?

²⁶² *Mothew*, above n 154.

²⁶³ With whom Staughton and Otton LJJ agreed.

²⁶⁴ *Mothew*, above n 154, at 16.

²⁶⁵ See *Chirnside v Fay* [2007] 1 NZLR 433 (SC), at [17] per Elias CJ, [72] per Blanchard and Tipping JJ (Tipping delivering): "[a] relationship of an inherently fiduciary kind may involve duties which have no fiduciary element"; *Bank of New Zealand v New Zealand Guardian Trust Co Ltd* [1999] 1 NZLR 664 (CA) at 680-681 ["*BNZ v NZGT*"]. In Canada see *LAC Minerals Ltd v International Corona Resources Ltd* (1989) 61 D.L.R. (4th) 14, 28 per La Forest J "not every legal claim arising out of a relationship with fiduciary incidents will give rise to a claim for breach of a fiduciary duty." In Australia see *Permanent Building Society v Wheeler* (1994) 14 ACSR 109 at 157 "[i]t is essential to bear in mind that the existence of a fiduciary relationship does not mean that every duty owed by a fiduciary to the beneficiary is a fiduciary duty."

2. *The Trustees' Duty of Care: Outside the "Irreducible Core"*

On a theoretical understanding of trusts, it is difficult to see how the duty of care forms part of the "core". In *Bank of New Zealand v New Zealand Guardian Trust Co Ltd* ("BNZ v NZGT"),²⁶⁶ the New Zealand Court of Appeal treated the trustees' duty of care as not fiduciary in nature. Notably, in *Wilden v Green*,²⁶⁷ the Supreme Court of Western Australia explicitly held that the trustees' duty of care does not lie at the "irreducible core" because it is not fiduciary in nature.²⁶⁸ In *Spread v Hutcheson*, Lord Clarke held the duty of care²⁶⁹ not to be a fiduciary duty and emphasised that just because one is considering the nature of the duty of care in the trust context does not mean it takes on additional meaning or significance.²⁷⁰

In contrast, Lord Kerr's judgment in *Spread v Hutcheson* described the duty of care as fiduciary in nature,²⁷¹ the "core duty of a trustee"²⁷² and "[c]entral to the notion of trusteeship".²⁷³ Writing in the Australian context, both Anthony Goldfinch²⁷⁴ and Dal Pont²⁷⁵ contend, in the words of Dal Pont "...it is well established that the trustee's duty of care is an equitable (fiduciary) duty, not a common law tortious duty of care".²⁷⁶ Goldfinch, after surveying a wide range

²⁶⁶ *BNZ v NZGT*, above n 265.

²⁶⁷ *Wilden Pty Ltd v Green* [2005] WASC 83

²⁶⁸ *Ibid*, at [594] and [499] citing *Permanent Building Society (In Liq) v Wheeler*, above n 265.

²⁶⁹ *Spread v Hutcheson*, above n 2. The case was specifically discussing the civil law trust duty of a trustee to act *en bon pere de famille*. At [146] Lord Kerr explains that this duty "implied a standard of care similar to that required of trustees in England, namely that of a prudent man in business." Thus, although the duty to act *en bon pere de famille* is not the same as the duty of reasonable skill, care, diligence and prudence there is considerable use in noting the arguments about the duty to act *en bon pere de famille* and considering how, by analogy, this reasoning could be applied to the duty of care.

²⁷⁰ *Spread v Hutcheson*, above n 2, at [60] per Lord Clarke. See also Charles Rickett "Understanding Remedies for Breach of Trust" (2008) 11(4) OLR 603 at 610; La Forest J in *LAC Minerals Ltd v International Corona Resources Ltd*, above n 265, at 28 per La Forest J; *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145 at 205 per Lord Browne-Wilkinson; *Permanent Building Society v Wheeler*, above n 265, at 157-158; R. P. Austin "Moulding the Content of Fiduciary Duties" in A.J. Oakley *Trends in Contemporary Trust Law* (Clarendon Press, Oxford, 1996) 153 at 168.

²⁷¹ *Spread v Hutcheson*, above n 2, at [177] per Lord Kerr.

²⁷² *Ibid*, at [145] per Lord Kerr.

²⁷³ *Ibid*, at [141] per Lord Kerr at [141].

²⁷⁴ Anthony Goldfinch "Trustee's Duty to Exercise Reasonable Care: Fiduciary Duty?" (2004) 78(10) ALJ 678.

²⁷⁵ G E Dal Pont, above n 205.

²⁷⁶ *Ibid*, at 50.

of case authority both for²⁷⁷ and against²⁷⁸ the fiduciary nature of the duty of care, explains the duty of care to be fiduciary because it “is a consequence of the function and position of a trustee”.²⁷⁹ The way Goldfinch frames the argument illuminates a flaw in the reasoning of those who contend that the duty of care is fiduciary in nature. Both *Mothew*²⁸⁰ and the Supreme Court of New Zealand in *Chirnside v Fay*,²⁸¹ make it clear that a fiduciary is, as Dr. Finn famously espoused, “...not subject to fiduciary obligations because he is a fiduciary; it is because he is subject to them that he is a fiduciary”.²⁸² With respect, the approach advanced by those who support the duty of care lying at the “irreducible core” puts the cart before the horse. The concerns raised by Lord Clarke demonstrate the need for caution in elevating duties owed by trustees to fiduciary status *just because* they are trustees. The strict approach to assessing damages under equitable remedies further reinforces the need for caution.²⁸³

The debate over whether the duty of care is fiduciary points against it belonging at the “core”, but there is a further problem. Fundamentally, the supposition that the duty of care lies at the “irreducible core” can be tested against the theoretical understanding of trusts argued in chapter I of this paper.

The problem with the trustees’ duty of care is that it is not a necessary implication of either side of the hybrid theoretical conception. From the obligational perspective, the “irreducible” duty to perform the trust honestly and in good faith for the benefit of the beneficiaries will be breached in instances of disloyalty, infidelity,²⁸⁴ dishonesty, bad faith and ‘equitable fraud’:

²⁷⁷ *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] AC 465 (HL) at 523, 536; *Henderson v Merrett Syndicates Ltd*, above n 270, at 204-205; *White v Jones* [1995] 2 AC 207 (HL) at 271; *Bennett v Minister of Community Welfare* (1992) 176 CLR 408 at 412, 426-427.

²⁷⁸ *Permanent Building Society v Wheeler*, above n 265; *BNZ v NZGT*, above n 265; *Youyang Pty Ltd v Minter Ellison* [2001] NSWCA 198 at [57]-[58].

²⁷⁹ Anthony Goldfinch, above n 274, at 680.

²⁸⁰ *Mothew*, above n 154.

²⁸¹ *Chirnside v Fay*, above n 265.

²⁸² Paul D. Finn, above n 155, at 2.

²⁸³ *Mothew*, above n 154, at 17-18; *BNZ v NZGT*, above n 265, at 681-682 per Gault J (on behalf of Richardson P, Gault, Henry and Blanchard JJ), 686-688 per Tipping J. The impact of broadening the “irreducible core” to make gross negligence non-excludable is discussed in chapter IV, where a more detailed discussion of how equitable remedies are assessed will be presented.

²⁸⁴ *Mothew*, above n 154, at 18 (cited with approval in *Chirnside v Fay*, above n 265, at [15] per Elias CJ).

tested against a primarily objective standard. This is reinforced by the duty to account and identify trust property, which gives meaning to the aforementioned duties, as trustees must account for their good faith and honesty. These obligations are enforced strictly as seen in a trustees' account for profits and the assessment of equitable compensation.²⁸⁵ In light of the broadly defined obligation of honesty and good faith it is difficult to see how the duty of care can be elevated to “core” status because, unlike the other duties, the duty of care does not involve an inquiry into the conscience of the trustee. On a proprietary conception, Cope explains that the duty of care emerged not out of the proprietary nature of the relationship between trustee and beneficiary (as legal and equitable owners respectively) but in the late nineteenth century, as trusts served increasingly as vehicles for commercial investment.²⁸⁶ This meant that the duty of care emerged primarily in the context of ensuring trustees *invested* with care, and not as a necessary corollary of the division between legal and equitable ownership, or in relation to their management of the trust more generally.

Thus, when approached from an inquiry into the nature of fiduciary duties and from a conceptual understanding of ‘what is a trust?’ it is very difficult to see how the trustees’ duty of care lies at the “irreducible core”. Consequently, trustee liability for negligence (ordinary and gross) can validly be excluded by a trustee exemption clause.

E. Case Study: BQ v DQ

In the recent case of *BQ and others v DQ and others*²⁸⁷ (“*BQ v DQ*”), the relevant trust deed contained a provision (Art. VIII H) that stipulated:

The written approval by the [Settlor] of any trust transaction during his lifetime shall be a complete release of the Trustee (including the [Settlor]) of

²⁸⁵ *BNZ v NZGT*, above n 265.

²⁸⁶ Malcolm Cope, above n 122, at 127. See also Donovan W.M. Waters “The Trust in a Changed and Yet Changing World” (2008) JTCP. 205, at 224–225; Donovan W.M. Waters “The Future of the Trust from a Worldwide Perspective” in John Glasson (ed) *The International Trust* (Jordan Publishing Ltd, Bristol, 2002) 597 at 602 [“Worldwide Perspective”]; and John H Langbein, above n 34 at 629 who describes how in the nineteenth century, trusts in the United States of America become more of “a management regime for a portfolio of financial assets”.

²⁸⁷ *BQ v DQ*, above n 122.

any liability or responsibility of the Trustee to any person with respect to this transaction.

Ground CJ held the trust to be “illusory” by the combination of the nature of the rights and powers that were retained by the settlor and the fact he was the sole trustee.²⁸⁸ His Honour held:²⁸⁹

While it may be that I would not have come to that conclusion had Art. VIII H been coupled with a distinct and independent trustee, in this case it is the combination that pushes it over the top.

Whilst the use of “may” in the passage quoted might indicate Ground CJ was not intent on offering a carefully considered view on the matter, the effect of this obiter dictum, if adopted in a later case, is nevertheless worth discussing.

If this line of reasoning was embraced in a subsequent cause, it would hold there to be a valid trust despite the existence of a provision that would, if there were independent trustees, allow a settlor at any time by his or her mere written consent to absolve an independent trust of *any* liability.²⁹⁰ There would be nothing to stop a settlor absolving an independent trustee of liability for fraudulent breaches and/or permitting a course of conduct that was carried out in bad faith or deliberately and knowingly detrimental to a beneficiary’s interests. Likewise, the trustee could be excused for refusing to account to the beneficiaries for, for example, their management of the trust property. If such an approach were followed, it would undermine there being an “irreducible core” of a trust and reduce the trust to a mere tool for a settlor to exercise at his or her unconstrained whim.

²⁸⁸ *BQ v DQ*, above n 122, at [29] where Ground CJ held the presence of Art. VII H to be “crucial” to this determination.

²⁸⁹ *Ibid.*

²⁹⁰ The obiter dictum of Chief Justice Ground is even more concerning given that *Armitage v Nurse*, above n 1, and Millet LJ’s conception of the “irreducible core” was cited in *BQ v DQ*, above n 122, at [18].

F. Conclusion

Chapter III has shown that the duty to act honestly and in good faith for the benefit of the beneficiaries lies at the “irreducible core”. In order for this duty to be meaningful, ‘actual fraud’ should be measured against a primarily objective yardstick that also subsumes ‘wilful default’²⁹¹ and ‘recklessness’. Similarly, ‘equitable fraud’ should be non-excludable; to hold otherwise would dilute the good faith and honesty requirement. The duty to account and the duty to identify trust property should also lie at the “irreducible core”. The duty to account and the duty to identify trust property primarily represent the proprietary portion of the hybrid conceptual understanding of a trust but also give meaning and make enforceable the duty to perform the trust honestly and in good faith for the benefit of the beneficiaries. The duty of care, on the other hand, does not fit within a conceptual understanding of what constitutes the substantive content of the “irreducible core” and thus negligence can validly be excluded by a trustee exemption clause.

²⁹¹ *Re Vickery*, above n 232.

Chapter IV – Trustee Exemption Clauses and Gross Negligence

A. Overview

This chapter considers whether there are good public policy reasons for broadening the “irreducible core” beyond its conceptual roots to render liability for gross negligence unable to be excluded by a trustee exemption clause.²⁹²

In presenting this discussion, I will briefly explain how the issue at hand has been re-opened by the recent Privy Council decision in *Spread v Hutcheson*.²⁹³ The relevance of the contemporary New Zealand trust landscape will then be set out. I will then present arguments both for and against broadening the “irreducible core”, with particular attention paid to how this move may affect other areas of trust law.

B. Recent Developments

Whether the “irreducible core” should be broadened to make gross negligence non-excludable is an unresolved issue. In *Armitage v Nurse*, Millet LJ rejected that gross negligence was non-excludable on public policy grounds.²⁹⁴ However, some members of the Privy Council have cast doubt over this pronouncement. In *Spread v Hutcheson* Lady Hale described Millet LJ’s conclusion on this point as “open to serious question”,²⁹⁵ whilst Lord Kerr went as far as to suggest Millet LJ failed to embark on a policy analysis of this question at all.²⁹⁶

²⁹² It is generally agreed that, for lay-trustees at least, drawing the line at ordinary negligence would pose too great a disincentive to accepting the office of trusteeship. This paper does not address the contentious issue of whether an even broader “irreducible core” should exist for professional trustees. As a useful starting point for addressing whether professional trustees should be able to exclude liability for ordinary negligence see Law Commission (New Zealand), above n 107; Law Commission for England and Wales *Consultation Paper on Trustee Exemption Clauses* (Consultation Paper 171, 2003); British Columbia Law Institute, Committee on the Modernization of the Trustee Act *A Modern Trustee Act for British Columbia* (BCLI 33, 2004); *Bartlett v Barclays Bank Trust Co Ltd* [1980] Ch 515.

²⁹³ *Spread v Hutcheson*, above n 2.

²⁹⁴ *Armitage v Nurse*, above n 1, at 254E-F. See also *Spread v Hutcheson*, above n 2, per Sir Robin Auld, Lord Mance, and Lord Clarke.

²⁹⁵ *Spread v Hutcheson*, above n 2, at [137] per Lady Hale.

²⁹⁶ *Ibid*, at [166] per Lord Kerr. See also *Spread Trustee Company Ltd v Hutcheson and Others* (2009-10) GLR 404 per Martin JA [*“Spread v Hutcheson (CA)”*].

C. *The New Zealand Trust Landscape*

The use of trusts in New Zealand is widespread.²⁹⁷ There is an ‘every man and his dog’ mentality towards having a trust, particularly family trusts.²⁹⁸ Recent estimates suggest there are 245,800 trusts in New Zealand²⁹⁹ or one to almost every seventeen people.³⁰⁰ The resultant landscape is one in which trusts are highly prone to being misunderstood.

D. *In Favour of Broadening the “Irreducible Core”*

This section will explain how making trustee liability for gross negligence non-excludable may provide greater protection of beneficiaries. It will then discuss the implication and relevance of a line of Scottish House of Lords cases (the “Scots cases”) which support broadening the “irreducible core” to include the non-excludability of gross negligence.

1. *Protecting Beneficiaries*

For the purpose of this paper,³⁰¹ the popularity of trusts in New Zealand and a widespread lack of understanding about their true legal nature and effect give

²⁹⁷ Trusts may become even more popular in New Zealand with the abolition of gift duty coming into force on 1 November 2011.

²⁹⁸ Trusts in New Zealand have been described as having gone “viral” and prone to a “me too” syndrome. See Law Commission (NZ) *Some Issues with the Use of Trusts in New Zealand – Review of the Law of Trusts Second Issues Paper* (NZLC IP20, 2010) at [1.13] citing R.C. Pope *The Practice and Pitfalls of Trusts and Wills* (New Zealand Society of Accountants, Wellington, 1972) at 7 who states “[t]here is even the element of the status symbol – every successful man should have a trust”.

²⁹⁹ See Inland Revenue “Returns Filed 2001 to 2009” <www.ird.govt.nz>. This figure is based purely on the number of tax returns filed by trust with the Inland Revenue Department. However, trusts are not required to alert the Inland Revenue Department to their existence if they are not income earning.

³⁰⁰ Based on figures from The World Bank “World Bank Development Indicator” (2011) <http://data.worldbank.org/data-catalog/world-development-indicators?cid=GPD_WDI>. Compare with one trust for every thirty-four Australians (every trust in Australia must lodge a tax return) and one trust for every two hundred and ninety four citizens of the United Kingdom (where, like New Zealand, trusts are not required to lodge a tax return) (see New Zealand Law Commission, above n 304, at [1.13]). But some sources suggest the actual number of trusts may be as many as one trust for every ten people in New Zealand (see Anthony Grant and Nicola Peart “The case for the spouse or partner” (paper presented at the NZLS Trusts Conference, June 2009); Nicola Peart “Intervention to Prevent the Abuse of Trust Structures” (2010) NZ Law Review 567, at 567).

³⁰¹ There are also concerns about how the misuse of trusts leads to the legitimate interests of creditors and spouses being defeated. For a useful starting point see Nicola Peart, above n 300.

rise to concerns about beneficiaries being inadequately protected³⁰² as they bear the loss in instances of trustee gross negligence. In *Spread v Hutcheson* Lord Kerr emphasised that beneficiaries are not privy to the trust deed and thereby need protecting:³⁰³

[A] beneficiary to a trust who might suffer grievously as a consequence of a trustee's gross negligence may not have had any input into the terms of the trust settlement.

The New Zealand Law Commission shares a concern about the vulnerability of beneficiaries, stating that "...in the current state of the law³⁰⁴ it is...open to the settlor to permit the trustee to be completely incompetent".³⁰⁵ Overseas jurisdictions have enacted legislation to counter this concern³⁰⁶ and the leading Canadian case on trustee exemption clauses held liability for gross negligence to be non-excludable.³⁰⁷ Thus a move to broaden the "irreducible core" would not be unsupported by case authority nor be, if implemented via statute, an unprecedented legislative step.

³⁰² For a recent example of how the trust has been misused or misunderstood in relation to the legitimate rights of beneficiaries see *L v P* HC Auckland CIV-2010-404-6103, 17 August 2011. In this case a father held half of his late sister's estate on trust for his seven-year-old daughter (and inherited the other half of the estate himself). He used both his and his daughter's interest to pay the mortgage owed on his house. Judge Aubin in the Family Court (cited at [60] of the High Court case) observed that the effect of the father's actions was that a "very substantial sum of approximately \$140,000, to which neither [the father's partner] nor [the father] was beneficially entitled, had been absorbed into their primary asset, the family home, to their significant financial advantage." For a discussion of the daughter's interests see [80]-[87] and in particular at [85] where Woodhouse J attempts to juggle the father and daughter's respective interests. See also *Official Assignee v Wilson & Clyma*, above n 132. The position of Ms Clyma's mother, who was a trustee, stands as a good example of trustees having very little knowledge of the true nature of their office. Although the claim in this case was from the Official Assignee, who argued the trust to be a 'sham', it nevertheless shows, more generally, how trusts can be misused or misunderstood in New Zealand.

³⁰³ *Spread v Hutcheson*, above n 2, at [160] per Lord Kerr.

³⁰⁴ This statement assumes that the *Armitage v Nurse*, above n 1, formulation of the "irreducible core" represents the current 'state of the law'.

³⁰⁵ Law Commission (New Zealand), above n 107, at 45; Law Reform Commission (Ireland), above n 120, at 76; and British Columbia Law Institute, above n 291, at 12.

³⁰⁶ See The Trusts (Guernsey) Law, 2007 s39(7); Jersey Trusts (Jersey) Law 1984 Art 26(9) which both forbid excluding trustee liability for gross negligence.

³⁰⁷ *Re Poche* (1983) 50 A.R. 264.

2. *The Scots Cases*

The Scots cases ought to be read as supporting the non-excludability of gross-negligence, but their interpretation has proven divisive.³⁰⁸ Debate centres around whether the Scots cases represent a firm line of authority for the proposition that gross negligence is non-excludable in Scotland or if they stand merely as authority for how a common clause in Scottish trust deeds at the time was construed by the courts.³⁰⁹

Both Millet LJ³¹⁰ and Lord Mance³¹¹ held the Scots cases to be about the construction of a popular clause in Scottish trust deeds at the time. As Lord Mance observed:³¹²

I appreciate the consistency of the views expressed in the Scottish cases to the effect that the standard form of exemption could not cover gross negligence...But I think it improbable that they would be read as involving or giving rise to an absolutely inflexible rule, effectively one of public policy, precluding any trustee from exempting him, her or itself from liability for gross negligence...

This approach can be contrasted with *Re Poche*,³¹³ the leading Canadian case on trustee exemption clauses, and three of the judgments in *Spread v Hutcheson*.³¹⁴ In *Re Poche*,³¹⁵ Hetherington J (as she then was) held:³¹⁶

³⁰⁸ The Scots cases: *Seton v Dawson* (1841) 4 D 310; *Knox v Mackinnon* (1888) 13 App Cas 753; *Rae v Meek* (1889) 14 App Cas 558; *Carruthers v Cairns* (1890) 17 R 769; *Wilson v Guthrie Smith* (1894) 2 SLT 338; *Carruthers v Carruthers* [1896] AC 659; *Wyman v Paterson* [1900] AC 271; *Clarke v Clarke's Trustees* (1925) SC 693; and *Lutea Trustees Ltd v Orbis Trustees Guernsey Ltd* [1998] SLT 471.

³⁰⁹ See also the English cases of *Wilkins v Hogg* (1861) LT (NS) 467; *Pass v Dundas* (1880) 43 LT (NS) 665. Both of these cases were discussed in *Armitage v Nurse*, above n 1, at 254H-255A; *Spread v Hutcheson*, above n 2, at [103]-[106], [47] per Lord Mance; contrast Paul Matthews, above n 157; *Spread v Hutcheson (CA)*, above n 296, at [22].

³¹⁰ *Armitage v Nurse*, above n 1.

³¹¹ *Spread v Hutcheson*, above n 2.

³¹² *Ibid* at [108] per Lord Mance; see also *Armitage v Nurse*, above n 1, at 254E-F; see generally *Spread v Hutcheson*, above n 2, at [88]-[108] per Lord Mance for a survey of the Scots cases.

³¹³ *Re Poche*, above n 307.

³¹⁴ *Spread v Hutcheson*, above n 2.

³¹⁵ *Re Poche*, above n 307.

³¹⁶ *Ibid*, at 276. As *Re Poche* was decided well before *Armitage v Nurse*, above n 1, the British Columbia Law Institute, above n 292, at 2 commented that the precedential value of the Scots cases was “very much open in all Canadian judicial forums except the trial level courts of Alberta”.

I am persuaded by the reasoning in [the Scots] cases. In my opinion a trustee must be held responsible for any loss resulting from his gross negligence, regardless of any provision in the trust instrument relieving him from such liability.

Similarly, in *Spread v Hutcheson* Lord Kerr,³¹⁷ Lord Clarke³¹⁸ and Lady Hale³¹⁹ held that the Scots cases represented a rule of law. Lord Clarke considered.³²⁰

...Millet LJ was wrong to say that the submission that it is contrary to public policy to exclude the liability of a trustee for gross negligence is not supported by any Scottish authority

The majority of commentary on the Scots cases agrees with the ‘rule of law’ interpretation,³²¹ which in my opinion is the correct view. For example, the most recent Scots case, *Lutea Trustees Ltd v Orbis Trustees Guernsey Ltd* (“*Lutea*”)³²² points in favour of the ‘rule of law’ interpretation being the correct one.³²³ In *Lutea*, the House of Lords and counsel for both parties treated it as uncontroversial that the earlier Scots cases represented a rule of law as opposed to one of construction.³²⁴

Scotland is a hybrid civil law/common law jurisdiction.³²⁵ Accordingly, one might question the relevance of the Scots cases to the English, and thereby

³¹⁷ *Spread v Hutcheson*, above n 2, at [160] and [174] per Lord Kerr.

³¹⁸ *Ibid*, at [48] per Lord Clarke.

³¹⁹ *Ibid*, at [133] and [136] per Lady Hale.

³²⁰ *Ibid*, at [48] per Lord Clarke who notably agreed with Millet LJ’s overall conclusion in *Armitage v Nurse*, above n 1, yet criticised his analysis of the Scots cases. See also Law Commission for England and Wales, above n 123 at [2.15].

³²¹ See The Scottish Law Commission *Discussion Paper on Breach of Trust* (Scot Law Com DP No 123, 2003) at [3.16]; Law Commission for England and Wales, above n 292, at [2.54] stated, in criticising Millet LJ’s treatment of the Scots cases: “The view taken [by Millet LJ] of the nineteenth century Scottish cases does not accord with the understanding of these decisions north of the border, where it is generally believed that trustees cannot invoke an exemption clause to escape liability for gross negligence”; see also Paul Matthews, above n 157, at 48; David Steele, above n 149, at 226-229; *Spread v Hutcheson (CA)*, above n 296, at 416.

³²² *Lutea Trustees Ltd v Orbis Trustees Guernsey Ltd*, above n 308.

³²³ Contrast *Spread v Hutcheson*, above n 2, at [100]-[101] per Lord Mance.

³²⁴ *Lutea Trustees Ltd v Orbis Trustees Guernsey Ltd*, above n 308, at 478 per Lord McCluskey.

³²⁵ For a useful starting point in assessing the English roots of the trust jurisdiction in Scotland see David M Walker *Principles of Scottish Private Law* (4th ed, Clarendon Press, Oxford, 1989) at 3-4; David M Walker *A Legal History of Scotland - Part VI The Nineteenth Century*

New Zealand, trust jurisdiction. In *Wyman v Paterson* both Lord Shand³²⁶ and Lord McNaghten³²⁷ acknowledged the overlap between the law of trusts in Scotland and that in England. Lord Shand, for example, held there to be “no real distinction between the common law of Scotland and that of England”³²⁸ on point. In *Spread v Hutcheson*, Lady Hale recognised that these comments were directed at “the general duties of trustees”³²⁹ but explains they must be read in light of the overall conclusion in *Wyman v Paterson* “which was to be drawn from the combination of those duties and the limited scope of the immunity clause”.³³⁰ Lord Herschell, who “took the lead”³³¹ in *Rae v Meek*³³² and *Carruthers v Carruthers*³³³, was an English Law Lord and thus, as Lady Hale observes, “the statements of principle [from the Scots cases cannot] be attributed only to the Scottish Law Lords”.³³⁴ In New Zealand, some remarks made by the Court of Appeal in *Robertson v Howden (No 2)*³³⁵ indicate they too considered the relevant laws of Scotland and England to be in sync on this point.³³⁶ Thus, it would be unsatisfactory to cast aside the Scots cases on the grounds of a lack of jurisdictional relevance alone.

The relevance of the Scots cases is heightened by the underlying concern that led the courts to hold gross negligence to be non-excludable. The courts wanted to ensure trustees effectively manage the property trusted to their care,³³⁷ which thereby served to protect the vulnerability of beneficiaries.³³⁸

(LexisNexis – Butterworths, Edinburgh, 2001) at 1002-1003; W.A. Wilson and Angelo Forte (eds) *Gloag and Henderson The Law of Scotland* (10th ed, W Green/Sweet & Maxwell, Edinburgh, 1995) at 814-816.

³²⁶ *Wyman v Paterson*, above n 308, at 286 per Lord Shand.

³²⁷ *Ibid*, at 279, per Lord McNaghten.

³²⁸ *Ibid*, at 286 per Lord Shand.

³²⁹ *Spread v Hutcheson*, above n 2, at [132] per Lady Hale.

³³⁰ *Ibid*, at [132]. Her Ladyship also cites the Law Commission for England and Wales, above n 202, which considered there to be no stark difference between English and Scottish law on this point. See also *Rae v Meek*, above n 308, per Lord Herschell.

³³¹ *Spread v Hutcheson*, above n 2, at [133] per Lady Hale.

³³² *Rae v Meek*, above n 308.

³³³ *Carruthers v Carruthers*, above n 308.

³³⁴ *Spread v Hutcheson*, above n 2, at [133] per Lady Hale.

³³⁵ *Robertson v Howden (No 2)* (1892) 10 NZLR 609 (CA).

³³⁶ *Ibid*, at 619, 621-622 where the court cited *Rae v Meek*, above n 308, as determining the relevant principles to be applied in Scotland and did not doubt that the same would be said for England and in New Zealand. In *Lewin on Trusts*, above n 234, at 1607 the authors treat *Robertson v Howden* as deeming gross negligence to be non-excludable in the trustee exemption clause context in New Zealand. But, with respect, such an authoritative determination by the court is difficult to read into Richmond J’s judgment.

³³⁷ See *Rae v Meek*, above n 308, at 573 per Lord Herschell who states “...it is the bounden duty of the Courts to enforce against trustees the obligations they have undertaken and to protect the trust funds committed to their charge”. See also *Knox v MacKinnon*, above n 308, at

Why then, despite the Scots cases arguably standing for a rule of law that gross negligence is non-excludable, did both Millet LJ and Lord Mance seek to resist the incursion of this Scottish rule of public policy into the conceptual idea of what constitutes the minimum essence of a trust?

E. Against Broadening the “Irreducible Core”

This section will discuss one policy argument against broadening the “core”, before considering the relevance of overseas legislative experiences. Some possible adverse consequences that this step may have to other areas of trust law will then be considered.

1. The Need for Certainty

As trusts are so widespread and prone to misunderstanding in New Zealand, clear and certain rules are needed.³³⁹ A problem with drawing the line at gross negligence is first, how to define it and, secondly, how to distinguish it from ordinary negligence. In *Couch v Attorney General*, Tipping J described gross negligence as “notoriously difficult to define and apply consistently”.³⁴⁰ This difficulty was one of the reasons for Millet LJ’s rejection of gross negligence being void for public policy in *Armitage v Nurse*.³⁴¹ Millet LJ held English

768 per Lord McNaghten who states “Any system of trusts which did not require trustees to act with perfect impartiality as between their cestuis que trust and to bring to the management of trust affairs the same care and diligence which a man of ordinary prudence may be expected to use in his own concerns, would be illusory and mischievous”.

³³⁸ Another way in which it has been recognised beneficiaries are vulnerable is through a strict approach (contra proferentum) to the construction of exemption clauses in trust deeds. See generally *Armitage v Nurse*, above n 1, at 255H; David Hayton “Irreducible Core Content”, above n 114, at 60; Paul Matthews, above n 157, at 53; Law Reform Commission (Ireland), above n 120, at 81, Andrew Butler and DJ Flinn, above n 120, at 468; *Underhill and Hayton*, above n 170, at 779; *Wight v Olswang* (No 2) (1999/2000) 2 ITELR 689; *Bogg v Raper* (1998/99) 1 ITELR 267 at 280. See also *DHL International Ltd v Richmond Ltd* [1993] 3 NZLR 10 (CA) at 17 citing *Aisla Craig Fishing Co Ltd v Malvern Fishing Co Ltd* [1983] 1 All ER 101 (HL) at 102 per Lord Wilberforce for a discussion of contra proferentum construction of exclusion clauses in contract.

³³⁹ This claim will be discussed further in chapter V (which argues that legislative reform is needed and then sets out the form that should take).

³⁴⁰ *Couch v Attorney General* [2010] NZSC 27 at [170].

³⁴¹ *Armitage v Nurse*, above n 1, at 254A-E.

lawyers to have a “healthy disrespect”³⁴² for gross negligence, as it is simply a question of degree between it and ordinary negligence.³⁴³

However, in *Spread v Hutcheson*, both Lady Hale³⁴⁴ and Lord Clarke,³⁴⁵ the latter notably agreeing with Millet LJ’s ultimate conclusion that it is inappropriate to draw the line at gross negligence,³⁴⁶ observed that English law does recognise the distinction between negligence and gross negligence in a number of areas. The English Trust Law Committee described concerns about how to define gross negligence as overstated.³⁴⁷

Nevertheless, although the law does draw the line at gross negligence in some contexts, it is without doubt a difficult one to draw. In a landscape where there is a widespread misunderstanding about the nature of trusts, the importing of such an ambiguous concept, to demarcate the line at which trustee exemption clauses are permissible, may serve to undermine the need for certainty in this area of the law.

2. *The Relevance of Overseas Experience*

From a legislative point of view, it would not be an unprecedented step to make gross negligence non-excludable. For example, both Guernsey and Jersey have taken this step.³⁴⁸ However, Donovan Waters explains that offshore trust jurisdictions, like Guernsey and Jersey, make commercial use of trusts one of the focal points of their status as financial centres.³⁴⁹ There is a highly competitive environment both intra and inter offshore trust jurisdictions.³⁵⁰

³⁴² *Armitage v Nurse*, above n 1, at 254.

³⁴³ See also *Spread v Hutcheson*, above n 2, at [117] per Sir Robin Auld; Law Reform Commission (Ireland), above n 120, at 78.

³⁴⁴ *Spread v Hutcheson*, above n 2, at [133] per Lady Hale.

³⁴⁵ *Ibid.*, at [50]-[51] per Lord Clarke. See also *Spread v Hutcheson (CA)*, above n 296, 418-419; British Columbia Law Institute, above n 292, at 6.

³⁴⁶ *Spread v Hutcheson*, above n 2, at [60] per Lord Clarke. His Lordship rejected the non-excludability of gross negligence on the grounds that the duty of care was not fiduciary in nature nor should its importance be raised just because we are examining its role in the trustee context.

³⁴⁷ English Trust Law Committee *Trustee Exemption Clauses* (June 1999) at [2.7]-[2.10].

³⁴⁸ See The Trusts (Guernsey) Law, 2007 s39(7); Jersey Trusts (Jersey) Law 1984 Art 26(9) which both forbid excluding trustee liability for gross negligence.

³⁴⁹ Donavon W.M. Waters “Worldwide Perspective”, above n 286, at 615.

³⁵⁰ *Ibid.* See also David Brownhill “The Role of Offshore Jurisdictions in the Development of the International Trust” (1999) 32 Vand J Transnat’l L 953 at 953, 954, and 962 where the

Thus these jurisdictions are more focused on the commercial and pragmatic use of trusts, making the conceptual origins of trusts largely secondary to such concerns.³⁵¹ These commercially heavy trust jurisdictions seem a world away from the family trust heavy New Zealand trust context. Additionally, as most trusts in offshore jurisdictions are commercial, professional trustees manage them, thereby creating less reluctance towards imposing a higher standard of care.³⁵²

3. *Assessment of Remedies*

If the “irreducible core” was broadened to make liability for gross negligence non-excludable the current law on remedies for breach of trust might require reconsideration.³⁵³

In *BNZ v NZGT*, Gault J³⁵⁴ held that the tortious assessment of causation and remoteness ought to apply for losses stemming from a breach of the trustees’ duty of care.³⁵⁵ Tipping J, who delivered a separate but concurring judgment, distinguished a situation where there is loss caused by a trustee’s disloyalty or infidelity from one where loss is caused by a breach of the duty of care. In the former case a strict liability approach is justified because fraudulent conduct means the conscience of the trustee is engaged.³⁵⁶ Thus, although Tipping J does not expressly refer to good faith and honesty, the mention of fraud as the standard of fault which is in question links it in with my discussion in chapter III, and serves to distinguish the “irreducible” good faith and honesty duty from the duty of care. Tipping J then explains that compensation for loss

author describes the “primary, if not sole, purpose of the legislation” in offshore trust jurisdiction is to enhance international trust business in that country.

³⁵¹ For a thorough comparative account of international developments in the law of trusts see Maurizio Lupoi *Trusts: A Comparative Study* (Cambridge University Press, Cambridge, 2000).

³⁵² Whereas in New Zealand, most family trusts are administered by lay people, hence the inclusion of section 13E of the Trustee Act 1956. See Property Law and Equity Reform Committee *Trustees’ Statutory Powers of Investment – Miscellaneous Powers* (Presented to the Minister of Justice 1984).

³⁵³ For a useful starting point of the law on remedies for breach of trust in New Zealand see Charles Rickett, above n 270.

³⁵⁴ On behalf of Richardson P, Gault, Henry and Blanchard JJ

³⁵⁵ *BNZ v NZGT*, above n 265, at 681-82 citing with approval *Henderson v Merrett Syndicates*, above n 270, at 205 per Lord Browne-Wilkinson; *Mothew*, above n 154; *Canson Enterprises Ltd v Boughton & Co* (1991) 85 DLR (4th) 129 at 146 and 152 per La Forest J; *Swindle v Harrison* [1997] 4 All ER 705 (CA) at 715, 717 per Evans LJ.

³⁵⁶ *Ibid*, at 687. Tipping J stated this rule applies unless the errant trustee can show that the loss would have occurred anyway (without there being any breach of fiduciary duty).

caused by a breach of a trustee's duty of care must assess causation, remoteness and foreseeability of damage of the relevant kind.³⁵⁷

If the "irreducible core" was expanded to make trustee liability for gross negligence non-excludable, then there might be a grave inconsistency in terms of remedies. Damages for a breach of a trustee's duty of care are currently assessed on a tortious basis, yet the duty being breached would be elevated into the "core". If the duty not to commit "gross negligence" lies at the "core" then should damages flowing from its breach be assessed strictly, in accordance with how Tipping J explained the breach of loyalty and fiduciary? And, if so, would this only apply to errant trustees, as opposed to other fiduciaries, and thereby result in a dual-path in terms of the approach to remedies between trustees and fiduciaries in general? Alternatively, if the assessment of damages for a breach of the duty of care remained the same, it would dilute the importance of the supposedly "irreducible" duty not to commit gross negligence, because damages flowing from breach of a core duty would still require causation, remoteness and foreseeability of damage of the relevant type.

4. *Other Implications of Broadening the "Irreducible Core"*

Expanding the "irreducible core" to make liability for gross negligence non-excludable would be inconsistent with the prudent person investment rules in the Trustee Act 1956.³⁵⁸ Trustees must exercise reasonable care and skill when investing,³⁵⁹ with a higher standard owed by those in the business of investing.³⁶⁰ But these duties can be excluded by the trust deed.³⁶¹ If the "irreducible core" includes the duty not to administer the trust through gross negligence, then the prudent person rules will need to be reformed as they set a lower standard than what lies at the "core" and are subject to contrary terms in the trust (which something at the "core" cannot be). A similar concern can be seen in section 38(1) of the Trustee Act 1956 which gives an implied indemnity for trustees in instances of acts, receipts, neglects and defaults

³⁵⁷ *BNZ v NZGT*, above n 265, at 686.

³⁵⁸ See Trustee Act 1956, ss13A-Q.

³⁵⁹ Trustee Act 1956, s13B.

³⁶⁰ Trustee Act 1956, s13C.

³⁶¹ Trustee Act 1956, s13D.

carried out by a bank or broker entrusted by the trustee to deal with securities on behalf of the trust *unless* caused by the trustees ‘wilful default’. There is no case law directly on what ‘wilful default’ means in this section, but in England the equivalent provision, s30 of the old Trustee Act 1925, saw ‘wilful default’ interpreted in the *Re Vickery* sense.³⁶² If such an interpretation applied in New Zealand, it would mean that section 38(1) would need reform to remove trustee indemnity in instances of default by professional agents in where there was gross negligence by the trustee.³⁶³

5. *A Final Word Against Broadening the “Irreducible Core”*

The concerns raised should not be read as meaning that changes to the law of trusts, to accommodate for the consequences of broadening the “irreducible core” to make gross negligence non-excludable, would be impossible. Of course, legislation can be reformed, and the case law on remedies could develop to reflect the elevated importance of the duty of care. Rather, the point is to show that one cannot examine a single area of trust law in a vacuum.

In the context of the “irreducible core” and trustee exemption clauses, there are without doubt legitimate concerns about the misuse and misunderstanding of trusts, particularly in New Zealand, that may provide sound policy reasons for making gross negligence non-excludable. The Scots cases provide a strong line of authority for taking this step.

Nevertheless, one must consider why the likes of Millet LJ³⁶⁴ and Lord Mance³⁶⁵ went to such great lengths to water down the precedential value of the Scots cases in order to uphold the conceptual understanding of the “irreducible core” of a trust. Gross negligence is a concept that is undoubtedly

³⁶² *Re Vickery*, above n 232, at 583, per Maugham J who stated that ‘wilful default’ requires a trustee to be “[c]onscious that, in doing the act which is complained of or in omitting to do the act which it is said he ought to have done, he is committing a breach of his duty, or is recklessly careless whether it is a breach of duty or not”.

³⁶³ Another area of trust law that might require reconsideration if the “irreducible core” were broadened to make trustee liability for gross negligence non-excludable is the common law on trustee indemnity clauses.

³⁶⁴ *Armitage v Nurse*, above n 1.

³⁶⁵ *Spread v Hutcheson*, above n 2.

difficult to define. It is a logical inconsistency to say, on the one hand, that certainty is needed in the law of trusts and then by the other hand make a vague concept a litmus test upon which the validity of trusts will be measured. In addition, although overseas jurisdictions have made gross negligence non-excludable, these commercial trust centres are a far cry from the ‘every man and his dog’ New Zealand family trust orientated landscape. The discussion of how remedies are assessed for different types of breaches by trustees demonstrates how deeming gross negligence to be non-excludable may have important flow on consequences in other areas of trust law, which may not be desirable.

F. Conclusion

This chapter has set out the contentious debate over whether trustee liability for gross negligence should be non-excludable. Whilst possessing some merit, broadening the “irreducible core” on policy grounds is a move that should be viewed with extreme caution. It must be borne in mind that the “irreducible core”, as explained in chapters II and III, is a conceptual discourse that defines the minimum essence required for a valid trust. The trustee’s duty of care does not fit within that conceptual understanding of ‘what is a trust’, and thus any step to broaden the core on policy grounds should be taken only by a legislature willing to cast aside the conceptual “core” of trusts in favour of some purported pragmatic benefit.

Chapter V – Reform in New Zealand

A. Overview

This chapter will explain why legislative reform should take place in New Zealand to define the “irreducible core”. The analysis will be developed through two steps. First, I will suggest why reform is necessary and that this issue should not be left solely in the hands of the courts. Secondly, I will canvass possible options for reform and suggest how it could be implemented to greatest effect

B. The Impetus for Reform

The Law Commission is undertaking a major review of trust law in New Zealand. There is thus a clear impetus for many of the problems plaguing the law of trusts in New Zealand to be closely scrutinised. An issue being addressed by the Law Commission is what to do with the “irreducible core” and trustee exemption clauses.

The current state of the of the common law means there is serious doubt over what makes up the substantive content of the “irreducible core”.³⁶⁶ The five judgments in *Spread v Hutcheson*³⁶⁷ are testament to the highly contentious nature of this issue and overshadow any claim that the seminal judgment of Millet LJ in *Armitage v Nurse*³⁶⁸ will be the last word on the matter. There is little Australian³⁶⁹ or New Zealand authority directly on point, and the leading Canadian case is the decision of the Alberta Surrogate Court in *Re Poche*,³⁷⁰ which conflicts with *Armitage v Nurse*³⁷¹ as to the excludability of trustee gross negligence. *Armitage v Nurse*³⁷² also construed too narrowly what is meant by ‘fraud’ in this context and thus dilutes the “irreducible” duty to act

³⁶⁶ British Columbia Law Institute, above n 292, at 2 described the law in this area as “ripe for legislative restatement of one form or another”.

³⁶⁷ *Spread v Hutcheson*, above n 2.

³⁶⁸ *Armitage v Nurse*, above n 1.

³⁶⁹ Although *Wilden v Green*, above n 208, seems to suggest that in Western Australia, at least, *Armitage v Nurse* represents the law.

³⁷⁰ *Re Poche*, above n 307.

³⁷¹ *Armitage v Nurse*, above n 1.

³⁷² *Ibid.*

honestly and in good faith for the benefit of the beneficiaries. In New Zealand, the matter is a moot point until an appropriate case reaches one of our higher courts for judicial consideration. There is thus an undesirable lack of clarity as to the state of the law and thereby limited guidance is provided as to the rights and obligations of settlors, trustees, and beneficiaries.

Opponents of regulation in this area frequently point to the erosion of settlor autonomy that would come about with any regulatory intervention.³⁷³ Regulation, according to the Law Commission for England and Wales, would harm one of the greatest assets of the trust instrument: its flexibility.³⁷⁴ Yet, the British Columbia Law Institute's Committee on the Modernization of the Trustee Act concluded their discussion on the merits of codification that:³⁷⁵

While the concept of settlor autonomy is entitled to great respect, it should not be permitted to override the protection of beneficiaries which has been the central concern of the law of trusts for hundreds of years.

Furthermore, there is much benefit to be gained from having a clear legislative statement as to where the line is drawn with trustee exemption clauses. In *Spread v Hutcheson*,³⁷⁶ Lord Clarke referred to a letter written by the President of the State Advisory and Finance Committee (Guernsey) that prompted the Guernsey review of trust law. The following passage from the letter aptly summarises the pragmatic benefit to be gained by settlors, trustees and beneficiaries via regulation in this area:³⁷⁷

[The proposed legislation] would also be of considerable advantage to beneficiaries...[as they would] know exactly what the trustees must do, and what remedies they will have in the event, say, of a threatened dissipation of trust funds. It would similarly be of great comfort to would-be settlors, who wish to place assets in the hands of trustees to be administered for their chosen beneficiaries, to know that firm and clear duties are placed by law on the trustees and that there is clear provision for action and redress in the event

³⁷³ Law Reform Commission (Ireland), above n 120, at 75.

³⁷⁴ Law Commission for England and Wales, above n 292, at [1.17].

³⁷⁵ British Columbia Law Institute, above n 292, at 12.

³⁷⁶ *Spread v Hutcheson*, above n 2.

³⁷⁷ *Ibid*, at [14] per Lord Clarke.

of a breach of trust.

There is one final, and perhaps overriding, reason why reform is needed. This paper has made it clear that a theoretical understanding of the “irreducible core” and a policy approach to the “irreducible core” may lead down different paths. If policy is to prevail, then perhaps gross negligence will be deemed non-excludable. Taking this step would be irreconcilable with the conceptual understanding of trusts posited in this paper. I have foreshadowed some problems that would result if the policy route was followed and recommended erring on the side of caution in abandoning the conceptual roots of the “irreducible core”. Nevertheless, in a situation where policy and theory point in different directions a choice must be made, and that choice should be made by Parliament.

C. Options for Reform

Any reform concerning with the “irreducible core” and trustee exemption clauses would have to be appropriate in the context of any wider reform of the law of trusts in New Zealand that may take place. But, for now, treating it as a stand-alone issue, a number of observations can be made. The New Zealand Law Commission have set out some possible options for reform of trustee exemption clauses.³⁷⁸ Two of these options should be ruled out³⁷⁹ and two lie outside the scope of this paper.³⁸⁰ What options remain and are there alternatives?

1. No Prohibition but a Beneficiary can Apply to the Court for Relief

One option suggested by the Law Commission is to have no prohibition on the permissible scope of trustee exemption clauses but create a statutory avenue for

³⁷⁸ Law Commission (New Zealand), above n 107, at [3.28]-[3.47].

³⁷⁹ Option 1 was for there to be no regulation of trustee exemption clauses. It has already been argued that reform should take place in this area. Option 7 suggested a total prohibition on trustee exemption clauses. Such a move would be disproportionate and would ignore the legitimate purpose served by trustee exemption clauses that do not impeach upon the “irreducible core”.

³⁸⁰ Options 4 and 6 touch on regulation to do with professional trustees. The “irreducible core” and professional trustees is an important and divisive issue but ultimately lies outside the scope of this paper.

beneficiaries to apply to the Court for relief to exclude the operation of a clause in a given case. The Law Commission suggested that, for example, a clause might be set aside if it would be unreasonable or unsatisfactory that the trustee could rely on the clause.³⁸¹

Adopting this path of reform is inadvisable. It would undermine the usefulness of the “irreducible core” as a tool of assessing the minimum validity of a trust as, for example, a trustee exemption clause could not be assessed for its validity until the trust has already been breached. This approach also lacks guidance and clarity for all parties involved (settlers, trustees and beneficiaries).

2. *Requirement of Reasonableness*

The Law Commission has suggested that, akin to the recommendation made by the Law Commission for England and Wales,³⁸² one option is to only allow a trustee to rely on an exemption clause if it would be ‘reasonable’ for them to do so.³⁸³ The Irish Law Commission also recommended this manner of reform.³⁸⁴

A problem with this approach is uncertainty as to what is ‘reasonable’ or not. Furthermore, it fails to recognise the inextricable link between trustee exemption clauses and the “irreducible core”. For example, it can never be reasonable for a trustee to act in bad faith or fraudulently or outright refuse to account to the beneficiaries. Bringing in an after the fact test of reasonableness does nothing to aid in a clear articulation of the “irreducible core” of trusts. Under this option for reform, and the one discussed above, the grounds for disregarding the exemption clause look very much like negligence, or at any rate a low level of breach, which, if implemented, would further serve to undermine the conceptual content of the “irreducible core” of a trust.

³⁸¹ Law Commission (New Zealand), above n 107, at [3.35].

³⁸² Law Commission for England and Wales, above n 292.

³⁸³ Law Commission (New Zealand), above n 107, at [3.42].

³⁸⁴ Law Reform Commission (Ireland), above n 120, at 82.

3. *Recommendation for Reform*

This paper recommends two possible options for reform in this area. One is to make a legislative statement declaring trustee exemption clauses unable to exclude liability for certain types of trustee conduct. A second option would be to list the trustee duties that make up the “irreducible core”.³⁸⁵ The first option would serve to define the “irreducible core” from the trustee exemption clause perspective and the second from the duties perspective. The second option would be a clear legislative statement about what trustee duties are required, at minimum, in order for there to be a valid trust. Under either approach, it would be left to the courts to determine the appropriate meaning of the duties (or standards of fault), but what is important is that a legislative step of this nature would clearly articulate what lies both inside and outside of the “irreducible core”.

D. *Conclusion*

The state of the common law in New Zealand concerning the “irreducible core” of trusts and the permissible scope of trustee exemption clauses is uncertain. This uncertainty serves to undermine the need for some guidance in New Zealand to alleviate the widespread misunderstanding about the true legal nature and effect of trusts. This section has explained that the most important choice is the one between concept and policy. The two, in this area, may point in an irreconcilable direction. If a legislative step is made, which this paper recommends it should, Parliament should seek to define the “irreducible core” either by reference to the permissible scope of trustee exemption clauses or by defining the “irreducible” duties a trustee must owe. Either option would stand as a clear legislative statement about the content of the “irreducible core” of trusts.

³⁸⁵ See s 22 of The Trusts (Guernsey) Law, 2007.

Conclusion

This paper set out to answer one fundamental question: ‘what is the “irreducible core” of a trust in New Zealand?’ Chapter I demonstrated how, from a theoretical point of view, a trust ought to be understood and defined. The proposed hybrid *sui generis* theoretical model of a trust encompasses proprietary and obligational elements. Both of these must be present for there to be a valid trust and neither side is subordinate to the other. These theoretical components of a trust are what give meaning to the “irreducible core”.

Chapter II demonstrated how the “irreducible core” is a useful pragmatic tool for determining the minimum validity of a trust. Importantly, I showed that the “core” should be viewed through two commensurate lenses: looking at the minimum duties a trustee must owe to beneficiaries and the permissible scope of trustee exemption clauses.

The heart of this paper can be found in chapters III and IV. I have argued that, from a conceptual point of view, the “irreducible core” is filled by the duty of the trustees to perform the trust honestly and in good faith for the benefit of the beneficiaries and the duty to account and identify trust property. These are the minimum duties that must be present for what is purported to be a ‘trust’ in name, to be a trust in substance. From the trustee exemption clause perspective, trustee liability for ‘actual fraud’ and ‘equitable fraud’ cannot be excluded. ‘Actual fraud’ should take on a primarily objective test in order to make the honesty and good faith requirement meaningful. Likewise, ‘equitable fraud’ should be non-excludable; as to conclude otherwise would be to absolve trustees of liability in instances where their conduct offends the public conscience. Importantly, chapter III argued that, from a conceptual understanding of trusts and the nature of fiduciary duties that make a trustee a trustee, the duty of care should not form part of the “irreducible core”. It is not a fiduciary duty and does not logically flow from the proprietary or obligational roots of a trust.

In chapter IV I presented a discussion of whether the “irreducible core” should be expanded beyond its conceptual roots to make trustee liability for gross

negligence non-excludable for lay trustees. There is some merit to this approach. It would serve to protect beneficiaries in the New Zealand trust landscape where misuse and misunderstanding of trusts is rife. Likewise, there is a strong line of precedent, the Scots cases, which points in favour of making gross negligence non-excludable. However, gross negligence is a nebulous concept and its incision into this area may lead to even greater uncertainty. Furthermore, overseas jurisdictions that have taken this step are a far cry away from the family trust focused New Zealand trust context. Most importantly, the discussion of how remedies are assessed for breach of the trustees' duty of care shows that broadening the "core" in this way may have consequences outside the immediate question of the permissible scope of trustee exemption clauses. I thus recommended one should err on the side of caution in taking a pragmatically infused step into trust law: an area rich in conceptual roots and embedded in its theoretical origins.

Finally, building upon the discussion in earlier chapters, chapter V has shown that the current state of the common law is unsatisfactory and reform ought to take place. Any reform should seek to define the "irreducible core" in an Act of Parliament. It could be defined from either the duty perspective or the exemption clause perspective. The main concern for any path of reform will be deciding between the conceptual route and the policy route. This paper has shown that the policy path, whilst perhaps overcoming a problem in this area of trust law, should be viewed with caution.

It is hoped that this paper has provided some much needed clarity as to what should provide the substantive content of the "irreducible core" of a trust in New Zealand. Despite considerable academic and Law Commission attention to the issue, there has been a distinct lack of cohesion in the approach taken to assessing this question. Importantly, many commentaries treat the conceptual and policy arguments as reconcilable. This paper has deliberately emphasised the conceptual origins of a trust and how the "irreducible core" is a theoretical construct, albeit one which serves a pragmatic ends. In the context of the widespread review of trust law taking place in New Zealand, it is important that the conceptual origins of a trust are not ignored and made subordinate to quick fix, isolated reform in individual areas of trust law. It is thus hoped that

any future consideration of the “irreducible core”, whether it be by the courts or Parliament, does not erode the underlying conceptual roots of trusts.

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