IN THE COURT OF APPEAL OF NEW ZEALAND

CA88/06
[2008] NZCA 122

	BETWEEN	OFFICIAL ASSIGNEE IN BANKRUPTCY IN THE PROPERTY OF GARY MARTIN REYNOLDS Appellant
	AND	ALEXANDER MCLENNAN WILSON AND JUDITH ANN HARVEY First Respondent
	AND	SUSAN JUDITH CLYMA Second Respondent

Hearing: 21 August 2007

Court: Glazebrook, O'Regan and Robertson JJ

Counsel: J C D Guest and G S Caro for Appellant
A J Forbes QC for Respondents

Judgment: 8 May 2008 at 4 pm

JUDGMENT OF THE COURT

A The appeal is dismissed.

B Costs lie where they fall.

REASONS

ROBERTSON AND O'REGAN JJ

(Given by Robertson J)

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Introduction

[1] This appeal, from a decision of Chisholm J (*Official Assignee v Wilson & Anor* CIV 2004-425-74 12 April 2006), involves the law relating to shams (including the concept of an emerging sham) and alter ego principles including whether they constitute a separate action or are only an evidentiary matter with regard to a sham. It must also focus on the position of the Official Assignee (OA) in this litigation. There was an underlying spirited challenge to the factual findings made by the Judge in light of the totality of the evidence he heard.

Background

[2] Mr G M Reynolds was a property developer. In the early 1990s, he was adjudged bankrupt. By 31 March 1996, when he entered into an agreement to purchase a house in Invercargill, he had been discharged. He signed the contract as agent in anticipation of a trust being established.

[3] He settled the G M Reynolds Family Trust in May 1996 with the first respondents as trustees. The beneficiaries were named children and Mr Reynolds' children and grandchildren.

[4] The Invercargill house transaction was completed in May 1996 and the property registered in the name of the trustees. The first mortgage, provided by Southland Building Society (SBS), was guaranteed by Mr Reynolds personally. One of Mr Reynolds' companies contributed $9,000 towards the purchase price. The family lived in the home and the outgoings, including mortgage instalments, were met by Mr Reynolds and Ms Clyma (his long term de facto partner).

[5] Mr Reynolds claimed (and the trustees agreed) that in late 1996 the trustees had orally agreed to sell the Invercargill property to Mr Reynolds because the trustees were not prepared to carry out renovations on the property. There was no written material relating to this arrangement. The OA argued that this assertion was unbelievable and the transfer was done to allow Mr Reynolds to use the house as security for his business finances.

[6] In 1997 the house was transferred to Mr Reynolds for $64,000 (the price originally paid for the house). The Bank of New Zealand (BNZ) secured a mortgage for $100,000 over the home which was personally guaranteed by Mr Reynolds. The SBS mortgage was repaid and $50,000 was spent by Mr Reynolds on renovations to what was then his property.

[7] On 25 February 1998 Mr Reynolds entered into a contract on behalf of the trust for the purchase of a property in Queenstown for $215,000. Settlement was deferred until 31 March 1999 and the property was rented in the meantime.

Mr Reynolds and Ms Clyma were responsible for the rental and maintenance of the home. The Invercargill house was put on the market but, as it was difficult to sell, it was rented. It eventually sold in 2000 for $135,000 notwithstanding the assertion a year earlier that it was valued at $220,000.

[8] Settlement of the Queenstown purchase was effected on 31 March 1999, a valuation having been obtained shortly before. To effect settlement the trustees borrowed more than was required to purchase the house. This funding came from SBS by way of a first mortgage advance of $244,500, Speirs Group Limited by way of a second mortgage advance of $50,000, and an unsecured advance of $75,000 from a company controlled by Ms Clyma. The funds were used in part to refinance the BNZ mortgage over the Invercargill property.

[9] Apart from the security over the Queenstown property both mortgages were collaterally secured over the Invercargill property and personally guaranteed by Mr Reynolds. Mr Reynolds' indebtedness to BNZ was reduced by $150,000 and that bank's mortgage over the Invercargill property was released.

[10] The trust agreed to allow Mr Reynolds and Ms Clyma to do renovations to the Queenstown home. The renovations were funded by way of an interest free loan from Ms Clyma.

[11] The trust was never administered well and there was intermingling and confusion between the affairs of the trust and Mr Reynolds, at a personal level and even in the record keeping in his solicitor's trust account.

[12] There were several defaults on the mortgages before the Invercargill house was sold.

[13] Mr Reynolds was adjudicated bankrupt again on 14 July 2001. His liability to creditors was over $500,000. The bankrupt had no assets to administer, but the OA contended that the Queenstown home was in reality the property of Mr Reynolds and the equity therein should be available for his creditors. Mr Reynolds was discharged from his second bankruptcy three years later.

Issues

Challenge to factual findings

[14] Mr Guest realistically accepted that a challenge to factual findings made by a trial Judge involved a serious hurdle.

[15] The main challenge was that the evidence given in Court was different to that given by the same witnesses when questioned under oath by the OA in accordance with s 68 of the Insolvency Act 1967. The OA asserted that the evidence given initially to him was more creditable and to be preferred. The key factual findings which Mr Guest sought to achieve were:

(a) the sale of the Invercargill house to Mr Reynolds was not to enable renovations but so that Mr Reynolds could use the house as security for his business finances;

(b) the trustees borrowed significantly more than was required to purchase the Queenstown property so that money was available to pay some of Mr Reynolds' debts; and

(c) inferences to be drawn from Mr Reynolds and Ms Clyma attempting/using the Queenstown property as security to raise money for their own purposes.

[16] We have a degree of sympathy for the appellant's challenge to the factual findings. Chisholm J appears to have taken a benign view of the activities of Mr Reynolds.

[17] However, it is helpful to turn first to the question of the relevant law to determine whether, even if the challenges to the factual findings succeeded, it would provide a basis for a Court to grant the relief sought by the OA.

The nature of this litigation

[18] This claim was brought by the OA against the legal owners of the Queenstown property who were the trustees of the G M Reynolds Family Trust.

[19] The OA stands in the shoes of Mr Reynolds. He was the settlor but not a trustee nor a beneficiary of the trust. There is an understandable perception that the OA was maintaining a position on behalf of those creditors of Mr Reynolds who were left lamenting because of his insolvency. That cannot overcome the fact that the OA cannot, as a matter of law or logic, be in a greater or different position than Mr Reynolds himself.

[20] When that fundamental premise is focused upon, this is a case where a representative of Mr Reynolds is endeavouring to have the Court declare that the trust which Mr Reynolds set up, and in respect of which he had no legal right or interest, was a sham or became a sham or was an alter ego of himself. It is argued that the Court, as a result of Mr Reynolds' improper, overbearing and perhaps unlawful activities, should treat the legitimate rights of the discretionary beneficiaries as being extinguished.

[21] In the course of the hearing we expressed concern that there was no separate representation of the beneficiaries in the litigation. The point was apparently raised, but not advanced, in the High Court. Although counsel offered to explore the possibility post the appeal hearing, that seemed rather too late.

[22] However this case is looked at, and even if we did not embrace Chisholm J's assessment of the behaviour of both Mr Reynolds and the trustees, we are unable to conclude that this proceeding could be the appropriate vehicle to obtain the relief which the OA seeks.

[23] It is unsustainable to assert that Mr Reynolds could come before the Court and ask to benefit as a result of his own slackness, informality or perhaps even illegality. The OA does not, in these circumstances, have a different stance from that of Mr Reynolds. No matter how condemnatory the Court were to be in its

assessment of the acts and omissions of the relevant players, it could never reach the point where there could be integrity or justification in allowing Mr Reynolds to seek relief which is effectively for his own benefit. The fact that the benefit might be able to be transferred to his creditors does not alter the analysis.

[24] The creditors behind the OA cannot use the legal position of Mr Reynolds as an avenue to seek redress for the losses they sustained through their dealings with him.

[25] That finding effectively disposes of the case, but lest we are mistaken in that approach, and in deference to the arguments presented with regard to the other issues, we turn to them.

Sham and alter ego trusts – the law

Sham

[26] A sham exists where there is an intention to conceal the true nature of a transaction: *Snook v London and West Riding Investments Ltd* [1967] 2 QB 786 (CA), per Lord Diplock; *Paintin and Nottingham Limited v Miller Gale and Winter* [1971] NZLR 164 (CA). A trust will be held to be a sham where there is an intention to have an express trust in appearance only. An example is where the settlor seeks the protection offered by the pretence of there being a valid trust. A sham requires an intention to mislead. Equity looks to intent rather than form. The absence of an intention to create a genuine trust prevents the trust from being valid, because one of the essential ingredients for its creation is missing. The trust is void for the lack of intention to create a trust: Peart "Trust busting – looking through trusts" in *Trusts* (Wellington, NZLS 2007) 176 at 190.

[27] The OA asserted that the Judge erred in not finding that the G M Reynolds Family Trust was a sham. He contended that the trust was a sham because Mr Reynolds intended that the trustees hold the assets for himself at his direction, rather than for his offspring.

[28] The OA raised three main issues in terms of his sham argument:

(a) Is a common intention between a settlor and the trustees necessary before a sham can be found?

(b) Can a valid trust become a sham?

(c) Did the Judge use the correct method of determining whether a trust is a sham?

(i) Must a sham involve a common intention?

[29] The OA submitted that, in order to find the trust a sham, it was not necessary to prove a common intention between both the settlor and the trustees. Mr Guest argued that there was no need to establish an actual intention to create a sham on the part of the trustees, but that it was sufficient if the trustees demonstrated a lack of care and concern in following along with Mr Reynolds' wishes. He relied on *Midland Bank plc v Wyatt* [1997] 1 BCLC 242 at 245 (Ch) as authority for the contention that, where a trustee goes along with a settlor neither knowing nor caring what he or she is signing, this constitutes sufficient intention to create a sham. The factual position in *Wyatt* is markedly different from the present. Mr Wilson was a professional trustee who the Judge found knew what he was signing. There is no basis to suggest that he was indifferent to what was occurring with the trust.

[30] In *Snook* (at 802), Diplock LJ held that all parties to the transaction must share a common intention before a sham finding could be made. The OA sought to distinguish *Snook* because it involved a bilateral transaction (hire purchase agreement) whereas in the context of trust, transactions are unilateral. A settlor can unilaterally create a trust, and a trust is complete, without any element of acceptance by the trustee: Mowbray and others *Lewin on Trusts* (18 ed 2008) at 4-01. Mr Guest thus argued that only the settlor's intention was significant.

[31] Relevant overseas authority is against Mr Guest: *Rahman v Chase Bank (CI) Trust Company Limited* [1991] JLR 103 (Royal Court) and [2002] BPIR 129; *Hitch*

v Stone [2001] STC 214 at [69] (EWCA (Civ)); *Re the Esteem Settlement: Grupo Torras SA v Al-Sabah (No 8)* [2004] WTLR 1 (JRC); *Shalson v Russo* [2005] Ch 281 at 342 (Ch);

[32] In *Rahman*, the defendant was a trustee under Jersey law. It had the power to apply capital and income to or for the benefit of the settlor and to have regard to the settlor's interests exclusively when deciding to exercise this power. The settlor retained power to appoint income and capital on such trusts with the consent of the trustees, but with power to appoint one-third of the capital without the trustees' consent. The Court found that the settlor referred to the trust fund as "his asset". There was no evidence that the trustee made independent investment decisions and often the settlor controlled the trust funds directly. Not surprisingly, the Court held the trust was a sham with the result that it was wholly invalid and ineffective.

[33] In *Re the Esteem Settlement* arguments similar to those raised by Mr Guest were put before the Royal Court of Jersey. The Court rejected the argument, finding that where a settlor transfers assets to a trustee to hold on trust the settlement will be a sham only if both the settlor and the trustee have a common intention. This was based on four main reasons:

(a) Previous authority suggests a common intention is required: at [53(i)].

(b) It would be absurd if in circumstances where a trustee has acted as a perfect trustee applying assets in good faith that the secret, unexpressed intention of the settlor that a trust be a sham could cause the trust to be held to be invalid: at [53(iii)]. Estoppel would prevent the settlor from attacking the trust but a third party would not be estopped. The Deputy Bailiff stated, "such extraordinary consequences, must at the very least, raise questions as to whether [the plaintiff's counsel's] formulation of the law can be correct".

(c) Gifts should not be invalidated solely on the basis of intention, some prejudice is required in order to reject the validity of a formal legal document: at [53(iv)].

(d) Trusts are not necessarily unilateral transactions: at [53(viii)]. The Court found that the trust deed in this case was not unilateral as it contained terms for the benefit of the trustee such as remuneration: at [53(xii)].

[34] *Re Esteem Settlement* was followed in *MacKinnon v The Regent Trust Company Ltd v Ors* [2005] WTLR 1367 (CA (Jer)).

[35] In *Shalson v Russo* at 342, Rimer J noted:

> When a settlor creates a settlement he purports to divest himself of assets in favour of the trustee, and the trustee accepts them on the basis of the trusts of the settlement. The settlor may have an unspoken intention that the assets are in fact to be treated as his own and that the trustee will accede to his every request or demand. But unless that intention is from the outset shared by the trustee (or later becomes so shared), I fail to see how the settlement can be regarded as a sham. Once the assets are vested in the trustee, they will be held on the declared trusts, and he is entitled to regard them as so held and to ignore any demands from the settlor as to how to deal with them. I cannot understand on what basis a third party could claim, merely by reference to the unilateral intentions of the settlor, that the settlement was a sham and the assets in fact remained the settlor's property. One might as well say that an apparently outright gift made by a donor can subsequently be held to be a sham on the basis of some unspoken intention by the donor not to part with the property in it. But if the donee accepted the gift on the footing that it was a genuine gift, the donor's undeclared intentions cannot turn an ostensibly valid disposition of his property into no disposition at all.

[36] Mr Guest placed particular reliance on *Wyatt*, in which David Young QC (sitting as a Deputy Judge of the High Court) held (at 245):

> I do not understand Diplock LJ's observation [in *Snook*] regarding the requirement that all the parties to the sham must have a common interest being a necessary requirement in respect of all sham transactions. I consider a sham transaction will still remain a sham transaction even if one of the parties to it merely went along with the 'shammer' not either knowing or caring about what he or she was signing.

[37] The particular factual situation in that case needs to be noted. Mr Wyatt settled his family home on trust for the benefit of his wife and daughter, so as to immunise it from any business failure he might suffer. When his business did fail, he sought to protect his house from creditors by relying on the settlement earlier executed, of which his wife was a trustee. It emerged that Mr Wyatt's wife had had no knowledge of the effect or nature of the declaration she signed as "trustee". The

Court therefore held that there was a sham, and that the declaration of trust was void and could not be enforced.

[38] Subsequent cases and commentators have interpreted *Wyatt* as authority for the proposition that recklessness or ignorance on the part of a trustee is tantamount to intention, rather than the weaker proposition that recklessness or ignorance is simply adequate without more for the finding of a sham. *Wyatt* does not dispense with the common intention requirement, but simply broadens the scope of "intention". But even if *Wyatt* could be read as authority for the proposition that something less than intention on the part of the trustee is required, that is a far cry from the view that no aspect of the trustee's mental state is relevant.

[39] An alternative view of *Wyatt* is that it was an instance of a unilateral declaratory trust, since Mr Wyatt did not transfer property to a separate trustee (i.e. his wife). On such a reading of the facts of that case, there was never any need to find – or indeed any possibility of finding – a common intention, since there was only one active party to the transaction.

[40] As discussed below (at [51]), it is possible – and conceptually desirable – to delineate types of ostensible trust transactions when ascertaining the kind of intention required to sham, rather than treating all alleged "sham" trusts as an homogenous class.

[41] The preponderance of overseas cases is firmly in favour of the requirement that there must be a common intention before a transaction is found to be a sham. A common intention requirement is appropriate and desirable where the transaction in question is properly described as bilateral (i.e. where the "trust" involves a trustee who is separate and distinct from the settlor). But this requirement fades when the trust is properly categorised as unilateral (i.e. where the "trust" is settled and "managed" by the same person). This delineation allows flexibility, focussing on the particular circumstances of each transaction, not the fallacious amalgamation of all "trust" transactions into one type.

[42] It is trite law that in order for a valid trust to be created three certainties must be satisfied, certainty of intention, certainty of subject matter and certainty of object: *Knight v Knight* (1840) 3 Beav 148 at 173; 4 ER 58 at 68 (CA). The absence of any of the certainties results in a failure to create an express trust. Where there is certainty of subject matter but there is no certainty of intention, the person entitled to the trust property (usually the settlor) holds it free from any trust: McGhee (ed.) *Snell's Equity* (31 ed 2005) at [20-25]. The trust is void ab initio.

[43] A Court cannot hold that a trust exists unless it is satisfied that there was the intention to create such a trust: Heydon & Leeming *Jacob's Law of Trusts in Australia* (7 ed 2006) at [501]. In determining whether the requisite intention exists the Court may look at the nature of the transaction and the whole of the circumstances attending the relationship between the parties. The overall question is whether in the circumstances of the case, and on the true construction of what was said and written, a sufficient intention to create a trust has been manifested: *In re Kayford Ltd (In liq)* [1975] 1 All ER 604 at 607 (Ch).

[44] Equity will look to the substance not simply at the form of any purported trust. It is not sufficient to create a trust that the settlor creates what is in fact some other legal device but labels it as a trust: Thomas & Hudson *The Law of Trusts* (2004) at [1.32]. The use of the word "trust" will not necessarily manifest an intention to create a trust if it appears that there was no intention to create a relationship properly so described: *Tito v Wadell (No 2)* [1977] 1 Ch 106 at 220 - 225 (Ch).

[45] The creation of a trust is rightly described as a unilateral transaction. If, objectively assessed, a settlor intends to create a trust, and the other certainties and requirements of constitution are present then the intentions of the trustee will be irrelevant. Conversely, if objectively the settlor does not intend to create a trust then one of the core certainties is missing and there cannot be a valid trust. The trustee**'s** intentions are not critical.

[46] A trust does not normally fail for lack of a trustee*: Snell's Equity* at [25-07]. If a trustee disclaims, the trust still subsists (*Mallott v Wilson* [1903] 2 Ch 494 (Ch)),

save in rare cases where the settlor has made the validity of the trust dependent upon the acceptance of office by a particular trustee: *Re Lysaght* [1966] Ch 191 (Ch). The identification, and therefore the intention, of the trustee are irrelevant to the existence of a valid trust.

[47] This feature of valid trust formation is the basis of Jessica Palmer's argument in her recent article "Dealing with the Emerging Popularity of Sham Trusts" [2007] NZ Law Rev 81. She contended that:

> The trustee's intention is irrelevant to the creation of a valid trust, and likewise it is irrelevant to the creation of the appearance of a trust (or what is otherwise the non-creation of a trust). If no mutuality of intention is required to create a valid trust, it is conceptually incoherent to require mutuality to create a sham trust [at 94].

[48] This argument equates the essential form of a valid trust with that of a sham. But, in the case of a sham, the intention goes to the "non-creation" of the trust, or the sham. The two situations (valid trust and sham trust) do not fall into combination. The finding that a purported trust is void as a sham does not amount to an invalidation of a trust. It is not the trust as such which is the sham. There is no trust to be a sham. It is the trust documentation that is the sham.

[49] Mathew Conaglen, in his more recent article "Sham Trusts" (2008 67 CLJ 176-207), argues that Ms Palmer mistakenly categorises all trusts as unilateral transactions, distinguishing them from consensual contractual agreements. He contends that in fact many trust transactions are closer to the contractual paradigm, being bilateral and involving the intentions and consciences of both settlor and trustee(s).

[50] An important prior question is whether common intention must be ascertained objectively, as is usual in the construction of commercial documents, or subjectively, in the departure from orthodox norms of construction. Where a sham is alleged, should a Court look behind the objective trust-appearance of an alleged sham so as to ascertain the true nature of the transaction? The answer must be yes. Otherwise, the most insidious kinds of shams are those most able to work their mischief. To answer "no" would be to give exaggerated weight to the objective

appearance of a transaction. While the objective appearance is the default determinant of a transaction's effect and substance, sham transactions are by definition transactional aberrations, and therefore require departure from the default principles of analysis.

[51] Not all trust transactions have the same form. Some are unilateral because the settlor and the trustee are not separate persons, and there is therefore no possibility of mutuality of any mental state, which precludes a common intention. But other trusts are, practically speaking, bilateral involving the actual intention and consciousness of both the settlor and the trustee(s). While the creation of a valid trust requires the intention only of the settlor, that is properly understood as a principled consequence of the norms of alienation of property, rather than a principle that should apply to any transaction that purports (even feebly) to be a trust.

[52] The principle that an arguable allegation of a sham trust legitimates examination of subjective intention, and not simply the objective intention as evinced by the "trust" documentation, is consistent with the proposition that courts will not wantonly interfere in ostensibly valid commercial transactions. In the context of trusts, where a transaction objectively appears to be a trust, it will be held out to be a trust, even if it is unclear whether the settlor actually intended for there to be a trust (see *Paul v Constance* [1997] 1 WLR 527 (CA)). A Court will only look behind a transaction's ostensible validity if there is good reason to do so, and "good reason" is a high threshold, since a premium is placed on commercial certainty.

[53] The requirement that the parties to an alleged sham commonly intend for the ostensible trust to operate as a sham might be viewed as an instance of this "high threshold". If only the settlor's duplicitous intention is required, then it is relatively straight-forward to set aside a "sham" trust. Many fewer sham trusts will be set aside if common intention is required, and this promotes commercial certainty.

[54] There needs to be a nuanced approach which recognises the variety of circumstances in which sham might emerge and a blanket approach is both unhelpful and unsustainable.

(ii) Emerging sham

[55] The OA argued that, even if it could not be established that Mr Reynolds intended the trust operate as a sham from its inception, he had developed such an intention by the time the Queenstown property was acquired. Counsel asserted that this was sufficient to turn the otherwise valid trust into a sham.

[56] In *Marac Finance Ltd v Virtue* [1981] 1 NZLR 586 at 588 (CA), Richardson J said:

> Where the essential genuineness of the documentation is challenged a document may be brushed aside if and to the extent that it is a sham. There are two such situations: (1) where the document does not reflect the true agreement between the parties in which case the cloak is removed and recognition given to their common intentions; and (2) where the document was bona fide in inception but the parties have departed from their initial agreement and yet have allowed its shadow to mask their new arrangement.

[57] *Marac Finance* involved a financing agreement not a trust. Once a trust is validly created, the beneficiaries have an interest in the trust property that cannot easily be undone. Unless the later appearance of a sham can be traced back to the creation of the trust, the trust remains valid. An exception to this could be where an item of property is later transferred to the trust, the trust could be a sham with respect to that property only, but the remainder of the trust would remain valid.

(iii) Method of assessment

[58] The OA also argued that the Judge erred in his method of assessing whether the trust was a sham. He asserted that the Judge undertook an assessment of whether individual transactions were shams – rather than assessing the overall picture.

[59] We find no merit in this argument. Given that Mr Guest argued that the trust was either a sham from inception or an emerging sham, it was necessary for the Judge to analyse individual pieces of property. We are satisfied that there was no error in the Judge's decision-making.

Alter ego trust

[60] As an alternative to the sham argument, the OA argued that the trust was the alter ego of Mr Reynolds. The contention was that Mr Reynolds controlled the trust to such an extent that the trustees were mere puppets. The trustee's discretion had been subsumed by Mr Reynolds to such an extent that in reality the decisions made about the trust were made by the controller. The OA contended that the relinquishment of control by the trustees to the controller enabled the Court to find that the trust structure was a façade that could be disregarded.

[61] In the High Court the Judge interpreted the OA's pleadings as arguing that evidence of an alter ego trust was advanced to prove that the trust was a sham. In so doing Mr Guest submitted that the Judge failed to engage with the alter ego argument. He asserted that it was not merely evidence in support of a sham, but a stand-alone ground upon which relief could be granted.

[62] It is therefore necessary for us to consider the status of alter ego trusts in New Zealand.

(i) Law on alter ego trusts

[63] Two High Court cases have affirmed the existence of the alter ego trust concept in New Zealand: *Prime v Hardie* [2003] NZFLR 481 and *Glass v Hughey* [2003] NZFLR 865. A number of Family Court decisions have relied on the concept: see for example *Begum v Ali* FC AK FAM-2001-004-866 10 December 2004 and *O v S* FC DUN FAM 2004-002-80 12 December 2006. All of the cases dealing with alter ego trusts have been in the context of de facto or marital relationships. None of the cases have addressed the theoretical basis upon which a Court is justified in finding an alter ego trust.

[64] There are some cases and legal writing which suggests that an alter ego trust occurs where a person is held to have control over an express trust to such an extent that the trustees are considered to be "mere puppets" of the defendant: *Ascot Investments Limited v Harper* (1981) 148 CLR 337 at 355 per Gibbs J; *In the*

Marriage of Gould (1993) 17 Fam LR 156 at 167 (Fam CA). These are instances of where a valid trust has been established but the trustee's discretion has been subsumed by the controller to such a degree that in reality decisions made about the operation of the trust are made by the controller. It is argued that the relinquishment of control by the trustee to the controller allows the Court to find that the trust structure is a façade that can be disregarded. The level of control over trust property by someone other than an appointed trustee is said to justify the Court piercing the express trust and thereby making what would otherwise be trust property, available to third party claimants.

(ii) Relationship between sham trusts and alter ego trusts

[65] The relationship between shams and alter ego trusts is not clear. In both *Prime v Hardie* and *Glass v Hughey* the two concepts were mentioned but there was no elaboration of the difference, if any, between them.

[66] The distinction between shams and alter egos, as they relate to trusts, came to New Zealand from Australia. In *Glass v Hughey* at [90], Priestley J referred to a line of Australian cases as authority for his alternate finding of an alter ego trust. In Australia the alter ego trust has developed, in the context of relationship property proceedings, as a separate cause of action to a sham. An alter ego occurs where the "controller" is deemed to have effective control over the trust and/or trust property. The control is such that it overrides the discretion of the trustees and makes trust property "in reality" the de facto property of the controller: *In the Marriage of Ashton* (1986) 11 Fam LR 457 (Fam CA). In such circumstances the Court is able to look through the trust and access trust property. This does not involve the Court in treating the trust as void. Unlike a sham, the alter ego trust is intended to be a genuine trust. There is no requirement of an intention to deceive.

[67] The place of alter ego trusts in relationship property law is not directly in issue in this case, but we observe that the Australian cases need to be viewed with some caution. Unlike New Zealand, Australia has a discretionary regime for altering the property interests of spouses when the marriage ends: Family Law Act 1975 (Cth), s 79. Section 79(4)(e) of that Act allows the Court to take into account the

"financial resources" available to each of the spouses. It is in that context that Australian courts have held that if a spouse has effective control of property, that asset can be included in the division of relationship assets. This is a significant difference as in Australia there is no need for the Court to invalidate the trust to access trust assets: Peart at 196.

[68] New Zealand courts do not have such a power. Sections 44 and 44C of the Property (Relationships) Act 1976 (PRA), the so-called "trust busting" provisions, do not go that far. These sections relate to dispositions made to a trust done "in order to defeat" the rights of a spouse/partner (s 44) or have the "effect of defeating" such rights: s 44C(1)(b). These provisions have strengthened the Court's ability, under the PRA, to access or make adjustment for trust property: *Nation v Nation* [2005] 3 NZLR 46 at [143] (CA). The Court's ability to access trust property, however, is confined to limited circumstances: PRA, s 44. In the absence of statutory authority, there needs to be an equitable basis for avoiding a trust. Section 182 of the Family Proceedings Act 1980 is also seen as having some characteristics of a "trust busting" provision, but it is also limited in its scope.

[69] The assumption of factual control by someone other than a trustee (or a sole trustee if there is more than one trustee) or by someone without legal right to exercise such power cannot of itself invalidate a trust. As noted by Jessica Palmer at 89:

> The alter ego, as factual control, should be an impotent, meaningless concept. In the eyes of the law, factual control has no effect on legal ownership. Indeed a stranger who takes control of trust assets will be considered a trustee de son tort and be liable to account for the property of beneficiaries. Factual control of trust property cannot justify recognition that the controller thereby owns the trust assets.
>
> …
>
> The alter ego concept, as it relates to factual control, serves to attribute an individual's actions to those of the organisation that he is controlling. It is not a mechanism whereby an individual can appropriate property to him or herself by virtue of the control that he or she exercises.

[70] Actual control alone does not provide justification for looking through/invalidating a trust. The uptake of control by someone other than an

authorised person cannot be sufficient to extinguish the rights of the beneficiaries under a trust. It is difficult to see the alter ego trust operating in New Zealand as an independent cause of action.

[71] Factual control of a trust by someone other than those authorised to have such power is not an irrelevant consideration. Such control may give rise to a claim for breach of trust. Evidence of such control may be relevant to the question of whether a trust is a sham in that it may evidence a lack of true intention to form a trust. That is not to say that an alter ego trust is the same as a sham. A finding of effective control may help establish that a trust is a sham if it indicates that it was not intended that the trust take effect according to its terms. To establish a sham, the intention to mislead must be shown to have existed from the inception of the trust (or from the time when particular property was disposed to the trust). Evidence of effective control of the trust post settlement maybe used to infer the requisite intention.

[72] We are satisfied that Chisholm J's treatment of the alter ego trust argument was correct. Alter ego trusts are not an independent cause of action, nor are they the same as shams. In the trust context, alter ego arguments are confined to evidence to help establish a sham which is how he treated the matter.

[73] The OA has recourse to a number of different provisions that allow the Court to invalidate dispositions made to a trust by a bankrupt and clawback property into the hands of the bankrupt. These include s 54 of the Insolvency Act which provides that a gift of property is voidable if made within two years of the donor being adjudicated bankrupt. A similar provision is provided for in the Insolvency Act 2006 which is now in force: s 204. Also available is s 60 of the Property Law Act 1952 which provides that every alienation of property made with the intent to defraud creditors is voidable. For dispositions made after 31 December 2007, s 348 of the new Property Law Act 2007 provides that a Court may set aside dispositions of property that prejudice creditors.

[74] If these mechanisms – which have undergone recent evaluation – are not sufficient, then it is a matter for Parliament. Mr Guest advanced his claim on the basis of sham because of the small amount of property which was transferred to the

trust. The majority of its current assets were acquired by it and so s 60 of the Property Law Act was not of assistance. There must, however, be caution in the Courts too readily finding a sham and depriving beneficiaries of their legal entitlement.

Was the trust a sham?

[75] For completeness we consider whether the evidence in this case is sufficient to establish that the G M Reynolds Family Trust was a sham.

[76] The OA addressed much of his evidence to the question of whether the trust was Mr Reynolds' alter ego. While we have found that there is no such independent cause of action, we will consider the alter ego evidence to see whether it helps establish that the trust was a sham.

[77] Where breaches of trust can be established, that does not necessarily suggest that the trust has been a sham from its inception. The breaches could be of evidential value, but cannot be treated as decisive. Finding that a properly created and executed arrangement is a sham is an extreme finding because of the effect which it has on the interests of beneficiaries. Caution needs to be exercised in determining whether acts or omissions after the creation of the trust provide compelling evidence at the high level required to justify such findings.

[78] The OA contended that, as all of the transactions made in the name of the trust were carried out at the direction of and in the interests of Mr Reynolds, the trust was invalid. He focused on four situations as evidence of this:

(a) the sale of the Invercargill property to Mr Reynolds by the trustees;

(b) the trustees borrowed more than was necessary to purchase the Queenstown property;

(c) attempts by Ms Clyma/Mr Reynolds to use trust property to raise money for their own personal use; and

(d) the poor administration of the trust.

Transfer of the Invercargill property to Mr Reynolds by Trustees

[79] Mr Guest contended that the transfer of the Invercargill property to Mr Reynolds was evidence of Mr Reynolds' control of the trust and was therefore evidence that the trust was invalid. His argument was based on a challenge to the High Court finding as to the motivation for the transfer. Counsel argued that the house was transferred in order to allow Mr Reynolds to raise a mortgage against the property to service his personal debt. He relied on evidence given by Mr Wilson under oath to the OA. The trustees, by contrast, argued that the transfer was made to allow Mr Reynolds and Ms Clyma to do renovations to the property as the trustees were not willing to undertake the risk of doing the renovations themselves.

[80] The Invercargill property was transferred to Mr Reynolds on 24 April 1997 and $64,000 was paid to the trust. This was the amount that the house had been purchased for less than a year before. The trust had net assets of $5,704 after all liabilities had been met.

[81] It is not necessarily the case that the transfer was not in the best interests of the beneficiaries. Mr Guest contended that it was arguable that a transfer of this sort was not in the best interests of the beneficiaries, in that the trust replaced an asset which had been the children's family home with just net assets of a bit over $5,000. His position seems to ignore the substantial borrowing secured over the house property. Whether there was likely to have been a capital increase in the value of the Invercargill house is speculative, so whether it was a better trust investment cannot be determined. It is not the wisdom of a transaction that is of relevance. The central question is whether this activity is evidence that there was an intention that the trust operate as a sham.

[82] Mr Guest suggested there was significance in the fact that the only asset in the trust was transferred to Mr Reynolds within a year of its purchase. This fact is equivocal at best. Adequate explanation has been given for the timing of the transaction.

[83] We are not satisfied that there is an adequate basis for overturning the factual findings of Chisholm J regarding the motivation for the transfer. There was evidence before the High Court that the trustees transferred the property to Mr Reynolds so that he could bear the risk of raising funds to make necessary renovations to the property and it was open to the Judge to make such a finding.

[84] This finding robs the transfer to Mr Reynolds of any significance in terms of the sham argument.

Borrowing more than necessary to purchase the Queenstown property

[85] Mr Guest asserted that the trustees borrowed more than was necessary to purchase the Queenstown property and the extra money borrowed was used to repay Mr Reynolds' personal debts. He contended that this was strong evidence of the existence of a sham, or of an emerging sham in relation to the Queenstown property.

[86] Mr Forbes sought to explain the transaction by noting that both the Queenstown property and the Invercargill property (which at the time was owned personally by Mr Reynolds) had been used to secure the funding in order to obtain better leverage and a better rate of interest for any loan. As both houses were used as security, more had to be borrowed than the purchase price so as to cover the mortgage over the Invercargill property ($150,000 mortgage held by the BNZ). Counsel argued that this was necessary because, at the time the Queenstown property was purchased, the trust only had assets valued at approximately $5,000.

[87] The trustees had entered into a transaction that required them to be involved in joint security with a discharged bankrupt. This was perhaps an unwise decision especially as Ms Clyma's company was willing to lend $75,000 towards the purchase. However unwise the decision, it does not establish an intention on behalf of the settlor that the trust was a sham. Nor does it establish that the trust was a sham as it related to the Queenstown property.

Attempts by Ms Clyma to use trust property to raise money

[88] Mr Guest argued that an attempt made by Ms Clyma to use trust property to raise money for her personal benefit was also evidence of sham. He asserted that this attempt was done at the direction of Mr Reynolds.

[89] There is insufficient evidence to reach that conclusion regarding Mr Reynolds' role in the attempt to obtain a loan by using trust assets as security. It cannot be established that such an attempt was directed by or was even done with the knowledge of, Mr Reynolds.

[90] Chisholm J accepted the trustees' evidence that they would not have gone along with anything that Mr Reynolds wanted, so even if it could be proven that Mr Reynolds directed Ms Clyma to make the loan application, that would be significant evidence, but insufficient of itself, to establish that Mr Reynolds intended the trust to be a sham from its inception.

Poor administration

[91] There is no direct evidence that Mr Reynolds intended that the G M Reynolds Family Trust be operated as a sham. Mr Guest noted that there was an absence of resolutions or minutes, no annual accounts, intermingling of financial arrangements between the trustees and Mr Reynolds and no record of decisions or other documentation relating to the use of trust properties by the beneficiaries' parents. The trust records were sent to Mr Reynolds rather than the trustees. Mr Guest argued that there was a general lack of engagement by the trustees with what was occurring in the trust. He gave the example of Mrs Harvey (Ms Clyma's mother and trustee) and her apparent failure to exercise independent judgment.

[92] Evidence of poor administration of the trust is insufficient, of itself, to establish a sham. This may be evidence of a breach of trust, but the fact that the trustees have acted poorly in managing the trust does not establish an intention that the trust operate as a sham.

Overall assessment

[93] There is no direct evidence that Mr Reynolds intended that the G M Reynolds Family Trust be operated as a sham. The OA invited the Court to draw this inference. To draw the inference of a sham in the absence of direct evidence needs compelling material. Such a finding cannot be made if another inference is at least equally open on the evidence: *Sharrment v Official Trustee*.

[94] We are not persuaded that there is a basis from which any factual scenario could be drawn from the evidence that was presented and available to a Judge, which could create the situation in which the Court could declare that what occurred was a sham.

[95] On a broad overview, it is likely in this case that Mr Reynolds subjectively wished to establish a trust (even if he may not fully have understood the implications or may even have contemplated to breach its terms when it suited him). The documentation which was completed was consistent with a subjective intent to create the trust. On the findings of the Judge, there were non-complicit trustees who entered into transactions and acquired property (and administered that property even if not very well) in the name of the trust and so they cannot be said to have intended the trust to operate as a mere sham.

Result

[96] Accordingly the appeal must be dismissed. This is not a case where it is appropriate to grant costs in favour of the trustees or Mr Reynolds himself who was so closely aligned with their position. The operation and activities of each during the ten years the trust has existed, invited challenge.

[97] Costs should lie where they fall.

GLAZEBROOK J

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Introduction

[98] I agree with the result of the appeal and (largely) with the reasons set out in the judgment delivered by Robertson J on behalf of himself and O'Regan J. I would, however, like to add some comments on the concept of sham and alter ego trusts.

[99] I intend to comment on these issues under the following headings:

(a) Is intention ascertained objectively or subjectively?

(b) Is the concept of sham different from that of intention?

(c) Is trustee complicity necessary for there to be a sham?

(d) Is the purpose for setting up a trust significant?

(e) What is the relevance of breaches of trust and bad administration?

(f) What is the effect of alter ego trusts?

Is intention ascertained objectively or subjectively?

[100] Certainty of intention is one of the three certainties necessary for there to be an express trust. It is fundamental to the creation of an express trust and it is the unilateral intent of the settlor that is at issue in this regard. If there is no settlor intent

then either the disposition will constitute an outright gift to the purported trustee or that trustee will hold the property on a resulting trust for the settlor – see Butler (ed) *Equity and Trusts in New Zealand* (2003) at [4.2.2(7)] and Richardson *Nevill's Law of Trusts, Wills and Administration* (9ed 2004) at [2.3.1]. I discuss the concept of resulting trust in more detail below – see below at [118] - [119].

[101] The High Court of Australia, in *The Commissioner of Stamp Duties (Queensland) v Jolliffe* (1920) 28 CLR 178, seemed to accept that intent can be judged subjectively. See also *Starr v Starr* [1935] SASR 263 (SC). In *Jolliffe,* Mr Jolliffe, opened an account at the bank solely for the purpose of procuring interest which would otherwise not have been paid. On opening the account he made a declaration, as required by the relevant legislation, that he was the bona fide trustee for his wife. His wife died intestate and the question was whether the deposit moneys formed part of her estate.

[102] The majority of the High Court (Knox CJ and Gavan Duffy J) found that Mr Jolliffe had been entitled to adduce evidence that he did not intend to hold the money on trust. As this evidence of his subjective lack of intent had been accepted by the Court at first instance, the majority held that the money in the account was not held on trust for his wife. This was because no form of words could be used to create a trust contrary to the real intention of the person alleged to have created it (see at 181).

[103] Isaacs J dissented. He held that the oral evidence of subjective intention should be rejected. The first reason given was that, once a clear declaration of trust is made, that is an effectual vesting of the property in equity in the beneficiary. He did not consider it open to Mr Jolliffe to affect the result by subsequent evidence of his then undisclosed intention, contrary to the unambiguous declaration he made (at 190 - 191). The second reason given by Isaacs J (at 191) was that parole evidence is not available to contradict a written document where the evidence amounts only to a personal secret intention not to do what the document purports to effect. The third reason was based on public policy. Mr Jolliffe was attempting to profit by his own fraud. Isaacs J said that no man can protect himself from the consequences of his intentional and deliberate acts, including the natural conclusions to be drawn from

them, by afterwards setting up his secret intention to defraud or break the law (at 191 - 192).

[104] For myself, I prefer Isaacs J's approach, which is based on an objective assessment of the settlor's words and actions and not subjective lack of intent. I do not consider that the majority's approach in *Jolliffe* should be adopted in New Zealand. I consider that intention should be judged objectively if what is meant is that intention, where there is a written trust deed, is judged on the true construction of that document according to the ordinary rules of construction (including as to the admissibility of extrinsic evidence) and not the subjective intent of the purported settlor. See Hanberry & Martin *Modern Equity* (17 ed 2005) at [3-019], Dal Pont & Chalmers *Equity and Trusts in Australia* (4 ed 2007) at [17.25], Heydon & Leeming *Jacobs' Law of Trusts in Australia* (7ed 2006) at [501] and Conaglen "Sham Trusts" (2008) 67 CLJ 176 at 181.

[105] In this case, there was a trust instrument, which, on its ordinary meaning, clearly created a trust. There was a small amount of property transferred to and further property acquired by non-complicit trustees (on the findings of the Judge). In such circumstances, a settlor (or the Official Assignee in the shoes of the settlor) cannot argue successfully that, objectively determined, there was no intention to create a trust. Unambiguous words were used to create the trust. Further, property has been transferred to and acquired by trustees who have, as far as they were concerned, assumed the obligations under the trust deed.

Is the concept of sham different from that of intent?

[106] I do not think it productive to equate the concept of sham with that of intention to create a trust as is done by Palmer (discussed at [47] above). The issue of intent usually arises where the words and/or documents involved are equivocal as to whether a trust has been created or whether there is some other type of legal relationship such as agency or bailment. See for example Butler at [3.1.6], [3.1.7] and [4.2.2]. On the other hand, a "shammer" will usually have made sure that the trust is documented in a manner that ostensibly makes intention clear. This creates the appearance of a trust when in fact it is clear from the surrounding circumstances

(factual matrix) and perhaps from subsequent conduct that the reality was not intended to match the appearance. See Conaglen at 184.

[107] If sham is equated with intention and intention is judged objectively then, where there is a written document that makes intention clear, a sham cannot (on the ordinary rules of construction) be found. While factual matrix and subsequent conduct can be used to interpret a written document, they cannot normally (absent duress or mistake for example) be used to contradict it. See, for example, the discussion in Burrows, Finn & Todd *Law of Contract in New Zealand* (3 ed 2007) at [6.2.2].

[108] In my view, where a sham is alleged, the search is for subjective intent that the transaction is a sham. After all, the whole point of a sham is that it is intended to have an effect other than the effect it would have if looked at objectively. See Conaglen at 186, *Hitch v Stone* [2001] STC 214 at [56] (EWCA) per Arden LJ (for the Court) and *Sharrment Pty Ltd v Official Trustee in Bankruptcy* (1988) 18 FCR 449 at 456 (FCA) where Lockhart J said:

> It is not clear from Diplock LJ's formulation [in *Snook v London & West Riding Investments Ltd* [1967] 2 QB 786 (CA)] whether it is the subjective intention of the parties that is determinative, although logically this seems to be the correct result. In *Coppleston's* case Hunt J (at 98;4022) took the view that the authorities established that it is the intention of the parties to the transaction which determines the question whether the act or document was never intended to be operative according to its tenor at all but rather was meant to cloak another and different transaction.

[109] This does not mean that a settlor is entitled to give later oral evidence of his or her subjective intentions, particularly where this is with a view of depriving the beneficiaries of their rights under the trust or, as in *Jolliffe*, defrauding a third party (in that case the Commissioner of Stamp Duties). See Malek (ed) *Phipson on Evidence* (16 ed 2005) at [5.09], which discusses the fundamental principle at common law that precludes a grantor of a deed from disputing the validity and effect of his or her own grant. In this regard, I do not consider *Hawke v Edwards* [1947] 48 SR (NSW) 21 (CA) would apply in New Zealand. At 23 of that case, it was said that oral evidence was admissible to show that the document was never intended to be operative according to its tenor. Indeed, in *Snook*, Diplock LJ (at 802) made it

clear, albeit in another context, that no unexpressed intentions of a "shammer" should affect the rights of a party whom he or she deceived.

[110] In assessing whether a trust is a sham, the Courts should have regard to contemporary evidence of the actions (and words) of the relevant parties showing that the trust was not intended to be genuine. Subsequent conduct and words can also be relevant but only with a view to ascertaining the subjective intention that the trust be a sham at the time it was set up or, in the case of an "emerging sham" in the sense set out in Robertson J's judgment in the last sentence of [57], at the time of any later impugned transfer to that trust.

[111] I agree with the discussion by Conaglen, at 192 – 193, on onus and burden in relation to allegations that a trust is a sham. The party asserting the existence of the sham bears the onus of proving this on the balance of probabilities. Further, the ordinary approach to proof in civil cases should apply, where the more serious the allegation, the less likely it is that the event occurred and, therefore the stronger the evidence must be before the allegation will be established on the balance of probabilities – see Conaglen at 193.

[112] I consider that any finding of sham where a trust is involved should not be lightly made. While other sham transactions are usually designed to defraud third parties, the sham transaction itself does not purportedly give rights to parties under the transaction itself apart from the sham parties to the transaction, all of whom know the true situation because of the requirement for mutuality of intention. With trusts, there are beneficiaries involved and a finding of sham will deprive them of their rights under the trust.

Is trustee complicity necessary for there to be a sham?

[113] Under the *Snook* formulation of sham, common intention to conceal the true nature of the transaction is necessary. That requirement was adopted by this Court in *Paintin and Nottingham Ltd v Miller Gale and Winter* [1971] NZLR 164 at 168 and 176, albeit not in a trust context.

[114] The weight of authority overseas suggests that trustee complicity or at least trustee ignorance and recklessness (as in *Midland Bank plc v* Wyatt [1995] 1 FLR 696 (Ch D)) is necessary for there to be a sham. See the discussion of those overseas authorities in Robertson J's judgment at [31] – [39] and also *Minwalla v Minwalla* [2005] 1 FLR 771 at [54] (Fam) per Singer J. The same applies to a number of commentators – see for example Underhill and Hayton *Law Relating to Trusts and Trustees* (17 ed 2006) at [4.7], Hanbury & Martin at [3-020] and Peart "Trust Busting - Looking Through Trusts" in *Trusts* (Wellington, NZLS 2007) 176 at 190 and Conaglen at 187 - 192. I agree.

[115] Where a trustee has entered into a trust deed and/or property has been transferred to or acquired by a trustee in accordance with a trust instrument, the transaction, in my view, ceases to be unilateral and becomes bilateral. The trustee undertakes obligations in relation to the trust property by signing the trust documentation and/or by accepting or acquiring the property on the terms of the trust. It is true that the trust would not fail if the trustee failed to perform those obligations or changed his or her mind about undertaking them but this seems to me beside the point in terms of whether trustee complicity is needed for a finding of sham.

[116] I do not consider that the settlor's subjective intention that the trust not be operative can invalidate a trustee's assumption of trustee responsibilities in circumstances where the trustee was effectively deceived by the settlor. If property is transferred to a complicit trustee in a sham transaction, that trustee will know that there was no intent to create a trust and therefore no intent to transfer the beneficial interest in that property to the beneficiaries. The trustee, by his or her complicity in the sham, will have effectively agreed to hold the property on what may well be a bare trust for the purported settlor. See Conaglen at 187 – 188.

[117] A different situation arises for a non-complicit trustee. Let us assume that legal title to property has been transferred to a trustee, who is not complicit in any sham. It seems to me that the trustee, by accepting the transfer on the basis of what the trustee considers to be a genuine trust instrument, will be conscience-bound to hold his or her legal title to the property for the benefit of the beneficiaries in

accordance with that trust instrument, particularly if he or she is a party to that documentation or has agreed in writing to become a trustee. As was said by Lord Browne-Wilkinson in *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] AC 669 at 705 (HL), the foundation of trusts is the conscience of the legal owner of the property. See also Watt *Trusts and Equity* (2003) at 85 and Thomas & Hudson *The Law of Trusts* (2004) at [1.51]

[118] The only way that the settlor (or the Official Assignee in the settlor's shoes) could call for a transfer back of the property would be through the imposition of a resulting trust. The commentators are divided on the basis for a resulting trust. One view is that it is restitutionary – see Chambers *Resulting Trusts* (1997). The other view, which was endorsed by the House of Lords in *Westdeutsche*, is based on the premise that a resulting trust can only arise if the conscience of the recipient is affected. In the case of a non-complicit trustee, it seems to me that that trustee's conscience is affected by the trust instrument and not by the settlor's subjective intentions, which were concealed from that trustee. There would thus be no resulting trust. In my view, the same result would apply even if the restitutionary view of resulting trusts is taken.

[119] In a case where the trustee acquired property after the trust has been set up, it is even more inconceivable that a settlor could argue that, despite the trustee's clear intent in acquiring the property, it was held in fact on a resulting trust for the settlor. This would effectively result in the settlor benefiting from his or her own deceit of the trustee. In any event, I do not think that the settlor's intentions on settlement of the trust could continue to taint the later transactions of the trustee which were undertaken, insofar as the trustee was concerned, in accordance with a written instrument, upon which the trustee was relying for authority to complete the transaction. This is particularly the case where the acquisitions were funded through borrowings and not trust assets.

[120] If I am wrong and mutual intent is not necessary for there to be a sham and/or intent is, as was held in *Jolliffe*, judged subjectively on the basis of settlor intent alone, then in my view a constructive trust should be imposed in favour of the beneficiaries (provided of course that they were not complicit in the sham) on the

basis that it would be unconscionable for the settlor to benefit from his or her fraud in deceiving the trustee (and/or the beneficiaries). See *Commonwealth Reserves I v Chodar* [2001] 2 NZLR 374 (HC) where a constructive trust was imposed on the basis of unconscionability. This would not be a radical remedy as it would merely put the trustee (and the beneficiaries if they are aware of the alleged trust) in the position they always thought to be the case.

[121] This section presupposes that the beneficiaries are not complicit in any sham. Where there is a common intention between the settlor and the beneficiaries that the trust not be operative, then the trust will in my view be a sham, even where the trustee is not complicit in that sham. Where the common intention is not shared by all the beneficiaries, however, the trust will likely be held not to be a sham but any distributions to the complicit beneficiaries will be held on resulting trust for the settlor.

[122] There may also be situations where there is a duped settlor (see Peart at 188). In such cases there may be a common intention on the part of the trustee, the beneficiaries and a third party that the trust not be operative but that the assets be held for the third party. In such circumstances, the trust will likely be held to be a sham. If, however, there is no complicit trustee or the common intention is shared by only some of the purported beneficiaries, then again the situation may be that the trust is valid (except that any complicit beneficiaries would likely hold any distributions on resulting trust for the third party).

Is the purpose for setting up a trust significant?

[123] Despite Chisholm J's finding that the purpose of the trust in this case was to provide for Mr Reynolds' children's future education and support (see at [65] of his judgment), it seems likely that Mr Reynolds was conscious that a trust could potentially keep the trust assets secure from creditors. Even if creditor protection had been the purpose of the trust, however, this would not by itself have meant that the trust was a sham. As Megarry J said in *Miles v Bull* [1969] 1 QB 258 at 264:

> [A] transaction is no sham merely because it is carried out with a particular purpose or object. If what is done is genuinely done, it does not remain undone merely because there was an ulterior purpose in doing it.

[124] Dispositions to a trust may of course be vulnerable to attack under the statutory provisions discussed in Robertson J's judgment at [73] – [74]. I agree with Robertson J that, if those provisions are not considered adequately to protect creditors, then it is for Parliament to strengthen them. This is particularly the case as Parliament must have recently considered those provisions when enacting the new Insolvency Act 2006 and Property Law Act 2007.

What is the relevance of breaches of trust and bad administration?

[125] I think it is important to distinguish between a sham and the situation where a settlor fully intends to set up a trust but also intends later to breach that trust, either through ignorance of trust obligations or even deliberately. To amount to a sham, the settlor has to intend, at the inception of the trust, to give third parties or the Court the appearance of creating rights and obligations different from the legal rights and obligations actually intended (to adapt the words of Diplock LJ at 802 of *Snook*). It is not in itself sufficient for there to be a sham trust that there is an intention to breach some or all of the trust obligations, although that could be relevant evidence of a sham. The settlor could nevertheless intend (whether subjectively or objectively determined) to create a trust. The same applies to bad administration. See the discussion in Garrow and Kelly *Law of Trusts and Trustees* (6 ed 2005) at [10.12] and Robertson J's judgment at [92].

[126] Equally, de facto or actual control, as pointed out by Robertson J at [71], can only be of evidential value in any assessment of whether there is the requisite sham intent. Again it is important to distinguish between a sham and the situation where a settlor intends to set up a trust but, perhaps in ignorance of trust obligations, intends (and maybe even manages) to keep control of assets. It is not enough for a sham to exist that there is a misunderstanding on the settlor's part of the nature or the effect of the documentation entered into.

[127] It must be remembered too, in evaluating the significance of evidence of de facto or actual control, that trustees are entitled to take into account the wishes of the settlor as long as they are prepared not to follow instructions blindly. See Conaglen at 196 and *Kain v Hutton* [2007] NZCA 199 at [272]. Settlor control may often occur with the view of benefiting the beneficiaries and thus be quite consistent with the existence of an intention on behalf of the settlor that the trust be operative.

What is the effect of alter ego trusts?

[128] I agree with Robertson J's discussion on alter ego trusts. I would, however, leave open (because it is not before us) the question of whether an "alter ego trust", which does not amount to a sham, can be treated as the property of the individual involved for the purposes, for example, of a relationship property division.

[129] I agree that the trust could not be looked through and that the trust assets themselves would not be available for division. It may be, however, that the trust property could nevertheless be treated as an asset of the individual involved and the other party awarded a larger share of the other available assets. Whether this approach is contrary to the legislative intent as manifested in the Property (Relationships) Act 1976, as suggested by Peart at 196, would, however, need to be considered. Section 182 of the Family Proceedings Act 1980 may also be relevant.

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