



Précis Paper

Litigation Involving Trustees

Discussion Includes

- What issues arise when litigation is commenced by or against a trustee?
- When should judicial advice be sought?
- When will judicial advice be refused?
- Section 63 of the *Trustee Act 1925* (NSW)
- What principles apply regarding costs?
- What lessons can be drawn from the recent case of *Fischer v Nemeske Pty Ltd* [2016] HCA 11?
- Cost principles of trust litigation

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Litigation Involving Trustees

1. In this edition of BenchTV, Ingrid King (Barrister) and Ian Benson (Solicitor) discuss the High Court's (French CJ; Kiefel, Bell, Gageler and Gordon JJ) recent decision of *Fischer v Nemeske Pty Ltd* [2016] HCA 11. The presentation considered judicial advice applications being made by trustees and trust litigation more generally.

Trustees in Litigation

2. The first step for trustees when they are contemplating litigation or when litigation is proposed against them is to consider seeking judicial advice. The need for judicial advice arises from the High Court's decision in *Macedonian Orthodox Community Church St Petka Inc v His Eminence Petar The Diocesan Bishop of Macedonian Orthodox Diocese of Australia and New Zealand* (2008) 237 CLR 66.
3. Judicial advice is sought from the Supreme Court pursuant to the inherent jurisdiction of the court to supervise trust matters and s 63 of the *Trustee Act 1925* (NSW):

SECTION 63:

Advice

- (1) *A trustee may apply to the Court for an opinion advice or direction on any question respecting the management or administration of the trust property, or respecting the interpretation of the trust instrument.*
- (2) *If the trustee acts in accordance with the opinion advice or direction, the trustee shall be deemed, so far as regards the trustee's own responsibility, to have discharged the trustee's duty as trustee in the subject matter of the application, provided that the trustee has not been guilty of any fraud or wilful concealment or misrepresentation in obtaining the opinion advice or direction.*
- (3) *Rules of court may provide for the use, on an application under this section, of a written statement signed by the trustee or the trustee's Australian legal practitioner, or for the use of other material, instead of evidence.*
- (4) *Unless the rules of court otherwise provide, or the Court otherwise directs, it shall not be necessary to serve notice of the application on any person, or to adduce evidence by affidavit or otherwise in support of the application.*
- (8) *Where the question is who are the beneficiaries or what are their rights as between themselves, the trustee before conveying or distributing any property in accordance with the opinion advice or direction shall, unless the Court otherwise directs, give notice to any person whose rights as beneficiary may be prejudiced by the conveyance or distribution.*

- (9) *The notice shall state shortly the opinion advice or direction, and the intention of the trustee to convey or distribute in accordance therewith.*
- (10) *Any person who claims that the person's rights as beneficiary will be prejudiced by the conveyance or distribution may within such time as may be prescribed by rules of court, or as may be fixed by the Court, apply to the Court for such order or directions as the circumstances may require, and during such time and while the application is pending, the trustee shall abstain from making the conveyance or distribution.*
- (11) *Subject to subsection (10), and subject to any appeal, any person on whom notice of any application under this section is served, or to whom notice is given in accordance with subsection (8), shall be bound by any opinion advice direction or order given or made under this section as if the opinion advice direction or order had been given or made in proceedings to which the person was a party.*
4. Subsection (1) provides that a trustee may apply to court for advice. Subsection (2) protects the trustee by providing that if a trustee acts in accordance with the advice, they will be taken to have discharged their responsibilities so long as they have not been guilty of any fraud, concealment or misrepresentation in obtaining the opinion. Subsection (4) provides that such applications for advice are generally personal between the trustee and the court and are kept private. However, there is provision in subsection (8) for trustees to notify any beneficiaries affected by the outcome of the judicial advice application.
5. It is difficult to fully determine the situations in which judicial advice applications are required partly because the courts have declined to provide an answer. Judicial advice tends to be declined where the subject matter of the advice is contentious because it is considered that the court will better assist the dispute where all parties can be joined to the proceedings and heard. That said, in such situations the court will give advice as to whether litigation should be defended or maintained but will not give advice as to the likely outcome of the litigation. The option for receiving judicial advice is also available to executors and liquidators as they similarly act as trustees.

Costs in Judicial Advice Applications

6. The fundamental principle in relation to costs for judicial advice applications is that generally, a trustee who prudently, reasonably and honestly litigates to protect trust property will be entitled to recover from the trust fund the costs of the litigation, as are all parties properly joined per *Hughes v NM Superannuation Pty Ltd* (1993) 29 NSWLR 653 at 671 (Sheller J).
7. This principle has been codified in rule 42.25 of the *Uniform Civil Procedure Rules 2005* (NSW):

RULE 42.25:

Costs of trustee or mortgagee

- (1) *Subject to subrule (2), a person who is or has been a party to any proceedings in the capacity of trustee or mortgagee is entitled to be paid his or her costs in the proceedings, in so far as they are not paid by any other person, out of the fund held by the trustee or out of the mortgaged property, as the case may be.*
 - (2) *The court may order that the person's costs not be so paid if:*
 - (a) *the trustee or mortgagee has acted unreasonably, or*
 - (b) *in the case of a trustee, the trustee has in substance acted for his or her own benefit rather than for the benefit of the fund.*
8. The threshold for 'unreasonableness' in subrule (2)(b) is high. In *Re Evans* [1957] St R Qd 345 it was determined that a trustee always receives costs in an action for construction unless the construction is so clear as not to admit of argument. A situation that falls within subrule (2)(b) might arise where a trustee is also a beneficiary of the trust.
9. It is also not uncommon that an unsuccessful party that has been joined to the litigation might be the recipient of a costs order but that would not normally be on the party-party basis. This situation can arise where there is trust litigation arising out of the administration of an estate and the dispute relates to the poor drafting of the will or is otherwise characterized as being caused by the unreasonable conduct of the testator.
10. Where a trustee fails to seek judicial advice prior to engaging in litigation they will lose the protection of a cost order out of the trust. In *Re Beddoe* [1893] 1 Ch 547 a trustee was not entitled to the costs of defending an action partly because the trustee had not sought the advice of the court. Additionally, they lose the protection against being accused of acting in breach of trust if they follow the advice of the court.

Fischer v Nemeske (2016)

11. The case concerned the Nemes Family Trust. Mr and Mrs Nemes were beneficiaries to the trust along with the Fischers, who are related to Mr Nemes. The only assets in the Trust were shares in Aladdin Ltd. The sole shareholder of the trustee company was Mr Nemes, although there were two independent directors. In 1994, presumably for taxation reasons, the trustee revalued the shares from \$100,000 at the time they had been settled on the trust to \$3,904,300. The revaluation occurred as a result of an accounting entry in the "asset revaluation reserve". The trustee then resolved to make a distribution out of the asset revaluation reserve to Mr and Mrs Nemes. However, no money or shares actually changed hands notwithstanding the amount of \$3,904,300 being credited to them in the trust's accounts and the trustee granting a charge of the shares in favour of the couple.

12. Mrs Nemes died in 2010 and the sole beneficiary of her estate was Mr Nemes. Mr Nemes died in 2011. In his will, Mr Nemes had bequeathed the shares in the trustee, and the shares in Aladdin, which were properly considered to be held in the trust, to the Fischers. His residuary estate went to other beneficiaries. The issue became, if the distribution in 1994 was upheld and the loan that was owed to Mr and Mrs Nemes by the trustee was valid then there was nothing in the trust for the Fischers to receive from the estate and the value of the assets in the trust went to the residuary beneficiaries of the estate.
13. The Fischers were unsuccessful at first instance and in the Court of Appeal. In the High Court, they were unsuccessful again but in a split 3:2 decision. If the Fischers had been successful in arguing that the distribution had no effect or that it was not authorised by the trust deed, then the assets within the trust would have remained as \$3.9million and the Fischers as trustees would have been able to make a distribution to themselves of the assets in the trust.
14. A Majority of the High Court found that the distributions were valid. It had been argued that it was not appropriate to advance the assets of a trust through the creation of a debt and that the creation of the debt instrument was not authorised by the trust deed. French CJ and Bell J, and Gageler J in a separate judgment, held that the clause in the trust deed which provided a power of advancement had a sufficiently broad meaning to empower the actions of the trustee. Gageler J said that there is no reason why an advance of capital from a trust must take the form of an alteration of the ownership of one or more trust assets. Further, his Honour said that an advance of capital can take the form of a debt owing to a beneficiary and that such a debt would be enforceable as a common law debt.
15. Kiefel and Gordon JJ were in vigorous dissent. Kiefel J held that the resolution making the advance was not authorised because it did not identify:
 - a. The source of the power for making the advance ([51]-[52]);
 - b. That the distribution was made for the "advancement in life or benefit" of the Nemes ([52]); or
 - c. Whether the distribution was made from capital or income ([53]).
16. Ms King considers that the judgment of Kiefel J might be regarded as a template for estates practitioners for how to draft a distribution declaration in a way that is unlikely to be challenged.
17. Further, Kiefel J held that the advance was of no effect because there was no corresponding reduction in the capital of the Trust ([64]).
18. Gordon J held that the power to make an advance under the particular clause of the trust deed could only be engaged with a change in the beneficial ownership of the shares. She

held that the advance did not cause a change in the beneficial ownership of the shares and on that basis the challenged advance was of no effect ([166]-[170]);

19. Her Honour's judgment concludes at [183] with a warning to the legal community that reads:

The text and purpose of cl 4 attaches precise legal effect to dealings with the capital and income of the Trust Funds. That precision is more than a mere formality. Specific legal meaning has been given to terms such as "advance", "raise", "pay" and "apply", so that, upon the exercise of a power such as that contained in cl 4(b), one can ascertain precisely the effect that the exercise of the power has on the capital and income of a trust. Unless provisions such as cl 4 are construed, are exercised and operate according to their terms, the potential for imprecise or wrongful dealings with trust property may be increased. Imprecise and wrongful dealings with trust property concern and affect not only a trust, its trustee and its beneficiaries but also third parties dealing with that trust.

20. Ms King considers that in this passage Gordon J is flagging the liability of trustees to third parties when they draft poorly worded resolutions under the second and third limbs of *Barnes v Addy* (1874) 43 LJCh 513.
21. Ms King further notes that the Majority's judgment does not mean that similar transactions would not necessarily be upheld and that the decision here was very specific to the words of the trust. Furthermore, Ms King considers that the way Mr Nemes' will was drafted indicates that the drafter did not have access to the dealings of the trust because the shares were clearly not his personal property. In order to avoid this problem, she argues that those drafting wills should insist upon having this information such that disputes such as this do not occur unnecessarily.

BIOGRAPHY

Ingrid King

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Ingrid King has been in legal practice since 1994 and has a special interest in regulatory and corporate litigation. Her other practice areas include land and environment law, employment law, equity, and insolvency law. Ingrid also teaches Securities Markets Law at UTS and has taught Takeovers and Securities Industries Law at ANU. Ingrid is a member of the Banking and Finance Lawyers Association. Prior to coming to the Bar, Ingrid worked in-house (in financial services and government) and in private practice as a litigation solicitor.

Ian Benson

Ian Benson is a solicitor at AR Conolly and Company and holds a First Class Honours degree in Law.

BIBLIOGRAPHY

Focus Case

Fischer v Nemeske Pty Ltd [2016] HCA 11

Benchmark Link

https://benchmarkinc.com.au/benchmark/composite/benchmark_08-04-2016_insurance_banking_construction_government.pdf

Judgment Link

<http://www.austlii.edu.au/au/cases/cth/HCA/2016/11.html>

Cases

Barnes v Addy (1874) 43 LJCh 513

Hughes v NM Superannuation Pty Ltd (1993) 29 NSWLR 653

Macedonian Orthodox Community Church St Petka Inc v His Eminence Petar The Diocesan Bishop of Macedonian Orthodox Diocese of Australia and New Zealand (2008) 237 CLR 66

Re Beddoe [1893] 1 Ch 547

Re Evans [1957] St R Qd 345

Legislation

Trustee Act 1925 (NSW)

Uniform Civil Procedure Rules 2005 (NSW)