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Should Directors of Corporate Trustees owe Direct Fiduciary Duties to Trust Beneficiaries?

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Contents

I Introduction

A decade long reform process was concluded at the beginning of 2021 when the new Trusts Act was implemented.[1] Whilst addressing many of today's most pressing issues regarding the application of trust law in New Zealand, some notable issues were left unresolved.[2] One of these issues is the focus of this paper: should the law impose a direct fiduciary relationship between the directors of a corporate trustee and trust beneficiaries?

It was initially thought by the Law Commission that the answer should be yes:[3]

> … legislation should require that directors (or equivalent) of a corporate acting as a trustee have the same obligations to the beneficiaries of the trust as they would have had if they and not the company had been the trustees.

However, upon receiving strong opposition to their proposal, the Law Commission sought to postpone the matter to a later review.[4] While it is unclear when such a review might occur, this paper seeks to further build on the work done by the Law Commission. It ultimately finds that the suggested provision should be included in legislation to maintain consistency with trust and fiduciary jurisprudence and to ensure the protection of trust beneficiaries.

Chapter II provides an overview of the problem at hand. It defines a corporate trustee and demonstrates the orthodox position of the law to elucidate the challenge being faced by trust beneficiaries. At the heart of this is the clash between the corporate veil and trust and fiduciary jurisprudence due to the creation of "limited liability trusteeship".

Chapter III and IV provide an explanation on the key legal concepts engaged in answering the question of this paper. Chapter III looks at trusts and fiduciaries and explains how trustees are the archetypal fiduciary. Chapter IV goes through the historical roots of the company and how the corporate veil plays a critical role in ensuring the company remains

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[1] Trusts Act 2019; and see Bell Gully "The Big Picture: New Rules for Trusts" (December 2020) <www.bellgully.com>.

[2] See Law Commission *Review of the Law of Trusts: A Trusts Act for New Zealand* (NZLC, R130, 2013) at [1.12]–[1.18]: where the Law Commission mentions that two other areas of law have been omitted in this review: the review on charitable and purpose trusts and the review on corporate trustees.

[3] Law Commission *Law of Trusts: Preferred Approach Paper* (NZLC IP31, 2012) at [P36]; This was also suggested in 2002 by the Law Commission *Some Problems in the Law of Trusts* (NZLC R79, 2002) at [29].

[4] Law Commission, above n 2, at [16.6]–[16.10].

relevant today. It also goes through the importance of company directors and their respective powers and duties.

Chapter V and VI address matters of reform. Chapter V justifies the need for reform in New Zealand based on the discrepancies found in practise between trustees who are companies and trustees who are natural persons. It contends that the opposing arguments are not enough to justify the law preferring corporate veil principles over that of trust and fiduciary law. Chapter VI agrees with the Law Commission on the preferred approach to legislative reform. It then points to existing avenues which may be open to the courts in finding that the director of a corporate trustee can owe fiduciary duties directly to trust beneficiaries.

II What is the problem?

A Overview

Whilst corporate trustees are nothing new, their increasing prevalence raises concerns that they may be used as a means to avoid liability.[5] The Law Commission's suggestion of finding a direct fiduciary relationship between the director and beneficiary conflicts with those who view the sanctity of the corporate veil as immutable. This section seeks to demonstrate the clash between the corporate veil and trust and fiduciary jurisprudence. It also reveals the problems with leaving the law as it stands.

B Defining a corporate trustee

The task of appropriately defining a corporate trustee is not without its challenges.[6] In response to the Law Commission's 2002 report, only two submitters supported the term being defined in legislation.[7] Nonetheless, to clarify the scope of this paper, the term corporate trustee will be used to refer to those companies, with little to no assets, incorporated to act as trustees of a trust. This was the approach taken by Heath J in *Levin v Ikiua*,[8] and affirmed by the Court of Appeal.[9] Expressly excluded are unit trusts, superannuation and investment trusts,[10] and business trusts.[11]

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[5] See Law Commission *Law of Trusts: Preferred Approach Paper*, above n 3, at [8.86]; and David Goddard QC "NZLC 79 – 'Some Problems in the Law of Trusts' – Implementation" (Draft Memorandum prepared for Ministry of Justice, 6 May 2007) at 2.

[6] Law Commission *Court jurisdiction, trading trusts and other issues: review of the law of trusts - fifth issues paper* (NZLC IP28, 2011) at [6.8], [8.32].

[7] Law Commission *Law of Trusts: Preferred Approach Paper*, above n 3, at [8.10].

[8] *Levin v Ikiua* [2010] 1 NZLR 400 (HC) at [97].

[9] *Levin v Ikiua* [2010] NZCA 509.

[10] Law Commission, above n 6, at [6.6].

[11] See at [6.10]: "Trading trusts also need to be distinguished from "business trusts"… where the trust holds the shares in a company which owns the business assets."

C Orthodox position

The corporate veil is central to the separate legal personality of companies and is inviolable barring certain exceptional circumstances. This can be traced back to the seminal case of *Salomon v A Salomon & Co Ltd* (*Salomon*).[12] The case involved a leather and boot manufacturing business which was sold by Aron Salomon to the company A Salomon & Co Ltd. The company had seven shareholders, including Mr Salomon (who held almost 100% of the shares). The six other shareholders were nominees and holding the shares on Mr Solomon's behalf. Upon the sale of the business by Mr Salomon to his company, part of the payment was left owing to him by the company and recorded by way of debenture. This debenture conferred preference for the debenture holder, before unsecured creditors, in the case of insolvency. When the business became insolvent the residual assets were enough to pay the debenture holder, who was a third party by then, but not the unsecured creditors. Unsecured debts were £7,000. The liquidator sued Mr Salomon on the ground that the company was merely his nominee and agent, and that he was liable to indemnify it for its unsecured debts. The House of Lords disagreed with the liquidator and held that a properly registered company is a legal person wholly separate from its directors and shareholders. This was the advent of the corporate veil which remains today.

In New Zealand, the Privy Council applied *Salomon* to the facts of *Lee v Lee's Air Farming Ltd* where a farm pilot formed a company to run his business.[13] Lee owned all but one of the company's shares, was sole employee, and its governing director. When he was killed at work in an airplane accident, the question was whether Lee's widow was entitled to compensation from the compulsory Workers' Compensation Insurance taken out by the company. The Privy Council followed *Salomon* in finding that Lee could be a company employee notwithstanding the fact he was a director. This became the general position of New Zealand law,[14] and is entrenched in the Companies Act 1993.[15]

When one considers the position of a corporate trustee it would appear at first instance that the directors cannot be held liable to trust beneficiaries for a breach of trust. The trustee is the company, and it is the company – separate from its shareholders and directors – which owes duties to the beneficiaries. Thus, in the context of a breach of trust, the only recourse

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[12] *Salomon v A Salomon & Co Ltd* [1897] AC 22 (HL).
[13] *Lee v Lee's Air Farming Ltd* [1961] NZLR 325 (PC).
[14] Jonathan Barrett and Ronán Feehily *Understanding Company Law* (4th ed, LexisNexis, Wellington, 2019) at 15.
[15] Companies Act 1993, s 15.

a beneficiary has is against the company as trustee. This is largely worthless where the company has little to no assets of its own. It should be noted that the directors of the company trustee still owe duties to the company itself, under the Companies Act. It is said that these can be used to cover the sharp practise of directors.[16] However, these can only be enforced by the company (or a liquidator) and not by trust beneficiaries.

The majority in *Bath v Standard Land Company Limited* (*Bath*) appear to confirm the orthodox position which prohibits a direct imposition of fiduciary duties on directors of corporate trustees.[17] *Bath* concerned a situation where directors of a corporate trustee had provided their various professional expertise to the trust and were seeking compensation. The Court held that the directors stood in a fiduciary position to the company, but not to trust beneficiaries, and so a reasonable profit for the directors in their professional capacity might be allowed. Andrew Butler appears to agree with the case and comments that *Bath* finally settled the general rule that directors of corporate trustees are not liable to beneficiaries for the actions of the corporate trustee.[18]

The finding of direct liability between the directors of corporate trustees and trust beneficiaries typically requires some form of piercing or lifting the corporate veil. In the United Kingdom Supreme Court decision of *Prest v Petrodel Resources Ltd* (*Prest*), Lord Sumption said that the "corporate veil may be pierced only to prevent the abuse of corporate legal personality."[19] He then concludes in the following paragraph that where a person deliberately frustrates or evades the enforcement of existing legal duties or liabilities by interposing a company under his control, then the court may pierce the corporate veil for the sole purpose of depriving the company or its controller of the advantage that they would otherwise have obtained by the company's separate legal personality.[20]

It is unclear what factual matrix would justify the piercing of the corporate veil to find that directors of a corporate trustee owe direct fiduciary duties to trust beneficiaries. Read together, *Bath* and *Prest* do not appear to permit the finding of a direct fiduciary duty. Directors owe a fiduciary duty to the company alone and it is the company, as a separate legal entity, which owes the fiduciary duty to trust beneficiaries. *Prest* does not appear to

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16 Law Commission, above n 6, at [6.23].

17 *Bath v Standard Land Company Limited* [1911] 1 Ch 618 (CA).

18 Andrew Butler and Tim Clarke *Equity and Trusts in New Zealand* (2nd ed, Thomson Reuters, 2009) at 421.

19 *Prest v Petrodel Resources Ltd and others* [2013] UKSC 34 at [34], [2013] 2 FLR 732 at 751.

20 *Prest*, above n 19, at 751.

capture a corporate trustee as a “deliberate frustration or evasion of the enforcement of existing legal duties”. Therefore, it would seem that piercing or lifting of the corporate veil to find directors liable to trust beneficiaries is unlikely.

D “A commercial monstrosity”

The problem with the orthodox position is that it produces a number of inconsistencies between the law of fiduciaries as applied to natural persons and to corporate trustees. It is often recognised that the board of directors are the corporate trustee’s “legal face”,[21] yet it is striking that the law does not recognise the practicalities of such an arrangement.[22] It leaves open the possibility for the corporate form to be used as a means to avoid liability to beneficiaries.[23] This makes little sense when the directors of the company are, for all intents and purposes, the trustees.[24]

Professor Harold Ford once wrote that the “fruit of this union of the law of trusts and the law of limited liability companies is a commercial monstrosity”.[25] He was talking particularly about how the fusion of the two could produce adverse results for creditors, and could detrimentally affect the corporate form. Nonetheless, these comments remain equally as appropriate when applied to trust beneficiaries. Fundamental to this position was the challenge with reconciling the two areas of law. Heath J in *Levin v Ikiua* identified the situation as being counter-intuitive:[26]

> …trust law has developed on an underlying expectation that a settler would want a responsible trustee to be appointed, to protect the interests of the beneficiaries. A solvent trustee can be sued if he or she were to commit a breach of trust. However, a trading trust is premised on the opposite assumption: namely it is preferable to trade through a corporate trustee with limited liability and no assets other than the right of indemnity.

The intertwining of company law in the law of trusts has produced this situation where beneficiaries could be left with a trustee who is merely a shell. The directors of the trustee,

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[21] *Hawke's Bay Trustee Co Ltd v Judd* [2016] NZCA 397 at [8].
[22] Law Commission *Law of Trusts: Preferred Approach Paper*, above n 3, at [8.84].
[23] At [8.86].
[24] At [8.84].
[25] Harold Ford “Trading Trusts and Creditors’ Rights” 13 Melb UL Rev 1 at 1.
[26] *Levin v Ikiua*, above n 8, at [115].

the "legal face", are protected from the beneficiaries by means of the corporate veil. Where trust law has ensured direct liability of trustees to beneficiaries to ensure the trust assets are administered appropriately, company law severs the chain of responsibility making it harder for beneficiaries to claim for a breach of fiduciary duty.[27]

E Conclusion

The use of corporate trustees has become increasingly encouraged as a means to effect a form of "limited liability trusteeship".[28] The approach raises concerns that impecunious corporate trustees may be incorporated to avoid liability. This would potentially leave trust beneficiaries with a shell company as their only recourse. The Law Commission's suggested provision for the Trusts Act created a direct fiduciary relationship between the director and beneficiary and was intended to go some way to resolving the issue posed by this relatively new phenomenon. It sought to bring the reality of the situation in line with the development of trust jurisprudence and remind directors of corporate trustees that, as the "legal face" of the company, they could not misuse the corporate veil to avoid responsibility to trust beneficiaries.

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[27] Law Commission *Law of Trusts: Preferred Approach Paper,* above n 3, at [8.74].

[28] See Lilly Falcon "Corporate vs Individual Trustees in NZ" (21 December 2020) LegalVision <www.legalvision.co.nz>; Toni Eisenhut and Kurt Fechner "Corporate Trustee vs Individual Trustee – What is the difference?" (19 July 2020) ABA Legal Group <www.abalegalgroup.com.au>; and Hana Lee and Hunter Watkin "The basics of appointing a corporate trustee" (22 March 2021) Forty Four Degrees <www.fortyfourdegrees.com.au>; but see Richard Ashby "I'm A Trustee – What's My Exposure?" Gillian Sheppard <www.gilliansheppard.co.nz>.

III Trusts and fiduciaries

A Overview

This section seeks to elucidate the idea of the trustee as archetypal fiduciary. First, the nature of the trust will be explored, including its historical origins, to help explain how it exists today. Second, the powers, rights and obligations of trustees are considered in light of the nature of trusts. Thirdly, the big questions are asked: who is a fiduciary, what is a fiduciary, and what are the implications of breaching duties as a fiduciary?

B The nature of trusts in New Zealand

It has been said that no definition of a trust can be given which is beyond contention.[29] Trusts have developed organically to meet the needs of its time.[30] It is difficult to come to an all-encompassing definition given that such a statement could only be made by examining judicial utterances spanning hundreds of years.[31] It is made more difficult by the fact that the way the institution of the trust has been described is dependent on the trend of thought at the relevant time.[32] Nonetheless, Simon Gardner provides a useful starting point:[33]

> A trust is a situation in which property vested in someone (a trustee) who is under legally recognised obligations, at least some of which are of a proprietary kind, to handle it in a certain way, and to the exclusion of any personal interest. These obligations may arise either by conscious creation by the previous owner of the property (the settlor), or because some other legally significant circumstances are present.

A typical express trust is an invention of equity.[34] It involves three groups of people: a settlor, trustees, and beneficiaries. It is settled by a settlor, an owner of property. The settlor

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[29] Simon Gardner *An Introduction to The Law of Trusts* (3rd edition, Oxford University Press, New York, 2011) at 2.

[30] Ian Rowe and Simon Weil *Working with Trusts* (online ed, Westlaw) at [1.1].

[31] Gardner, above n 29, at 1.

[32] At 1.

[33] At 2.

[34] Jeremy Johnson and James Anson-Holland *Law of Trusts (NZ)* Trusts and Asset Planning: An Introduction (online ed) at [1.3].

entrusts that property to another who is known as a trustee. The trustee undertakes to care for that property in the best interests of those with beneficial ownership in the property (the beneficiaries).

The historical roots of trusts are believed to have originated from feudal times, coming to the fore at the time of the Christian Crusades in the eleventh to thirteenth centuries.[35] As property owners went into battle, they wanted custodians to care for their property, in the best interests of their family, whilst they were away. The trust enabled owners to empower trustees to administer trust property, acting in their family's best interests, whilst being able to reclaim the property on their return.

Today the law of trusts still espouses the same basic principles. In New Zealand, a person (the settlor) generally creates an express trust by clearly and with reasonable certainty:[36]

(1) indicating an intention to create a trust; and
(2) identifying the beneficiaries (or classes of beneficiaries); and
(3) identifying the trust property.

This is often done by the execution of a deed which also names the settlor, trustees and beneficiaries and directs how the trust is to be administered.[37] After creating the trust, the settlor drops out of the picture and has no rights in respect of the trust unless they also happen to be a beneficiary or trustee of the trust, or have expressly reserved some power within the trust deed.[38] At this point, it should be noted that, unlike a company, a trust is not its own legal entity.[39] The trustee holds trust property in their own name whilst knowing that such property is kept independent from their own (it remains property held on trust).[40]

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[35] Johnson and Anson-Holland, above n 34, at [1.3].

[36] Trusts Act 2019, s 15.

[37] Greg Kelly and Chris Kelly *Garrow and Kelly's Law of Trusts and Trustees* (7th edition, LexisNexis, Wellington, 2013) at [2.5].

[38] Richard Wilson *Halsbury's Laws of England* Meaning of 'trust' and 'power' (online ed) at 1.

[39] "The Family Trust" (17 March 2020) <www.lawsociety.org.nz>.

[40] Geoffrey Fuller *The Laws of New Zealand* Nature of Trusts and of the Trust Relationship (online ed) at [1].

C Powers, rights, and obligations of trustees

A trust produces corresponding powers, rights and obligations between trustees and beneficiaries. Trustees have a general power to administer trust property as if they were the absolute owner of the property.[41] This is a substantial responsibility which could incur significant liabilities and costs. The trustee is properly entitled to be indemnified by trust assets for any expenses reasonably incurred in preserving trust property.[42] However, this leads to the foreseeable situation of beneficiaries who disagree with trustee decisions. This was the case from the earliest of days.[43] At the trust's advent, the common law was unable to address the concerns arising from this unusual arrangement because it was too rigid. Thus, trusts became a child of equity, with equity enforcing certain duties on trustees to carry out their obligations to the settlor and to the beneficiaries.[44]

Today, the Trusts Act 2019 prescribes mandatory and default duties. Mandatory duties cannot be altered,[45] whereas default duties which can be removed by the trust instrument.[46] These duties can be enforced by trust beneficiaries. Many of these duties already exist at common law but have been stipulated in the new Act in order to provide a reference point for increased accessibility.[47] The following table identifies the mandatory duties and the more notable default duties:

	Mandatory Duties	**Default Duties[48]**
(a)	know the terms of trust	a general duty of care
(b)	act in accordance with terms of trust	invest prudently
(c)	act honestly and in good faith	not exercise power for one's own benefit
(d)	act for the benefit of beneficiaries	avoid conflicts of interests
(e)	exercise powers for proper purpose	remain impartial
(f)		not to profit
(g)		to act unanimously

[41] Trusts Act 2019, s 56.
[42] Trusts Act 2019, s 81.
[43] Johnson and Anson-Holland, above n 34, at [1.3].
[44] At [1.3].
[45] Trusts Act 2019, s 23–27.
[46] Trusts Act 2019, s 29–38.
[47] Trusts Act 2019; see Law Commission, above n 2, at [3.7].
[48] Key examples shown. For complete list of default duties see Trusts Act 2019, s 29–38.

Some of the mentioned duties are fiduciary in nature. The Trusts Act 2019 recognises the fiduciary *relationship* between trustee and beneficiaries in s 13. Section 13 states that an express trust must have the characteristics of a fiduciary relationship in which a trustee holds or deals with trust property for the benefit of the beneficiaries.[49] The concept of a fiduciary is another matter which "defies definition".[50]

D Who and what is a fiduciary?

Arriving at an all-encompassing definition of "who, and what, is a fiduciary" is rather challenging. There is a missing consensus of a basic principle.[51] There are also troubles plaguing such attempts to define it. Too narrow a definition provides better guidance, but omits guidance for those who are fiduciaries but are not caught in the definition. Broad over-arching principles tend to capture all who are considered fiduciaries, and also those who ought not to be held as such.[52] Lord Briggs said that they also have "such a high level of generality that [they] provide little useful guidance in the factually complicated world of real people, real events and real transactions."[53] This part will follow the approach taken by Sarah Worthington in her paper "Four Questions on Fiduciary Law" in first asking *who* is a fiduciary, *what* is a fiduciary, and what are the *implications* for said fiduciary?[54]

1 Who is a fiduciary?

Coming to an understanding of what a fiduciary is will assist in discovering who might be a fiduciary. Equally, identifying who might be a fiduciary can assist in coming to an understanding of what is a fiduciary. Yet, taking the second approach is made more difficult by the fact that the category of "fiduciary" has grown beyond its traditional roots to wider spheres.[55] Historically, the type of *relationship* involved was used to identify a fiduciary.[56]

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[49] Trusts Act 2019.

[50] *Breen v Williams* (1996) 186 CLR 71 (HCA) at 106.

[51] Lord Briggs of Westbourne, Justice of The Supreme Court of the United Kingdom "Equity in Business" (The Denning Society Annual Lecture, Lincoln's Inn, London, 8 November 2018) at [3].

[52] Sarah Worthington "Four Questions on Fiduciaries" (2016) 2 CJCCL 723 at 727.

[53] Lord Briggs of Westbourne, above n 51, at [3].

[54] Worthington, above n 52.

[55] Butler and Clarke, above n 18, at 475.

[56] A status based approach. See Rob Batty "Examining the Incidence of Fiduciary Duties in Employment" (2012) 18 Canta LR 187 at 188.

These were relationships of trust where there was an expectation that the fiduciary would act in the interests of beneficiaries, because they exerted some measure of control which might put beneficiaries at a disadvantage.[57] Common examples include company directors, trustees, and agents.[58] Today, the concept has broadened to include commercial intermediaries like joint ventures and financial advisors.[59] As a result, it is no longer workable to apply a solely status-based approach in asking who is a fiduciary.[60] Thankfully, trustees (as the archetypal fiduciary) and directors are governed by the full expectation of fiduciaries, so a comprehensive discussion on who might be a fiduciary can be set aside for now. Nonetheless, a discussion on what *is* a fiduciary is still required.

2 What is a fiduciary?

Worthington suggests, that fiduciaries are those subject to the no-conflict/non-compete rule.[61] They are expected to put their principal's interests *ahead* of their own.[62] Lord Millett provides a starting point in assessing what is a fiduciary with his statement that:[63]

> The *distinguishing obligation of a fiduciary is the obligation of loyalty* … This core liability has several facets. A fiduciary must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and his interest may conflict. (Emphasis added)

Note that Lord Millet points to the duty of loyalty being the *distinguishing* one, not a fiduciary's *only* obligation. Furthermore, a fiduciary is not obliged to act positively to produce some advantageous end.[64] A fiduciary is instead bound by a *proscriptive duty* to adhere to rules relating to improper profits from the misuse of position, and the avoidance of conflicts of interests and duties.[65] This too appears to be in line with Paul Finn's thinking.[66]

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[57] Butler and Clarke, above n 18, at 473.
[58] Worthington, above n 52, at 735.
[59] At 736.
[60] Rowe and Weil, above n 30, ch 1.3.02; Butler and Clarke, above n 18, at [17.2.2].
[61] Worthington, above n 52, at 737.
[62] At 734.
[63] *Bristol and West Building Society v Mothew* [1997] 2 WLR 436 (Ch) at 449.
[64] *P & V Industries Pty Ltd v Porto* [2006] VSC 131 at [23]; and *Pilmer v Duke Group Ltd* (in liq) [2001] HCA 31 at [74].
[65] Worthington, above n 52, at 740.
[66] See Paul Finn "The Fiduciary Principle" in Worthington, above n 52, at 739.

Moving to another aspect, Paul Finn makes an important observation regarding those who are fiduciaries. He draws a distinction between breaches of fiduciary and non-fiduciary duties:[67]

> if no issue of disloyalty is involved, [pure negligence of a lawyer, an agent's excess of authority, a partner's breach of the partnership contract or a trustee's improvident investment] will be actionable through those primary bodies of law which constitute or govern the ordinary incidents of the relationship in question – negligence, breach of contract or breach of trust.

The key to this observation is that fiduciaries are inevitably subject to a number of different duties. Yet, not all of these are fiduciary ones.[68] The result is that when asking "what is a fiduciary duty?", there are two possible answers:[69]

> (a) the narrow, proscriptive, no-conflict/non-compete rule; and
> (b) the wider approach which includes *all the obligations a fiduciary might be subject to* including:
>   (i) to comply with the terms of engagement;
>   (ii) in an appropriate manner; and
>   (iii) to do so loyally (the fiduciary proscription).
>
> (Emphasis added)

Paul Finn points out this distinction because, historically the distinction had been ignored. Fiduciaries who breached *any* duty would have been implicated as having broken *fiduciary duties*, even when that was not the case.[70] To illustrate, take the example of the negligent lawyer given by Finn. A lawyer who acts on behalf of a client in pure negligence breaches the *non-fiduciary* duty of care he owes to that client. That breach ought to be addressed by the usual mechanism of the law of torts because it is not an issue which raises a question of conflict or competition – even though a lawyer is held to be a fiduciary at law. Yet, because the courts would historically identify a relationship as fiduciary first, subsequent

[67] Finn, above n 66 in Worthington, above n 52, at 739.
[68] Worthington, above n 52, at 744.
[69] At 740.
[70] At 743.

discourse would loosely apply fiduciary terminology to standards of good faith, disclosure standards, limits on the proper exercise of discretionary powers, and even fiduciary care.[71]

Another aggravating factor which has led to the misconception that all breaches by a fiduciary are breaches of fiduciary duty is that damages were historically discussed through the language of "account".[72] The approach was that a "fiduciary" described a relationship, which embraced all the relationship duties, and account provided a vehicle for the remedy.[73] This is problematic because "account" tells one very little about the remedy relevant to the breach. Does it refer to standard common law remedies for breaches of duties which were not fiduciary in nature? Or does it refer to equitable remedies like disgorgement?

The inevitable problem with using the word "account", suggesting a breach of fiduciary duties, is that the negligent lawyer might now be held to a greater standard than a non-fiduciary person. There would become a distinction between a fiduciary negligence, and a "standard" negligence, even though the same offence was committed. If the imposition of a higher standard for the fiduciary is applicable, it must be on principled grounds – something more substantial than just being by virtue of holding a fiduciary position. Sarah Worthington suggests that a breach of a non-fiduciary duty by a person in a fiduciary position should be treated the same way as if it had been breached by a non-fiduciary.[74]

3 What remedies follow a breach of duty by fiduciaries

There is ongoing academic debate about what remedies are appropriate for a breach of fiduciary duties, and non-fiduciary duties, when committed by a fiduciary.[75] Without going into undue complexities, the aim is to help the reader to gain an appreciation of the consequences for both breaches, when committed by a fiduciary.

Beginning with a breach of fiduciary duties, these can generally arise in two forms. A breach of fiduciary duty is a breach of the no-conflict/non-compete principle, which can be referred to as disloyal profiteering. The first class of disloyal profiteering is when the

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[71] Robert Austin "Moulding the content of Fiduciary Duties" in A Oakley *Trends in Contemporary Trust Law* (Oxford University Press, New York, 1996) at 156.
[72] Worthington, above n 52, at 743.
[73] At 744.
[74] At 744.
[75] At 745.

fiduciary deals disloyally with the assets themselves.[76] They can do this by either taking the assets without authority or engineering a transaction where they are on both sides of the deal.[77] In these circumstances the remedy of disgorgement, which is proprietary, is universally accepted to exist. Disgorgement is "where a person is forced to give back any profit he has made or money he has received either illegally or unethically at the expense of another."[78] The nature of it being proprietary is significant. It means that if the trustee simply takes the asset from a trust fund, the asset will continue to be held on the original trust, and its traceable proceeds will be held on constructive trust.[79]

The second class of disloyal profiteering is when the fiduciary competes with the principal for an advantage which, if the fiduciary had acted loyally, might have been acquired for the principal.[80] Examples include pursuing competing business opportunities, or taking a bribe or secret commission from the counterparty to a deal being done on behalf of the principal.[81] It is here where the question arises of whether disgorgement is a personal or proprietary remedy. If it is a proprietary remedy, then the proceeds can be traced into the hands of third parties who are not bona fide purchasers for value (without notice of the principal's interests).[82]

There are two possible policy aims for disgorgement in such a situation. The first is to disgorge disloyal gains because the fiduciary *must not* have them. In this case, there is no necessary reason the principal must have them. The aim is to be proscriptive and prophylactic in nature.[83] The second is to disgorge disloyal gains because the principal *must* have the asset in question. The first can be achieved by a personal remedy of disgorgement whereas the second requires a proprietary remedy of disgorgement. The type of disgorgement applied will depend on the obligation owed by the fiduciary and whether it is seen as necessary to the underlying relationship that the proprietary form of "over-protection" is warranted.[84] Worthington states:[85]

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[76] Worthington, above n 52, at 745.

[77] At 745.

[78] "Glossary: disgorgement" Thomson Reuters Practical Law <www.uk.practicallaw.thomsonreuters.com>.

[79] Worthington, above n 52, at 746.

[80] At 746.

[81] At 746.

[82] At 748.

[83] Butler and Clarke, above n 18, at 478.

[84] Worthington, above n 52, at 752.

[85] At 753.

> This choice about where the benefits should lie is difficult because it is not a matter of doctrine; it is exclusively a matter of policy: what is the obligation in issue and what is its purpose? The appropriate remedy follows ineluctably from that.

Moving now to a breach of non-fiduciary duties by a fiduciary, countless claimants have tried to hold the fiduciary to "account". The end is to claim harsher remedies for what is an ordinary breach of a non-fiduciary duty. Accepting the position that there is no reason to hold fiduciaries to a higher standard than anyone else in the case of a breach of a non-fiduciary duty, the same measure for damages should apply.

In assessing the remedy, the United Kingdom Supreme Court in *AIB Group (UK) v Mark Redler & Co Solicitors* (*Redler*) emphasised the need to begin with understanding the obligation required, which had been breached, and all its detailed requirements. [86] Only after doing so can discussion on the appropriate remedy begin.

Applying the approach in *Redler* to a fact scenario assists in illustrating that there should be no real difference between a claim in equity and a claim for damage at common law.[87] $1 million is taken from a trust fund by a trustee to use in a non-traceable way. This should have been invested in certain shares, and would now only be worth $500,000. What was the obligation of the trustee, and what would be the corresponding damages? The trustee was obligated to act in a certain way, which they did not do. Was this obligation to preserve trust assets, or was it to manage the trust assets? Preserving the trust assets focuses on how the $1 million should never have been misappropriated and punishes the trustee by a remedy which would seek $1 million from him. This is the case the claimant is likely to make.

On the other hand, managing trust assets focuses on how the $1 million should have been invested properly and would seek to restore the fund to a state as if the management had properly been carried out. Damages would remain at $500,000, the same as at common law. This example alone illustrates the critical nature of establishing what exactly is the obligation breached which the court seeks to address. It also demonstrates that there should be no real differences between a claim in equity and a claim for damages at common law, when due consideration has been given to the obligation breached. Ultimately, the same breach should produce the same compensation.

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[86] *AIB Group (UK) v Mark Redler & Co Solicitors* [2014] UKSC 58 [*Redler*].

[87] Example based off Worthington, above n 52, at 762.

E Conclusion

Trusts are a creature of equity, taken on because the common law was too rigid to engage with it. Trusts involve a settlor who vests property in a trustee so that the trustee might selflessly deal with the property to the benefit of trust beneficiaries. Trustees are given full power to deal with the property as if it were their own. They are therefore subject to corresponding obligations, which they are accountable to trust beneficiaries for. Trustees are the archetypal fiduciary from which fiduciary jurisprudence developed.[88] Such duties were developed to balance the fact that trustees were given the power to affect the legal and practical interests of the beneficiaries, who are vulnerable to a misapplication of that power.[89] Today, through the application of strict remedies,[90] the law continues to proscribe trustees ensuring that they act in good faith for the beneficiary's best interests.[91]

[88] Charles Rickett *The Laws of New Zealand* Relationships Recognised as Fiduciary (online ed) at [104].

[89] Rowe and Weil, above n 30, at [1.3.02].

[90] Charles Rickett "Understanding Remedies for Breach of Trust" (2008) 11 Otago LR 603 at 612.

[91] Rowe and Weil, above n 30, at [1.3.02]; and Butler and Clarke, above n 18, at [17.2.2].

IV Companies

A Overview

This section provides a discussion on the key features of a company. Whilst too extensive to cover comprehensively, the aim is to provide an overview of company law and the importance of the corporate veil. It begins with the historical origins of corporations in order to understand the roots and reasons for separate corporate identity. Then a brief overview is given as to how a company operates in New Zealand today. That includes the role of directors and their related duties. Finally, the corporate veil is explained in more detail to reveal its primacy and the situations which may justify its dismissal.

B What is a company and why did it come about?

The corporate form is so ubiquitous that lay people put little thought into its significance.[92] Most people are unaware that a great number of their daily interactions involve contact with a company. However, it was not always the case that companies were so prolific.

Before going into the history, it is important to understand the defining features of a modern company. Armour, Hansmann, and Kraakman provide a summary on the five basic legal characteristics of a business: legal personality, limited liability, transferable shares, delegated management under a board structure, and investor ownership.[93] They claim that these characteristics are found in almost every large-scale business found in market economies, and that small firms also replicate this with slight deviations to fit their needs.[94]

A core tenet of company law is that the company has the benefit of its own legal personality, bringing with it limited liability.[95] The company is a separate person from the persons setting it up, which means that the shareholders' personal estates cannot be attacked if the company becomes insolvent.[96] This is also known as the corporate veil

[92] At the time of writing, there were 692,000 registered companies on the register. See New Zealand Companies Office (25 September 2021) <www.companiesoffice.govt.nz>.
[93] John Armour, Henry Hansmann and Reinier Kraakman "The Essential Elements of Corporate Law: What is Corporate Law?" (Discussion Paper, Harvard Law School, 2009) at 2.
[94] At 2.
[95] Barrett and Feehily, above n 14, at 3.
[96] Rodney Craig *Morison's Company Law (New Zealand)* Directors' Powers and Duties (online ed) at [2.4].

which separates shareholders from the company's creditors.[97] Take note of this concept as, later on, this paper will include consideration on the corporate veil and whether that ought to prevent a direct fiduciary relationship between the director of a corporate trustee and trust beneficiaries.

Separate legal personality and limited liability have not always been features of companies. Back in the 16th century, most United Kingdom companies were created for mercantilist corporations – acting as a body of individuals with the common purpose of uniting their capital for profit.[98] In the 17th century, the London Stock Market was formed,[99] and two milestones were achieved: the raising of capital from investors, and a permanent and perpetual joint stock.[100] By the start of the 18th century, company and capital market developments had led to the selling of government debt.[101] Yet companies still did not have limited liability.

In the 18th century, the unincorporated company became more common in cases where the business enterprise had large capital requirements.[102] These had some elements of separation between ownership and control by means of trust deed.[103] However, these deeds were ignored by the common law with all shareholders being treated as partners in legal proceedings.[104] This posed a problem to rich investors who did not want to risk all of their personal wealth through risky enterprises.[105]

It was in the 19th century that the modern company came to be. After a few legislative predecessors,[106] the United Kingdom passed the Companies Act 1862. Every business could now become incorporated through a simple registration process.[107] These changes were instigated by the political need for large capital investment in infrastructure projects,

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[97] Barrett and Feehily, above n 14, at 15.

[98] John Turner "The development of English company law before 1900" in Harwell Wells (ed) *Research Handbook on the History of Corporate and Company Law* (Edward Elgar Publishing, Cheltenham, 2018) at 123.

[99] At 126. London Stock Market dates back to the 1690s.

[100] At 125. Capital raising occurred to fund the East India Company's voyage to the Indies.

[101] At 125. Three large companies (The Bank of England, South Sea Company, and East India Company) held 39 percent of the United Kingdom's government debt.

[102] At 128.

[103] At 128.

[104] At 129.

[105] Barrett and Feehily, above n 14, at 3.

[106] Including the Joint Stock Companies Act of 1844 (UK).

[107] Turner, above n 98, at 135.

which could only be met by the aggregation of investor funds.[108] Additionally, the increasing wealth of the middle classes required more outlets for investment and pushed the need for limited liability.[109]

In New Zealand, the Companies Act 1993 governs how companies are set-up and run. New Zealand is a relatively small country and its business context is different from the more complex economies of the countries from which it has adopted legislation.[110] Notably, New Zealand's business environment includes a small stock exchange, a lack of professional directors, few large companies, and an overwhelming number of small and medium-sized enterprises (SMEs). Whilst New Zealand has previously tried to keep its companies legislation in line with the global community, our unique business environment is making it increasingly difficult to do so. Especially because SMEs, companies with fewer than 20 employees, make up 97% of businesses in New Zealand.[111]

Turning to the Companies Act 1993, to be incorporated a company must have:[112]

(i) a name, a registered office, and an address for service in New Zealand (one address can be used for both functions); and
(ii) at least one share, one shareholder, and one director (a minimum of one director must reside in New Zealand).

The process of incorporation is designed to be quick and straightforward. It can be completed online.[113]

More generally, the Companies Act provides for only one type of company: a company with shares that has either limited or unlimited liability for its members.[114] The existence of these companies continues indefinitely, despite the death of any shareholder.[115] Limited companies provide the effect that the shareholders of the company are only liable for debts

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108 Turner, above n 98, at 138.
109 At 138.
110 Barrett and Feehily, above n 14, at 5.
111 Ministry of Business, Innovation and Employment "Small business" (28 September 2020) <www.mbie.govt.nz>.
112 Companies Act 1993, ss 10, 186, and 192.
113 See Companies Office <www.business.govt.nz/companies>.
114 Craig, above n 96, at [1.3].
115 At [2.4].

of the company up to the amount committed upfront to share capital.[116] Their personal assets are generally considered to be distinct from the company. The long title of the Act also reaffirms the value of the company as, "a means of achieving economic and social benefits through the aggregation of capital for productive purposes, the spreading of economic risk, and the taking of business risks."[117]

The Act partially codifies the general duties of directors and their powers,[118] but does not remove those duties which still exist at common law.[119] It also clearly recognises the concept of the "one-person" company.[120] A disclosure-based approach is taken to conflicts of interest, as opposed to prohibiting or restricting transactions where a conflict exists.[121] The Act also provides for a variety of remedies to enforce obligations owed by the directors and the company, including the concept of derivative actions.[122]

C Directors' powers and duties

The board of directors is the company's "legal face",[123] responsible to shareholders for the management of its business and affairs.[124] The common law on companies has, to a large extent, developed from trust law and has brought with it notions of fiduciary and non-fiduciary duties.[125] However, some of these have been amended in substance by the Companies Act.[126] This section will briefly outline the key powers and duties of directors under New Zealand law.

Part 8 of the Act contains the finer details of directors' powers and duties.[127] It gives the definition of a director and the meaning of "the board".[128] Section 128 states that "the board

[116] Note that earlier Acts and certain equivalent legislation overseas can provide for multiple types of companies. See Craig, above n 96, at [3.1].
[117] Companies Act 1993, Title.
[118] Companies Act 1993, pt 8.
[119] Craig, above n 96, at [1.3].
[120] At [2.2].
[121] See Companies Act 1993, ss 139–149.
[122] See Companies Act 1993, pt 9.
[123] *Hawke's Bay Trustee Co Ltd v Judd*, above n 21, at [8].
[124] Tom Pasley *Morison's Company Law (New Zealand)* Directors' Powers and Duties (online ed) at [24.1].
[125] Barrett and Feehily, above n 14, at 198.
[126] At 182.
[127] Companies Act 1993.
[128] See Companies Act 1993, ss 126, 127.

of a company has all the powers necessary for managing, and for directing and supervising the management of, the business and affairs of the company", subject to any changes made in the company's constitution.[129] Counter-balancing these broad discretionary powers, are the duties which directors owe. These are vast and will not be covered extensively here. For the purposes of this paper, the following will provide an outline of the key duties of company directors.

Sections 131 to 149 of the Companies Act represent the duties of a fiduciary nature which accompany the office of director.[130] A director is regarded as a fiduciary and has fiduciary obligations imposed on them,[131] namely, "a director must not put his or her personal interests ahead of those of the company."[132] Directors must also act in good faith in the interests of the company, exercise powers for a proper purpose, exercise reasonable care and skill in the performance of their duties, and avoid unnecessary conflict of interests between their own interests and those of the company.[133]

Director's duties have traditionally been held as being owed to the company itself. Under the Companies Act, it is unclear whether this remains the general rule. Some duties explicitly mention that they are owed to the company and not to shareholders.[134] Some duties provide that they are owed directly to shareholders.[135] The remaining duties are not owed expressly to any person.[136] The better position appears to be that the traditional starting point remains and that the duties are generally owed to the company.[137]

1 Section 131: Good faith and best interests

The duty to act in good faith and best interests is a core duty of directors. It has great parallels with a trustee's duty to put the interests of the principal ahead of their own. For directors, the company is owed this duty.[138] This section has been referred to as requiring

[129] Companies Act 1993.
[130] Pasley, above n 124, at [24.1].
[131] Rickett, above n 88, at [105].
[132] *Morgenstern v Jeffreys* [2014] NZCA 449 at [55].
[133] Pasley, above n 124, at [24.1]; and see Companies Act 1993, ss 131, 133, 137, 139–149.
[134] Companies Act 1993, ss 131, 133, 135, 136, 137, 145.
[135] Companies Act 1993, ss 90, 140, 148.
[136] Pasley, above n 124, at [24.7].
[137] At [24.7].
[138] Companies Act 1993, s 131.

the directors to ensure there is some "corporate benefit".[139] The classic situation in which a director breaches s 131 occurs where the director puts his or her own interests, the interests of a third party, or the interests of another company in the group ahead of the company's interests.[140]

Examples of a s 131 breach include:

(a) *Wagner v Gill*:[141] Mr Gill was CEO and director of a company that had a sponsorship contract with Netball NZ. The contract gave Netball NZ the right to terminate if Mr Gill resigned as CEO. When the company encountered financial difficulties, Mr Gill resigned as CEO and procured Netball NZ to terminate the contract with the company and enter into a new sponsorship contract with another company he controlled. Mr Gill's steps to engineer the transfer of the contract were for his own personal benefit, and in breach of his duty to the company under s 131.[142]

(b) *Lakeside Ventures 2010 Ltd (in liq) v Levin*:[143] Mr Burrows was the sole director of a trustee company that made a profit for which it was immediately liable for income tax. The director caused the trustee company to distribute all of the profit to himself as the beneficiary of the trust, leaving the company with no money to meet its tax liability. Mr Burrows then delayed filing the company's tax return, exposing it to penalties and interest. The Court found that Mr Burrows was in breach of s 131.[144]

Section 131 can also be breached by directors' failure to consider the interests of creditors and other stakeholders.[145] Whilst the traditional approach holds that director's duties are only owed to the company, where a company is nearing insolvency or insolvent, the interests of creditors must be considered.[146] This was the case in *Debut Homes Limited (in liq) v Cooper* (*Debut Homes*). *Debut Homes* also brought to light the fact that s 131

[139] *Westpac Banking Corp v Bell Group Ltd (in liq) (No 3)* [2012] WASCA 157 at [2069] per Drummond AJA and at [2781] per Carr AJA.
[140] Pasley, above n 124, at [24.9].
[141] *Wagner v Gill* [2013] NZHC 1304 at [133]; and see *Wagner v Gill* [2014] NZCA 336 where the Court upheld the decision on appeal without substantive discussion of this point.
[142] Example from Pasley, above n 124, at [24.10].
[143] *Lakeside Ventures 2010 Ltd (in liq) v Levin* [2014] NZHC 1048 at [42].
[144] Example from Pasley, above n 124, at [24.10].
[145] At [24.13].
[146] See *Debut Homes Limited (in liq) v Cooper* [2020] NZSC 100 at [183]–[188].

breaches of this kind are also likely to result in a breach of s 135, reckless trading, for a lack of consideration of the creditors' interests.

Additionally, s 138A of the Companies Act makes it a criminal offence for a *serious breach* of s 131:[147]

> A director commits an offence if the director exercises powers or performs duties as a director of the company—
>
> (a) in bad faith towards the company and believing that the conduct is not in the best interests of the company; and
>
> (b) knowing that the conduct will cause serious loss to the company.

The consequence of such an offence is imprisonment for a term not exceeding 5 years or to a fine not exceeding $200,000.[148]

2 Section 133: Proper purpose

Section 133 of the Companies Act simply states, "a director must exercise a power for a proper purpose." Case law suggests that the courts will apply the following test in such a consideration:[149]

(a) identify the power being exercised;
(b) identify the proper purpose for which that power was delegated to the directors;
(c) identify the substantial purpose for which the power was in fact exercised; and
(d) decide whether that purpose was proper.

The proper purpose rule is aimed at prohibiting a director's abuse of power by acting for an improper reason, even if the act itself is within the scope of his or her powers.[150] Note that in New Zealand, few cases engage s 133 of the Companies Act without reference to another breach of duty.[151] More commonly, the Courts consider the issue of whether a

[147] Companies Act 1993, s 138A(1).
[148] Companies Act 1993, s 373(4)(aaa).
[149] *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821 (PC) at 835.
[150] Pasley, above n 124, at [24.14].
[151] At [24.15A].

director has breached s 131, and then rely on the same reasoning to rule that the director has breached s 133 as well.[152]

3 Section 135: Reckless trading

This section states that the director of a company must not *agree, cause, or allow* the business of the company to be carried on in a manner likely to create a substantial risk of serious loss to the company's creditors. The law in this area focuses on a "substantial risk" of "serious loss". According to the Court of Appeal in *Yan v Mainzeal Property and Construction Ltd (in liq)* (*Mainzeal*), it applies an objective test to the director's circumstances and focuses on what the directors knew or ought to have known at the relevant time.[153] This provision is similar to the old s 320 of the Companies Act 1955 which only applied to insolvent companies. The 1993 Act has no such qualifications and can theoretically apply at any point.[154] However, in practice, it is likely to only apply in near insolvent or insolvent cases.

4 Section 136: Reasonable grounds for incurring obligations

This provision prohibits the director of a company from agreeing to the company taking on an obligation unless they believe at that time, on reasonable grounds, that the company will be able to perform the obligation when it is required to do so. The Supreme Court in *Debut Homes* held that this duty applies, not only to contractual and specific obligations, but also to obligations in the broader sense.[155] Like the reckless trading provision, this section is most likely to be engaged in situations where the company is in financial difficulties.

Section 136 applies a subjective element, relating to the belief of the director, and an objective element concerning the grounds on which the belief is based.[156] An example occurs in *Mainzeal,*[157] where the Court of Appeal held that it will clearly not be reasonable for directors to trade on, and incur obligations, especially those that run long into the future,

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[152] At [24.15A].
[153] *Yan v Mainzeal Property and Construction Limited (in liq)* [2021] NZCA 99 at [441].
[154] Companies Act 1993.
[155] *Debut Homes Limited (in liq) v Cooper*, above n 146, at [91].
[156] Pasley, above n 124, at [24.18].
[157] *Yan v Mainzeal Property and Construction Limited (in liq)*, above n 153, at [462]–[464].

knowing that the company is vulnerable to failure, and that if it stops trading there will be a serious deficiency to some creditors.[158]

5 Section 137: Duty of care

Section 137 requires a director to exercise the care, diligence, and skill of a reasonable director in the same circumstances, taking into account, but without limitation:[159]

(a) the nature of the company; and
(b) the nature of the decision; and
(c) the position of the director and the nature of the responsibilities undertaken by him or her.

The traditional position at common law held directors liable to the extent they breached the duty when compared to directors of the same degree of knowledge and experience.[160] The statutory provision employs a higher standard, that of the "reasonable director in the circumstances".[161]

D The corporate veil

The effect of the corporate veil is that companies can act as legal persons distinct from their owners and managers.[162] John Turner states that:[163]

> [C]ompanies can now enter contracts more efficiently; sue and be sued in the name of the firm's designated officers; own real estate and assets; and pledge real estate and assets to creditors.

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[158] Pasley, above n 124, at [24.18].
[159] Companies Act 1993.
[160] See *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* [1990] 3 NZLR 513, [1990] 3 WLR 297 (PC).
[161] Companies Act 1993, s 137.
[162] Turner, above n 98, at 121.
[163] At 121.

This feature is also known as asset partitioning and is strongly preserved by the courts. However, it leads to some difficult questions. For example:[164]

(a) Can we ever look behind the so-called veil of incorporation to see the human beings who control it or even ignore the corporate form altogether?
(b) Since a company can only act through human beings, whose acts are to be counted as those of the company?
(c) If a person's act is that of the company, can the act be attributed also to the person as an individual?

Such questions arise in cases where the courts have not strictly applied the principle of separate personality, and have taken into consideration the persons actually controlling the company. This is often termed as "piercing the corporate veil" (PCV).[165]

This area of law is strongly contested by commentators, largely because it is hard to find a common thread running through such decisions.[166] The Court of Appeal in *Attorney-General v Equiticorp Industries Group Ltd (Equiticorp)* said:[167]

> The phrase "to lift the corporate veil" is a description of the process by which in certain situations the Courts can look behind the corporate facade and identify the real nature of a transaction and the reality of the relationships created. It is not a principle. It describes the process, but provides no guidance as to when it can be used.

This quote is consistent with the wider definition which views PCV or lifting the corporate veil as "disparate occasions on which some rule of law produces apparent exceptions to the [*Salomon*] principle.[168]

The other, narrow, approach holds that piercing and lifting the corporate veil refer to two distinct ideas.[169] Key texts like *Gore-Browne on Companies* suggest there is a distinction

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[164] Barrett and Feehily, above n 14, at 13.
[165] Craig, above n 96, at [3.3].
[166] See at [3.4]; and Barrett and Feehily, above n 14, at 24.
[167] *Attorney-General v Equiticorp Industries Group Ltd (in statutory management)* [1996] 1 NZLR 528, (1996) 7 NZCLC 261,064 (CA) [*Equiticorp*] at 261,074.
[168] See *Prest,* above n 19, at [106]: Lord Walker states that piercing the corporate veil is merely a label "used indiscriminately".
[169] Barrett and Feehily, above n 14, at 15.

between cases which circumvent/lift and those which pierce the corporate veil.[170] Even then, such a distinction has been historically difficult to make because of the loose application of the terms. For example, in the recent United Kingdom Supreme Court case of *Prest,* Lord Sumption held *Gilford Motor Co Ltd v Horne*[171] to be a case of piercing the corporate veil,[172] yet *Jones v Lipman*,[173] "a case very much of the same kind", was supposedly more akin to lifting the corporate veil.[174] This is one of many such cases where judges have labelled cases more akin to piercing as lifting.[175] A possible explanation for this might be that the judge in these cases subscribes to the wider notion of PCV, which results in little distinction between lifting and PCV .

For the purposes of this paper, the narrow approach which *distinguishes* between lifting and piercing will be adopted.[176] PCV will be referred to as the process used by the courts to treat the company and the individuals behind it as one, ignoring the corporate form.[177] In comparison, the wider approach sees any form of looking beyond the corporate veil, even where it does not outright ignore the corporate form, as PCV. The result of taking the narrow definition is that a distinction is drawn between piercing and lifting the corporate veil. An example of lifting the corporate veil, might include a finding of a constructive trust, or liability through the rules of attribution.[178] There is no necessary requirement of dishonesty or abuse of the corporate form. The courts do not question the legal validity of the company; rather they are looking at the role the company plays in relation to its shareholders.[179]

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[170] See Alistair Alcock, Michael Todd and Lord Millett *Gore-Browne on Companies* (45th ed, LexisNexis, UK, 2021) at [10]; Bryan Clark *Boyle and Birds' Company Law* (9th ed, LexisNexis, UK, 2014) at [3.3] and following; and Barrett and Feehily, above n 14, at 16.

[171] *Gilford Motor Co Ltd v Horne* [1933] Ch 935, [1933] All ER Rep 109 (CA).

[172] *Prest,* above n 19, at [29]: Lord Sumption agreed with "the Court of Appeal in *VTB Capital*, at para 63, that this is properly to be regarded as a decision to pierce the corporate veil."

[173] *Jones v Lipman* [1962] 1 All ER 442, [1962] 1 WLR 832 (Ch).

[174] See *Prest,* above n 19, at [30]: "did not involve piercing the corporate veil".

[175] See *Chen v Butterfield* (1996) 7 NZCLC 261,086 (HC) at 261092: for a NZ example of where Tipping J describes what is happening as lifting when others would classify it as piercing; but see Barrett and Feehily, above n 14, at 18: classify this as piercing.

[176] Clark, above n 170, at [3.3].

[177] See *Atlas Maritime Co SA v Avalon Maritime Ltd* [1991] 4 All ER 769 (CA) at 779; *Adams and others v Cape Industries plc and another* [1991] 1 All ER 929 (CA) at 1024–1025.

[178] See *Official Assignee v Sanctuary Propvest Ltd* HC Auckland CIV-2009-404-852, 11 June 2009; Alcock, Todd and Lord Millett, above n 170, at [14C].

[179] Barrett and Feehily, above n 14, at 16.

Generally, the courts will not need to PCV as they can achieve the proper result by lifting the corporate veil or applying other legal means.[180] *Prest* is one of the more recent attempts to make sense of PCV by the United Kingdom Supreme Court.[181] Whilst it is not necessarily binding on a New Zealand court, it serves as a good anchor point for discussion. Two important points were made by Lord Sumption. The first is the affirmation of Lord Denning in *Lazarus Estates Ltd* that "fraud unravels everything".[182] The second is the ratio decidendi:[183]

> There is a limited principle of English law which applies when a person is under an *existing legal obligation or liability* or subject to an existing legal restriction which he *deliberately evades or whose enforcement he deliberately frustrates by interposing a company under his control*. The court may then pierce the corporate veil for the purpose, and only for the purpose, of depriving the company or its controller of the advantage that they would otherwise have obtained by the company's separate legal personality. (Emphasis added)

Lord Sumption continues by describing what limits this principle:[184]

> The principle is properly described as a limited one, because in almost every case where the test is satisfied, the facts will in practice disclose a legal relationship between the company and its controller which will make it unnecessary to pierce the corporate veil.

In other words, PCV only happens in exceptional circumstances. These are cases of fraud or where a defendant, with an existing legal obligation, interposes a company to frustrate the actioning of that obligation. Most of the time, PCV will not be engaged as there will be other legal avenues by which to pursue the defendant – even in cases which warrant PCV. PCV will only be used to prevent abuses of the corporate form where such alternatives are exhausted and fail.[185] Note, that whilst Lords Sumption and Neuberger did agree on the test as stated above, Lords Mance and Clarke were reluctant to close off the possibility of other circumstances in which the doctrine might be used.[186]

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[180] At 24.
[181] *Prest*, above n 19.
[182] *Prest*, above n 19, at [18]; and *Lazarus Estates Ltd v Beasley* [1956] 1 QB 702 (CA) at 712.
[183] *Prest*, above n 19, at [35].
[184] At [35].
[185] Clark, above n 170, at [3.3]; and see *Equiticorp*, above n 167.
[186] *Prest*, above n 19, at [100], [103].

New Zealand has not yet had a case which implements the ratio decidendi in *Prest*. Therefore, the pre-*Prest* rules may still apply. In general, pre-*Prest* PCV cases have been found to exist under the broad categories of:[187]

(a) agency;[188]
(b) fraud;[189]
(c) groups of one economic unit;[190]
(d) war;[191]
(e) statutory exceptions.[192]

For the purposes of answering the question posed in this paper, the categories that might apply are agency, fraud and statutory exceptions (if a relevant provision is enacted).

E Conclusion

Companies in New Zealand are governed by the Companies Act 1993 which builds upon hundreds of years of common law. It reaffirms certain powers and duties upon directors who are the company's "legal face".[193] Many of these appear fiduciary in nature. Historically, companies were a product of the need to aggregate capital, and encourage risk taking, in a way which did not expose capitalists to the risk of losing all their private wealth. The principal means of achieving this was through the corporate veil which separates a company from its directors and shareholders, limiting liability. Today, the corporate veil still exists but can be "pierced" in exceptional circumstances where alternative avenues have failed.

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[187] Barrett and Feehily, above n 14, at 24.
[188] *Smith, Stone & Knight Ltd v Birmingham Corporation* (1939) 4 All ER 116 (KB).
[189] *Prest*, above n 19, at [34]; *Gilford Motor Co Ltd v Horne,* above n 171.
[190] *Re Securitibank Ltd (No 2)* [1978] 2 NZLR 136 (CA); and *Bentley Poultry Farm Ltd v Canterbury Poultry Farmers Co-operative Ltd (No 2)* (1989) 4 NZCLC 64,780 (HC).
[191] *Daimler Co Ltd v Continental Tyre and Rubber Co (Great Britain) Ltd* [1916] 2 AC 307 (HL).
[192] For example, Companies Act 1993, s 271.
[193] *Hawke's Bay Trustee Co Ltd v Judd,* above n 21, at [8].

V Justifying reform

A Overview

This part explains why the Law Commission's suggested provision should be implemented. It justifies that the current state of the law is unsatisfactory because it creates inconsistencies between the application of trust and fiduciary law for corporate trustees and trustees who are natural persons. Such differences are especially clear when one looks at the practical effects of the law on the two different trustees. The law currently permits insolvent trustees, ignores reality, and lacks the ability to enforce fiduciary duties upon corporate trustees. The objections to such changes are not substantial enough to justify leaving the law as it stands.

B Why the law must change

The combination of the law of trusts and company law has produced a legal Frankenstein which requires a proactive legislative response. As corporate trustees increase in prevalence, measures must be taken to ensure trusts, and companies, continue to be useful organisational structures in society. There should not be differences in the approach taken to corporate trustees when compared to trustees who are natural persons. This means that consideration should be had to the *practical effects* of these organisational structures, to ensure material aspects remain consistent between the two. Directors of corporate trustees should therefore be held accountable to beneficiaries, just as a natural trustee would be.

1 Permitting insolvent trustees

As archetypal fiduciary, a trustee can be distinguished by their obligation of loyalty.[194] There is little question that a trustee, who is a natural person, owes fiduciary duties to trust beneficiaries. In fact, the Trust Act 2019 now stipulates certain fiduciary duties under the "mandatory duties".[195] These mandatory duties must be performed by the trustee and cannot be removed or amended, regardless of what is written in the trust instrument.[196] There would be great surprise if a trust instrument would permit natural trustees to contract

[194] *Bristol and West Building Society v Mothew*, above n 63, at 449.
[195] Section 23–27.
[196] Section 22.

out of their fiduciary obligation. Yet, that is the very effect of an impecunious corporate trustee.

Impecunious corporate trustees are effectively "limited liability trustees". Such a concept goes against the very understanding of what it means to have a trustee – someone *responsible* to care for the beneficiaries' interests.[197] Being responsible is generally encouraged by the fact that failure to conduct ones duties appropriately can result in being sued. For this reason, becoming a trustee is generally conditional upon the trustee's personal solvency. For example, the New Zealand Court of Appeal in *Commissioner of Inland Revenue v Newmarket Trustees Ltd (Newmarket)*, a case dealing involving an impecunious corporate trustee, said:[198]

> As a general rule in England the Court will almost invariably order the removal of a bankrupt trustee on the grounds that his or her impecuniosity may result in temptation to misappropriate trust funds and demonstrates an absence of prudence and success in managing business affairs.

Yet, impecunious corporate trustees are allowed to continue even when on the verge of insolvency. In *Newmarket*, White J alluded to the problem here in referring to the generous "concession" the Commissioner had made in not pursuing claims under s 135 (reckless trading) and s 136 (incurring obligations) of the Companies Act 1993.[199] The Commissioner would have been well within reason to pursue a claim under those sections. Nonetheless, the point remains that there is an unusual inconsistency between the approach of the law when it comes to trustees who are natural persons as opposed to a company.

2 Ignoring reality

Directors of impecunious corporate trustees should be directly liable to trust beneficiaries. There should be no practical difference between having a natural person or a company as the trustee. If directors are considered the "legal face" of the company then it would follow that they should be directly liable to trust beneficiaries because it is they who make all the decisions.[200] This is especially so when the company is set up for the primary purpose of

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[197] See *Levin v Ikiua*, above n 8, at [115].

[198] *Commissioner of Inland Revenue v Newmarket Trustees Ltd* [2012] NZCA 351 at [70].

[199] At [25], [38]. These provisions of the Companies Act 1993 also raise a raft of additional issues which will not be considered in this paper.

[200] *Hawke's Bay Trustee Co Ltd v Judd*, above n 21, at [8].

being a trustee. Fletcher Moulton LJ in his dissenting judgment in *Bath* summarises this perfectly:[201]

> [Directors] have complete and perfect knowledge of the nature of the acts which the company is doing through them. But they have even more than this. They know that there is *no mind interposed between them and the cestui que trust which administers the trust. It is they who are in fact doing it and no one else*, although it may be done in the name of the company. (Emphasis added)

With no mind interposed between the directors and the company, so as to make the mind of the company different from the mind of the director, it should follow that directors should be treated as trustees. That merely provides recognition of the reality of the situation.

The Law Commission also acknowledged the reality of the situation in suggesting a "direct look-through" provision which treats directors like trustees.[202] Whilst corporate trustees are directly liable to the beneficiaries, it does not necessarily mean that beneficiaries have recourse against the *directors* in the case of a breach. The Law Commission recognised the need for greater certainty in the law and were not satisfied with the indirect mechanisms currently available in holding the director of a corporate trustee to account.[203] In coming to this conclusion, the Law Commission appear to align with submitters who were focused on the reality of the situation and were concerned that:[204]

> …the directors of the company are to all intents and purposes the trustees, and so should be treated as such. It would seem *sensible for the law to recognise the practical reality of the arrangement, notwithstanding the conventional protection of the corporate veil.* (Emphasis added)

In the Law Commission Issues Papers those in opposition of recognising the reality of the situation gave a variety of reasons, none of which engaged directly with this point.[205] It might be plausible to permit limited liability trustees on certain policy grounds but none

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[201] *Bath v Standard Land Company Limited*, above n 17, at 637.
[202] Law Commission *Law of Trusts: Preferred Approach Paper*, above n 3, at [8.86].
[203] At [8.86].
[204] At [8.84].
[205] See at [8.85] where submitted raise concerns about how extending such liability might (i) discourage third parties from acting as corporate directors; (ii) cut across and complicate fundamental aspects of company and trust law; and (iii) be difficult to design.

can be easily ascertained. In company law, the corporate veil is justified on the policy ground that the benefits substantially outweigh the risks. Companies encourage business risk and the aggregation of capital, which produces economic and social benefits.[206] Yet the same cannot be said for limited liability trustees.

With limited liability trustees the most evident benefit is the limited liability. Yet, trusts were not designed to be as such – it is contrary to the entire development of trust and fiduciary jurisprudence.[207] There is little discernible reason to allow limited liability trustees on the basis of policy or social utility. A limited liability trustee is essentially insolvent, contrary to the development of trust law which typically necessitates trustee solvency.[208] It should not be permitted because, as recognised by the Law Commission, it may be used "as a means to avoid liability to beneficiaries".[209] Heath J, in the case of *Levin v Ikiua*, summarises that the use of an assetless corporate trustee may achieve the object of protecting shareholders from creditors of the company "but it [should] not absolve the directors of the corporate trustee to make good any losses caused by their wrongful actions."[210]

3 Lack of enforceability

The fiduciary duty of corporate trustees is severely compromised by the practical lack of enforceability. This is especially so where the defendant is an impecunious corporate trustee.[211] Whilst it is true that corporate trustees do owe fiduciary duties directly to trust beneficiaries, the duty is only as proscriptive as the ability to enforce it. For limited liability trustees the threat of being sued is effectively neutralised by the fact that a company has limited liability, and very little assets of its own from which to claim against. The impecunious corporate trustee is but a shell with no other assets but the right to indemnity.[212] The end result is that the fiduciary duties, which proscribe trustee activities

[206] See Companies Act 1993, Title.

[207] *Levin v Ikiua*, above n 8, at [98]: "The appointment of an assetless corporate trustee is inconsistent with the interests of beneficiaries of a trust."

[208] *Commissioner of Inland Revenue v Chester Trustee Services Ltd* [2003] 1 NZLR 395 (CA) at [63] per Baragwanath J.

[209] Law Commission *Law of Trusts: Preferred Approach Paper*, above n 3, at [8.86].

[210] *Levin v Ikiua*, above n 8, at [99].

[211] See *Commissioner of Inland Revenue v Newmarket Trustees Ltd*, above n 198, for such an example.

[212] Which does not generally exist in the case of a breach of trust.

and ensure they do not compete or conflict with the interests of beneficiaries, are rendered ineffective.

It has been said that the relevant directors' duties in the Companies Act 1993 go some way in addressing the concern for a lack of enforceability.[213] Directors owe duties, particularly under s 131, 135, and 136, to ensure they are not adversely affecting beneficiaries' rights.[214] These so far have proven to be adequate and there seem to be "…no problems with the status quo."[215] However, this ignores the fundamental point of difference: that such duties are owed to the *company* and not to beneficiaries.

The Companies Act says nothing about the relationship between directors and trust beneficiaries.[216] Even duties like s 135 and 136 which are designed to protect creditors have generally been held to be duties owed to the company.[217] At best, beneficiaries might be held to be creditors in the situation of a breach of duty by directors. Yet the likelihood is that some other convoluted means, like the dog-legged claim, would have to be sought in claiming against the directors.[218] A dog-legged claim occurs when the beneficiaries of a corporate trustee sue the directors for breach of trust, not through the direct imposition of a duty, but through "indirect enforcement of the already existent duty between the director and corporate trustee".[219] The lack of real enforceability against the directing minds of the company is what gave the Law Commission cause for concern that "beneficiaries do not have any special protection in these circumstances, and may be vulnerable."[220]

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[213] See Law Commission, above n 2, at [16.6]; and John Hart "Trading Trusts" (paper presented to New Zealand Law Society Trusts Conference, 2003) at 160; and Steele, above n 213, at 339: "Objection 1: The companies legislation already imposes sufficient obligations on directors and there are no problems with the status quo."
[214] Companies Act 1993.
[215] Steele, above n 213, at 339.
[216] At 339.
[217] See *Debut Homes Limited (in liq) v Cooper*, above n 146; and *Yan v Mainzeal Property and Construction Limited (in liq)*, above n 153. There is also the issue that money claimed goes to the general pool for creditors.
[218] See *HR v JAPT* [1997] PLR 99 (Ch); and Law Commission *Law of Trusts: Preferred Approach Paper*, above n 3, at [8.75].
[219] James Anson-Holland "The corporate trustee safety net?" [2019] NZLJ 211 at 211.
[220] Law Commission *Law of Trusts: Preferred Approach Paper*, above n 3, at [8.76].

C Objections to change

The objections to change are spearheaded by the notion that it is unacceptable to pierce the corporate veil. Whilst this is a genuine concern, it is easily addressed. Under the narrow conception of PCV, no piercing is required. Even if it is considered to be PCV under the wide conception, it is justifiable. Additional objections headed under "creating more problems" and "negates the use of corporate trustees" raise minor objections which lack impetus when assessed in greater detail.

1 Piercing the corporate veil

One of the strongest objections to legislative intervention is the perceived breach of the sanctity of the corporate veil.[221] As previously discussed, the corporate veil is fundamental to the corporate vehicle and allows for the aggregation of capital, the spreading of risk, and the taking of business risks.[222] Understandably, some may be alarmed to hear of legislative attempts to pierce the corporate veil. However, this is not necessarily the case under the narrow conception of PCV. Even if one subscribes to the wider conception of PCV, such a statutory change remains localised and justified.

Under the narrow conception of PCV, which authoritative texts hold to be the better approach,[223] the Legislature would not be PCV in applying a "direct look-through" approach.[224] The narrow approach views PCV as treating the company and the individuals behind it as one, ignoring the corporate form.[225] The proposed legislation would be classed as a lifting of the corporate veil to reveal the reality of the arrangements. The company can still make decisions and act just as a company would. That is still recognised by law. The only change is that, in the case of breach of trust, the law will look behind the corporate veil to attribute liability to the directors. It is akin to a statutory addition to the rules of attribution.

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[221] See at [8.85]; and Law Commission *Review of the Law of Trusts: A Trusts Act for New Zealand,* above n 2, at [16.6]: "Submitters also said it was inappropriate to modify the fundamental principle of limited liability of companies and separate legal personality."
[222] Companies Act 1993, Title.
[223] See Alcock, Todd and Lord Millett, above n 170, at [10]; Clark, above n 170, at [3.3] and following; and Barrett and Feehily, above n 14, at 16.
[224] Law Commission *Law of Trusts: Preferred Approach Paper,* above n 3, at [8.86].
[225] See *Atlas Maritime Co SA v Avalon Maritime Ltd,* above n 177, at 779; *Adams and others v Cape Industries plc and another,* above n 177, at 1024–1025.

Subscribers of the wider notion of PCV would claim that the direct look-through approach is a breach of the corporate veil. Even if the wider notion were to be accepted, it can be argued that such a breach of the corporate veil is justified. Beginning with the ratio decidendi in *Prest*, it was Lords Sumption and Neuberger which agreed on the test focusing on a defendant who interposes a company to evade liability. On the other hand, Lords Mance and Clarke were reluctant to close off the possibility of other circumstances in which the doctrine of PCV might be applied.[226] There was not an unequivocal acceptance of the ratio of Lord Sumption. On this basis, if a New Zealand court or the Legislature were to look to *Prest* for guidance, there may be grounds other than that stated in Lord Sumption's ratio for piercing the corporate veil.

If the pre-*Prest* approach to PCV were to be taken, two main categories apply which justify PCV through legislation: agency, and statutory exceptions. Statutory exceptions are permissible in and of themselves to allow PCV, as a product of parliamentary supremacy. Another alternative is through the category of agency. Agency cases typically involve a company which becomes an agent for its principal.[227] In the case of the director of an impecunious corporate trustee, it could well be said that the director uses the company as its agent in carrying out trustee duties.

One could justify PCV under the category of agency to find liability between director and beneficiary. In *Smith, Stone & Knight Ltd v Birmingham Corporation* the Court found that it was "a question of fact in each case… whether the subsidiary was carrying on the business as the company's business or as its own."[228] Atkinson J then lists six following questions that should be answered to elucidate what control the relevant party might have over the (subsidiary) company in order to assess if the (subsidiary) company was the effective agent. Application of the six questions to the context of a corporate trustee may find that PCV could be justified on the category of agency.

Opponents of the legislative changes might respond that the common law has a long-standing principle which states the corporate veil must not be pierced for reasons of being

[226] *Prest*, above n 19, at [100], [103].
[227] See *Smith, Stone & Knight Ltd v Birmingham Corporation*, above n 188.
[228] *Smith, Stone & Knight Ltd v Birmingham Corporation*, above n 188.

just and equitable.[229] The principal concern is that to allow the courts to PCV on such grounds may produce enormous commercial uncertainty.[230] This concern is a valid one. Any attempts to undermine commercial certainty should be constrained. Yet, the bulk of this argument does not so much apply in the context of legislative reform involving the directors of corporate trustees. Firstly, legislation involves a blanket application to the directors of corporate trustees. It does not so much involve the discretion of the courts, that which can produce inconsistency and uncertainty. Second, there is a lack of a commercial implication in the current context. Finding direct look-through liability affects the directors and their relationship with trust beneficiaries. It does not have a direct effect on commercial operations, if any exist. Thirdly, there is precedent of similar provisions which have worked. These are Section 142(3) of the Financial Markets Conduct Act 2013 and s 27(1) of the now repealed Unit Trusts Act 1960.[231]

2 Creating more problems

It has been argued that there are no problems with the status quo and so the law should be left alone.[232] Existing avenues can be pursued if necessary. Some examples include recourse against the directors for providing dishonest assistance in breach of trust, knowing receipt, trustee de son tort (trustee of own wrong) or the indirect dog-legged claim.[233] The Law Commission recognises that these routes for finding a director liable to beneficiaries are likely to exist, but that there have been few such claims in New Zealand.[234] Consequently, it is difficult to assess whether they are adequate, and even if they are, they are likely to require high thresholds in order to succeed.[235] The Law Commission also emphasises that the lack of claims cannot necessarily be taken to indicate that there is no

[229] See *Adams v Cape Industries plc*, above n 177; *DHN Food Distributors Ltd v Tower Hamlets London Borough Council* [1976] 1 WLR 852 (CA); *Chen v Butterfield*, above n 175; *Re Wiseline* (2002) 16 PRNZ 347 (HC); *Bentley Poultry Farm Ltd v Canterbury Poultry Farmers Co-operative Ltd (No 2)*, above n 190: where a suggestion that the veil could be lifted if its presence leads to an inequitable or generally unfair result was firmly rejected on the grounds that it would cause enormous commercial uncertainty.

[230] Barrett and Feehily, above n 14, at 21.

[231] See Companies Act, s 131–137, s 174, s 241, s 271 for other examples.

[232] Steele, above n 213, at 339: "Objection 1: The companies legislation already imposes sufficient obligations on directors and there are no problems with the status quo."

[233] Law Commission *Court jurisdiction, trading trusts and other issues: review of the law of trusts - fifth issues paper*, above n 6, at [8.3]–[8.6].

[234] Law Commission *Law of Trusts: Preferred Approach Paper*, above n 3, at [8.83].

[235] At [8.83].

problem in this area.[236] It may well be due to the fact that "the relatively small value of many of these trusts, mak[e] protracted litigation uneconomical."[237] For that reason, corporate trusts are likely to have received little judicial attention in New Zealand, especially at the appellate level.[238]

Objectors to the proposals also suggest that such a change is likely to involve issues with design and could create problems in the interaction between trust and company law.[239] What issues might arise due to such a change was not put forth by submitters, even after the Law Commission twice asked for feedback in Issues Papers 28 and 31.[240] Inevitably, there may be some tweaking required by the Legislature if certain facts create problems for the law. However, this is no different to other areas of law and the possibility for conflict is not a reason, in and of itself, to avoid enacting such a change.

3 Negates the use of corporate trustees

Submitters suggest that legislative reform will effectively "negate" the use of corporate trustees.[241] Andrew Steele responds that the reform would only remove one aspect, being the corporate 'shield'.[242] Other aspects such as being able to change directors easily, tax benefits, and administration benefits would remain.[243] The submission itself appears to reflect the approach commonly taken by those who employ corporate trustees – that they enable some acceptable form of limited liability trusteeship. This is because the utility of a corporate trustee would only be "negated" if the sole benefit one sought was limited liability trusteeship. As discussed, there is good reason that this feature of the corporate trustee be removed – so as to remain consistent with trust and fiduciary jurisprudence.

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[236] Law Commission *Law of Trusts: Preferred Approach Paper,* above n 3, at [8.83].

[237] Peter Moore "Trading Trusts: Law and Policy" (February 2008) at 1.

[238] Law Commission *Court jurisdiction, trading trusts and other issues: review of the law of trusts - fifth issues paper,* above n 6, at [6.11].

[239] Law Commission *Law of Trusts: Preferred Approach Paper,* above n 3, at [8.85].

[240] See Law Commission *Court jurisdiction, trading trusts and other issues: review of the law of trusts - fifth issues paper,* above n 6, at [8.9]; and Law Commission *Law of Trusts: Preferred Approach Paper,* above n 3, at [8.87].

[241] Law Commission, above n 2, at [16.9].

[242] Steele, above n 213, at 339.

[243] At 339.

It has also been suggested by submitters that "the proposal would be impractical and ineffective and "… significant numbers of people could become unwilling to act as directors of corporate trustees, due to the expansion of liability."[244] Andrew Steele retorts that "it is conjecture to suggest that the proposal will be ineffective and impractical".[245] He too cites that as a matter of principle, it should not be open to a director to conduct the affairs of a trust, but by use of a company avoid the usual duties imposed on trustees.[246] It, "seems inconsistent with the jurisprudential underpinnings of fiduciary relationships."[247]

The second part of the submission refers to the possibility of existing corporate trustees retiring from their roles due to the additional legislative duties. It suggests that the additional burden might be too much to impose on top of existing duties under the Companies Act 1993.[248] However, that should not be an issue in practise, as the new duty would not be any different from a trustee who is a natural person. If the other benefits of corporate trustees are not enough to justify adding duties under the Companies Act, then a more standard form of trust should be applied.

Submitters opposed to the change also mention that the use of a corporate trustee is legitimate, that they are prevalent and useful. It is uncertain whether these submissions refer to limited liability trusteeship as being legitimate or whether they refer to the other benefits such as administration benefits. If it is the former, then that would not be legitimate in accordance with trust and fiduciary jurisprudence. If it is the latter, then that is well accepted as being the case. As Heath J said in *Levin v Ikiua*, "it is as well to remember that a trading trust can be used for legitimate purposes".[249] The suggested law reforms do not seek to remove the use of the corporate trustee but rather take the approach of caution, acknowledging that it may be used incorrectly to defeat the interests of genuine creditors.[250]

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[244] Law Commission, above n 2, at [16.6].

[245] Steele, above n 213, at 339.

[246] At 339.

[247] At 339.

[248] See Law Commission, *Review of the Law of Trusts: A Trusts Act for New Zealand,* above n 2, at [16.6]; and Law Commission *Law of Trusts: Preferred Approach Paper,* above n 3, at [8.85].

[249] *Levin v Ikiua,* above n 8, at [101]: refers to a trading trust as a type of corporate trustee.

[250] See at [101]: "Because the use of an assetless corporate trustee has the potential to defeat the interests of genuine creditors of a company, there is (rightly) a healthy degree of cynicism surrounding its use."

D Conclusion

Law reform is justified on the basis that it introduces consistency in the law between trustees who are companies and natural persons. Reform realigns the practical realities of corporate trustees with the development of fiduciary and trust jurisprudence. It ensures that the proscriptive nature of fiduciary duties can be enforced on the true actor(s) behind a corporate trustee. The objections to such changes are spearheaded by the notion that it is unacceptable to pierce the corporate veil. This need not be the case. Yet, even if it is considered to PCV, it is justified on the basis of consistency between trustees who are natural persons and corporations.

VI New Zealand Reform

A Overview

The current state of the law lacks the clarity required to protect beneficiaries.[251] It is not satisfactory. It is difficult to ascertain whether directors of a corporate trustee might owe fiduciary duties directly to trust beneficiaries and, if so, by what means? The Law Commission noted this issue and "considered it preferable to put it beyond doubt."[252] The best means of doing so is by implementing legislative changes which hold that the directors of a corporate trustees owe fiduciary duties directly to trust beneficiaries. If this is not done, then the courts have existing avenues by which they could effect such change.

B Legislative reform

As recommended by the Law Commission, the government should implement legislative reform.[253] This would be the most effective way of addressing the uncertainty around whether directors of corporate trustees owe a direct fiduciary duty to trust beneficiaries.[254] It will also "prevent the occurrence in New Zealand of difficulties of the type that have been encountered in Australia before they actually happen."[255]

The ultimate suggestion of the Law Commission was that legislation include "a direct look-through with directors of companies acting as trustees being directly accountable to beneficiaries."[256] This was after evaluating four options, which are as follows:[257]

> (a) A "direct look-through" extending the liability of directors of a trust company, to impose on the directors the same obligations to beneficiaries to which they would have been subject if they personally had been the trustees (also proposed by the Commission in its 2002 review);

[251] Law Commission *Some Problems in the Law of Trusts* (NZLC PP48, 2002) at [23]–[24].
[252] At [25].
[253] See Law Commission *Law of Trusts: Preferred Approach Paper*, above n 3, at [P36].
[254] At [8.86].
[255] Law Commission *Some Problems in the Law of Trusts*, above n 251, at [28].
[256] Law Commission *Law of Trusts: Preferred Approach Paper*, above n 3, at [8.86].
[257] At [8.78].

(b) a requirement for a professional trustee to disclose to the client settlor the implications of the choice of a corporate trustee and to advise on what trustee insurance the trustee has in place (as proposed by Taylor Grant Tesiram);
(c) a provision similar to section 27 of the Unit Trusts Act 1960, under which the directors of a trustee of a trust can be found liable as delinquent directors on the application to the court by the trustee, a liquidator of the trustee or a unit holder (as proposed by KPMG);
(d) to retain the status quo, with no reforms targeted at beneficiaries.

The appeal of option (a), the preferred approach, is its relative simplicity. The law requires the directors of corporate trustees to be treated as if they themselves were the trustees. It would mean that the existing body of law on trusts and fiduciaries, in relation to trustees, could be applied in a more straightforward manner. This proposal also amends the law so that there is direct accountability for all trust structures, recognising the reality of the situation. This preferred approach should be pursued by the Legislature.

Turning to option (b), the Law Commission considered that option (a) remains preferable, but that disclosure requirements could be workable. Disclosure could operate in addition to, or as an alternative to, option (a). This proposal by Taylor Grant Tesiram (TGT) requires professional trustees to disclose to the client settlor the implications of the choice of a corporate trustee, and advise as to what trustee insurance is in place.[258] TGT also suggests that minimum requirements as to trustee insurance cover may be appropriate. However, with this option, many of the issues covered in this paper still remain.

Disclosure and insurance requirements do not appear to address the lack of direct accountability between directors of corporate trustees and trust beneficiaries. The settlor is usually the director in these cases. Therefore, this proposal does not directly address the problem of the risk to beneficiaries.[259] Additional practical concerns also exist: administrative and cost burdens on those settling trusts, questions about effectiveness, evidential difficulties in establishing compliance, and an issue about the consequences attaching to a failure to inform the client as required.[260] Option (b) does not appear to be a solution in itself. It would have to be applied in conjunction with option (a) to produce meaningful reform.

[258] Law Commission *Law of Trusts: Preferred Approach Paper*, above n 3, at [8.88].
[259] At [8.88].
[260] At [8.88].

Option (c), which is comparable to s 27 of the Unit Trusts Act 1960, is another sensible alternative. It would allow the court, on the application of the trustee, a liquidator of the trustee, or beneficiaries to examine the conduct of any past or present director. In doing so, if the director has been party to misconduct, the court can order the director to repay or restore the money or property as the court thinks just. This route arguably leaves too much discretion to the court in terms of what can be ordered and its quantum. It is preferable to use existing, long established, principles from trust and fiduciary law as per the preferred option.

Option (d) changes nothing and is the current decision after the implementation of the Trusts Act 2019. This leaves beneficiaries in a precarious position because the avenues which exist for them to sue for breaches of fiduciary duties remain unclear.[261]

C Common law and equity

If no legislative reform is undertaken then it will be left to the courts to decide on a course of action.[262] New Zealand has little law on its own and is heavily reliant on other jurisdictions, particularly the United Kingdom, for guidance.[263] This part will consider key cases a New Zealand court might engage with in determining whether a direct fiduciary duty is owed by the director of a corporate trustee to trust beneficiaries. It is not intended to be a compendium of relevant cases but rather a brief exploration of the law. Doing so should demonstrate that it appears "there is no impassable barrier preventing a director of a company which itself owes a fiduciary obligation from himself being liable for breach of that obligation."[264]

1 New Zealand cases

Searches of New Zealand case law yield only a few cases of relevance. When looking for direct statements of law, the Privy Council in *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd (Kuwait)* comes up as recognising the principle that "a director does not by

[261] Law Commission *Law of Trusts: Preferred Approach Paper*, above n 3, at [8.83].
[262] Steele, above n 213, at 339.
[263] Law Commission *Court jurisdiction, trading trusts and other issues: review of the law of trusts - fifth issues paper*, above n 6, at [6.11].
[264] Steele, above n 213, at 340.

reason only of his position as director owe any duty to shareholders or to trustees for creditors of a company."[265] However, this was an obiter statement which had little relevance to the ultimate decision – that Kuwait Bank did not have jurisdiction to sue.

In that case, the Kuwait Bank were trustees for deposits taken by a New Zealand company, AICS. When AICS was liquidated, depositors sought their deposited money from Kuwait Bank who paid out $6.75m of the $14.5m owed.[266] Now Kuwait Bank sought to reclaim that loss from directors of AICS by reaching around the corporate veil.

The Privy Council was most concerned with Kuwait Bank's lack of jurisdiction, notwithstanding the fact that most of the claims made by the Bank against AICS directors lacked substance. The Court decided to dismiss the proceedings based on a lack of jurisdiction – the bank was based in Bahrain and had no New Zealand presence.[267] However, prior to doing so it added obiter dictum about the sanctity of the corporate form and how the veil will not be pierced just to enable Kuwait Bank to account for a bad business decision on their part. That is the context in which the statement arises. It is therefore not a conclusive response to the question being asked in this paper.

In the New Zealand Court of Appeal decision of *Milloy v Dobson (Milloy)*, the Court also appears to make a definitive statement of law.[268] *Milloy* is a rather convoluted case made more complex by the web of legal arrangements involved.[269] The Court stated that "a director of a corporate trustee does not owe duties directly to beneficiaries."[270] Yet, this statement is, again, not as conclusive as it may seem because it was not a core focus of litigation. Instead, it was a counterclaim made by the Milloys in the High Court,[271] which continued to be pursued in the Court of Appeal.[272]

Starting with the factual matrix of the proceedings, the case of *Milloy v Dobson* involved two litigants who were former business associates.[273] The main litigation revolved around

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[265] *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd*, above n 160, in *McNulty v McNulty* HC Dunedin CIV-2010-412-000810, 30 September 2011, at [81].
[266] *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd*, above n 160, at 202.
[267] At 224.
[268] *Milloy v Dobson* [2016] NZCA 25.
[269] See *Milloy v Dobson*, above n 268: appendix for a diagram of the legal arrangements involved.
[270] At [118].
[271] *Dobson v Milloy* [2014] NZHC 1631 at [134]–[151].
[272] *Milloy v Dobson*, above n 268, at [110]–[123].
[273] *Milloy v Dobson*, above n 268.

the splitting of business debts due to insolvency related issues. Dobson had to sell his house to pay his portion of the business debt, yet some of the net proceeds were applied to Milloy's debt.[274] It is this amount which Dobson was trying to recover.

The counterclaim by Milloy is relevant for the purposes of this paper.[275] In the High Court, the principal allegation was that Dobson removed Milloy as director and beneficiary (for several companies and trusts) to disentitle the Milloys of their rights and benefits under the corporate structure.[276] The Milloys claimed that this was a breach of trust. Moore J in the High Court found that the actions were "designed and intended to dishonestly deprive Mr Milloy of any entitlement to the sub-trust's funds."[277] However, no breach of trust occurred because there was no loss.[278] In other words, there was little hope for such a claim to succeed.

In the Court of Appeal, the issue was re-litigated as the Molloys claimed that the trial judge erred in his judgment.[279] Stevens J agreed with the High Court in finding the Molloys had *no standing to make the relevant claim*.[280] That was the end of the case. However, it is the following obiter dicta which is a point of interest for the purposes of this paper. Stevens J states that even if the Milloys had standing, there is no breach of fiduciary duty on the part of the trustee company (of which Dobson was a director). Going yet a step further, Stevens J makes the second *obiter* statement we are focused on for this enquiry:[281]

> Mr Hollyman contends that Mr Dobson, as a director of Clusevau, directly owed the Milloy interests duties. *However, a director of a corporate trustee does not owe duties directly to beneficiaries*. Clusevau as the corporate trustee owed duties to the beneficiaries. Accordingly it must be established that Clusevau breached the fiduciary duties it owed… This has not been established on the evidence…. The parties structured their affairs in a manner that took advantage of the separate and individual legal position of each corporate body. *In these circumstances, we see no principled basis on which to look behind it*. (Emphasis added)

[274] *Milloy v Dobson*, above n 268, at [3].
[275] At [25]–[35].
[276] *Dobson v Milloy*, above n 271, at [140].
[277] At [144].
[278] At [150].
[279] *Milloy v Dobson*, above n 268, at [111].
[280] At [117].
[281] At [118].

This second obiter statement is not an absolute answer to the question this paper seeks to answer. Firstly, it is an obiter statement unnecessary for the actual decision made that the Milloys had no standing on which to claim. Secondly, the obiter statement was not just a contingency argument if the primary argument failed. It was a contingency argument if the *second* contingency argument failed. In other words, it was the *third* line of defence. This makes it well removed from the core decision being made. Thirdly, the last italicised sentence in the quote states, "In these circumstances, we see no principled basis on which to look behind it."[282] This suggests that each decision is a fact dependent inquiry asking whether there may be a "principled basis on which to look behind [the arrangements]."[283]

Turning to the New Zealand Supreme Court in *Chirnside v Fay*, support is found for the notion that there is not an exhaustive category of relationships which are classified as fiduciaries:[284]

> … [whether] a relationship will be classed as fiduciary depends not on the inherent nature of the relationship but upon an examination of whether its particular aspects justify it being so classified. No single formula or test has received universal acceptance in deciding whether a relationship outside the recognised categories is such that the parties owe each other obligations of a fiduciary kind.

Read in conjunction with *Milloy*, it appears that the Supreme Court is leading the way with a willingness to recognise fiduciaries, where they are held to exist, *after an extensive fact specific enquiry*. Fiduciaries are not limited just to set types of relationships. They can be found given each case's particular facts.

2 United Kingdom cases

The main case of significance is *Bath*.[285] This case obliged the Court to decide whether or not the directors of a company, which itself was in a fiduciary position arising from contract with a stranger, owed a fiduciary duty to that stranger.[286] The commonly cited statements of law arise from Cozens-Hardy MR. Two statements are key to the question of this paper.

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[282] *Milloy v Dobson*, above n 268, at [118].
[283] At [118].
[284] *Chirnside v Fay* [2006] NZSC 68 at [73].
[285] *Bath v Standard Land Company Limited*, above n 17.
[286] Steele, above n 213, at 339.

The first is that, "directors stand in a fiduciary relation to the company, but not to a stranger with whom the company is dealing."[287] He continues:

> Directors stand in a fiduciary position only to the company, not to creditors of the company, not even to individual shareholders of the company, still less to strangers dealing with the company. This principle applies equally whether the relation between the company and the stranger is one purely of contract, such as principal and agent, or is one of trustee and cestui que trust.

This has been the longstanding position of the law of England in relation to the question of this paper. As time has progressed, other jurisdictions have found ways around this judgment by means of indirect claims such as the dog-legged claim.[288] However, this appears convoluted. Especially as closer inspection reveals that this statement is not as impermeable as may be perceived.

In *Bath*, each Judge wrote a separate decision.[289] Andrew Steele notes that Buckley LJ acknowledged that a fiduciary relationship could arise by "implication of law" on the particular facts of a case but the contractual relationship of the company to the plaintiff *in the case before him* did not warrant such an implication.[290] This is not an unequivocal statement of support of Cozens-Hardy MR. Additionally, the dissent of Fletcher Moulton LJ accepts the absolute proposition that a person does not come into fiduciary relations with the cestuis que trust merely by becoming an agent of the trustee.[291] Yet, His Honour adds that it did not follow that this meant that person was consequently barred from entering into such relations:[292]

> Fiduciary relations may exist in innumerable forms and are of innumerable kinds. They may arise from specific contract, but they may and often do arise out of acts or relationships creating a duty.

Both the statements of Buckley and Fletcher Moulton LJJ resonate with that made by the New Zealand Supreme Court in *Chirnside v Fay*.[293] Though a strict approach might find

[287] *Bath v Standard Land Company Limited*, above n 17, at 625.
[288] Anson-Holland, above n 219.
[289] *Bath v Standard Land Company Limited*, above n 17.
[290] *Bath v Standard Land Company Limited*, above n 17, at 642 in Steele, above n 213, at 340.
[291] Steele, above n 213, at 340.
[292] *Bath v Standard Land Company Limited*, above n 17, at 636.
[293] See *Chirnside v Fay*, above n 284, at [73].

that existing cases say no fiduciary duty is owed directly to beneficiaries by directors of corporate trustees, there is certainly room for movement if an appellate court decided to find in the alternative. The statements of Buckley and Fletcher Moulton LJJ in conjunction with the New Zealand Supreme Court appear to suggest that a workable solution can be produced. As Andrew Steele summarises:[294]

> I expect that as a general rule it is accepted that a trustee may not profit from his or her position. Would equity nevertheless allow a director of a company incorporated for the sole purpose of being trustee of a trust to do what the company itself is precluded from doing, say, profit from the trust property? One would expect the answer to be "of course not".

D Conclusion

The best way to enact reform on this area of law is by implementing the preferred approach through legislative change. It is unclear when the Law Commission's corporate trustee review will be conducted, so it is likely to remain as a decision for the courts. A candid approach to the existing law reveals that New Zealand does have options if it is ever faced with the question of whether the director of a corporate trustee owes direct fiduciary duties to trust beneficiaries. Where the court deems appropriate it can draw from key New Zealand and United Kingdom statements of law which suggest that fiduciary relationships will be found to exist where it is appropriate on the facts.

[294] Steele, above n 213, at 340.

VII Conclusion

This paper set out to build upon the work done by the Law Commission in assessing whether the law should impose a direct fiduciary duty between directors of corporate trustees and trust beneficiaries. Chapter II covered the basic underpinnings of the problem: that companies were being used to create a Frankenstein of company and trust law which was referred to as the "limited liability trustee". It raised the concern that the underpinnings of trust and fiduciary law, having a responsible trustee, are removed in favour of having a shell company with limited liability. This is a problem because the directors, the "legal face" of the company, are hidden behind the corporate veil – far out of reach from trust beneficiaries.

Chapter III and chapter IV provided a foundational understanding of the concepts which rest at the heart of this paper. Chapter III explained the law surrounding trusts and fiduciaries. Trusts involve a settlor who vests property in a trustee so that the trustee might selflessly deal with the property to the benefit of trust beneficiaries. Trustees are given full power to deal with the property as if it were their own and are subject to corresponding obligations to the trust beneficiaries. These obligations include fiduciary duties which proscribe one to act *loyally*. These are enforced strongly by the courts through harsh measures, including the proprietary remedy of disgorgement, so that trustees act in good faith for the beneficiary's best interests.

Chapter IV gave the context in which companies arose and how they operate today. It highlighted the importance of the board of directors as the legal face of the company. Companies provided, and continue to provide, a means to aggregate capital, and encourage risk taking, in a way which does not expose investors to the risk of losing all their private wealth. At the heart of the company is the corporate veil which separates a company from its directors and shareholders, limiting liability. Today, the corporate veil still exists but can be "pierced" in exceptional circumstances where alternative avenues have failed.

Chapter V justifies the need for reform due to the practical inconsistencies apparent when one compares the trusteeship of a natural person as opposed to a company. Three main problems exist: that directors are practically untouchable, although they are the directing minds of the corporate trustee, the impecunious corporate trustee is effectively insolvent, and the typically harsh remedies of equity lack meaningful enforceability. Chapter V also outlines the strongest arguments against legislative change – spearheaded by the notion that it is unacceptable to pierce the corporate veil. These objections are addressed with the ultimate conclusion that they are not so significant, in this context, so as to prohibit the implementation of legislative change.

Chapter VI provides an outline of the way forward for New Zealand. The first priority should be to legislate for a “direct look-through” approach which ensures the directors of corporate trustees owe direct fiduciary duties to trust beneficiaries. In the event that a decision is left to the courts, a candid approach to the law reveals that there are key New Zealand and English cases which provide the means by which to effect the necessary change.

Imposing fiduciary duties on the directors of corporate trustees is neither onerous, nor unreasonable. The duties fundamentally proscribe trustees from competing and conflicting with trust beneficiaries. If these duties are readily accepted for the trustee that is a natural person, then that same approach should be applied to the directors of corporate trustees who have no mind interposed between themselves and the company. It is the directors who are in fact acting and no one else.

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