

Constructive trust claims against express trusts

*Marshall v Bourneville*¹ is notable for the Court of Appeal's consideration as to whether a constructive trust claim may lie against the assets of an express trust.

The claim involved property transactions occurring within the context of a de facto relationship². When Ms M and Mr B began their relationship they each owned a house. M sold her house and combined the proceeds with B's funds to purchase a property together (**Property X**). Some of this property was put into B's sole name and on sold. The proceeds from that sale were used to purchase a property that was ultimately put into B's family trust.

M's claim relied on the fact her funds were used to buy Property X the value of which, after various property transactions, wended its way into B's family trust.

The Court of Appeal began its legal analysis by citing the requirements of a constructive trust claim from *Lankow v Rose*³ namely that the claiming party must show:

- (a) Contributions, direct or indirect, to the property in question.
- (b) The expectation of an interest in the property.
- (c) That such expectation is a reasonable one.
- (d) That the defendant should reasonably expect to yield to the claimant an interest.

Stripping away the complexities, the Court of Appeal observed that the parties made approximately equal capital contributions at the commencement of their de facto relationship. And by their joint endeavours had accumulated substantial assets. Yet, by reason of the series of transactions beginning with the transfer to B of M's interest in Property X, the lion's share of the parties' wealth ended up in B's trust. The Court concluded that it seems unlikely that this outcome represented the reasonable expectations of the parties.

This gave rise to the key question – did the transfer to M's trust provide an insuperable barrier to M's claim. Despite cases suggesting so, the Court observed that there was no New Zealand case where a court has declined to grant relief against assets owned by a trust in which an expectation of an interest had been demonstrated⁴.

¹ [2013] NZCA 271 (1 July 2013)

² The Property (Relationships) Act 1976 did not apply because the transactions in question occurred before the Act was extended to de facto relationships.

³ [1995] 1 NZLR 277 (CA)

⁴ Judgment [34]. On the other hand there are several High Court cases where such relief has been granted against an express trust; see *Prime v Hardie* [2003] NZFLR 481, *Rea v Rea* (2004) 23 FRNZ 449 and *Clark v Clark* [2012] NZHC 3159.

The Court saw no reason why relief by way of constructive trust should not be ordered against trust property⁵. As B was the settlor and a trustee of his trust, the court considered it obvious that he had knowledge of the circumstances giving rise to any expectation M may have. It is noteworthy that the Court did not mention what if any 'knowledge' B's co-trustee needed to have. This issue is addressed later in this article.

The next Court of Appeal judgment to address a constructive claim against an express trust is *Murrell v Hamilton*⁶. This involved a de facto relationship between Ms M and Mr H who together developed land owned by H's family trust. Here the Court simply accepted that a constructive trust claim could succeed against property owned in an express trust⁷.

Again, *Lankow's* 4 requirements were cited:

- [a] Contributions, direct or indirect, to the property in question;
- [b] The expectation of an interest therein;
- [c] That such expectation is a reasonable one; and
- [d] That a defendant should reasonably expect to yield the interest.

Pausing to consider [a], the Court of Appeal in *Horsfield v Giltrap*⁸ held that the efforts of one partner in running a household, effectively as a housekeeper and looking after the home and children, constituted an indirect contribution towards the other partner's creation of property sufficient to yield a proprietary interest in that property. *Horsfield* provides a powerful example of how the expectation based constructive trust can provide relief in the context of a personal relationship.

This article does not explore the nature of M's contributions and how they qualified for relief. Instead, focus is directed to the requirements in [b], [c] and [d] in the context of a trust or, more specifically, whether M could reasonably expect an interest to be yielded by H's trust and whether, in turn, the trustees should be reasonably expected to yield such an interest. This involves closer consideration of the facts.

H's co-trustee was a professional trustee who was held by the Court to have abjured his trustee responsibilities in favour of H. He did this by leaving everything to do with the development of the trust property to H and simply signing off on H's decisions implicitly accepting that the trust would be liable for the expenses and liabilities he incurred⁹.

In short, H's actions were treated as the actions of both trustees, or at least as actions binding on both trustees vis-a-vis the contract counterparties¹⁰. In law, H's actions breached both the non-delegation and unanimity rules. That is, the rules whereby trustees must exercise their trustee powers personally and cannot delegate them to another, even to their

⁵ Judgment [39]

⁶ [2014] NZCA 377

⁷ Judgment para [22] which affirms the position stated in *Marshall v Bourneville*

⁸ (2001) 20 FRNZ 404 (COA)

⁹ Judgment para.s [27] and [28]

¹⁰ There is a similar factual situation in *Lang v Southen* (24 July 2001, HC Chch, per Panckhurst J, AP15/01) where 'active' trustee entered a contract without co-trustee consent or knowledge, yet the creditor successfully enforced the contract against the co-trustee.

co-trustee¹¹. And that they must decide on the exercise of their powers unanimously¹². As an aside, such breaches may be curable by subsequent co-trustee consent¹³.

The Court of Appeal made no reference to the unanimity or non-delegation rules however, instead it simply held that because of the way the trustees' proceeded in the development, it would be unconscionable for them to deny M's claim. The Court held that when H stimulated M's expectation of an interest in the trust property, both trustees must be taken to have done so¹⁴.

The effect of the Judgment would seem to be that although:

- The professional trustee cannot delegate his powers to H; and
- H cannot unilaterally exercise his trustee powers to affect the trust property;

H may nevertheless bind the professional trustee in stimulating M's 'reasonable' expectation of an interest in the trust's property.

Underscoring the nature of the constructive trust interest, the Court emphasised that M's claim did not alienate trust property, that is, it did not take away something to which the beneficiaries were entitled¹⁵. It follows presumably that H's actions should not be taken as constituting an exercise of a trustee power which affects trust property, nor the incurring of an expense or liability as against trust property. Perhaps this obviated consideration of the non-delegation and unanimity rules.

But what if H had made it clear to M that she should not and could not expect an interest in the property? Then any contrary expectation she may have had ought to be rendered unreasonable¹⁶. And if that was the case, M's contributions could not have resulted in an interest in the property, with the effect that all the developed property would benefit the beneficiaries. Put this way, there was an arguable alienation of trust property which occurred when H failed to disabuse M of her expectation of an interest in the property.

The professional trustee apparently believed H was developing the trust property for the trust. The professional trustee therefore neither consented nor knew that H was stimulating M's expectations of an interest in the development. Presumably, if he had been aware of the possibility that M might claim an interest, he would have taken steps to avoid or preclude the claim before it became too late to do so.

¹¹ *Commissioner of Inland Revenue v Newmarket Trustees Limited* [2012] NZCA 351, para 51. *Niak v MacDonald* [2001] 3 NZLR 334, para.s [16] and [18] line 20. There are exceptions notably in s.31 of the Trust Act or the terms of trust.

¹² *Phipps v Boardman* [1965] 1 All ER 849, 855, *Luke v South Kensington Hotel Company* [1879] 11 Ch D 121, 125 and *Lewin on Trusts*, 16th ed, page 181. Again, the position may be modified by the terms of trust.

¹³ *Visini v Cadman* [2012] NZCA 122, paragraph 17

¹⁴ Judgment para [29]

¹⁵ Judgment para [30]

¹⁶ In *Gillies Cooke P* at page 334 accepted that that a legal owner can protect their position by making it clear to the other party that, while the use of the property is shared, ownership is not. The principle of freedom to stipulate against any trust or obligation is consistent with all the theories. And a party cannot normally be said to act unconscionably if there is no objectively reasonable expectation of other action. Nor will any enrichment be unjust. Again, there is juristic reason for it in that the other party has simply exercised their freedom to dispose of resources for purposes not giving rise to a property interest or money claim.

Clearly, the professional trustees' expectations as to the legal effect of his trustee decisions and consents in respect to the development were thwarted by the unilateral actions of his co-trustee at the direct expense of the beneficiaries. These outcomes do not appear to sit comfortably with the rules on delegation and unanimity.

The effect of the judgment is that by dint of the history of subsequent consent of H's unilateral decisions in the development, the professional trustee has, in effect, clothed H with an actual, apparent or ostensible authority to stimulate M's reasonable expectations, and by so doing, convey a proprietary interest in property that, save for such stimulation, would have been trust property.

Of course, agency concepts are inappropriate, since H cannot act as the professional trustee's agent – that would offend the non-delegation rule. Additionally, there was no finding that M relied on any 'holding out' by the professional trustee of H, such that H may have been seen to have had authority to 'stimulate' M's expectations.

One must reflect on the fact that the Court was exercising its equitable jurisdiction in deciding the claim. At the heart of M's claim is an unjust enrichment of the trust's estate at M's expense coupled with unconscionability by the defendants who sought to deny M an interest for the enrichment she supplied.

As Tipping J stated in *Lankow*, the Court stands as a defendant's conscience in such claims¹⁷. That a defendant did not expect to have to yield an interest is no bar to a claim if they should reasonably expect to yield one. This is precisely when equity intervenes.

In the writer's view, it was necessary on some basis to impute to the professional trustee H's knowing acceptance of M's contributions and generation of the expectation interest otherwise it is difficult to see the legal basis upon which that trustee should yield an interest. The legal basis for such imputation is not explained in the Judgment, perhaps it was simply the Court exercising its equitable jurisdiction as the 'conscience of the defendants'.

At a practical level, the writer doubts that the result would have been different even if H had dutifully taken every decision in respect to the development back to the professional trustee for antecedent consent. The reality of the situation was that H and M were living in the home being developed. H supplied building services and M's supplied other valuable direct and indirect assistance. Realistically, a professional trustee would rarely have insight into these day-to-day circumstances. The Court's determination that when H's stimulated M's expectation of an interest in the trust property he did so for both trustees could well have been irresistible.

If these observations are sound, then the professional trustee in *Murrell* would most likely have been obliged to yield an interest in the trust property whether or not he had abjured his trustee responsibilities in favour of H.

The Court of Appeal considered the facts in *Murrell* to be unusual¹⁸ and peculiar¹⁹. The writer is not so sure. Given the wide judicial view of what constitutes as a qualifying indirect

¹⁷ [1995] 1 NZLR 277 at 294

¹⁸ Judgment para [28]

¹⁹ Judgment para [31]

contribution, the factual situation whereby one spouse may have a valid expectation based claim against trust property where their partner-in-life is a trustee may be relatively common.

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