Trust busting: How far have we come and how far can we go?

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The use of discretionary trusts to shield wealth has become an international obsession that is extensive in Australia. Australian courts have made the most significant inroads in developing a jurisprudential basis for finding that assets held on discretionary trusts are property of spouses. The methods by which trust assets can arguably be accessed by spouses in property settlement proceedings are catalogued and described, including: powers without fiduciary obligations, distinguishing discretions from facts determining eligibility to a benefit, the powers analysis of the Australian courts, nuptial settlement provisions, oppression proceedings, remedial trusts over assets held on express trusts, legislative powers to alter rights of third parties, and the 'financial resources' provisions. The common considerations in the various methods are identified, leading to a proposal for a simplified alternative theory for, so called, 'trust busting'.

I INTRODUCTION

In this paper, the discretionary trust is considered in the context of family law property disputes. After a brief introduction noting the important features of such trusts, a range of possible methods to access assets held on trust are identified and briefly described. It is argued that an underlying commonality in respect of each option is the court ultimately making findings or assumptions about the extent to which a spouse would receive the benefit of trust assets if there was an appropriate exercise of the dispositive discretions by the trustee. It is argued that this is a common feature of the various methods which points to an answer to the key question 'How far can we go?', at least in the antipodes: that is, the courts assessing (and effectively directing) the appropriate exercise of the trustee's dispositive discretion when making property orders consequent upon spousal separation.

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A *Background*

Property rights are the central legal concept by which wealth is owned and transferred: the common law and legislation such as taxation, bankruptcy and family law property statutes rely upon rules and provisions with respect to 'property'. Thus, there is a significant practical incentive to develop structures that separate 'property' (as defined in the legal system) from the ability to benefit from assets, and thus minimise taxation and avoid claims by creditors and spouses.

The 'discretionary trust' is an ingenious development of the law of equity, providing a structure by which title to property is separated from the enjoyment of benefits of assets. The trustee of the trust holds legal title to the trust assets for the benefit of the beneficiaries. However, unlike a fixed trust, the trustee has a discretion as to when distributions are made, who among the beneficiaries or objects of the trustee's powers receives a distribution and how much anyone receives. In some cases the trustee may even have power to alter the list of potential beneficiaries or the terms of the trust. The practical result is that no beneficiary has an identifiable (nor quantifiable) share in the assets of the trust, and thus, has no equitable property interest in the trust assets. Whilst the trustee seems to have absolute dominion over the assets, there is usually a form of control in place: a power to replace the trustee, held by the 'controller' or 'guardian' of the trust.

There are more than 600,000 discretionary trusts in Australia, yet only 12.96 million individual taxpayers.[2] With the increase in the number of trusts over the past 50 years came an increase in the number of cases where a spouse established a discretionary trust primarily for tax benefits and protection from creditors (if the need arose), but continued to utilise the trust assets as assets of their family. In these cases the trust assets are often the most significant financial resource of the parties, making the trust a central feature of property settlement cases.

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[2] See *Taxation Statistics*, a publication of the Australian Tax Office, available on their website at www.ato.gov.au. Similarly high numbers of trusts appear in New Zealand: Nicola Peart, 'Intervention to Prevent the Abuse of Trust Structures' (2010) 9 *NZ Law Review* 567; Nicola Peart, 'Can Your Trust Be Trusted' (2009) 12 *Otago Law Review* 59.

Among trusts lawyers there is an open acknowledgement that the purpose of family discretionary trusts is to thwart wives, creditors and the revenue.[3] For example, Aitken recently described the purpose of family discretionary trusts, when discussing *Spry's Case*, saying:

> The underlying motivation for separation of ownership and control by means of a discretionary trust is banal. Usually, the 'owner' will wish to protect assets from the depredations of the Commissioner, or some other overreaching authority like ASIC, in the event of a corporate collapse. Or, as in *Kennon v Spry*, what commences as a legal construction with fiscal attractions, becomes a means by which a disaffected husband may seek to place matrimonial assets beyond the reach of his estranged spouse by transferring the benefit to his four daughters. But just because the motive is banal does not mean that the court should ignore basic matters of principle.[4]

Such an open acknowledgement that the underlying motivation for the structure of the family discretionary trust is merely to thwart the legitimate rights of others is startling, particularly when the foundation for the structure itself is Equity's preparedness to enforce obligations based upon conscience. However, it should not be thought that this is a purely modern use of the trust. Hill recounts that it 'was at one time not unusual for purchasers to take a conveyance of the legal fee to a dry trustee, as a mode of barring the dowers of their widows.'[5]

Not surprisingly, drafters of discretionary trust instruments were quickly drawn to a form of drafting that provided merely for powers of appointment by the trustee until the vesting date, which is usually set as far off as the rule against perpetuities will permit. Garton[6] refers to *Re Gea Settlement*[7] as an example of

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3 For a detailed criticism of the courts for permitting these outcomes see Lucie Greenwood, *Discretionary Trusts – What Happened to "Practical Intelligence" in the Law?* (LLB (Hons) Thesis, University of Otago, 2012).

4 Lee Aitken, 'Muddying the Waters Further — Kennon v Spry: "Ownership", "Control" and the Discretionary Trust' (2009) 32 *Australian Bar Review* 173.

5 James Hill, *A Practical Treatise on the Law Relating to Trustees: Their Powers, Duties, Privileges and Liabilities* (Lea and Blanchard, 3rd ed, 1857) 460.

6 Jonathon Garton et al, *Moffat's Trusts Law: Text and Materials* (Cambridge University Press, 6th ed, 2015) 268.

this type of 'black hole' trust where the named beneficiaries were various charities, and the trustees were given a power of appointment that could be exercised in favour of a group (objects[8] of the discretion) including those intended to benefit.[9] It was never intended that the charities would actually benefit. Property effectively 'disappears' as no object of the discretion has a property interest until the discretion is exercised.

B *The legal mechanism of the discretionary trust*

The 'discretionary trust' is not a separate legal category of trust structures: '… the usage of the term "discretionary trust" is essentially descriptive rather than normative.'[10] The essential nature of the discretionary trust is that of an express trust 'where the entitlement of beneficiaries to income, or to corpus, or both, is not immediately ascertainable. Rather, the beneficiaries are selected from a nominated class by the trustee or some other person and this power may be exercisable once or from time to time.'[11]

The first part of the mechanism of discretionary trusts is the usual trust mechanism of separating the legal title to assets (by placing title with a trustee) from those who enjoy the use of assets (the beneficiaries). As modern courts recognise equitable property interests, trusts with fixed entitlements for

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7 *Re Gea Settlement* (1992) 13 TLI 188 (17 March, 1992, Jersey Islands).

8 The term 'object' is not used in the sense of an objective, such as the object of a statute. Where reference is made to the objective or purpose of the trust, the word 'purpose' is used throughout.

9 Fiduciary powers are often divided into two types: (a) Dispositive powers where the instrument imposes an express duty on the trustee to exercise the discretion (such as the discretion to determine the amount that each of a group of 'beneficiaries' receives on vesting of a trust) referred to as 'discretionary trust powers'; and (b) Dispositive powers where the trust instrument does not contain an express duty to exercise the discretion (such as powers to appoint assets to an 'object' who may not be a residual beneficiary) referred to as 'fiduciary powers'. In this work the terms 'beneficiary', 'discretionary trust power', 'object' and 'fiduciary power' will be used in this sense. Where there is no need to distinguish between objects and beneficiaries, beneficiaries is used as a general term to include both, for ease of reading.

10 *Commissioner of Taxation v Vegners* [1989] FCA 480, [14].

11 Ibid.

beneficiaries are not sufficient to separate the 'property' from the beneficiary for the purpose of tax minimisation or asset protection.[12] It is only by making the beneficiary's entitlements uncertain that the equitable interest becomes so 'thin' that it is no longer considered 'property' for many purposes. The second part of the mechanism of discretionary trusts is to create uncertainty of entitlement by providing the trustee with a discretion to determine who among a class of beneficiaries will receive the benefits of the trust assets, and when those benefits may be conferred. It is these mechanisms (separating legal title and making benefits uncertain) that result in asset protection as the beneficiary no longer appears to have any 'property'.

The obligation model of a trust outlined by Parkinson[13] is adopted, rather than a property institution or contractual model.[14] Parkinson's definition places the obligations of the trustee at the core of a trust:

> 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 or by operation of law.

This model is consistent with the definition given in *Lewin on Trusts* that a trust 'refers to the duty or aggregate accumulation of obligations that rest upon a person described as trustee'[15] and adopted by *Moffat's Trusts Law*.[16]

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12 *Official Receiver in Bankruptcy v Schultz* [1990] HCA 45.

13 Patrick Parkinson, 'Reconceptualising the Express Trust' (2002) 61(3) *The Cambridge Law Journal* 657; See also David J Hayton, 'Developing the Obligation Characteristic of the Trust' (2001) 117(Jan) *Law Quarterly Review* 96.

14 The classic argument that a trust is based upon contract appears in John H Langbein, 'The Contractarian Basis of the Law of Trusts' (1995) 105(3) *The Yale Law Journal* 625; A contractual analysis underpins the decision in *Cook v Benson* [2003] HCA 36 where the High Court concluded that a superannuant purchased his entitlements pursuant to the trust from the trustee.

1 *Practical Consequences*

Regardless of the model adopted to understand a discretionary trust, the practical consequence, as Hannen P observed in a polite and understated way nearly 150 years ago, is that following separation,

> trustees, especially relations of [one spouse], may possibly, … be influenced by motives which [the other spouse] would not anticipate would come into play.[17]

As family law legislation usually provides only for the 'property' of the spouses to be the subject of orders for property settlements,[18] this can leave a spouse without access to trust assets. In families where the bulk of the assets are held in trust structures, an inability to access resources held on trust can cause significant injustices.

Thus, the esoteric world of the trust can have a huge practical impact upon those seeking appropriate property settlements following the end of intimate relationships.

II 'TRUST BUSTING' STRATEGIES

In this section, various 'trust busting' strategies that have been developed are listed and briefly described. This catalogue will, I hope, be of practical assistance to lawyers called upon to consider whether the assets of a trust can be accessed by a spouse: the process of 'trust busting'. On a broader level, however, it is argued that a common theme emerges from these various 'trust busting' methods: each method involves, in some way, the assessment of the interests of a beneficiary, based upon the proper administration of the trust. That is, in keeping with an obligations model of the trust, we see that obligations of the trustee to the potential beneficiaries (or objects of discretions) are generally considered before trust assets are the subject of orders. It is this important

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15 Professor Robert Rennie et al, *Lewin on Trusts* (Sweet & Maxwell, 18th edition, 2006) 4.

16 Garton et al, above n 6, 3. Interestingly, as is identified in therein, the definition appears to come from a South Australian case: *Re Scott* [1948] SASR 193.

17 *Marsh v Marsh* (1878) 39 LT(NS) 107, 110.

18 For example, *Family Law Act 1975* (Aust), s.79.

feature that forms the basis of the arguments in the following section when we turn to consider where 'trust busting' may be heading.

A *Distinguishing 'discretion' from 'facts determining eligibility to a benefit'*

The nature of a trustee's decision in cases involving factual questions as to eligibility must be distinguished from that of exercising a discretion. In *Finch's Case*[19] the High Court pointed out the difference between a discretion to distribute trust assets and a determination of a person's eligibility to receive trust assets. The case concerned an entitlement to a disability payment in defined circumstances. Whilst the deed used the term 'discretion', the Court identified that the trustee 'had a duty to distribute to those who fell within the definition'.[20] As a result, '[f]orming that opinion was not a matter of discretionary power to think one thing or the other; it was an ingredient in the performance of a trust duty.'[21] Thus, the court will determine a person's eligibility or entitlement to benefit if the decision is not a truly discretionary one.

Whilst it is rare for a modern discretionary trust deed to be open to such interpretations, there may be some fixed rights, such as private school fees for children or grand-children. This distinction highlights the importance of obtaining a copy of the trust deed and carefully reviewing the provisions.

B *Powers without fiduciary obligations*

Where a person has powers to distribute assets, unfettered by fiduciary obligations, the powers may be treated as the equivalent to property. In *TMSF's Case*[22] the Privy Council concluded that a power to terminate a trust (which power was not subject to any fiduciary obligations) was tantamount to ownership. Importantly, where the donee of a power owes 'no duty of trust or confidence to another person', the power is capable of being delegated to a receiver. That is, the court may vest the power in a receiver who may then exercise the power in favour of a different beneficiary: a consequence not

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19 *Finch v Telstra Super Pty Ltd* [2010] HCA 36.

20 Ibid [30].

21 Ibid [30].

22 *Tasarruf Mevduati Sigorta Fonu v Merrill Lynch Bank and Trust Company (Cayman) Ltd & Ors (Cayman Islands)* [2011] UKPC 17.

dissimilar to the ultimate practical consequence that followed the litigation sagas in *Davidson's case*[23] where the appointor company was transferred to the wife and then replaced the trustee.

The New Zealand Supreme Court in *Clayton v Clayton*[24] recently considered that a husband's powers as trustee of a discretionary trust were sufficiently free of fiduciary obligations that he was in a position tantamount to the property owner. This decision takes the reasoning process in *TMSF* one step further as the case did not involve a simple power of revocation, but the conduct of a trustee of a discretionary trust. However, the principle that emerges is not only that a power will be treated as tantamount to property (at least in matrimonial proceedings) in cases where there is no fiduciary duties to others, but that this conclusion can be reached despite the terms of a trust deed that establishes a group of potential beneficiaries of the trustee's discretion.

In these scenarios, the courts effectively enforce the exercise of a discretion if it is unrestricted by fiduciary obligations (or only theoretical obligations). The cases demonstrate that the court will enforce a trust, by treating non-fiduciary powers as the equivalent of property in the assets of the trust: the exercise of the court's jurisdiction requires a trustee to deal with trust assets in a particular way. Significantly, even if there are prima facie fiduciary duties, the court will determine if a trustee is bound by actual fiduciary obligations in the exercise of a discretion.

The more disturbing aspect of the discussion in *Clayton's case* is the proposition that perhaps there is no trust at all if there are no fiduciary duties limiting the conduct of the trustee. If that were the ultimate finding, many modern trust structures may be at risk, with potentially significant taxation consequences.

C *The 'financial resources' provisions*

In most legislative schemes for family law property settlements there are provisions that require the court to have regard to the 'financial resources' of the

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[23] *Thurlstane (Aust) Pty Ltd v Andco Nominees Pty Ltd* [1997] NSWSC 517; *In the Marriage of Davidson and Davidson* (1990) 14 Fam LR 817; *In the Marriage of Davidson and Davidson (No 2)* [1994] FamCA 33.

[24] *Clayton v Clayton; Re Vaughan Road Property Trust* [2016] NZSC 29.

parties.[25] The High Court of Australia recently affirmed the definition developed by the Family Court of Australia, that a financial resource is 'a source of financial support which a party can reasonably expect will be available to him or her to supply a financial need or deficiency'.[26] The High Court went on to explain that the source of the financial support must 'be one on which the party is capable of drawing', and whilst the party need not 'control the source of financial support' it 'must involve something more than an expectation of benevolence on the part of another.' The Court remarked on the normative outcome that flows from the application of the provision saying that 'it has long correctly been recognised that a nominated beneficiary of a discretionary trust, who has no control over the trustee but who has a reasonable expectation that the trustee's discretion will be exercised in his or her favour, has a financial resource to the extent of that expectation.'[27]

The High Court said that application of the test 'turns in most cases on a factual inquiry as to whether or not support from that source could reasonably be expected to be forthcoming were the party to call on it.'[28] In the particular case, the wife was found to have a financial resource in circumstances where she was the discretionary beneficiary of her father's estate which was controlled by her brothers. The Court was satisfied that it was open to draw the inference that 'The payment was available to her if she asked for it' as it 'was the subject of specific provision in [her] father's will' and that 'making of the payment was at least a

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25 *Family Law Act 1975* (Aust), s.79. This method is impractical in cases where a significant proportion of the wealth of the spouses is held in discretionary trusts as there may not be sufficient other property that can be the subject of orders for transfer to enable an appropriate property settlement. For example, where the parties have property of only furniture, motor-vehicles and day-to-day bank accounts, they may have property of little value; however they may live in a home owned by a trustee, and receive regular distributions from trust assets held as investments. In these circumstances, no adjustment to the property to which the spouses have property rights will result in an appropriate property settlement for the spouse who is no longer receiving trust distributions.

26 *Hall v Hall* [2016] HCA 23, [54]. The definition comes from *In the Marriage of Kelly (No 2)* (1981) 7 Fam LR 762, [1981] FLC 91-108 at 76,803.

27 Ibid [54].

28 Ibid, [55].

moral obligation of the wife's brothers, who were in any case well-disposed towards her.'[29] A similar approach is adopted in the UK[30] and Hong Kong.[31]

In substance, the court decides whether the spouse has more than a 'mere expectation' to receive a distribution from the trust, and the likelihood of receiving such distributions. Such findings can only be sustained by a conclusion that it is not only open to the trustee to make distributions to the spouse, but that there are facts and circumstances making it appropriate and likely that the trustee would exercise the discretion to make such distributions.

Where the trust assets form only a relatively small part of the overall pool of assets being considered in the property settlement proceedings, this is a simple and effective method to utilise as the adjustment can be made from other assets. However, the risk of the practitioner with such a course lies in failing to provide sufficient proof of the likelihood of distributions.

D *The 'polite request' or 'judicious encouragement'*

In a number of cases involving significant wealth, the courts have proceeded on the basis of making a 'polite request' to the trustee of a discretionary trust to make a distribution to a spouse, in order to give effect to the determinations of the court. This practice does not appear in the Australian decisions (although sometimes settlements are reached on the basis that trustees will make distributions to give effect to the settlement), but is referred to in some overseas cases.[32]

On a technical level, in *Netherton v Netherton*, Charles J found that appointment of assets to a husband so that he could make a payment to the wife was not a fraud on the power of the trustees.[33] This aspect of fraud on a power is discussed

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29 Ibid [56].

30 *Charman v Charman* [2005] EWCA Civ 1606.

31 *Kan Lai Kwan v Poon Lok To Otto* [2014] HKCFA 65.

32 See for example, *Thomas v Thomas* [1995] 2 FLR 668 at p 670 and *Charman v Charman* [2005] EWCA Civ 1606.

33 *Netherton v Netherton* [2000] WTLR 1171; see also *In re X Trust* [2002] JLR 377; Geoffrey Todd, 'Extent of Power to Apply Trust Money for the Benefit of a Beneficiary: X & Anr v A & Ors [2005] EWHC 2706 (Ch)' (2006) 12(10) *Trusts & Trustees* 31.

in *Moffat's Trusts Law*, where the outcome in *Netherton's Case* was considered 'somewhat surprising'.[34] However, the outcome would be justified if it represents the appropriate exercise of the trustee's discretion.

In substance, the cases involving a 'polite request' must proceed on the basis that the distribution of assets from the trust estate to the particular spouse is considered by the court to be an appropriate exercise of the trustee's discretion. If this were not the case, the court would be pressuring a trustee to make a distribution different to that demanded by a conscientious exercise of the trustee's fiduciary obligations, to the detriment of the other potential beneficiaries (or objects of the discretion).

This approach, whilst appearing to avoid any need for analysis of difficult questions of equity concerning the operation of discretionary trusts, nonetheless proceeds on an implicit assumption that this course is the appropriate outcome for the exercise of the trustee's discretion when considering calls upon the assets of the trust.

Of course, the polite request relies upon a polite and compliant response – something that may be from a largely bygone era. I suspect that it may have had a place among the cases involving the landed gentry in Britain in past eras where estates were large and property settlements for wives rather modest, but is of little practical use in today's world.

E *The 'nuptial settlement' provisions*

The 'nuptial settlement' provisions[35] allow for the court to alter settlements that have the requisite 'nuptial' character. These provisions have had surprisingly little use in Australia,[36] probably because the 'powers analysis' has been most commonly used in Australia (see below).

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34 Garton et al, above n 6, 534.

35 See *Family Law Act 1975* (Aust), s.85A.

36 Peter Nygh, 'Section 85A: Is It of Much Use?' (1986) 1(1) *Australian Journal of Family Law* 10.

It was established early in the operation of the provisions that the settlement need not be solely for the spouses and their children: Thus, in *Marsh's Case*[37] a discretionary trust that provided for a class that included relatives other than the husband and wife was nonetheless altered to provide for a spouse following divorce.

The precise modern limits on the definition of a nuptial settlement are unclear: it is a category that has become wider than may have originally been contemplated.[38] The breadth of the provision now encompasses trusts that provide for a larger number of beneficiaries than the spouses and their children, often where other potential beneficiaries appear to have strong claims to benefit from the assets held on trust.

In order to make appropriate orders resettling nuptial settlements the court must make a determination of the appropriate use that is to be made of the trust assets in order to inform the terms of any resettlement. This must necessarily involve an assessment of the extent to which the assets are properly to be applied to the spouses. In order to make this assessment the courts must be considering the obligations of the trustee to potential beneficiaries other than the spouses.

Significantly, it was this methodology upon which Kiefel J (now Chief Justice) decided *Spry's Case.*[39] It is a convenient path, now that the category of 'nuptial settlements' appears much wider than it was in the past, although it presents two difficult problems for the practitioner: first, the actual width of the provisions is still unclear in Australia as Kiefel J's judgment is a minority judgment in the High Court; and secondly, no equivalent provision appears in the defacto provisions (probably because there are no formal 'nuptials' upon which an equivalent provision could be conveniently attached).

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37 *Marsh v Marsh* (1878) 39 LT(NS) 107. See also *Prinsep v Prinsep* [1929] P 225. *Lort-Williams v Lort-Williams* [1951] P 395; *Brooks v Brooks* [1995] UKHL 19. In Australia, see the judgment of Kiefel J (as her Honour then was) in *Kennon v Spry* [2008] HCA 56.

38 *Brooks v Brooks* [1995] UKHL 19.

39 *Kennon v Spry* [2008] HCA 56.

F *Managing trust assets in oppression proceedings*

Most jurisdictions admit of orders being made by the court where the conduct of a company is oppressive ('oppression' proceedings). Where a spouse holds a share in a corporate trustee of a family discretionary trust, the conduct of the company following separation may justify oppression proceedings. As corporate trustees rarely have any assets (other than title to the trust assets) there is no property of the company that can be distributed to the shareholders, however, the problem of administering the trust remains.

In *Vigliaroni's Case*[40] the Victorian Supreme Court found that the power to make orders in oppression proceedings extended to making orders with respect to trust property held by the company. However, whilst this may solve the problem in Victoria, such an extended reading of the corporations' statute is not yet well accepted throughout Australia.[41]

Importantly, any orders made with respect of trust property must necessarily be informed by a consideration of the appropriate exercise of the trustee's obligations and duties under the trust: that is, the orders would be tantamount to executing or re-settling the trust.

The difficulty with such a method is that it may result in litigation in the Supreme Court as well as the Federal courts, making it an expensive process on a practical level. It is also of limited benefit as a result of the need for a spouse to be a shareholder of the trustee company, which is often not the situation in family law cases.

G *Remedial trusts over assets held on express trusts*

In New Zealand it is has been accepted that a spouse can have an equitable interest in property on the basis of a constructive trust (based upon contributions or improvements to the land), despite the land being held by trustees of a discretionary trust. This argument, whilst at first attractive, presents many difficulties when one turns to consider the competing claims of the beneficiaries of the constructive trust against those of the discretionary trust.

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40 *Vigliaroni & Ors v CPS Investment Holdings Pty Ltd & Ors* [2009] VSC 428.

41 For a detailed discussion of the issues, and limits of this potential remedy, see Victorian Law Reform Commission, 'Trading Trusts - Oppression Remedies' (Final Report 30, January 2015).

The authorities on this topic are quite restricted in their breadth. The New Zealand courts have found that an interest can arise on their usual constructive trust principles if relevant contributions to the property by the claimant were made with the knowledge and approval of the trustees, 'such that their collective conscience is bound to recognise the validity of the claim.'[42] The New Zealand Court of Appeal emphasised that allowing such a claim '… does not take away from the beneficiaries of the Trust something to which they are entitled. … Allowing [such a] claim averts the unjust enrichment which would otherwise result to the Trust – essentially the Trust getting … a windfall.'[43]

Difficulty arises where there are multiple trustees, as rarely will all of them be involved in the conduct. Where one trustee has 'abjured his trustee responsibilities in favour of' the other trustee, the Court in *Murrell v Hamilton*[44] was prepared to treat the actions of the active trustee as actions of both trustees. This outcome is a prioritisation of the equity of the constructive trust claimant over the express trust beneficiaries. One would expect that the failure of the trustee who abjured his responsibilities would not ordinarily lead to an equity by constructive trust greater than that of the beneficiaries of the express trust, but personal obligations imposed on the trustee, which may explain the reliance on notions of unjust enrichment.

Significant problems would also arise if such claims were based upon a promissory estoppel style of argument[45] as the trustee would then owe competing duties to the beneficiaries of the trust and to the person in respect of whom there was conduct giving rise to the promissory estoppel, but without an 'enrichment' of the trust assets. That is, there would be competing equities, one based upon the express trust and one based upon the conduct of the trustees: It is difficult to see that the conduct of the trustees could give rise to an equity based upon a promissory estoppel that would take priority over the equity of the express trust beneficiaries. This strategy of 'trust busting' is likely to lead to many fine distinctions with respect to the equities that may arise, and their priorities.

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42 *Murrell v Hamilton* [2014] NZCA 377 (7 August 2014) [19](b). See also, *Glass v Hughey* [2003] NZFLR 865 and *Prime v Hardie* [2003] NZFLR 481.

43 Ibid [30].

44 Ibid [28].

45 See the principles set out in *Sidhu v Van Dyke* [2014] HCA 19; *Donis & Ors v Donis* [2007] VSCA 89.

Arguably, these circumstances are better described as those where a discretionary object or beneficiary of a trust has either contributed to the trust property, or altered their position reliant upon expectations that the trustees will exercise their discretions to admit of future use of trust property, resulting in the court attempting to shoehorn the case into the rubric of the discretionary trust when a distribution of trust assets to the relevant beneficiary would be the appropriate exercise of the trustee's obligations.

Ultimately, the nature of the trustees' obligations makes this an unattractive 'trust busting' methodology. However, it serves to highlight the obligations nature of the trust, and the requirement that the trustees' obligations are carefully considered in any proceedings.

H *Legislative powers to alter rights of third parties*

In Australia, the provisions contained in Part VIIIAA of the *Family Law Act* allow for an order or injunction 'in relation to the property of' a spouse 'that is directed to, or alters the rights, liabilities or property interests of a third party.'[46] Not surprisingly the breadth of the provision has caused considerable difficulty in determining the extent to which property rights of third parties (which are constitutionally protected) can be altered.

In *B Pty Ltd v K*[47] the Full Court of the Family Court dismissed a claim by a wife for orders directing a trustee of a discretionary trust to make a capital distribution to the husband as beyond the scope of the provisions. The Full Court explained that the provisions may be used 'in the sense that altering interests may leave a bundle of rights or interests that are consequent upon the alteration, … but these "new" interests will be the residue of what already existed at law.'[48] However, the Court concluded that the 'order that the wife proposed was for the purpose of increasing the property of the parties' and therefore not permissible.[49]

More recently, the Full Court concluded that 'the Part can be used to require a trustee (including a third party trustee) to bring forward the vesting date of a trust fund for what can be termed, the "ancillary" purposes of valuing an irrevocable

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46 *Family Law Act 1975* (Aust), s.90AA.

47 *B Pty Ltd and Ors & K and Anor* [2008] FamCAFC 113 (31 July 2008).

48 Ibid [28].

49 Ibid [63].

entitlement to ultimately share in the trust fund, and of distributing that share to the party entitled.'[50] The difference in the certainty of entitlement (not quantum) appears to be the significant factor, with a potential to receive a distribution on the exercise of a trustee's discretion falling short of the requisite standard.

The Full Court decisions appear to rely upon a literal interpretation of trust deeds to determine which claims are sufficiently certain to admit of orders under Part VIIIAA. However, in many discretionary trust cases the underlying purpose of the trust is to hold assets for the use of one or both spouses, making the strength of their claims overwhelming in comparison to other potential discretionary objects or beneficiaries. This may lead to a requirement to determine the strength of beneficiaries' claims in the context of particular trusts in order to determine whether Part VIIIAA is engaged.[51] At this point, the findings arguably appear equivalent to determining the appropriate exercise of discretion.

However, the jurisprudence under Part VIIIAA has not developed far at all. This is not surprising given the high probability of a constitutional challenge when the powers are exercised in a significant way. Indeed, whether the legislation is sufficient to overcome even the *Ascot Investments*[52] problems remains unclear. Thus, on a practical level this presents another 'trust busting' option, but one that may not be very appealing for a practical litigator.

I *The 'powers analysis' of the Australian courts*

The most commonly used method to access assets held on discretionary trusts in Australia is based upon an analysis of the powers of the spouses to cause a distribution to be made to one or other of them. Whilst I have used the description 'powers analysis' this is by no means widely accepted as the appropriate descriptor for this approach.

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50 *AC and Ors & VC and Anor* [2013] FamCAFC 60, [85].

51 This problem of classification between mere expectations and property interests is similar to the problem of classifying contingent and vested interests, which Grbich convincingly argues is a charade that only states the outcome and not the reasons for which classification is adopted in a particular case: see Yuri Filip Rangmarie Grbich, 'Vesting: The Classification Charade' (1973) 9 *Melbourne University Law Review* 81.

52 *Ascot Investments Pty Ltd v Harper* [1981] HCA 1.

The availability of this approach was affirmed by the High Court of Australia in *Spry's Case*.[53] In essence, the approach is to identify whether the spouses have power to control the trustee's exercise of discretion. The simplest form of control is where a spouse is the trustee and one or both are potential beneficiaries. More extended forms of control have been found sufficient as the jurisprudence has developed: for example, where a spouse controls a company that is the corporate trustee. More complex, but still sufficient, is where a spouse is the appointor of the trustee and can therefore replace the trustee.[54] In these circumstances the Family Court has found that the trust assets are the property of the spouses. In *Spry's Case*, the trust assets were held to be property of the spouses where one spouse was the trustee and the other a potential beneficiary.

The significant extension of the powers analysis in the Australian cases gives the appearance that fiduciary duties have been ignored by the courts in the cases, a point made by Glover.[55] However, Glover identifies no specific fiduciary duties beyond the abstract claims. The lack of specific or particularised fiduciary duties likely flows from the fact that in the cases, the discretion has been very widely drawn, and the trust operated largely as a repository for the assets of the spouses. Aitken and Bryant describe the approach as 'heterodox' (one pejoratively and one positively),[56] in the general sense of a departure from existing norms, although the real justification for the heterodoxy claim may lie in the powers analysis being focused on powers, not trustee obligations.

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53 *Kennon v Spry* [2008] HCA 56.

54 For an example of this course see *In the Marriage of Davidson and Davidson* (1990) 14 Fam LR 817; *In the Marriage of Davidson and Davidson (No 2)* [1994] FamCA 33; *Thurlstane (Aust) Pty Ltd v Andco Nominees Pty Ltd* [1997] NSWSC 517.

55 John Glover, 'Discretionary Trusts, Fiduciary Duties and the Family Law Act: Has the Family Court Acted beyond Power?' (2000) 14(3) *Australian Journal of Family Law* 184.

56 Lee Aitken, '"Control", "Ownership" and the Beneficiary of the Discretionary Trust' (2008) 31(1) *Australian Bar Review* 128; Diana Bryant, 'Heterodox Is the New Orthodox – Discretionary Trusts and Family Law: A General Law Comparison' (2014) 20(7) *Trusts & Trustees* 654.

Although lack of legal control over the trustee is said to be insufficient,[57] on the horizon is the difficulty of cases where the trustee and appointor are mere puppets of a spouse who has no legal power to control or remove them. In *Romano v June*, the Court found de facto control was sufficient for the powers analysis.[58] Whilst the comments in *Romano v June* may be closer to judicial hubris than doctrinal development, there can be no doubt that there will be ongoing pressure to extend the powers analysis in this way as those drawing discretionary trusts take more nuanced steps to remove vestiges of control of trusts from spouses.

The powers analysis approach[59] effectively collapses corporate and trust structures, provided that a spouse has power to control the trustee either through control of a corporation or a power of appointment. Such a simplistically broad approach is too wide for cases where there appears to be a beneficiary with more than a nominal interest in the operation of the trust. French CJ, in *Spry's Case*, attempted to address this difficulty by limiting the operation of the doctrine to trusts that were not mixed purpose trusts and hold property that would be property of the parties but for the trust.[60] Gummow and Hayne JJ left this difficulty to the enforcement stage.

The Family Court has adopted an approach of considering whether another person has a 'real interest' in the trust.[61] Arguably, such limits reduce the ambit of the principles to cases where there are unlikely to be fiduciary duties owed to others that are more than purely theoretical, or at least do not result in others

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57 *Choate & Choate and Ors* [2009] FamCA 525, [173]. Similar reasoning has been adopted in other cases: *Keach & Keach* [2011] FamCA 192; *Sand & Sand* [2012] FamCAFC 179; *Searle (formerly Pencious) & Pencious and Anor* [2013] FamCA 375.

58 *Romano & June* [2013] FamCA 344.

59 Which is not limited to the family law cases: see *Richstar Enterprises Pty Ltd v Carey (No 6)* [2006] FCA 814; John Glover, 'A Challenge to Established Law on Discretionary Trusts? — Re Richstar Enterprises' (2007) 30 *Australian Bar Review* 70.

60 *Kennon v Spry* [2008] HCA 56, [54]. French CJ's limits bear some resemblance to the statutory scheme in British Columbia: see *Family Relations Act*, R.S.B.C. 1979, c. 121, s. 45.

61 *In the Marriage of Webster* [1998] FamCA 1517.

having more than a mere expectation that is unlikely to ever result in a distribution of trust assets. Although, as Peart identifies,[62] the interests of children (who are commonly potential beneficiaries) are often ignored, without real discussion.[63]

Ultimately, when the court is assessing the interests of others, the court must be making a determination of whether a distribution to the spouses is a proper exercise of the discretion of the trustee, lest orders be made in expectation of a fraud on a power be the trustee.

III HOW FAR CAN WE GO?

This brief review of the various methods employed for 'trust busting' admits of an underlying theme: the court making findings as to the proper execution of the trust, albeit in an indirect fashion. These approaches are used to avoid the narrow limits upon the circumstances where the court will review the exercise of a trustee's discretion.[64] That the methods have developed this far indicates that the reasons underpinning the traditional restrictive approach to reviewing a trustee's discretion are far from appropriate, at least in the context of spousal property proceedings.[65]

A *The court may direct the exercise of a discretion*

In *McPhail v Doulton*,[66] the power of the court to direct the exercise of a power was specifically acknowledged in the speech of Lord Wilberforce:

> … in the case of a trust power, if the trustees do not exercise it, the Court will ... I would venture to amplify this by saying that the Court, if called upon to execute the trust power, will do so in the

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62 Nicola Peart, 'Protecting Children's Interests in Relationship Property Proceedings' (2013) 13 *Otago Law Review* 26.

63 Grant T Riethmuller, 'The interests of non-spouses in discretionary trusts in family property cases' (2017) 30 *Australian Journal of Family Law* 1.

64 *Vatcher v Paull* [1914] UKPC 100; *Karger v Paul* [1982] VicRp 13; *Attorney-General (Cth) v Breckler* [1999] HCA 28.

65 Indeed the basis for the existing principles is far from satisfying in modern society.

66 *Re Baden (No 1) McPhail v Doulton* [1970] UKHL 1.

> manner best calculated to give effect to the settlor's or testator's intentions.

Later cases have continued to acknowledge this power.[67] Gardner observes, with respect to the potential flow-on effect of the decisions in pension cases:

> This adoption of discretionary trust remedies for fully fiduciary powers of appointment is of considerable doctrinal importance. *Ubi remedium, ibi jus*.[68] The idea of such powers involving duties to their objects no longer rests even partly on statements about these duties in the abstract: the new position on remedies means that they have now been given the most comprehensive available concrete form.[69]

However, the general reluctance of the court to intervene was acknowledged by Lord Wilberforce, who said in *McPhail v Doulton* that 'the Court will not normally compel its exercise.'

Thus, the court can enforce the execution of a trust, even if that involves exercising a discretion. The methods available to the court include executing the trust, which necessarily includes the court determining the appropriate exercise of the trustee's discretion.

B *Are the limits on the court interfering appropriate?*

In *A-G v Breckler*[70] the High Court summarised the grounds upon which a trustee's exercise of discretion can be reviewed by the court, saying:[71]

> Where a trustee exercises a discretion, it may be impugned on a number of different bases such as that it was exercised in bad faith, arbitrarily, capriciously (*Re Pauling's Settlement Trusts* [1964] Ch

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67 See, for example, *Mettoy Pensions v Evans* [1991] 2 All ER 513; *Re Courage Group's Pension Schemes* [1987] 1 All ER 528; *Schmidt v Rosewood Trust Ltd* [2003] UKPC 26.

68 'Where there is a right there is a remedy.'

69 Simon Gardner, 'Fiduciary Powers in Toytown' (1991) 107 *Law Quarterly Review* 214, 218.

70 *Attorney-General (Cth) v Breckler* [1999] HCA 28.

71 Ibid [7].

> 303 at p. 333), wantonly, irresponsibly (*Lutheran Church of Australia South Australian District Incorporated v Farmers' Co-Operative Executor and Trustees Ltd*. [1970] HCA 12; (1970) 121 CLR 628 at p.639), mischievously or irrelevantly to any sensible expectation of the settlor (*Re Manisty's Settlement* [1974] Ch 17), or without giving a real and genuine consideration to the exercise of the discretion (*Karger v Paul* [1984] VicRp 13; [1984] V.R. 161, which includes a survey of the authorities). The exercise of a discretion by trustees cannot of course be impugned upon the basis that their decision was unfair or unreasonable (see *Dundee General Hospital's Board of Management v Walker* [1952] 1 All ER 896) or unwise (*Gisborne v Gisborne* (1877) 2 App Cas 300 at p.307). Where a discretion is expressed to be absolute it may be that bad faith needs to be shown (*Gisborne v Gisborne* supra at p.305). The soundness of the exercise of a discretion can be examined where reasons have been given, but the test is not fairness or reasonableness (see *Re Londonderry's Settlement* [1965] Ch. 918 at pp 928-9; *Karger v Paul* at pp 165-6).[72]

This impressive array of tests highlights the unsatisfactory nature of the law in this area. Hardingham and Baxt[73] point to the 'multitude of expressions' used to attempt to define the court's discretion. As they identify, 'none of these generalisations is particularly helpful when it comes to determining whether a court will interfere in a particular case.' Hardingham and Baxt argue that the court will only intervene where the conduct of the trustee is so unreasonable 'that the trustee could not have been acting honestly for the benefit of the objects or could not have addressed his [or her] mind to the appropriate question.'[74]

The inadequacy of the law in this regard, at least with respect to family law cases, is further highlighted by the fact that *In re Crawshay (decd)*[75] was

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[72] It should be noted that this summary was provided by counsel to the trial judge and repeated in the High Court judgment on the basis that '[i]n this Court, the accuracy of that summary was not disputed': see *Clerical, Administrative & Related Employees Superannuation Pty Ltd v Bishop* [1997] FCA 714.

[73] Ian James Hardingham and Robert Baxt, *Discretionary Trusts* (2nd ed, 1984) 92.

[74] Ibid 108.

[75] *In re Crawshay (decd)* [1946] Ch 327.

effectively ignored by the Family Court of Australia in *Goodwin's Case*.[76] Whilst no substantive reasons were given, presumably the distinguishing feature in *Goodwin's Case*, (where it was considered that the husband could establish a company to overcome the prohibition in the trust against distributions to him) was that the underlying purpose of the trust as a whole (although not expressly stated in the instrument), was to hold the assets to the use of the husband and wife. Arguably, there would be no 'fraud on a power' if the purpose of the appointment was ultimately to benefit the family, not simply the named object.

C *The reasoning behind these limits*

The argument that the primary purpose of a discretionary trust is to benefit default beneficiaries as discussed above is obviously fatuous in the vast majority of modern discretionary trusts. The most common example in family law cases are family trusts where the primary purpose is to provide a safe harbour and tax minimisation arrangements to maximise the resources available to a family (in this regard most of the family law cases, including *Spry's Case*, are good examples).[77] Employee benefit trusts are implemented to provide an incentive to employees, and therefore the primary purpose must be that discretionary appointments be made from time to time, not the preservation of the assets for the residual beneficiaries. The most extreme examples are the 'black-hole trusts' where there is no intention that the residual beneficiaries ever receive a benefit.[78] More generally, as Perry argues, 'where the trust is designed to operate for a long period of time, it is unreasonable to assume that the settlor was primarily concerned to benefit the takers in default. If that was his [or her] intention, why would he [or she] force the takers in default to wait for so long to receive any benefit?'[79]

1 *Respecting the wishes of the settlor*

The trustee is chosen by the settlor and charged with the duty of administering the trust assets for the purposes determined by the settlor. It can be argued that by granting a wide discretion the settlor did not intend the exercise of the

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[76] *In the Marriage of Goodwin and Goodwin Alpe* [1990] FamCA 147.

[77] A more extreme example is *Re Gea Settlement* (1992) 13 TLI 188.

[78] Garton et al, above n 6, 268.

[79] Melissa Perry, *Supervision of the Trustee's Discretion to Distribute under a Discretionary Trust* (LLB (Hons) Thesis, University of Adelaide, 1984) 94.

discretion to be reviewable[80] and that settlors' wishes in this regard should be respected.[81] This argument is buttressed by the proposition that the settlor often has personal trust and confidence in the trustee.[82] Harris puts the proposition more formally, saying that 'the intention of the settlor as expressed in the trust instrument is the paramount local law for the trustees'.[83] It is an argument that is superficially attractive, but which fails to withstand scrutiny.

If the settlor was entirely content with the trustee's fidelity there would be no need to establish a trust – the property could be given to the trustee with a letter of wishes. The establishment of a discretionary trust ensures that there is a defined structure or 'local law' to limit the conduct of the trustee and ensure the trustee's fidelity. The very purpose of the court having power to review the discretionary determinations of the trustee is to ensure that the purpose of the trust is properly achieved, that is that the trustees comply with the 'local law' of the trust.

The argument fails entirely when the settlor (or a settlor of assets on the trust) is one of the beneficiaries or objects, or where a beneficiary or object has provided value for (or altered their position in reliance upon) their rights under the trust. Hence, in *Finch's Case* the High Court specifically distinguished cases where the beneficiaries are 'not volunteers or objects of bounty' but had contributed to the fund,[84] and found that important interests of beneficiaries were not adequately protected under the *Karger v Paul* principles.[85]

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80 Dimity Kingsford Smith, 'Who Knows Best? Review of Discretionary Powers in Superannuation Funds' (2000) 28 *Australian Business Law Review* 428, 435; citing *Re Londonderry's Settlement* [1965] Ch 918; *Karger v Paul* [1982] VicRp 13; *Hartigan Nominees Pty Ltd v Rydge* (1992) 29 NSWLR 405, 436.

81 *Re Beloved Wilkes's Charity* [1851] EngR 357; Derek Davies, 'Trust Administration: Secrecy and Responsibility' (1995) 7 *Bond Law Review* 2, 7.

82 *Finch v Telstra Super Pty Ltd* [2010] HCA 36, [59].

83 James W Harris, 'Trust, Power and Duty' (1971) 87 *Law Quarterly Review* 31, 62.

84 *Finch v Telstra Super Pty Ltd* [2010] HCA 36, [59].

85 Ibid [62]-[66].

2 *Respect for families*

An argument that is often relied upon is concern that review may embitter family feelings.[86] It is not surprising that secrecy may have been important to the dignity of the landed gentry of England, even at the time of the decision of *Re Londonderry's Settlement*,[87] yet it is difficult to see that such secrecy has a place in modern society. Such an approach is fundamentally at odds with the very purpose of the FLA which is to provide a remedy when family relationships (sometimes including the communitarian relationships of those involved in the trust)[88] irretrievably break down.

3 *Efficiency issues*

The primary efficiency issue is identified by Gardner[89] who notes that 'one explanation … lies in a desire to husband judicial resources.' On a policy level Gardner explains that:

> One might see a judge as an inescapably public functionary, but regard trust discretions as essentially private, so that his or her proactive involvement in them would be inappropriate from both points of view. However, that model may be too simple. It may be right to see family trusts as quite private in this way, but for example charities and pension funds have a strong public dimension. [90]

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86 Kingsford Smith, above n 65, 435–6; *Re Londonderry's Settlement* [1965] Ch 918, 937; *Hartigan Nominees Pty Ltd v Rydge* (1992) 29 NSWLR 405, 418; Alec Samuels, 'Disclosure of Trust Documents' (1965) 28 *The Modern Law Review* 220, 223.

87 *Re Londonderry's Settlement* [1965] Ch 918.

88 In cases where the spouse is a shareholder of a corporate trustee, remedies are available as an incident of a 'just and equitable' winding-up of the trustee company: See *Vigliaroni & Ors v CPS Investment Holdings Pty Ltd & Ors* [2009] VSC 428; Michael May, 'Oppression in the Context of Corporate Trustees' (2013) 87 *Australian Law Journal* 271.

89 Gardner, above n 69.

90 Ibid 218.

Gardner's identification of the weakness of the argument with respect to charities and pension funds can easily be taken further to family trusts when considering family discretionary trusts in the midst of family property settlement disputes. In such cases the courts are already dealing with quintessentially private issues when making family property settlement orders. On a broader level, the courts have already taken on the role of ensuring the due administration of trusts.

Interestingly, in many of the cases a detailed review of the relevant facts and circumstances has ultimately been necessary in order to determine whether there has been a fraud on the power. The judgments demonstrate that the litigation has not been more efficient. The judgments also allow the reader to form a view as to whether the trustee's decision was likely to be overturned as being unreasonable or unconscionable. In few cases could it be said that the applicant was likely to succeed on a merits based review of the trustee's discretion.[91] In some cases the court has nonetheless confirmed the reasonableness of the trustee's decision as an alternative finding in the judgment.[92]

4 *Discouraging people from accepting roles as trustees*

It has been argued that any retreat from the 'rule' may result in difficulty in obtaining trustees,[93] and that in the end discretionary trusts could become unworkable if the trustees' decisions were easily reviewable. This argument fails to reflect the modern condition where the trustees of discretionary trusts are rarely a family friend, but most commonly a company controlled by the main contributor to the trust corpus, or a professional such as an accountant. As Samuels[94] argues:

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91 For example, see *Re Beloved Wilkes's Charity* [1851] EngR 357; *Gisborne v Gisborne* (1877) 2 App. Cas. 300; *In Re Bryant* [1894] 1 Ch 324; *Re Steed's Will Trusts* [1960] Ch 407; *Craig v National Trustees Executors and Agency Company of Australasia Ltd* [1920] VLR 569; *Karger v Paul* [1982] VicRp 13. The significant exception is *Tabor v Brooks* (1878) 10 ChD 273.

92 For example *In Re Bryant* [1894] 1 Ch 324.

93 *Finch v Telstra Super Pty Ltd* [2010] HCA 36, [59]; Kingsford Smith, above n 65, 436; *Re Londonderry's Settlement* [1965] Ch 918, 937; cf *Hartigan Nominees Pty Ltd v Rydge* (1992) 29 NSWLR 405, 419 per Kirby J.

94 Alec Samuels, 'Disclosure of Trust Documents' (1965) 28 *The Modern Law Review* 220, 222.

> Trustees are no longer retired country gentlemen, giving their services to the family gratuitously as an act of friendship, who would refuse to take on or to continue the office if they were placed under this obligation. Nowadays they are usually professional people, paid for their services, who are accustomed to justifying their conduct.

Even if the trustee is not a professional, or controlled by one, the realities of modern life with respect to taxation returns and annual reports for companies inevitably lead to trustees regularly relying upon advisors to comply with the various regulatory requirements. Arguably the most common reason for the establishment of a family discretionary trust is a recommendation of an accountant to assist in minimising liability for tax.

D *Conclusions*

It is argued that the jurisprudence will ultimately lead to a more effective answer: an acknowledgement that in circumstances where separated spouses have relied upon or contributed to assets held on a discretionary trust, the court should consider exercising the power to determine, and if necessary direct, the appropriate exercise of the dispositive power of the trustee.[95] Such an approach avoids the need to bring cases within one of a thicket of technical categories, and would ensure that a central focus of the proceedings is a consideration of the appropriate application of trust assets in accordance with the trustee's obligations under the trust instrument.

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[95] The court has power to direct a trustee in the exercise of dispositive discretions, at least in some circumstances: see *Re Baden (No 1) McPhail v Doulton* [1970] UKHL 1.