

Trusteeships – trick or treat?

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Many firms would not consider taking on the role of independent trustee of a client's family trust as a particularly risky move. However some recent examples of Professional Indemnity claims notified by NZ LAW members suggest that there may be some unexpected risks involved in signing up as a trustee.

We have come across a number of claims over the years where the lawyer, as a trustee, does not do anything to breach a duty owed but because of the actions of others, the lawyer becomes liable to a third party. The problem tends to arise as a result of the solicitor agreeing to act as a trustee but then leaving the day to day management and control with the client and co-trustee. The "sin" lies in omission rather than commission. There may in fact be no liability to a third party arising from a breach of duty, but rather a liability which arises because of the lawyer's status as a trustee.

For example there may be liability as a trustee for the tax activity carried on by the trust through the actions of others. A number of claims have arisen against trustees for GST associated with developments projects, such as the sale of land. An example of this is the decision of *AMP v MacAlister Todd Phillips* [2006] NZSC 105.

There can also be claims against trustees for voidable transactions. A co-trustee, who is in control of a trust business, may arrange for the repayment of shareholder loans or dividends to the trust and then remove these. Because the trust has received the funds his fellow trustee may receive demands from the liquidator to claw back the money as a voidable transaction.

Some recent claims which have been notified by NZ LAW members are discussed below:

Example 1

The leaky home claim

This claim involved a lawyer who was the independent trustee of a family trust. In May 2007 the trust sold the house which it owned for \$1,175,000. In September 2014 the purchasers commenced Weathertight Homes Tribunal proceedings against the Council, building inspector, builder, and vendor. They alleged that the trust breached the vendor warranty contained in the sale and purchase agreement which provided that any building works done to the property were completed in compliance with the building consent, and a code compliance certificate issued for the works. NZI sought to have the independent trustee removed from the WHT proceeding on the basis that the sale and purchase agreement limited the liability of a trustee to the value of the assets of the trust available to meet that liability, and the trust had no assets.

Rather surprisingly, the WHT refused the removal application. The WHT held that the lawyer was simply listed as one of the vendors on the agreement and the agreement did not state that he entered into the agreement in his capacity as trustee. He was therefore unable to rely on the limitation of liability provision in the agreement because he did not give notice that he was entering into the agreement as trustee. Furthermore, the WHT referred to the decision of *Frimley Estate Ltd v Stonewall Homes Ltd* (2010) 12 NZCPR 769 which held that the correct date for assessing a trustee's liability was the date on which the agreement became unconditional. At this point in time the trust's assets would have been the selling price less the outstanding mortgage.

While NZI considered that the WHT decision was wrong and sought judicial review of this, the claim settled on a cost-saving basis before the judicial review application was heard.

*Example 2**The matrimonial split claim*

This claim also involved a lawyer who was the independent trustee of a family trust. The trust purchased a section with the intention of building a house on it. At about the same time, the other trustee began a defacto relationship with Ms X. Over the next 5 years the house was built and then sold. The following year, the couple split up. Ms X then commenced High Court proceedings against the trustees, seeking a share of the \$200,000 profit made on the sale of the house on the basis of a constructive trust. While the High Court rejected the claim, this was overturned in the Court of Appeal. The Court of Appeal held that the trust was the alter-ego of the other trustee, and criticised the independent trustee for leaving all of the decisions to do with the construction of the house to the other trustee. The trust was held liable to pay \$37,400 to Ms X. An application to appeal this decision to the Supreme Court was refused. Arguably the Court of Appeal's decision increases the level of governance imposed upon professional trustees in relation to family trusts.

*Example 3**The litigation costs claim*

In this case litigation was commenced by a trust of which the firm's trustee company was the independent trustee. The trustee company had no real involvement in the litigation. However when the litigation was unsuccessful, the Court made a costs order of over \$125,000 against the unsuccessful plaintiff. As the other trustees were impecunious, the trustee company was left to meet the costs order. In addition a Law Society complaint was made against the partner involved as trustee.

So what lessons can be learned from these examples? It is important to remember that trustees may not delegate their duties, and generally trustees must act unanimously. So decisions such as whether to enter into property transactions or to issue and continue legal proceedings require the trustees to act unanimously and cannot be delegated to another. What this means is that a court will quickly conclude a dereliction of duty on the part of an inert trustee. Therefore, if the role of trustee is to be undertaken, it is important for the lawyer to get a good understanding of the activities and assets of the trust, and to take an ongoing interest and involvement in the trust's actions. The failure to do so may result in unexpected liabilities as trustee.

How does the NZ LAW Professional Indemnity Insurance Policy respond?

The PI policy provides indemnity to the insured lawyer for claims arising out of the conduct of professional services. "Professional Services" is defined in the PI Policy to include all advice or services performed in the conduct of the profession, including trusteeships of a Trust. So the starting point is that services provided as a trustee fall within the ambit of the PI policy coverage.

However the PI policy has an exclusion for trading losses or liabilities, which provides that there is no indemnity for a claim or loss arising from a trading loss or trading liability incurred by a business managed by or carried on by the insured. So if for example a trust carrying out property developments incurred a GST liability which it simply couldn't pay, the lawyer trustee would have no cover for the GST debt.

There is also an exclusion for claims brought by a trust which are brought with the direct or indirect consent of the insured; but this does not apply if the claim relates to legal advice provided by the insured.

If the trustee role is provided by a trustee company, then there may be some coverage available under the Directors' and Officers' Liability Insurance policy, if a claim is pursued against a director as opposed to the company itself.

With any PI or D&O claim, policy coverage would need to be considered at the time of the claim as the policy response will turn on the specific allegations and circumstances involved.