

What is the real impact of *Clayton v Clayton*?

LARNA JENSEN-McCLOY

THERE ARE TWO SUPREME COURT DECISIONS in *Clayton v Clayton*. The first, which is considered in this article, relates to the Vaughan Road Property Trust (VRPT) and a claim under the Property (Relationships) Act 1976 (PRA).¹ The second decision will be considered in the next issue and relates to the Claymark Trust and a claim under s182 of the Family Proceedings Act 1980.²

The facts

Mr and Mrs Clayton commenced a de-facto relationship in 1986 and married in 1989. They separated in 2006 after 17 years of marriage. The marriage was then dissolved by Order of the Court in 2009. The Claytons have two daughters to their relationship.

Shortly before their marriage Mr and Mrs Clayton signed a s21 Agreement, contracting out of the provisions of the then

States, was a multi-million dollar enterprise.

The VRPT was one of the various trusts involved in the proceedings between the parties. The VRPT was settled during the parties' relationship, on 14 June 1999. Mr Clayton was the settlor and sole trustee of VRPT. Mr Clayton also held the sole power of appointment. The discretionary beneficiaries included Mr Clayton as the "principal family member", Mrs Clayton as his wife (or former wife) and their two daughters. The daughters were also the final beneficiaries.

The claims

Following the parties' separation, Mr Clayton claimed Mrs Clayton was only entitled to share in the family home worth \$850,000.00 and the parties' chattels, and that she was not entitled to any property or interest in the trust or business.

Mrs Clayton initially claimed that the trusts (including the VRPT) were sham or an illusory trusts owing to Mr Clayton's ultimate ownership or control of all of the assets. In the alternative Mrs Clayton claimed she was entitled to compensation under s44C of the PRA.

The Family Court decision

Judge Munro set aside the s21 Agreement pursuant to s21J of the PRA. Judge Munro held the VRPT was an illusory trust and that the assets of the VRPT (excluding the two of the blocks of land that were Mr Clayton's separate property) were relationship property. The value of the property was based on the registered valuation as at 31 March 2011, being the agreed date of valuation.³

The High Court decision

The High Court upheld Judge Munro's decision to set aside the s21 Agreement. Rodney Hansen J rejected the claim the VRPT was a sham but upheld the finding of an illusory trust, though for differing reasons to those of Judge Munro.⁴

Court of Appeal

When the case went before the Court of Appeal,⁵ the Court of Appeal posed two questions (in addition to the points of appeal as raised by the parties and the Trustees of the VRPT). The questions were:

- a. whether Mr Clayton's general Power of Appointment under clause 7.1 of the VRPT Deed itself constituted relationship property under the PRA; and
- b. in the event the Court of Appeal found the VRPT was not a sham or illusory trust, whether Mrs Clayton might be entitled to compensation under s44C of the PRA in relation to the disposition of relationship property made to the VRPT.

The Court of Appeal overturned the finding of an illusory trust.

After considering the Privy Council decision in *Tasaruf Mevduati Sigorta Fonu v Merrill Lynch Bank and Trust Co.(Cayman) Ltd (TMSF)*⁶ the Court of Appeal upheld Mrs Clayton's claim that the power of appointment held by Mr Clayton as "principal family member" under the VRPT trust Deed was relationship property. It held that the value of that relationship property was equivalent to the net value of the assets of the VRPT.

In *TMSF* the issue before the Privy Council was whether the general power of revocation held by Mr Demirel was a property right that Mr Demirel could be required to delegate to the receivers in his bankruptcy. This would allow the receivers to exercise the power to obtain access to the assets of two discretionary trusts, for the benefit of Mr Demirel's creditors. Lord Collins of Mapsbury delivered the advice of the Privy Council and concluded⁷:

"The powers of revocation are such that in equity, in the circumstances of a case such as this, Mr Demirel can be regarded as having rights tantamount to ownership... In the present case the power of revocation cannot be regarded in any sense as a fiduciary power...the only discretion which Mr Demirel has is whether to execute the power in his own favour. He owes no fiduciary duties. As has been explained, the powers of revocation are tantamount to ownership."

In applying *TMSF*, the Court of Appeal

“Mr Clayton's powers and entitlements gave [him] such a degree of control over the assets of the VRPT that it was appropriate to classify those powers as "rights or interests" in terms of section 2(e) of the PRA.

Matrimonial Property Act 1976.

When Mr and Mrs Clayton met, Mr Clayton owned a small timber supply business, which owned two blocks of land in Vaughan Road, Rotorua. Mr Clayton also owned a block of land near Rotorua which the parties later built their family home on. At the date of separation Mr Clayton's business (the Claymark business), which was owned and controlled by companies and trusts in New Zealand and the United

concluded:

1. Where the donee of a power is entitled to appoint the subject matter of the power to himself or herself without regard to the interests of others, it was appropriate to regard the donee as the effective owner of the property.
2. There was no practical distinction between the power to revoke the trust subject to the decision in *TMSF* and Mr Clayton's power to appoint himself as the sole beneficiary of VRPT. If Mr Clayton had exercised the power he would effectively have revoked the trust.
3. The power under clause 7.1 was conferred by Mr Clayton as settlor on himself in his capacity as "principal family member" and not in his capacity as a trustee. The principal family member had no fiduciary duty to the beneficiaries. It would be wrong to interpret the VRPT Deed as if the power was a trustee power.
4. The doctrine of fraud on a power would not apply and the Court would not be able to constrain Mr Clayton from exercising the general power of appointment under clause 7.1 if he wished to do so.

The Supreme Court decision

The Supreme Court agreed with the Court of Appeal in that, if Mr Clayton had a non-fiduciary power as principal family member and was able to make himself the sole beneficiary of the VRPT, the effect of the exercise of the power would be analogous to a power of revocation as in *TMSF*.

However, the Supreme Court disagreed with the Court of Appeal's finding that Mr Clayton's power of appointment alone under clause 7.1 of the VRPT Deed gave Mr Clayton the unfettered right to remove the discretionary beneficiaries and final beneficiaries of the trust.

The Supreme Court found there was a

distinction between *TMSF* and Mr Clayton's powers under clause 7.1 of the VRPT. The Supreme Court held Mr Clayton continued to owe fiduciary duties to the final beneficiaries, and the removal of the final beneficiaries as discretionary beneficiaries did not mean they ceased to be final beneficiaries, given the construction of the VRPT Deed.

Consideration of the powers held by Mr Clayton

The Supreme Court considered Mr Clayton's powers and entitlements as "principal family member", trustee and discretionary beneficiary. It held that this gave Mr Clayton such a degree of control over the assets of the VRPT that it was appropriate to classify those powers as "rights or interests" in terms of section 2(e) of the PRA.

The Supreme Court acknowledged the following factors had contextual significance in reaching the above finding:

- a. Mr Clayton was the settlor;
- b. he was the sole trustee;
- c. he was the principal family member;
- d. he had the power to appoint discretionary beneficiaries and trustees;
- e. he could transfer the power of appointment of trustees to another person;
- f. he had the power to change any provision relating to the management and administration of the VRPT; and
- g. there was a provision requiring the VRPT Deed to be interpreted in a manner which broadened the powers and restricted the liability of Mr Clayton as trustee.

There were however three particular provisions the Court of Appeal considered decisive. The specific provisions in the VRPT Deed included:⁸

1. distribution of capital before the vesting day;

2. distribution on the vesting day; and
3. re-settlement of the trust fund.

The Supreme Court held that those provisions:

"made it possible for Mr Clayton, even if he has not exercised the power conferred on him as Principal Family Member by clause 7.1, to resolve as Trustee to apply the Trust capital and income to himself (to the exclusion of the Final Beneficiaries and the remaining Discretionary Beneficiaries). He could do this without considering the interests of the other Discretionary Beneficiaries (if any) or those of the Final Beneficiaries, even if it meant all the Trust capital and income was distributed to him to the exclusion of the other Beneficiaries. The position of the Final Beneficiaries is contingent on the Trust capital not being distributed before the Vesting Day. The fact that the Decision involved conflict between his personal interest and the interests of other Beneficiaries would not matter".⁹

"These provisions mean that Mr Clayton is not constrained by any fiduciary duty when exercising the VRPT powers in his own favour to the detriment of the Final Beneficiaries. The fact that he cannot remove the Final Beneficiaries does not alter the fact that he can, unrestrained by fiduciary obligations, exercise the VRPT powers to appoint the whole of the trust property to himself".¹⁰

The effect of the powers held by Mr Clayton

The Supreme Court concluded the practical

Continued on next page...



It's the **cloud based conveyancing software** that's got everyone talking

conveyit Maestro is an automated cloud based conveyancing system designed by New Zealand Lawyers for New Zealand Lawyers, Professionals and Conveyancers



www.conveyit.co.nz



0508 33 22 88



Photo by Ben Harrington ©iStock

effect of the provisions when considered together, meant Mr Clayton, as trustee of the VRPT, could appoint all of the assets of the VRPT to himself, whether or not he had already exercised his power as principal family member under clause 7.1 to remove all other discretionary beneficiaries. He could also appoint the assets of the VRPT to anyone else of his choosing by first utilising clause 7.1 to appoint a new discretionary beneficiary and then, exercising his power as trustee, appoint the property of the VRPT to the new discretionary beneficiary, without recourse and without being constrained by the usual fiduciary obligations that exist.¹⁴

The Supreme Court referred to *Lewin on Trusts* where it was suggested the “distinctive feature of a general power is that the donee is free to appoint to himself without considering the interests of anyone else”.¹² As was made clear in *TMSF*, a general power of appointment is usually viewed as tantamount to ownership and can be treated as property for particular purposes.

The Supreme Court concluded there was no effective constraint on the exercise of powers in favour of Mr Clayton and that the combination of powers and entitlements Mr Clayton held as principal family member, trustee and discretionary beneficiary of the VRPT amounted in effect to a general power of appointment in relation to the assets of the trust.

Were Mr Clayton’s powers over the VRPT “property”?

The Supreme Court referred to the Austral-

ian decision *Kennon v Spry*¹³ as authority for the proposition that the definition of property must be interpreted in the context of relationship property legislation.

Reference was also made to various British cases and a case determined in Hong Kong. While the distinct statutory context of those jurisdictions was acknowledged, the Supreme Court found the cases nonetheless “illustrate the need for “worldly realism” in this context and also acceptance that strict concepts of property law may not be appropriate in a relationship property context”.¹⁴

Taking account of the statutory context of the PRA, the Supreme Court concluded the VRPT powers were properly classified as “rights” that gave Mr Clayton an “interest” in the VRPT and its assets pursuant to section 2(e) of the PRA.¹⁵

The Supreme Court accepted the submission by counsel for Mr Clayton that Parliament did not intend the Court to have a “trust-busting” power. The Supreme Court however noted “a finding that rights and powers associated with a trust or the assets held on trust as being relationship property, did not of itself lead to an order requiring capital of the trust to be paid to a spouse. Rather, it meant the size and pool of the assets subject to the default equal sharing regime in the PRA is greater than it otherwise would be”.¹⁶

Was the property “relationship property”?

The Supreme Court noted the VRPT was formed and the powers were acquired by Mr Clayton during the relationship and as

such, was relationship property as defined in Section 8(1)(e) of the PRA.¹⁷

Valuation of the VRPT powers

The Supreme Court treated the VRPT powers as having a value equal to the net value of the assets of the trust and suggested that was consistent with the approach to general powers of appointment.

Sham trust or illusory trust?

Mrs Clayton claimed the VRPT was a sham and if not, it was an illusory trust. Both the Family and High Courts rejected the claim the VRPT was a sham trust.

However both the Family and High Court determined the VRPT was an illusory trust, albeit for different reasons. This was subsequently overturned in the Court of Appeal where it was suggested the terms “sham trust” and “illusory trust” are synonymous and that their legal definitions overlap.

The Court of Appeal suggested both sham and illusory trusts hinge on the settlor’s intention to create a trust that was valid and enforceable. Once the Court accepts a valid trust has been established, it should not be able to be treated as non-existent for the reason that the trustee has wide powers of control over the trust’s property. In short, “[T]here is either a valid trust or there is not”.¹⁸

The Supreme Court referred to the decision of *Ben Nevis Forestry Ventures Ltd v Commission of Inland Revenue*¹⁹, where it was suggested a “sham is a pretence: a document that does not evidence the true common intention of the parties”. The Supreme Court held that the application of

the *Ben Nevis* test here required the Court to determine whether the intention of Mr Clayton as a settlor and trustee was to create a trust when he entered into the VRPT Deed and settled the Vaughn Road properties on the trust.

The Court of Appeal found Mr Clayton had genuinely intended to create a valid and enforceable trust when he entered into the VRPT Deed. It was noted that this finding was consistent with the findings in the Family and High Courts.²⁰

The Supreme Court rejected the allegation that Mr Clayton's reliance on his advisors in relation to the VRPT and his lack of knowledge of the legal ramifications of the trust structure and the terms of the trust Deed, led to a conclusion that the VRPT Deed was a sham.

To answer the question of whether the VRPT was an illusory trust, the Supreme Court suggested that the attributes of the VRPT Deed led them to conclude that Mr Clayton's powers as settlor, principal family member and trustee were effectively a general power of appointment. These were the same attributes that led the High Court Judge to conclude the VRPT was an illusory trust.

Summary and the implications of *Clayton v Clayton*

Under the doctrine of "Bundle of Rights", powers which can be considered "property" include powers such as directorship of a trustee company, shares in a trustee company, the power of appointment to add or remove trustees, or the power of appointment to add or remove beneficiaries and a party's discretionary interests in a trust.²¹

Following the inception of the doctrine (which has existed for over a decade now), property lawyers have understandably been anxious to see how the doctrine would be applied in practice. It appears the doctrine has not gained the traction that was anticipated and possibly feared. This may in part be due to the difficulties experienced in valuing an intangible bundle of rights.

In the present case, Mr Clayton's power of appointment under clause 7.1 of the VRPT was the subject of the Appeal to the Supreme Court.

The Court of Appeal interpreted Mr Clayton's power to appoint and remove

beneficiaries under clause 7.1 of the VRPT Deed as principal family member, as by itself, one that enabled Mr Clayton to remove all of the beneficiaries (including the final beneficiaries). He could also bring the VRPT to an end without regard to the beneficiaries' interests, as he was not bound by any fiduciary obligations in exercising the power.

Based on that interpretation, the Court of Appeal held Mr Clayton's power of appointment under clause 7.1 was akin to the power of revocation. In applying TMSF the Court of Appeal concluded Mr Clayton's power was a general power of appointment and was relationship property for the purposes of the PRA. It therefore had a value equal to the value of the assets held by VRPT.

While the VRPT Deed is unusual, there has been concern arising from the Court of Appeal decision that the judgment went a step too far and could have wide and potentially unintended consequences.

The Supreme Court decision makes it clear a power such as that held by Mr Clayton under clause 7.1 of the VRPT Deed will not by itself constitute 'property' for the purposes of the PRA. Where there are various powers that when read together give a person wide and unfettered powers, it is appropriate to consider those as a general power of appointment (tantamount to ownership), and the assets held by the trust may be considered property for the purposes of the PRA. Where that property is found to be relationship property, the value to be applied to the powers will be equal to the value of the assets held.

In practical terms the real effect of this decision may be in relation to valuation matters. The Supreme Court decision is authority for the proposition that, where powers meet the threshold of property under the PRA, there is no longer a need for some form of complex or irresolute valuation, as the value will be determined based on the value of the assets held by the trust.

Given the finding of the High Court and comments in the Supreme Court in relation to sham or illusory trusts, there may also be a greater focus on the extent and interrelationship of the powers held by a trustee or non-trustee. This may result in a decline in the number of sham or illusory trust claims, and a greater number

of claims concerning a party's "bundle of rights", in order to bring the value of the assets of a trust into a pool for division under the PRA.

It must of course not be overlooked that the VRPT Deed is unusual and the threshold for a finding of relationship property has been set high as a result of the facts of this case.

The legal landscape in which we practice is ever-changing. Practitioners must consider each client's situation and needs. It is important to understand the interrelationship and effect of the provisions in a trust Deed, especially when read together. This is required to ensure the trust reflects the client's intentions; that it is a valid trust, and that the trust will be enduring (in perpetuity).



Larna Jensen-McCloy is an Associate at Webb Farry in Dunedin.

1. Clayton v Clayton (as trustee of the Vaughan Road Property Trust) [2016] NZSC 29
1. Clayton v Clayton [2016] NZSC 30 [The Claymark Trust Judgment]
2. Mac v Mac FC Rotorua FAM-2007-063-652, 2 December 2011 (Judge Munro) [Clayton (FC)].
3. Clayton v Clayton [2013] NZHC 301; [2013] 3 NZLR 236 (RODNEY Hansen J [Clayton (HC)].
4. Clayton v Clayton [2015] NZCA 30; [2015] 3 NZLR 293 (Ellen France, Randerson and White JJ) [Clayton (CA)] at [99].
5. Tasaruf Mevduati Sigorta Fonu v Merrill Lynch Bank and Trust Co.(Cayman) Ltd (TMSF) [2011] UKPC 17; [2012] 1 WLR 1721
6. TMSF above n 6 at [59] and [62].
7. Clayton (SC), above n 1, in the Appendix which sets out the relevant provisions of the VRPT Deed
8. Clayton (SC), above n 1, at [57]
9. Clayton (SC), above n 1, at [58]
10. Clayton (SC), above n 1, at [62]
11. Clayton (SC), above n 1, at [60]
12. Kennon v Spry [2008] HCA 56; (2008) 238 CLR 366 (Australia)
13. Clayton (SC), above n 1, at [74 and 79]
14. Clayton (SC), above n 1, at [80]
15. Clayton (SC), above n 1, at [84]
16. Clayton (SC), above n 1, at [86]
17. Clayton v Clayton above n4 at [122]
18. Ben Nevis Forestry Ventures Ltd v Commission of Inland Revenue [2008] NZSC 115; [2009] 2 NZLR 289 at [33] per Tipping McGrath and Gault JJ
19. Clayton v Clayton above n3 at [111]
20. Walker v Walker [2007] NZCA 30