Estates, Trusts & Pensions Journal

Volume 35, No. 4 **August 2016**

FROM THE LAW REPORTS

Clayton v. Clayton in the New Zealand Supreme Court: It's Hard to Keep a Good Court Down

In an earlier edition of this journal[1] I commented on the decision of the New Zealand Court of Appeal ("N.Z. C.A.") in *Clayton v. Clayton*.[2] At the time I wrote my comment, the parties had argued an appeal to the New Zealand Supreme Court ("N.Z. S.C.") and the N.Z. S.C. had reserved its decision.[3] But then the parties settled their case, so I assumed that the N.Z. S.C. would not issue a decision. I was wrong. On March 23, 2016, the N.Z. S.C. issued decisions in two parallel cases: *Mark Clayton, Personally and as Trustee of the Vaughan Road Property Trust (the "VRPT") v. Melanie Clayon*,[4] and *Melanie Clayton v. Mark Clayton Personally and Mark Clayton and Bryan Chesire as Trustees of the Claymark Trust*.[5] This comment will discuss only the first case, as the second deals with family law issues and not trust issues *per se*.

1. Facts

I will assume the reader has read my earlier comment, but briefly, the facts are these: Mr. and Mrs. Clayton married when he was just starting a timber business. She signed a marriage agreement that opted out of the *Property (Relationships) Act 1976* (NZ) (the "PRA"),[6] which at that time was called the

1. Joel Nitikman, "Sham, Illusion and All that Jazz: A Case Comment on *Clayton v. Clayton*" (2016), 35 E.T.P.J. 146.
2. [2015] NZCA 30, [2015] 3 N.Z.L.R. 293 (New Zealand C.A.).
3. *Clayton v. Clayton*, [2015] NZSC 84 (New Zealand S.C.).
4. [2016] NZSC 29 (New Zealand S.C.).
5. [2016] NZSC 30 (New Zealand S.C.).
6. 1976 No. 166.

Matrimonial Property Act 1976. The marriage agreement provided that in case of a divorce she was to receive $NZ 10,000 per year of marriage to a maximum of $NZ 30,000.

Many years later the timber business was a large, valuable conglomerate, owned and controlled by companies and trusts in New Zealand and the United States, including the VRPT and the Claymark Trust. The VRPT owned land and buildings in New Zealand from which the Claymark business was operated.

When the Claytons separated, Mrs. Clayton applied successfully to the Family Court to set aside the marriage agreement, on the ground that it would cause "serious injustice". The Family Court's decision was upheld by the High Court and Mr. Clayton did not appeal further to the Court of Appeal.

After the marriage agreement was set aside Mrs. Clayton applied to, in essence, set aside the VRPT. That trust was settled by a declaration of trust executed by Mr. Clayton. He was the settlor and sole trustee. The discretionary beneficiaries included Mr. Clayton as "Principal Family Member", Mrs. Clayton as his wife or former wife and their two daughters as the "Final Beneficiaries".

The Family Court found that the VRPT acted as a banker to the rest of the corporate group. It borrowed from the Bank of New Zealand to advance loans to other entities associated with Mr. Clayton. Mr. Clayton set up the VRPT to separate the ownership of the land associated with the Claymark business from the operating assets of the company that held the assets of that business.

2. Prior proceedings

Mrs. Clayton argued that the VRPT was (a) a sham or (b) an illusionary trust and in either case was not truly a trust. She argued in the alternative that Mr. Clayton held a power of appointment as "Principal Family Member" under the VRPT and that that power was "relationship property" (*i.e.*, a marital asset the value of which could be divided between them on divorce) under the PRA. She also argued that the value of that relationship property was equivalent to the net value of the assets of the VRPT.

Last, she argued that the bundle of rights and powers held by her and/or Mr. Clayton under the VRPT together comprised "property" for the purposes of the PRA and that that property was relationship property.

The sham argument failed at all lower court levels but both the Family Court and the High Court held, albeit for different reasons, that the VRPT was an illusory trust. The N.Z. C.A. held that the VRPT was not an illusory trust but that Mr. Clayton's power of appointment was relationship property, the value of which was equal to the net value of the VRPT's assets.

3. Was the Power of Appointment "Property" for Purposes of the PRA?

As discussed in my earlier comment, the N.Z. C.A. held that Mr. Clayton held a general power of appointment under the VRPT Deed and that that power was both "property" and "relationship property" for purposes of the PRA. The N.Z. C.A. relied on the Privy Council decision in *TMSF*,[7] which had been applied in a matrimonial context by the High Court of Australia in *Kennon v. Spry*.[8] I criticized the N.Z. C.A. for its holding because, under general law, a power of appointment is not property. The issue was whether the N.Z. S.C. would uphold the N.Z. C.A. on this point.

Mr. Clayton was a discretionary beneficiary for purposes of the VRPT. Under clause 7.1 of the VRPT Deed Mr. Clayton had the right to appoint or remove other discretionary beneficiaries. The N.Z. C.A. held that he could, therefore, make himself the only discretionary beneficiary. The N.Z. C.A. held that this was a general power of appointment similar, in practical terms, to a power to revoke the VRPT and tantamount to ownership of the assets of the VRPT.

The PRA defined "property" to include:

(a) real property;
(b) personal property;
(c) any estate or interest in any real property or personal property;
(d) any debt or any thing in action; and
(e) any other right or interest.

The N.Z. S.C. accepted Mrs. Clayton's argument that the definition of "property" in the PRA was to be interpreted in a manner that reflected its statutory context, that is, as part of

7. *Tasarruf Mevduati Sigorta Fonu v. Merrill Lynch Bank & Trust Co. (Cayman) Ltd.* (2011), [2011] UKPC 17, [2012] 1 W.L.R. 1721 (U.K. P.C.).
8. [2008] HCA 56, 238 CLR 366 (Australian H.C.).

remedial social legislation. The N.Z. S.C. held that the reference to "any other right or interest" was broader than traditional concepts of property and could include rights and interests that would not, in other contexts, be regarded as property rights or interests.

The N.Z. S.C. made a number of other findings. First, it held that if the N.Z. C.A. were correct that Mr. Clayton could make himself the sole beneficiary of the VRPT, then that power would be equal to a power to revoke the VRPT (because he was the sole trustee and it is a fundamental trust law principle that a trust with only one trustee who is also the sole beneficiary ceases to exist by operation of law). He would, therefore, have a power tantamount to ownership of the VRPT's property.

However, it then agreed with Mr. Clayton that, although he could remove the other discretionary beneficiaries, he could not remove his daughters as final beneficiaries. His power was not, therefore, tantamount to personal ownership of the VRPT's property because at all times he would have a fiduciary responsibility as sole trustee to the final beneficiaries (subject to the comments below about an illusory trust).

I do not agree with the N.Z. S.C.'s first point: in my view, there is no such thing as a power that is "tantamount" to ownership or, to be more precise, such a concept is meaningless. Until the power is exercised Mr. Clayton was a trustee merely and did not own the VRPT property; I fail to see the need to employ a concept such as "tantamount" to ownership, which is just another way of saying he was not the owner. The N.Z. S.C. itself appears to have recognized this in footnote 101 of its reasons when it said: "It was not argued that the VRPT powers gave Mr Clayton a direct interest in the underlying assets of the VRPT and we leave that issue for argument in a future case."

But in any event, the N.Z. S.C. then asked whether the fact that his power did not allow him to become the sole beneficiary was fatal to Mrs. Clayton's argument. This issue was framed as follows:

> [50] We do not see that conclusion as fatal to Mrs Clayton's claim in relation to the VRPT, however. We consider it is necessary to analyse the VRPT deed more closely to see whether Mr Clayton's powers and entitlements as Principal Family Member, Trustee and Discretionary Beneficiary give him such a degree of control over the assets of the VRPT that it is appropriate to classify those powers as rights or interests in terms of paragraph (e) of the definition of property in s 2 of the PRA. We will refer to these powers and entitlements as "the VRPT powers". In

> order to do this, it is necessary to consider what practical limitations the rights of the Final Beneficiaries had on Mr Clayton's ability to appoint the property of the VRPT to himself.

The N.Z. S.C. noted that Mr. Clayton, while he could not remove the final beneficiaries, had the right either to (a) appoint all income or capital or both to himself and that doing so would not breach any fiduciary duty to the daughters[9] or (b) resettle the VRPT's property on a new trust of which he could be the sole beneficiary, again without breaching any fiduciary duty. This power was a "general power of appointment" as defined under general legal principles, in that it allowed him, in essence, to appoint the VRPT's property to anyone in the world, including himself.

Following this interpretation of the VRPT Deed, the N.Z. S.C. appears to have held that a general power of appointment can be "property" for some purposes under general common law. But it also held, more narrowly, that Mr. Clayton's powers amounted to "rights or interests" for purposes of paragraph (e) of the definition of "property" in s. 2 of the PRA. The N.Z. S.C. held that, as with all statutory definitions, that paragraph had to be interpreted and applied in its statutory context; given the social nature of the PRA and the fact that it states that it is intended to be a complete code, the conclusion was that "strict concepts of property law may not be appropriate in a relationship property context."[10] Mr. Clayton's powers were, therefore, "property" under this definition, even though for other purposes they might not be.

I am prepared to agree with the N.Z. S.C. on its reasoning on this latter point. So long as one does not try to expand that reasoning to suggest that a general power of appointment is property under common law, which it is not, I can agree that Mr. Clayton's broad power to appoint all the VRPT's property to himself was the kind of "right or interest" that was likely intended to be "property" for purposes of matrimonial legislation such as the PRA. It follows that I disagree with the following comment by the N.Z. S.C.: "As the Privy Council recognised in *TMSF*, the power of appointment may be treated as property for some purposes even where there is no legislative provision requiring that to be done."

---

9. There would be no breach of duty because the VRPT Deed specifically allowed such appointment.
10. *Clayton v. Clayton* (New Zealand S.C.), *supra*, footnote 4, at para. 79.

4. Valuation

If one accepts that Mr. Clayton had the power to appoint all of the VRPT's property to himself and that the wording of the VRPT Deed was such that doing so did not result in a breach of his fiduciary duty as trustee to the daughters as final beneficiaries, then it stands to reason that there was "no reason to differentiate the value of the power to do this from the value of the assets to which the power relates."[11] As Mrs. Clayton's counsel put it so aptly, if Mr. Clayton sold that power, it is hard to see that he would demand less for it than the value of the VRPT property that he could appoint to himself with it.[12]

5. Sham and Illusion

As noted above, the three lower courts held that the VRPT was not a sham. The first two courts held it was an "illusion" while the N.Z. C.A. held it was not. In my earlier comment I suggested that it was not a sham and that the concept of an illusion was meaningless. I am pleased to say that the N.Z. S.C. agreed with both conclusions.

The N.Z. S.C. held that the VRPT was not a sham. As in Canada and many other counties, in New Zealand "a sham is a pretence: a document that does not evidence the true common intention of the parties."[13] In this case, the lower courts made a finding of fact that Mr. Clayton intended to create a trust when he settled the VRPT; that finding by itself was sufficient to negative a holding of sham.

Mrs. Clayton argued that the VRPT was set up with the help of legal advisors and that Mr. Clayton knew little about the details of the VRPT Deed. The N.Z. S.C., in what I consider to be an important passage, said that this did not create a sham:

---

11. *Clayton v. Clayton* (New Zealand S.C.), *supra*, footnote 4, at para. 104.
12. As was pointed out to me by a person reviewing a previous draft of this article, this argument presupposes that the general power is property, as otherwise it could not be sold. The argument was made by Mrs. Clayton's counsel, who of course argued that the power was property and accepted by the court, which held that the power was "property", at least as defined by the PRA and maybe outside it. But the gist of the argument is still apt even if a power is not property: one might say that if Mrs. Clayton or their daughters *qua* beneficiaries were willing to pay Mr. Clayton to give up the power, he would demand an amount equal to the value of the VRFPT property he could appoint to himself using the power.
13. *Clayton v. Clayton* (New Zealand S.C.), *supra*, footnote 4, at para. 113.

> [115] We do not consider 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 itself leads to the conclusion that the VRPT deed is a sham. Mr Clayton's reliance on his advisors does not indicate any lack of intent on his part to create a trust, nor does his lack of knowledge of the legal detail. The fact that the trust deed gives Mr Clayton powers that amount in effect, to a general power of appointment does not indicate that when entering into the VRPT deed, Mr Clayton in fact intended to create a structure different from that set out in the terms of the VRPT deed itself.[14]

6. Unfairness is not the same as sham

In response to Mrs. Clayton's further argument, the N.Z. S.C. quite correctly held that a trust is not a sham merely because in fairness it should not have been established in the first place. A sham is a pretence. But, "there is no basis to extend the sham concept to encompass a trust created under a document that was not intended to be a pretence but that the court considers is otherwise reprehensible in some way."[15]

7. Illusory trusts: is there an irreducible core of obligations?

In *Armitage v. Nurse*[16] the court held, in what has now become a famous phrase, that there is a fundamental, "irreducible core"[17] of obligations owed by a trustee to the beneficiaries of a trust and enforceable by the beneficiaries, in the absence of which there is no trust:

> I accept the submission made on behalf of Paula that there is an irreducible core of obligations owed by the trustees to the beneficiaries and enforceable by them which is fundamental to the concept of a trust.[18]

14. *Clayton v. Clayton* (New Zealand S.C.), *supra*, footnote 4.
15. *Clayton v. Clayton* (New Zealand S.C.), *supra*, footnote 4, at para. 116.
16. (1997), [1998] Ch. 241 (Eng. C.A.) at pp. 253-254, application for leave to appeal dismissed [1998] 1 W.L.R. 270 (H.L.).
17. This phrase is often associated with David Hayton, now Mr. Justice Hayton, from his chapter "The Irreducible Core Content of Trusteeship", ch. 3 of A.J. Oakley, ed., *Trends in Contemporary Trust Law* (New York, Oxford University Press, 1996), but it was used earlier by Ernest J. Weinrib in his article "The Fiduciary Obligation" (1975), 25 U. Toronto L.J. 1, at p. 16.
18. The submission was, in part, as follows:
    > The irreducible core duties of a trustee include (1) a duty to inquire as to the extent and nature the property and the trusts (see *Hallows v. Lloyd* (1888) 39 Ch.D. 686, 691; *Nestlé v. National Westminster Bank Plc.* [1993] 1 W.L.R. 1260, 1265E, 1266H, 1275E-G and *Wyman v. Paterson* [1900] A.C. 271); (2) a duty to

> If the beneficiaries have no rights enforceable against the trustees there are no trusts.

Following on that concept, the High Court in *Clayton* defined an illusory trust as one the terms of which give the trustee such broad powers that he does not have that irreducible core of duties and hence, although it looks like a trust and acts like a trust, it is clear that no real trust was intended.

The N.Z. C.A. held that there was no real difference between that definition and that of sham. The N.Z. S.C. disagreed with the N.Z. C.A. that a lack of intention to deceive (leading to a finding that there is no sham) meant automatically that the trust was valid. The N.Z. S.C. noted, quite correctly, in my view, that a putative trust settlor might, quite innocently, attempt to establish a trust and intend to create a trust but fail to do so validly for some technical reason, in which case the trust would not be a sham but also would not be trust. For example, the settler might not take the steps necessary to transfer the trust property to the trustee. Or he might reserve such wide powers in respect of the trust property that what on paper was a transfer of property really was not. As the N.Z. S.C. said, again quite correctly, there seems to be no reason to attach a label of "illusion" to such a trust: it is simply an invalid trust.

On the other hand, the N.Z. S.C. considered, and again I agree, that while one may speak of a trustee's powers as being "tantamount" to ownership of the trust property, until those powers are exercised there is no basis for saying that the trust does not exist:

> [125] Second, it can be argued that, even though the VRPT is effectively defeasible, in the sense that the VRPT powers in substance give Mr Clayton power to bring the VRPT to an end, there is no reason in principle why it should not be regarded as a trust and required to be administered in accordance with the VRPT deed until the exercise of the VRPT powers in that manner. In *TMSF*, the Privy Council found that the settlor's powers to revoke the trust were such that the settlor could be regarded as having rights tantamount to ownership. It made no finding about the status of the trust in the period before the revocation powers were exercised, because it was not required to do so in order to resolve

---

obey directions in the settlement unless the deviation is sanctioned by the court (see *Harrison v. Randall* (1851) 9 Hare 397, 407 and *Royal Brunei Airlines Sdn. Bhd. v. Tan* [1995] 2 A.C. 378, 390A-B); (3) a duty to account for his stewardship of the assets under his control; (4) a duty to carry on the business of the trust with the degree of prudence to be expected of a hypothetically reasonably prudent man of business (see *Speight v. Gaunt* (1883) 9 App.Cas. 1, 19 and *In re Whiteley; Whiteley v. Learoyd* (1886) 33 Ch.D. 347, 355).

> the issue before it. However, there was nothing in the judgment to indicate that the trust was invalid in the period before the power to revoke it was exercised.

In the end, the N.Z. S.C. indicated that the judges who heard the appeal were not unanimous in their views as to whether the VRPT abolished the irreducible core of a trust relationship or whether the powers given to Mr. Clayton were so wide that he did not really transfer the trust property to the VRPT, or neither. Given that the parties settled, the N.Z. S.C. held it did not have to come to a conclusion on that point. The N.Z. S.C. suggested that the breadth of the VRPT Deed was unlikely to be duplicated in other cases. I have my doubts on that but time will tell.

Last, the N.Z. S.C. held that there is a difference between a sham trust and an illusory trust, if the latter is regarded as a bad or unnecessary label for an invalid trust. To repeat, there may be a trust that is intended to be a true trust and hence not a sham, but for various reasons may be an invalid trust. I agree.

Canadian case-law has not, as yet, adopted the concept of an irreducible core of fiduciary duties owing by a trustee to a beneficiary. If that concept is accepted, one could see that one situation in which an invalid but non-sham trust would be created is where the trustee's powers are so wide as to negate any fiduciary duty towards the beneficiaries. A trustee without fiduciary duties would be a fish out of water; it is not clear exactly what it would be, but it would be difficult to call it a trustee.

8. Conclusions

I think the N.Z. S.C. has issued a valuable judgement in doing away with the concept of an illusory trust and instead adopting a simple test: is the trust a valid trust? If not, no label is required. If it is a valid trust, then and only then does the concept of sham come in and that depends on the settlor's and trustee's (if they are different people) subjective intentions.

I also agree that, as in Canada, a statutory definition of "property", interpreted in its context and in light of the purpose of a particular statute, might lead to the conclusion that "property" includes either a general power of appointment over property or a collection of powers under a trust deed.

But I disagree that under general common law either power is

property, nor do I think that the concept that such powers are "tantamount" to ownership serves any function. Until the power is exercised the power-holder does not own the property; one is better off not attaching a label to a power when doing so only clouds the analysis.

Joel Nitikman*

* Joel Nitikman, Tax Partner, Dentons Canada LLP, Vancouver.