Clayton v Clayton – the last chapter?

Senior relationship property barrister, Ross Knight with his specialty interest in relationship property and trust litigation, decided he would sit in on the recent Supreme Court hearing of *Clayton v Clayton*. His comments on the appeal as an observer and his views on possible outcomes follow. The Supreme Court reserved its decision, which had not been released when this issue of *LawTalk* went to press.

In a further chapter to the long running and much publicised trust busting case between Rotorua couple Mark and Melanie Clayton, and their closely held nuptial entities, the Supreme Court sat over three days in early September to hear complicated cross-appeals arising out of the Court of Appeal decision handed down on 26 February 2015 (*Clayton v Clayton* [2015] NZCA 30).

On 18 June 2015, the Supreme Court granted leave for the appeals to be brought on limited grounds, those being:

- Was the Court of Appeal correct to find that there is no distinction between a sham trust and what the Family Court and the High Court had held to be an "illusory trust"?
- Was the Court of Appeal correct to find that the Vaughn Road Property Trust (VRPT) was neither a sham trust nor an illusory trust?

If so:

- Was the bundle of rights and powers held by Mr and/or Mrs Clayton under the VRPT Trust Deed *property* for the purposes of the Property (Relationships) Act 1976 (PRA)?
- Was the Court of Appeal correct to find that the power of appointment under the VRPT was *relationship property* for the purposes of the PRA?
- If so, did the Court of Appeal err in its approach to the valuation of the power [of appointment]?

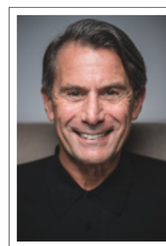
In relation to the Claymark Trust, was the Court of Appeal correct in its interpretation and application of:

- Section 44C of the PRA?
- Section 182 of the Family Proceedings Act 1980 (FPA)?

The facts, briefly stated, were these: the Claytons began a de facto relationship in 1986 and were married in 1989. There were two children of their marriage who were adult and self-supporting at the date of separation in 2006. In 2009 the marriage was dissolved.

In contemplation of their marriage in 1989, the Claytons had entered into a prenuptial agreement, the essence of which was to preserve as separate, property owned by Mr Clayton at that time.

Mr Clayton was the sole shareholder and director of a number of companies which owned and operated joinery and sawmilling businesses. During the marriage he settled the VRPT of which he was the sole trustee and he and Mrs Clayton and their children were among the discretionary beneficiaries. The purpose of the trust was to separate the land and buildings from the operating assets of the businesses. In addition, Mr Clayton held the power to appoint and remove trustees and beneficiaries. In that regard he had reserved those powers to himself not as trustee of the trust, but in his personal capacity. This was to assume great significance in the February 2015 decision of the Court of Appeal.



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In his capacity as trustee, Mr Clayton had the power to appoint any or all of the income and capital for the benefit of any of the discretionary beneficiaries. Moreover, the trust deed permitted him (as trustee) to exercise the power in his own favour. At separation Mrs Clayton challenged the validity of the trust claiming it to be a sham because of the fact that Mr Clayton could exercise the powers he held in his own favour. She also claimed that the pre-nuptial agreement gave rise to a serious injustice and ought to be set aside.

Unsurprisingly the parties failed to reach agreement on anything to do with their financial (nuptial) affairs and, in 2007, proceedings were issued in the Family Court at Rotorua. In the period since there have been multiple decisions of the Family Court, the High Court, Court of Appeal and Supreme Court, arising out of the separation of this couple, and, on all accounts, their dispute is far from over. In its decision of 26 February 2015, the Court of Appeal remitted matters of quantum back to the High Court for determination in light of its findings. Whether or not the Supreme Court elects to determine that issue, as part of its consideration of the recent appeals, remains to be seen, but is probably unlikely given that issues of quantum will doubtless require further evidence and/or updating evidence – none of which was before the Supreme Court when it heard the appeals this month.

Neither the Family Court, High Court or Court of Appeal found the VRPT to be a sham. Rather the Family Court (upheld by the High Court) found the trust to be "illusory" in that because of the nature of the powers vested in him, Mr Clayton had effective ownership over the trust's assets to do with those assets as he pleased.

The Court of Appeal disagreed. It rejected the notion of an "illusory" trust. It held that the VRPT was either a sham

or not; that because Mr Clayton had a genuine intention to establish the trust he could not have intended a sham. However, because of his effective (and personal) control over the trust and its assets – and the ability he had to self-deal with impunity – the Court found that Mr Clayton could act to benefit himself if he wanted to and therefore the general power of appointment held by him to add and remove beneficiaries was a personal property right for the purposes of the PRA. The value of that right, said the Court, was to be determined by reference to the net assets of the VRPT.

Those of us who specialise in relationship property and trust litigation have watched this case closely. It has thrown up a number of contentious issues which have been the subject of conflicting academic opinion and law conferences across New Zealand over the past 12 months or so. For my part, I wanted to witness first-hand how the Supreme Court would receive the appeals and cross-appeals before it. I travelled to Wellington and sat in Court for the duration of the hearing, which in and of itself was invaluable and frankly the best continuing legal education experience I have enjoyed in the entire time I have been a member of the independent bar. As for the likely outcome, my impressions are these.

Sham, or illusory, or not

The Supreme Court is unlikely to find that the Court of Appeal was wrong in finding that there is no distinction between a sham trust and an illusory trust. Such a distinction creates confusion. Nor do I think the Court likely to find that the trusts (or either of them) are/were shams.

A trust is either a sham or it is not in which case it is a valid trust. There can be no half way house. That said, New Zealand Courts have recognised the distinction between a sham at inception as opposed to a sham emerging. Let me explain by reference to the Court of Appeal decision in *Marac Finance Limited v Virtue* [1981] 1 NZLR 586 (CA) where Richardson J said:

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

The *Marac* decision led commentators to distinguish between those cases where a sham is evident from the outset and an emerging sham, which comes to light subsequently.

The leading case on sham in New Zealand is the Court of Appeal decision in *Official Assignee v Wilson* [2008] 3 NZLR 45 (CA). In that case the court said at [57]:

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

So it is then that the position in New Zealand is that for a trust to be regarded as sham, both the settlor and the trustee must have a common intention that the true position is, or should be, other than what is contained in the documents establishing the trust. In other words, the trust documents are intended to be a ruse. But the threshold for proving sham is high – tantamount, in essence, to fraud.

Counsel for Mrs Clayton argued, strenuously, that by his conduct, and having regard to the VRPT deed, Mr Clayton had no intention to create a valid trust; that his actions and the terms of the deed were consistent with the trust property being his property; that if the trust was not a sham then it was illusory – this being an acceptable concept.

There is no doubt that having regard to the evidence before the Court, Mr Clayton seemed in the dark as to the effects and implication of a valid trust – much less the VRPT. But, even so, the threshold for sham is, as I have mentioned, high. My pick is that the Court will not declare the trust a sham, but it may put a gloss on *Official Assignee v Wilson* having regard to findings in all three lower Courts about sham and illusory trusts. I do not expect the Court to legitimise the latter category but I would not be at all surprised if the threshold was softened somewhat.

Was Mr Clayton's power of appointment and removal of trustees and beneficiaries a personal (as opposed to a trust/fiduciary) power?

Assuming the Court of Appeal decision on sham/illusory trusts is upheld, the next question is whether or not that Court was correct in finding that Mr Clayton's power of appointment and removal of trustees and beneficiaries was a personal (as opposed to a trust/fiduciary) power. And, because of that, was "property" capable of being valued, classified as relationship property and therefore notionally, at least, divided equally.

This was a controversial finding in the Court of Appeal, and, as expected, the competing legal argument in relation to it occupied a disproportionately greater part of the hearing than anything else. Mrs Clayton invited the Court to uphold the approach taken by the Court of Appeal to extend the definition of property and to follow overseas trends (especially England and Australia) as to the treatment of trust assets when, in a nuptial setting, one party has effective control over a family trust and its assets which he/she may utilise to his/her own benefit.

I think Mrs Clayton will succeed on this point. But whether the Court extends the definition of property under the PRA or decides the appeal on its own particular facts, remains to be seen.

Importantly, the Court of Appeal did not say that the trust assets were

relationship property. But rather, that the ***power*** of appointment and removal was relationship property, and the value of that power was to be determined by reference to value of the net assets of the trust. How Mr Clayton satisfied the payment to Mrs Clayton as to her notional one half share was a matter for him, and if he resorted to sell down or borrow against trust assets to meet the Judgment debt then so be it. He argued that the business of the trust would be detrimentally affected because he would be forced to sell or borrow against trust assets. He urged their Honours to factor these things into their thinking. My sense is that the Court was unmoved.

This led to an interesting discussion about how Mrs Clayton might be secured which included the court exercising ancillary powers under s 33(1)(m) PRA (never used before as far as I am aware) … "varying the terms of [the] trust" … or alternatively vesting the power [of appointment and removal] in the Claytons jointly – something I am sure would be most unattractive to Mr Clayton and for that reason, probably an incentive for him to find a way of settling his Judgment debt with Mrs Clayton using personal or trust assets under his control.

Did the Court of Appeal apply correctly apply ss 44C PRA and 182 FPA?

The Court was asked to consider whether the Court of Appeal erred in its interpretation and application of s 44C PRA and s 182 FPA.

In respect of the former, Mrs Clayton had sought a compensatory adjustment in respect of the loss of relationship property that had found its way into the Claymark Trust during the marriage, the effect of which was to defeat her claim/entitlement to share in that property at separation. The Court heard considerable debate as to whether or not there had been [a] disposition(s) of relationship property. My sense is that their Honours appeared unconvinced that there had not been, and even less convinced that Mr Clayton should have no claim or interest against the Claymark Trust – a nuptial trust.

My overall sense and lasting impression is that the Court is likely to find it can act under s 182 FPA to grant relief to Mrs Clayton rather than necessarily having to make a finding under s 44C PRA. It may in fact do both, but relief under s 182 FPA is likely to obviate the need to grant relief under s 44C PRA.

Section 182 FPA gives the Court jurisdiction to vary the terms of a nuptial settlement. The argument in respect of this claim was fascinating to say the least. Mr Clayton argued that the Claymark Trust – unlike the VRPT – was a business trust and for that reason ought to be considered differently. I do not expect for one minute that the Supreme Court will have a bar of that. Counsel for the trust was asked but was unable to refer the Court to any authority where that distinction had been made. Their Honours could see no difference between a nuptial trust set up for domestic purposes as opposed to one set up for business purposes, and rightly so.

In some ways the challenge for the Court will be overcoming some ambiguous dicta in its own decision of *Ward v Ward* [2009] NZSC 125. That is the seminal case in New Zealand on s 182 FPA. But if the Court intends to grant Mrs Clayton relief under s 182, it will, in all likelihood, need to refresh its thinking in *Ward* and clarify some points that have led to confusion. My sense is that it will do so.

The Supreme Court has reserved its decision. The state of the law is such that the Court will need to be bold and perhaps creative too if parties – usually women – are to be treated fairly on the breakdown of a lengthy relationship where closely held nuptial trusts and third parties entities are involved.

The interrelationship between trusts and relationship property featured as part of the Law Commission's Review of the Law of Trusts in 2013. Sweeping changes were proposed to regularise jurisdictional obstacles as between the District and High Courts, and importantly the ability of the Court to divide trust property in relationship property disputes. But these things require legislative reform and although anecdotally there is, and has been for some time, a pressing need for change, successive governments have not shown they have the appetite to do so – at least not in a comprehensive fashion – top to bottom.

So for now, we look to our appellate Courts to find clear and sensible pathways within a restrictive and clumsy legislative framework which recognises the equal contributions of parties to their marriages, de facto relationships or civil unions and purports to provide for a just division of relationship property when relationships end. ■

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