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Précis Paper

Powers of Attorney, Fiduciary Obligations & Liability of Third Parties

A discussion of the decision in *Smith v Smith* [2017] NSWSC 408, which dealt with powers of attorney, fiduciary duties, and the liability of third parties

Discussion Includes

- Key facts
- Legal principles considered
- Effect of second wife's appointment as Attorney
- Liability of third parties obtaining benefit from actions of Attorney
- Relevance of NCAT to proceedings of this kind
- Orders made
- Key takeaways

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Power of Attorney, Fiduciary Obligations & Liability of Third Parties

1. In this edition of BenchTV, Andrew Bulley (Barrister, 5 Wentworth Chambers, Sydney) and Richard McCullagh (Lawyer, Retirement Village Lawyer, Sydney) discuss Lindsay J's judgement in the case of *Smith v Smith* [2017] NSWSC 408 which considered the exercise of power of attorney, the fiduciary obligations that arise from a power of attorney arrangement, and the liability of third parties who may benefit by reason of the attorney's actions pursuant to the power of attorney.

Key facts

2. The Plaintiffs in this case, two brothers, brought an action in relation to their deceased father's estate. They were informed by the executor of the deceased's will, the Second Defendant, that there was little left of the estate due to the actions of the second wife, the First Defendant.

3. The second wife, the First Defendant, argued that she was "wife, carer, and most importantly an enduring power of attorney', and therefore was acting within her powers. The Third and Fourth Defendants, the daughter and son in law, respectively, of the First Defendant, agreed with the First Defendant, arguably because they benefitted substantially.

4. This case highlighted a number of issues, including:
    - a deceased's loss of capacity
    - the clashes that may occur when there are blended families
    - issues arising out of actions taken by an attorney pursuant to an enduring power of attorney

Legal principles considered

5. In this case, Lindsay J examined whether or not fiduciary obligations arise out of powers of attorney executed pursuant to the *Powers of Attorney Act 2003* (NSW). By reason of the relationship between the donor and the attorney, fiduciary obligations arise from the fact that the donor is in effect a principal, and the attorney is an agent. The relationship of principal and agent is a relationship which has been long recognised in equity as giving rise to equitable obligations arising out of the fiduciary relationship.

6. Section 7 of the *Powers of Attorney Act 2003* (NSW) preserves the general law in relation to powers of attorney that are executed under the *Powers of Attorney Act 2003* (NSW). When that preservation takes place, and in the absence of there being any additional powers

conferred upon the attorney, here being the second wife, the general law otherwise applies, which imports equitable fiduciary obligations.

7. In relation to the First Defendant being aware of her obligations as attorney, she admitted that she had:
    - read the power of attorney before signing it
    - it was her signature on the document
    - the document was certified in the usual way by a solicitor
    - she understood the terms of the power of attorney

8. The deceased's will provided that upon the deceased's death, a home unit at Emu Plains would be passed to the second wife, and the residuary estate, containing a share portfolio of approximately $1 million, would be shared: a half share to the second wife, and a quarter share each to the deceased's two sons from his first marriage (the Plaintiffs).

9. Whilst the deceased was confined to a nursing home, for a period of 4 years until his death, the second wife embarked on a process of expenditure, spending about $1.2 million, which largely came from the $1 million share portfolio.

10. The First Defendant, in her defence, relied upon the fact that she was the deceased wife, the deceased's carer, and that she was a beneficiary under the deceased's will, claiming she would have received the monies in question anyway, essentially ignoring the terms of the will. The court relied upon the *Marriage (Equality of Status) Act* 1996 to provide that there is no agency deemed in relation to spouses, so the Second Defendant's 'I am wife' argument, was irrelevant. The fact the second wife was a carer for the deceased was also held to be irrelevant. The focus was upon what occurred pursuant to the enduring power of attorney, which became active when the deceased lost capacity in May 2008.

11. At paragraph [19], Lindsay J focused upon the need for the law of agency, an amalgam of common law rules and equitable principles, to accommodate the protective jurisdiction where a principal has lost the mental capacity requisite to managing his or her own business. This view can be contrasted against the decision in *Taheri v Vitek* [2014] NSWCA 209 per Leeming JA at [118]-[131], which provides that where there is a power of attorney that permits self-benefitting, the attorney is under no duty to inquire into the propriety of the use of that power of attorney. In the current case there was no power to self-benefit, but Lindsay J focused upon the need for the protective nature of the appointment in the context of a domestic situation.

12. Incapacity can be a very powerful tool. Barrett J in *Szoda v Szoda* [2010] NSWSC 804 provided that "Incapacity at inception of granting a power of attorney pulls the rug out

completely on any purported transaction using the power of attorney, in effect making it a legal nullity". However this was not relevant in the current case as there was no evidence of incapacity at the time the power of attorney was granted.

13. Where an agent is conferred with authority, that authority is revoked under the common law in circumstances where the principal or the donor of the authority loses capacity. So at the time the deceased lost his capacity in May 2008, in effect, any authority which may have been conferred on the second wife by the trading authority in relation to the share portfolio, would have been revoked.

14. Sections 11, 12 and 13 of the *Power of Attorney Act* 2003 (NSW) provide that unless the power of attorney expressly provides extra powers and rights, there are no powers and rights, such that the attorney can only exercise the powers under the enduring power of attorney for the benefit of the deceased, and not for the benefit of the attorney, or for the benefit of third parties.

Effect of second wife's appointment as Attorney

15. A month or so after the power of attorney and the deceased's will were executed, there was a transfer, and the deceased transferred a half share in the home unit to the second wife for $1, which was originally held solely by the deceased.

16. In May 2010, the second wife sold the property in not only her own right as a joint tenant, but also as the attorney of the deceased pursuant to the power of attorney. The home unit sold for approximately $400,000 and the evidence seemed to suggest that of the $400,000, her share was expended by her upon her own purposes. The deceased's $200,000 share of the sale was not held by the attorney on trust for the deceased, but was expended by the second wife in the construction of a granny flat on the Third and Fourth Defendant's property.

17. As joint tenancy is severable at any time, legally it was valid, in terms of the authority conferred by the power of attorney, that the second wife was able to sever the joint tenancy. However, it was held that at this point, equity intervenes to hold her to account for the deceased's share of the sale.

18. There was also a joint bank account between the second wife and the deceased, and as co-owner of the bank account, the second wife had expended money out of the joint bank account during the deceased's incapacity. The Court found, in effect, that she had become a constructive trustee of the monies she had expended out of that account as co-owner, as she was not entitled to spend the deceased share that was held in the joint bank account.

19. As a fiduciary, the second wife also had other duties she had to uphold, one of those being record keeping. In equity, a fiduciary or an agent is obliged to account, or provide accounts for all expenditure - in this case the second wife failed to do so. The conclusion drawn by the court was that by reason of the fact that the second wife, as the fiduciary, was unable to provide proper books and accounts of the expenditure, the Court effectively presumed against the fiduciary, the attorney, in circumstances where she was otherwise unable to prove that any of the expenditure she had undertaken was done for the benefit of the deceased. In the absence of any contravening evidence, it was held that all of the expenditure that had taken place occurred for the benefit of the second wife and third parties.

Liability of third parties obtaining benefit from actions of Attorney

20. In 2008, shortly after the deceased lost capacity, the second wife began liquidating the share portfolio, at one point raising approximately $400,000 from the sale of shares. Those monies were, in effect, put into a home in Emu Plains which was purchased by the second wife, and registered in the name of her daughter and son in law, the Third and Fourth Defendants. The Court found that by reason of the knowledge which the Third and Fourth Defendants were fixed with, as to where the money had come from, and the deceased's incapacity, a tracing exercise was able to be undertaken, such that the monies were able to be traced into the Emu Plains home. Therefore, it was determined that the Third and Fourth Defendants held the property on trust for the estate of the deceased.

21. In addition to the principles provided by *Barnes v Addy* (1874) LR 9 Ch App 244, Lindsay J also relied upon the rule in *Black and Black v S Freedman and Company* [1910] HCA 58; 12 CLR 105, which provides that where volunteers(in this case being the Third and Fourth Defendants as they provided no value for the money put into the property)obtains monies in breach of trust as volunteers, they are obliged to account for, or otherwise disgorge, the monies that were paid into the property.

22. The court concluded that the Third and Fourth Defendants had to have known that the monies must have come from the deceased's funds, and were also aware of the particular circumstances being that the deceased was in a nursing home and did not have the capacity to consent to this taking place. The daughter and son-in-law were held to have been fixed with the relevant knowledge such that a constructive trust could be imposed upon the property at Emu Plains, notwithstanding the fact that the property came to be registered in the names of the Third and Fourth Defendants, and would otherwise attract the indefeasibility provisions of s 42 of the *Real Property Act 1900* (NSW).

23. Indefeasibility under s 42 of the *Real Property Act 1900* (NSW) did not apply here by reason of the relevant notice, which the daughter and son-in-law had been fixed with prior to them becoming indefeasible owners of the property. The court was therefore able to impose a constructive trust. Prior knowledge of a breach of duty, which funded the acquisition of which they were the beneficiaries and had become the registered proprietors, was enough to undermine indefeasibility.

24. Another interesting feature of this case was that the deceased's $200,000 share from the sale of the matrimonial home was expended by the second wife in the construction of a granny flat upon the land which had been purchased by the Third and Fourth Defendants. Tracing also occurred here to find that the granny flat was included upon the property that was held on constructive trust for the deceased's estate.

25. The Defendants did attempt to bring the defence of laches against the Plaintiffs, but Lindsay J concluded that there was not any deliberate inattention or inactivity on the part of the Plaintiffs such as to give rise to a defence of laches.

Relevance of NCAT to proceedings of this kind

26. At any time, any of the relevant parties could have applied to the Guardianship Division of the NSW Civil and Administrative Tribunal (NCAT). In this case His Honour repeatedly mentioned that the second wife should have applied to the Supreme Court or NCAT for an order seeking consent to her proposals. The second wife took no steps whatsoever to obtain authorisation from NCAT or the Supreme Court in relation to the expenditure that she undertook pursuant to the power of attorney, and therefore had failed to act honestly and reasonably in the circumstances of her office, and therefore she should not be relieved of any liability that the Plaintiffs were otherwise entitled to in accordance with s 85 of the *Trustee Act 1925* (NSW).

27. The Plaintiffs also could have applied to NCAT at any time to seek a review of the exercise of the power of attorney. This could have been beneficial for the Plaintiffs as NCAT, when compared to the Supreme Court, is relatively cheap, fast, informal, and there are fewer fees involved.

Orders of the Court

28. Ultimately, the Court ordered that the second wife reimburse the estate the $1 million which had been improperly taken out of the deceased's share portfolio. As discussed above, the Court also made orders in the way of constructive trust as against the daughter

and son-in-law in relation to the Emu Plains property which included the $200,000 granny flat.

29. The Court made a declaration that the Emu Plains property be held on constructive trust for the estate of the deceased. It was also ordered that the property vest in Second Defendant, the executor of the estate, on behalf of the estate. The Court also found that the Second Defendant be impaled to sell that property and hold it for the benefit of the estate.

30. Due to the way the will was constructed, being that the second wife was entitled to obtain a half share of the residuary estate, unless otherwise ordered by the Court, the second wife would still obtain benefit from the sale of the Emu Plains property.

31. The Court applied the rule in *Cherry v Boultbee* [1838] EngR 541 which provides that where a party owes money to a fund, that party has to reimburse that fund before it can otherwise benefit from the monies in the fund. Therefore, upon the sale of the property, a second wife is not to benefit from the sale of the property until she is able to reimburse the estate for the $1 million that was wrongly taken from the estate. This, in effect, denies the second wife any entitlement whatsoever to the sale proceeds of the Emu Plains property.

Key takeaways

32. Advice in this case should have be given to the two sons of the deceased to take steps to have their matter dealt with by the NSW Civil and Administrative Tribunal as soon as possible. The primary aim would be to stop the errant fiduciary from taking unnecessary steps, by having a financial manager appointed in NCAT.

33. The next step would be that where there have been substantial funds or property taken from the estate, it would be necessary to commence proceedings in the Supreme Court to try to recover either those assets, or to recover something by way of compensation for those assets.

34. In addition to applying to NCAT, another quick potential measure is, where there is real estate that seems to still be owned by the principal, or is traceable to the principal, to apply for a caveat. In the current case, a caveat was applied for by the Plaintiffs, and it essentially prevented the daughter and son-in-law from dealing with the property in any way, and ultimately that became important in terms of recovery, given that the Emu Plains property was the only recoverable asset.

35. A caveat is always a good idea when dealing with an attorney who is otherwise a fiduciary, and so that the equitable caveatable interest can be specified in a caveating question. The property in question is held on constructive trust for the relevant estate so that a caveatable interest can withstand any attempt by the registered proprietor to lodge a lapsing notice to remove the caveat.

36. In this case, it became clear as to what had occurred with the monies, and therefore the view was taken that it may be possible to trace these monies and allege a constructive trust against the property such that there is a relevant caveatable interest which could be specified in the caveat document itself.

BIOGRAPHY

Andrew Bulley

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Andrew commenced his professional career as a Solicitor and then Senior Associate with Ebsworth & Ebsworth in Sydney. Since coming to the Bar in 1997 he appeared in a variety of jurisdictions in a wide range of matters. His practice now involves commercial and equity matters and in more recent times he has also appeared in appellant matters in the New South Wales Court of Appeal and the Supreme Court. Since 2009 he has been an Advocacy Instructor in the Bar Readers Course run by the NSW Bar Association. Andrew has been a Director of Counsel's Chambers Limited since 2007.

Richard McCullagh

Lawyer, Retirement Village Lawyer, Patrick McHugh & Co, Sydney

Richard McCullagh has practised law since 1985, mostly in the area of retirement village law, and has been an adjunct lecturer in Elder Law at the College of Law in Sydney since 2013. This covers areas such decision-making agency, accommodation and remedies for elders. He regularly presents seminars, and publishes articles in the Law Society Journal, about developments in elder law. His textbook, "Retirement Village Law in NSW" was published by Thomson Reuters in 2013. Richard is a legal director of a suburban legal practice on the Central Coast of NSW, Patrick McHugh & Co, in close proximity to a multitude of aged care facilities, retirement villages and an elderly clientele.

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Smith v Smith [2017] NSWSC 408

Benchmark Link

Smith v Smith [2017] NSWSC 408

Judgment Link

Smith v Smith [2017] NSWSC 408

Cases

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Legislation

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Real Property Act 1900 (NSW)

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