Non-Trusts and Sham Trusts: The *Pugachev* Case and its Relevance to Trusts in New Zealand

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Contents

My talk today is about two cases:

a) *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch) (the Pugachev case); and

b) *Goldie v Campbell* [2017] NZHC 1692.

The *Pugachev* case is primarily concerned with sham trusts and "trusts" that purport to be trusts but which aren't trusts because the settlor never intended to relinquish control of the assets that were settled on them.

This is not a straight-forward case for New Zealand Trust lawyers since Bill Patterson acted for Mr Pugachev and was criticised by Birss J, the Judge who tried the case. Bill rightly feels aggrieved about a number of aspects of the decision.

Despite these difficulties, I think it likely that the *Pugachev* case will be a leading case on the subject of Trust validity. From my topical reading of international Trust literature there have been more articles written on this decision in recent times than on any other case.

The *Goldie* case is related to it, where a New Zealand Court suggests that Trusts that lack a provision which expressly prevents a trustee from self-benefiting can be treated as "property" for the purposes of the PRA.

In both cases the fundamental purpose of a Trust is defeated. Assets that are intended to be held for the benefit of beneficiaries, are intercepted by creditors and others, and the beneficiaries get nothing.

Pugachev — Some Facts

Mr Pugachev is a Russian. He was an oligarch who currently lives in a Chateau in the south of France. He founded one of Russia's largest private Banks and was active in Russian politics at the highest level, assisting President Putin's rise to power.

Following a lengthy separation from his wife he formed a relationship with Ms Alexandra Tolstoy – a descendent of Leo Tolstoy, the Russian author.

At the time he met Ms Tolstoy he told her he was worth US$15 billion. He said that he owned the Mezhprom Bank; a huge property on Red Square; the largest shipyard in Russia; the second largest coking coal mine in the world; a French retail chain of stores; the French national newspaper France-Soir; a Chateau in the south of France; three "yachts" worth US$35 million, US$25 million and US$5 million; two private jets; and a "massive" helicopter. He had houses in London, Moscow, the South of France, the Caribbean and Herefordshire.

But times turned against him. His Bank collapsed and in 2011 he fled Russia after criminal investigations were opened against him. The Russian State took the coking coal mine and other assets.

He refused to marry Ms Tolstoy because, so he told her, his first wife would make a "huge claim" on his assets.

He formed five New Zealand Trusts, the assets of which were said to be worth about US$95 million[1]. These were, what are known as "*New Zealand foreign Trusts*." They were essentially discretionary

1 Paragraph 32

Trusts of which he and his children were discretionary beneficiaries and he is the "Protector" of the Trusts.

The Mezhprom Bank went into liquidation owing about US$2.2 billion and in April 2015 a Russian Court entered judgment against Mr Pugachev for about US$1bn. One of Mr Pugachev's responses to this set-back was to sue senior Russian officials for dishonest and fraudulent conduct. The defendants in this litigation included President Putin. It is hard to believe that Mr Pugachev could have thought that litigation of that nature would help him.

A worldwide asset freezing injunction was obtained against him and as part of that process he was required to disclose information about the Trusts.

Mr Pugachev did not cooperate with the English Courts and he was held to be in contempt of Court on a large number of grounds. The maximum penalty for being in contempt of Court in England is 24 months and Mr Pugachev's contempts were so egregious that he was given the maximum penalty.

Despite that, he hasn't spent a day in an English prison. Having been ordered to surrender his passports he surrendered all but one of them, keeping back a French passport which he used to slip over to France where he now lives.

He said he was forced to leave England because he feared for his life and he gave evidence that devices had been found underneath cars that he owned. The Anti-Terrorist Branch of the English Police – SO15 – were called. They identified the devices as tracking devices, and not explosives. They had been used by the plaintiffs - although their lawyers denied being aware of them.

One of the findings of contempt of Court was that Mr Pugachev had given false evidence with no honest belief that it was true.

Bill Patterson has told me that many of these facts were not known when the Deeds of Trust were drafted but by the time of trial, the facts were all known and they gave the impression of a man who was not deserving of sympathy.

Pugachev had a minimal role in the subsequent litigation and he didn't participate in the hearing which is the subject of this Paper.

The Five Trusts Were Held to be Invalid

The circumstances in which a Trust is valid lie at the heart of the law of Trusts and all settlors need to know of them.

The trial Judge Mr Justice Birss – an intellectual property lawyer by training – held that the five Trusts were invalid. He held first, that the assets that were settled on them had not been properly divested and that Mr Pugachev who was in substance the settlor (although not in name) had not ceded legal ownership of them to the trustees of the five Trusts.

The five Trusts were structured so that Mr Pugachev, as Protector, had very wide powers. The Judge said the powers that he held as Protector were not held in a fiduciary capacity and that he could exercise them selfishly. In short, he could take back legal ownership of the assets whenever he wanted to.

If, in the alternative, the powers were to be regarded as fiduciary, it was held that the Trusts were shams since Mr Pugachev always intended to retain control of the assets that were ostensibly

"owned" by the Trustees and the trustees were party to a regime by which he could recover legal control of the assets whenever he wanted.

The Judge's Assessment of the Intentions of the Trustees

Birss J held that the claimants had to show that the trustees *"were in on the sham"*[2] and *"went along with any sham"*[3] so that Mr Pugachev could *"recover... control whenever [he] liked*[4]*."*

In *A v A*[5] Munby J made the following statements about shams:

> "(i) A finding of sham requires a careful analysis of the facts. External evidence is relevant. The fact that an arrangement is artificial is not the same as saying it is a sham. The fact that parties subsequently depart from an agreement does not necessarily mean they never intended the agreement to be effective.[6]
>
> (ii) The unilateral intentions of the settlor are not enough to establish a sham.
>
> (iii) For a sham there must be a common intention.
>
> (iv) Reckless indifference will be taken to constitute a common intention. That is the way to interpret the point made in Midland Bank about a person "going along with" the shammer neither knowing or caring about what he or she is signing.
>
> (v) A trust which is not initially a sham cannot subsequently become one.
>
> (vi) The finding of sham is a serious matter especially for professional trustees.[7]"

Birss J approved of this analysis.

In the *Pugachev* case the trustees were Companies. It was held that:

> "Therefore to ascertain the intentions of those trustees one needs to consider the principles for the attribution of intention to companies.... The intention is that of the natural person or persons who manage and control the relevant actions of the company."[8]

There were two directors of the trustee Companies – a husband and wife, both of whom were lawyers.

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2 Paragraph 76

3 Paragraph 76

4 Paragraph 182

5 [2007] EWHC 99 [Fam]

6 Paragraph 33

7 The quotation from the *Pugachev* judgment paraphrases what Mr Justice Munby had previously referred to in *A v A*. This was derived from the Judgment that Arden LJ gave in *Hitch & Others v Stone (Inspector of Taxes)* [2001] EWCA Civ 63, [2001] STC 214. The other two Judges in the *Hitch* case were Sir Martin Nourse and May LJ and they both agreed with Arden LJ's analysis of what constitutes a sham.

8 Paragraph 154

The husband director said he didn't know what Mr Pugachev's intentions were but the Judge didn't accept this:

> "That may be so, but I do not accept that [the husband] did in fact infer that Mr Pugachev wanted to relinquish control. If [the husband] had wanted to find out what the settlor's actual intentions were, he could have asked, but he did not. [The husband] did nothing to suggest to Mr Pugachev's team that the new deed might not have the effect of leaving Mr Pugachev in ultimate control as Protector. If he had raised it then I am sure there would have been a negative reaction. If he had turned his mind to raising it, then [the husband] would have realised that that is what would be likely to happen. The best that can be said is that [the husband] prepared and signed these Deeds entirely recklessly as to the settlor's true intentions.[9]
>
> ...[the husband] was asked about his own intentions. He said that he had no intention that Mr Pugachev would have complete control over the assets of the trust, that he would not have regarded Mr Pugachev as the absolute owner and that it was never his intention to relinquish control over the trust to Mr Pugachev. I have given this a lot of thought I do not accept that evidence. It does not sit comfortably with other evidence....[10]
>
> If these really were [the husband's] intentions at the time then it is striking that there is no evidence he expressed them to Mr Pugachev directly or indirectly through his lieutenants. Nor does [the husband] suggest he ever told Mr Pugachev directly or indirectly that any of Mr Pugachev's powers as Protector, such as to remove trustees, were fiduciary and therefore fettered in some way.[11]

How did the Court conclude that the wife director was party to a sham?

> To the extent the evidence relates to [the wife] at all, she was clearly working closely with [her husband] throughout. [The husband] did not suggest that [his wife] exercised any independent judgment as a director or shareholder of the trustee companies. Based on everything I have seen, it is sufficient to consider [the husband] alone; there is no need to consider the position of [the wife] separately."[12]

9 Paragraph 435
10 Paragraph 429
11 Paragraph 430
12 Paragraph 283

Some Observations About the Finding of Sham

Lawyers who attend Cradle to Grave conferences want practical advice: they want to know how Courts may act and they don't want to get distracted by academic theories.

I think most trust lawyers on learning of the actions of the directors of the corporate trustee of the trusts would say there was no sham. These are some of the reasons why:

- The husband director is one of the best known Trust practitioners in New Zealand and I think it very likely that those who know him well would never believe that he would be a *"mere cypher"* who would do whatever he was asked – no matter how unreasonable, how partisan, how harmful, or how destructive it might be.
- The husband had refused to cooperate with Mr Pugachev which angered Mr Pugachev who then fired him. This was not the action of a person who is typically characterised as a *"mere cypher."* Justice Birss said that the trustee had intended at the outset to be a *"mere cypher"* but when he realised that the question of sham was going to arise, he began to assert himself.
- Bill tells me that one of the findings of contempt related to the trustees being sacked because they would not transfer some assets to his lawyers. Such opposition seems strangely inconsistent with being a *"mere cypher."*
- Some lawyers — usually inexperienced — have a naive belief that the Courts can be relied upon to be predictable and sensible in their decisions. Lawyers who frequent the Courts know the error of this belief. All lawyers who act as trustees (whether directly, or indirectly as a director of a corporate trustee) need to understand that no matter how *"orthodox"* and *"reliable"* their conduct may appear to be, a Court may decide against them if it does not like the substance of the transactions.

For practical purposes, you should therefore be weary of being a trustee in circumstances where a Judge considers that a Trust fails *"the smell test."*

How many of you, for example, would ever have thought that the position of the female director of the corporate trustee could be found to be party to a sham when she didn't give evidence and there was virtually no evidence about what she did and what she knew as a trustee?

Similarities With the *Clayton* Case

There were significant similarities between the powers given to Mr Clayton in *Clayton v Clayton*[13] and the powers given to Mr Pugachev, and Birss J spent a considerable amount of time on the comparison. Mr Pugachev was the "Protector" who was given powers to request information from the Trustee. The trust deed provided that his requests *"shall not be unreasonably refused."* The Trustee could not exercise any of the following powers without first securing his consent: appointing a new discretionary beneficiary; varying the trust deed; releasing and revoking any power inferred on the trustee by the Deed; and appointing and removing trustees.

A superficial assessment of the Deed did not reveal the full extent of the Protector's powers:

> "Whether 'sham' is a perfect description is not clear but it does not matter. This is not a case in which, contrary to what an ordinary looking trust deed

13 [2016] NZSC 29

> with just a settlor and a trustee may state in words, the whole scheme always was in truth that the settlor would exercise covert control of the trustee and both settlor and trustee always intended that that would be so. In that sort of case the word 'sham' accurately describes the trust deed. [My emphasis]
>
> However, whatever label is to be applied to this case, in my judgment the combination of circumstances here means that the court should not give an effect to these instruments that would result in the assets being regarded as outside Mr Pugachev's ultimate control. The whole scheme was set up to facilitate a pretence about ownership (or rather its absence) should the need arise.[14]
>
> Given Mr Pugachev's true intentions, the finding on the True Effect of the Trusts claim means that these Trusts are not shams. They fulfil Mr Pugachev's true intention not to lose control .... while the trustees of these deeds are properly appointed as Trustees, effective control of the actions of the trustees is held by the Protector through the Protector's powers. In this respect the Protector has ultimate control of the trusts."[15]

This finding was made on the basis that the Protector's powers were not fiduciary powers. The Judge held that if the powers were fiduciary rather than non-fiduciary there would be a different outcome:

> "... if a proper approach to the construction of these deeds was to lead to a conclusion that the Protector's relevant powers are fiduciary ... and that in turn was to lead to a conclusion that under the deeds Mr Pugachev is not the beneficial owner, then those deeds are a sham. The settlor intended to use them to create a false impression as to his true intentions and the trustees went along with that intention recklessly.[16] [My emphasis]
>
> I find that at all material times [Mr Pugachev] regarded all the assets in these trusts as belonging to him and intended to retain ultimate control. The point of the trusts was not to cede control of his assets to someone else, it was to hide his control of them. In other words Mr Pugachev intended to use the trusts as a pretence to mislead other people, by creating the appearance that the property did not belong to him when really it did. The role of Protector was the means by which control was to be exercised. The position of [his son] Victor as a potential Protector was part of the pretence. Victor was acting on his father's instructions.[17]
>
> Assume that the relevant persons setting up the trusts all intended that control of the assets was to remain with Mr Pugachev. The first clever thing about the trust deeds here, if that is their purpose, is that the only aspect which would need to be a sham in order for the trust deeds to mislead anyone would be the status of the Protector (Mr Pugachev and

14 Paragraphs 441 and 442

15 Paragraph 436

16 Paragraph 437

17 Paragraph 424

> Victor) as a fiduciary. As I have already held, if the Protector's powers are purely personal and not fiduciary then control has not been relinquished at all anyway. In that case the deeds simply fulfil their assumed purpose. They are not shams."[18]

Whether powers are fiduciary or not fiduciary requires a close examination of the Trust Deeds:

> "The case shows that when considering what powers a person actually has as a result of a Trust Deed, the court is entitled to construe the powers and duties as a whole and work out what is going on as a matter of substance. Even though the VRPT Deed in [the Clayton] case named more than one Discretionary Beneficiary and named Final Beneficiaries which did not include Mr Clayton, when the Deed is examined with care, what emerged was in fact Mr Clayton had effectively retained the powers of ownership.[19]
>
> This conclusion is not the same thing as a finding of sham. The analysis is all concerned with what the effect of the Deed truly is. It is not concerned with the subjective intentions of the parties to create a pretence to mislead.[20]"

The *Pugachev* Deeds did not say whether the Protector's powers were fiduciary or non-fiduciary. The most obvious way to overcome this difficulty – in trust deeds that are intended to be upheld as creating a valid trust – is to state explicitly in the deeds whether particular powers are fiduciary or non-fiduciary.

As can be seen from the passages quoted above, if the powers are non-fiduciary and can be used selfishly, there may be a serious risk that a Trust will be held to be invalid.

Some Lessons From *Pugachev*

What are the lessons to be learned from these findings?

There are two obvious lessons. The first relates to "effective control". If a person is able to exercise "effective control" over a trust whether in the capacity of settlor, appointor, protector, or otherwise, there is a strong likelihood that the trust will be held to be invalid.

A second lesson concerns the need to prove that legal ownership of assets was in truth settled on the trustees.

The Judge conjectured that the Trust Deed had been deliberately written so that the status of the Protector's powers was unspecified in the hope that a Court which examined the Deed would not realise that the powers were non-fiduciary with the consequence that Mr Pugachev could act selfishly in his own interests.

> "...the second thing about these deeds is that the putative status of the Protector as a fiduciary is not stated expressly at all. The Deeds leave it unspoken. So if a Court, when faced with the Protector's powers,

18 Paragraph 304

19 Paragraph 167

20 Paragraph 168

> construed the deeds so as to read in a limitation on their exercise which is not stated expressly, the court itself would be fulfilling the shamer's purpose for them."[21]

Birss J's speculation that the clause was deliberately vague is unfair. The clause itself is not uncommon.

It is not common for Trust Deeds in New Zealand to declare whether powers are fiduciary or not so that an examination of a Deed may not be particularly helpful.

There are, however, some judicial guidelines in New Zealand. In *Carmine v Ritchie,*[22] Gilbert J said that:

> "The power to appoint new trustees is generally acknowledged to be a fiduciary power even though it may not have been conferred on trustees or the holder of any office. Equally the power to remove a trustee and replace him with a new trustee is almost always considered to be a fiduciary power... This is because the subject matter of the power is the office of the trustee which lies at the core of the Trust and carries fundamental and onerous obligations to act in the best interests of the beneficiaries as a whole."[23]

In the subsequent decision of *Harre v Clarke,*[24] Brewer J cited *Carmine v Ritchie* and said:

> "The power of appointment and removal of trustees is a fiduciary power regardless of whether that power is possessed by a trustee or any other individual."[25]

In *Green v Green,*[26] Winkelmann J cited the above passage from *Harre v Clarke* with approval.

In *New Zealand Maori Council v Foulkes,*[27] the Court of Appeal referred with approval to both *Carmine v Ritchie* and *Harre v Clarke* and said:

> "We must first identify the legal principles applying to this issue. As confirmed by two recent decisions of Gilbert J and Brewer J in the High Court, the power to appoint new trustees is of a fiduciary nature because the subject matter of the power is the office of the trustee. That office lies at the core of trust and carries fundamental and onerous obligations to act in the best interests of the beneficiaries as a whole to the exclusion of the trustee's own interest. And, as it reposes the settlor's personal trust and confidence in the done to exercise its own judgment and discretion, the power cannot be delegated to a third party..."[28]

21 Paragraph 306

22 [2012] NZHC 2279, (2012) 3 NZTR 22-025

23 Paragraph 66

24 [2014] NZHC 2533

25 Paragraph 24

26 [2015] NZHC 1218, (2015) 4 NZTR 25-017

27 [2015] NZCA 552, [2016] 2 NZLR 337

28 Paragraph 22

Although the Trusts in the *Pugachev* case were governed by New Zealand law, Birss J made no mention of *Carmine, Harre, NZMC v Foulkes*, or *Green v Green* and for this reason it can be said that Birss J's finding that a power to remove trustees was non-fiduciary is, at the very least, questionable.

The three cases of *Carmine, Harre* and *Foulkes* were subsequently referred to by Moore J in *Goldie v Campbell (2017)*[29] in the context of a relationship property dispute in which a wife argued that powers that a husband had in a Trust constituted "property" for the purposes of the PRA. The husband's lawyer argued that his power to appoint and remove trustees was a fiduciary power and that with fiduciary constraints he couldn't exercise that power selfishly. Moore J accepted that the powers to appoint and remove trustees were governed by fiduciary constraints but even so, he held that the existence of the fiduciary constraints was not enough to stop the husband from being able to exercise the powers selfishly. The Trust under consideration contained a prohibition on a trustee who was also a beneficiary from making a distribution to himself. Moore J said that without this constraint, it is possible that the fiduciary constraints would be inadequate to prevent the power to add and remove trustees from being exercised selfishly:

> "I observe... that the fetters constraining Mr Campbell are derived largely from the no self-benefit clause. Without this clause, it would be arguable the powers he enjoys under the deed are sufficiently similar to that in Clayton v Clayton that they could constitute property under the PRA."[30]

Moore J's decision in *Goldie v Campbell* is significant for the observation that a fiduciary constraint on a power to appoint and remove trustees may not be sufficient to restrain a trustee from self-benefiting, and for the assets of a Trust to be treated as relationship property and lost.

Asset Protection Trusts

One of the most striking aspects of the *Pugachev* decision is Birss J's apparent belief that a Trust established for asset protection purposes may be invalid for that reason alone. He said:

> "The circumstances as a whole and Mr Pugachev's character, support a credible inference that one of Mr Pugachev's purposes in transferring the property into these trusts was what is euphemistically called 'asset protection' in other words to hide them from possible claims, facilitate a plausible deniable of ownership, while retaining control in fact."[31]

> "Why should a court help a settlor who tried to hide but retain his beneficial ownership of property by using a trust deed which vested unfettered powers on the settlor as protector so that the settlor could retain control. By construing expressly unfettered powers as subject to a fetter, whether it is as a fiduciary or as subject to some other limit and scrutiny, the court could be assisting the settlor in avoiding his creditors.[32]"

It is not clear from the first passage set out above whether an absence of "effective control" would satisfy the Judge's inherent suspicion about asset protection Trusts.

29 [2017] NZHC 1692, (2017) 4 NZTR 27-020

30 Paragraph 73

31 Paragraph 298

32 Paragraph 187

I suspect that most lawyers listening to this Address will have established one or more Trusts and that a primary purpose in doing so was to protect their assets from claims of professional negligence. With the restraints that have prevented lawyers from working in an incorporated entity, we have all had 100% exposure to risks that a mistake might destroy us financially.

It is a sign of prudence that lawyers who do not work beneath the umbrella of incorporation, should protect their financial assets in Trusts.

However, the operative word from the quotation above is "control". It is most important that none of us with asset protection Trusts should be said to have "effective control" of them.

Does New Zealand Have an Aberrant Rule About "Effective Control"?

Although "effective control" is traditionally a hallmark of Trust invalidity, New Zealand lawyers need to recall that in *Kain v Hutton*[33] the Supreme Court held that a Trust over which a Mrs Couper was said to have "*complete control of the Trust assets*" was upheld as valid. When Blanchard J said this, he spoke on behalf of himself, Elias CJ, McGrath J, Anderson J and it would appear Tipping J.[34]

Blanchard J said:

> "It put her in effective control of [the Ponui] shares with the ability to take the benefit herself, or if she saw fit, to pass all or some of it to her daughters or other family members."[35]

These statements were made in the context of a Trust that had three Trustees, one of whom was an accountant and supposedly an "*independent*" trustee. It is implicit in what the Court said that Mrs Couper could remove any trustee who would not cooperate with her wishes and it was explicitly said that "*if she saw fit*," she could arrange to take all of the Trust's assets for herself.

So far as I am aware, no Judge in either New Zealand or overseas has subsequently suggested that what Elias CJ, Blanchard, McGrath, Anderson and Tipping JJ said in this passage has changed the otherwise universal belief that "*effective control*" is a sign of invalidity.

In the *Pugachev* case, Birss J held that the terms of the Trusts allowed Mr Pugachev to have "*effective complete control*" of them[36] and that they were accordingly invalid.

New Zealand lawyers would do well to treat the Supreme Court's statement about effective control as being unreliable. "*Effective control*" is synonymous with invalidity, not validity.

The Validity of a Clause That Automatically Transferred Powers From One Person to Another, to Avoid Compliance With Court Orders

The Pugachev Trusts provided that if a Protector was "under a disability" his powers would automatically be transferred to another person. In this case the powers would be transferred to Mr Pugachev's son, Victor. I understand that this is a common clause that is aimed at cases of kidnapping, duress, and other cases of involuntary difficulty. Birss J interpreted the clause as being deliberately designed to strip the Protector of his powers so that he couldn't comply with a Court

33 [2008] NZSC 61,[2008] 3 NZLR 589

34 Blanchard J held that Mrs Cooper's ability to appoint and remove trustees and discretionary beneficiaries gave her complete ongoing control of the trust.

35 Paragraph 23

36 Paragraph 275

order that might prejudice him: ie the clause was intended to enable Mr Pugachev to say that he didn't have any of the Protector's powers and he couldn't comply with a Court order that might prejudice him.

Mr Justice Birss said this clause should be rejected by the Courts:

> "What [the clause] does is allows Mr Pugachev's effective complete control of the Trusts to cease to exist the moment he is compelled to do something he does not want to do, like hand over the assets to a creditor. It is an attempt to make the Trust judgment-proof and should not be accepted."[37]

Birss J's opinion that such a clause is invalid is important. He appears to say that under New Zealand law, clauses that appear to be unnecessarily prejudicial to creditors may be ignored by the Courts on the grounds that they are unreasonable and unfair.

When Can a Beneficiary Self-Benefit?

One of the questions that frequently arises in practice is the validity of distributions made by a Trustee to himself/herself as a beneficiary.

In general, if a Settlor appoints a person as both a Trustee and a Beneficiary, it can be assumed unless the Trust Deed says something to the contrary that he/she intends the Trustee to be able to make a distribution to himself/herself. If the situation were otherwise, the Trustee would be unable to benefit as a beneficiary even though the Settlor clearly contemplated that he/she should be able to do so.

The situation is otherwise where the Settlor does not appoint a person to both roles. If for example, a father appoints a friend to be a Trustee and his children to be beneficiaries, and after the friend retires subsequent Trustees appoint the children to be Trustees, there will be no permission for the children who are trustees to self-benefit.

This is because the Settlor did not intend the children to have both roles.

The *Pugachev* decision is of some assistance in this context:

> "If such extensive powers had been conferred on a third party as protector, with provisions barring that person from being a beneficiary, then I can see that a different result might follow but the fact it is a beneficiary on whom these powers are conferred, militates against the idea of a limitation. One would expect a beneficiary ordinarily to be entitled to act in their own interests."[38]

The Judge went on to say:

> "The fact that Mr Pugachev is also the settlor reinforces the conclusion."[39]

In the *Pugachev* case the fact that so many powers were given to Mr Pugachev was a detriment to him as they suggested to a Court that he was intended to be able to take the Trust assets as and when he wanted to. In this way the Trust was held to be invalid.

37 Paragraph 275

38 Paragraph 268

39 Paragraph 269

One of the main lessons of the *Pugachev* case is that powers of appointment and removal of beneficiaries and powers of appointment and removal of trustees should not be given to the substantive "*settlor*" of a Trust, but should be shared.

In the family law context, the giving of sole powers to a person also gives rise to problems under the "Bundle of Rights" regime – where the powers can be treated as relationship property, and then be valued and divided.

People who wish their Trusts to be upheld as valid need to divest powers so that it cannot be said that the substantive settlor has control over the assets of a Trust.

Identifying the True "Settlor" of a Trust

It is common for Trusts to be settled by a lawyer or other third party for a nominal sum.

In other cases, no Settlor is identified and there is merely a declaration of trust.

The *Pugachev* judgment is interesting in its identification of a Settlor in such circumstances:

> "At times the defendants made submissions about the intentions of the 'settlor', by which they meant the trust companies. I reject that approach. It is true that these deeds are drafted so that the declaration of trust is over a nominal sum and so from that perspective the trust company could be called a settlor. However this is unreal. The real settlor of these Trusts is Mr Pugachev.[40]
>
> By not showing on the face of the deed that the settlor is the same person as the First Protector and first named Discretionary Beneficiary, the deed does not make what is going on quite so stark."[41]

i.e. the Judge did not believe the statement that the "Settlor" was a Company was true. The true Settlor was Mr Pugachev who arranged for the Trust to be formed and arranged for assets to be settled on it.

In practice, some assets were settled on the Trusts by one of Mr Pugachev's children. The Judge held it was to be inferred that Mr Pugachev had in turn made the assets available to the children and that he was the true Settlor and not the children.

The identification of a settlor is of particular importance in relationship property disputes.

Section 10(i)(a)(iv) of the PRA provides that moneys derived from a Trust which were not "settled" by the spouses are not relationship property.[42]

One effect of Birss J's reasoning in *Pugachev* is that if a New Zealand Trust is settled by a solicitor for a nominal sum, but one of the spouses subsequently settles substantial assets on it, the "*settlor*" may be deemed to be the spouse and not the named settlor, with the consequence that distributions from the Trust are to be treated as relationship property and not separate property. This form of reasoning has plausible New Zealand justification: see the landmark cases of *Tucker v CIR*[43] and *Baldwin v CIR.*[44]

40 Paragraph 214

41 Paragraph 271

42 But see s 44c(2) for means by which such property might be recovered.

43 [1965] NZLR 1027

A second consequence of Birss J's assessment of a "settlor" concerns Memoranda of Wishes. In circumstances where the named settlor of a Trust is a lawyer who has contributed $10 to the Trust, it can be said that a Memorandum of Wishes from anyone other than that person has no weight. If, however, the Court takes the more realistic approach to the identification of the settlor, and if that person is not in fact the solicitor who advanced $10 but one of the spouses who settled substantial assets on the Trust, then a Memorandum of Wishes from the spouse should be treated by trustees with respect.

The Importance of Memoranda of Wishes

I referred earlier to the case of *Goldie v Campbell*[45] and I now want to refer to it in a different context. It was argued in that case that the husband could avoid the self-benefit clause by removing his daughters as beneficiaries and appointing a corporate trustee that he controlled. One of the reasons that Moore J gave for refuting this argument was that the husband had written a Memorandum of Wishes in which he had said that they should consider the reasonable needs and requirements of his two daughters to be paramount. The wording of the Memorandum was this:

> "After making such provision... you should consider the reasonable needs and requirements of my daughters [A] and [B] as paramount and having priority over the needs and requirements of all other beneficiaries..."[46]

Moore J held that the husband's power to remove beneficiaries didn't entitle him to remove the two daughters and one of the reasons that they gave for this decision was that to remove them would be "*inconsistent*" with the Memorandum of Wishes.

The Judge held that the two Memoranda of Wishes:

> "Make clear that it was the intention of the settlors that [the husband] daughters reasonable needs and requirements are to be considered by the trustees before exercising powers of discretion invested in them under the trust deed.... it would be entirely inconsistent with this intention if the appointor was empowered to remove the daughters as discretionary beneficiaries."[47]

Memoranda of Wishes are generally regarded as being advisory only and able to be ignored by trustees. It can be argued that Moore J has elevated Memoranda of Wishes into a new and unjustified status. Not only are they to be of significant persuasive authority for trustees but they can be used to construe the meaning of the trust deed itself.

Whether the elevation of Memoranda of Wishes to this status is correct is not a matter on which I propose to comment in this Paper since my purpose is to tell you what the law appears to be, and not what it ought to be. When Judges proceed in new directions, only time will tell whether the paths they took were correct.

The significance of Memoranda of Wishes was emphasised in another recent New Zealand decision: *Clement v Lucas & Another [2017] NZHC 3278*. In that case Bohemen J held that trustees "*were under a duty to consider the purposes for which [a] Trust was established and the intentions of the*

44 [1965] NZLR 1

45 [2017] NZHC 1692, (2017) 4 NZTR 27-020

46 Paragraph 15

47 Paragraph 51

Settlors..."[48] and that the failure to do this amounted to a breach of the trustees' duty and the setting aside of a decision.

The settlor's intentions had been set out in various Memoranda of Wishes.

The *Clement* case and the *Goldie* case both emphasise the need for Trust practitioners to tell settlors that they should provide Memoranda of Wishes to trustees if they want their intentions for their Trusts to have a reasonable prospect of implementation.

48 Paragraph 98