CHALLENGING THE EXERCISE OF POWER UNDER A DISCRETIONARY TRUST

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Discretionary trusts are complex things. In the context of succession law, they can alongside the operation of estates play a key role in reflecting the wishes of the deceased and in distributing wealth. There are, however, circumstances where decision-making under a discretionary trust is liable to fall foul of the requirements of the trust or otherwise be subject to challenge. In this paper, I analyse two appellate decisions — one involving the removal of beneficiaries, and the other the removal and appointment of a trustee. In doing so, I explore the law governing the exercise of such powers and I identify some practicalities in challenging or defending their exercise.

Introduction

The principles governing trusts and trust deeds, as well as the rights and obligations of the various actors in a trust, are extensive. They involve both legal and equitable concepts and they take their footing in statute as well as in the common law. When I write about 'challenging the exercise of power under a discretionary trust', I cover two particular sources of power and the ways they can be challenged. Specifically, this paper focuses on:

(1) the power of a trustee to exclude a beneficiary; and

(2) the power of an appointor to appoint and remove a trustee.

In succession matters, understanding the nature and scope of such powers is crucial; trustees and appointors have a great degree of control — whether direct or indirect — over those assets which, although not forming part of a deceased's estate, ultimately may end up in the hands of beneficiaries. For that reason, it is important not only to have persons in those positions whom the settlor desires throughout the life of the trust, but also for stakeholders to continually monitor the actions of trustees and appointors in light of what the law permits.

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* Barrister at Law. This is a revised version of a paper which was presented at the 17th Annual Wills and Estates Symposium, hosted by Legalwise Seminars, on 2 March 2022. This paper is intended to be of a general nature only and does not constitute legal advice. The law evolves, and the material discussed in this paper may be subject to change. My recount of the facts of cases is based on my interpretation of published court decisions.

A number of principles interact with and restrain the exercise of such powers. It is clear, for example, that a trustee and beneficiary share a fiduciary relationship[1] and that a trustee must not profit from its position or stray into a conflict of interest. There are also non-fiduciary duties which bind a trustee, including the prohibition on a trustee acting in a way that fetters its own discretion.[2]

Elsewhere, the terms of a trust deed itself often are the clearest source and limit on powers. A trust deed, for example, typically allows a trustee to deal with income or assets in various ways. A trust deed also commonly allows a trustee to remove beneficiaries. It is on this latter power that the following case study is focused.

Removal of a beneficiary

The case of *Mandie v Memart Nominees Pty Ltd* (‘*Mandie*’) involved a challenge to the exercise of the power to remove beneficiaries from a discretionary trust.[3] The applicants on appeal alleged that a corporate trustee of a family trust, in purporting to remove certain beneficiaries by two formal declarations, had acted beyond power, for an improper purpose, and in bad faith.

Before I explore those concepts and the law governing the removal of a beneficiary, it is useful to first set out the facts in *Mandie*.

The facts

David Mandie, a successful businessman, established a family trust for the benefit of his children and their own spouses and children. Among David’s children were Ian and Stephen Mandie. They were classified as ‘Specified Beneficiaries’ under the trust deed. The trust also catered for ‘General Beneficiaries’ who, according to the terms of the deed, included all Specified Beneficiaries as well as various persons related to or connected with the Specified Beneficiaries. Memart Nominees Pty Ltd was corporate trustee.

In September 1995, David and his wife signed a document styled a ‘Statement of Wishes’. It set out matters regarding their wishes for management of their ‘affairs and those of the various trusts and companies’ following their deaths. Pursuant to a settlement agreement reached in December that year, Ian and Stephen disclaimed any interest in the family trust.

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[1] *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41, 68.

[2] *Thacker v Key* (1869) LR 8 Eq 408; see also *Fitzwood Pty Ltd v Unique Goal Pty Ltd (in liq)* (2001) 188 ALR 566.

[3] (2020) 62 VR 528 (‘*Mandie*’).

David passed away in August 2011. In May 2014, the trustee by declaration resolved to remove Ian and Stephen as beneficiaries (the 'May Declaration'). In September that year, the trustee made a further declaration removing the applicants, who were the spouses and children of Ian and Stephen, as General Beneficiaries (the 'September Declaration').

The power of removal was set out in clause 1(2) of the trust deed. The clause stated that 'the Trustee at any time and from time to time may … declare in writing that any person shall thereafter be excluded from the class of General Beneficiaries'. The trustee was not, however, empowered either by that clause or by any other provision in the trust deed to remove *Specified* Beneficiaries. Prior to making the declarations, the trustee had sought advice from counsel as to its powers of exclusion.

The applicants had been affected indirectly by the May Declaration — by virtue of their relationship to Ian and Stephen Mandie and their eligibility, under the terms of the trust deed, to become 'takers in default' as a consequence of that relationship — and directly by the September Declaration. They commenced a proceeding in the Supreme Court challenging the two declarations and seeking that they be set aside. They also sought orders for replacement of the trustee. The trial judge dismissed their claims.[4]

The power to remove a beneficiary

The power of a trustee to remove a beneficiary is subject to the terms of the trust deed as well as principles governing discretionary trusts in general. As regards the common law restraint on the exercise of a trustee's discretion, the High Court in *Attorney-General (Cth) v Breckler* ('*Breckler*')[5] summarised things as follows:

> Where a trustee exercises a discretion, it may be impugned on a number of different bases such as that it was exercised in bad faith, arbitrarily, capriciously, wantonly, irresponsibility, mischievously or irrelevantly to any sensible expectation of the settlor, or without giving a real or genuine consideration to the exercise of the discretion. The exercise of a discretion by trustees cannot of course be impugned upon the basis that their decision was unfair or unreasonable or unwise. Where a discretion is expressed to be absolute it may be that bad faith needs to be shown. The soundness of the exercise of a discretion can be examined where reasons have been given, but the test is not fairness or reasonableness.[6]

A key concern, then, is whether the trustee has acted in bad faith rather than whether the actions were (in their outcome) fair or reasonable. More recently, and at least in Victoria, the position seems to be that despite the High Court's comments in *Breckler* on the role of bad faith — '[w]here a discretion is

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[4] *Mandie v Memart Nominees Pty Ltd* [2018] VSC 719.

[5] (1999) 197 CLR 83.

[6] Ibid 99 (citations omitted).

expressed to be absolute it may be that bad faith needs to be shown' — such a quality need not be established in order to successfully challenge the exercise of an absolute discretion.[7]

The ability to impugn a trustee's decision is tied to the degree of latitude the trustee is afforded by the terms of the trust deed; the broader the discretion, the lower the prospects of successfully challenging its exercise. In *Wareham v Marsella*,[8] the Victorian Court of Appeal held:

> [T]he tests for impugning a trustee's discretion are to be applied in every case by reference to the nature, scope and purpose of the discretion in issue, properly construed. *Where that discretion is absolute and unfettered, the trustee's latitude to act is plainly broader and the task of the party seeking to displace the exercise of discretion is correspondingly more difficult*. In particular, it will be more difficult to establish that the outcome of the exercise of the discretion was so unreasonable as to found an inference that it was not done in good faith, upon a real and genuine consideration, and in accordance with the purpose for which the discretion was conferred.[9]

In *Karger v Paul*,[10] an earlier case involving a challenge to distribution under a discretionary trust, McGarvie J examined the authorities governing circumstances where a trustee has unfettered discretion and held:

> In my opinion the effect of the authorities is that, with one exception, the exercise of a discretion in these terms will not be examined or reviewed by the courts so long as the essential component parts of the exercise of the particular discretion are present. Those essential component parts are present if the discretion is exercised by the trustees in good faith, upon real and genuine consideration and in accordance with the purposes for which the discretion was conferred.[11]

McGarvie J's 'seminal observations'[12] arguably extend beyond situations involving distributions to any case involving the exercise of a trustee's discretion.

The 'one exception' to being precluded from examining or reviewing the exercise of a trustee's discretion, McGarvie J held in *Karger v Paul*, was that 'the validity of the trustees' reasons will be examined and reviewed if the trustees choose to state their reasons for their exercise of discretion'.[13]

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[7] *Wareham v Marsella* (2020) 61 VR 262, 289; see also *Mandie* (n 3) 569.

[8] (2020) 61 VR 262.

[9] Ibid 289 (emphasis added).

[10] [1984] VR 161.

[11] Ibid 163.

[12] *Re Owies Family Trust* [2020] VSC 716, [283].

[13] *Karger v Paul* [1984] VR 161, 163.

His Honour made clear that a trustee is not obliged to provide reasons for a decision.[14] More recently, in Victoria, the Court of Appeal in *Curwen v Vanbreck Pty Ltd* ('*Curwen*') held that '[a] discretionary trustee is not obliged to disclose to objects the reasons actuating them in arriving at a decision'[15] and that '[n]o adverse inference of any improper purpose [can] be drawn from the non-disclosure in … evidence of the trustee's reasons'.[16] Clearly, this presents an obstacle to a party seeking to get at the reasons for a trustee's decision in order to challenge it.

The way around such an obstacle may lie in the summary of the applicable principles given by Byrne J in *Sinclair v Moss.*[17] There, his Honour held:

> Notwithstanding that it is not a case where the trustees provided reasons for their determinations, the Court may examine the material available to the trustees and enquiries which they did or did not make in order to determine whether they took into account matters which they should have taken into account.[18]

His Honour also held that '[t]here may be a point of distinction between a discretion which is unfettered or absolute and that which requires the trustees to be satisfied of or to form an opinion about a fact'.[19] It follows, then, that the ability of a court to 'examine the material' surrounding a trustee's decision will be greatly diminished if the trustee has absolute discretion.

On appeal

On appeal, the applicants in *Mandie* largely maintained the submissions they had made before the trial judge. So far as the trustee's declarations were concerned,[20] the issues on appeal were:

(1) Whether the May Declaration was invalid for having been made:

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[14] Ibid 165.

[15] (2009) 26 VR 335, 348 ('*Curwen*').

[16] Ibid 349.

[17] [2006] VSC 130.

[18] Ibid [17].

[19] Ibid (citation omitted).

[20] Besides the impact of the declarations, other issues raised on appeal were whether the trial judge had erred in refusing leave to amend pleadings and whether, in light of Ian's and Stephen's disclaimers, the applicant grandchildren had become takers in default of appointment with a vested interest in the trust property from the time of the disclaimers. A discussion of those matters is beyond the scope of this paper.

(a) beyond power, insofar as it may have sought to exclude Ian and Stephen as Specified Beneficiaries; and/or

(b) for an improper purpose.

(2) Whether the September Declaration was invalid for having been made:

(a) beyond power (being an argument the applicants sought to advance subject to having leave to amend their pleadings, which matter the trial judge refused);

(b) in bad faith; and/or

(c) for an improper purpose.

Challenging the May Declaration

The May Declaration stated, relevantly, that 'from the date of [the] declaration … neither Ian Mandie nor Stephen Mandie shall have any interest whether as a … Specified Beneficiary or otherwise'. The applicants took issue with the declaration on the basis, they submitted, it purported to exclude Ian and Stephen as Specified Beneficiaries. This was contrary to the terms of the trust deed which allowed the trustee to remove a *General* Beneficiary only. It was for this reason the applicants argued that the May Declaration had been made beyond power. The applicants also alleged that the declaration had been made for an improper purpose, such purpose being to take steps to exclude the applicant grandchildren from the trust. This was said to be the case in view of a clause in the trust deed whereby the grandchildren stood to become takers in default on the proviso they were (and could remain) 'children of a Specified Beneficiary'; removal of Ian and Stephen Mandie as Specified Beneficiaries could prejudice this position.

The trial judge held that the May Declaration sought to do nothing more than remove Ian and Stephen as General Beneficiaries. Among other things, the judge looked at both the wording of the declaration and the context in which it had been made. It was relevant that, a few months prior to the May Declaration, a subsidiary of the trustee had sought approval to sell liquor at Perth International Airport and a government regulator in Western Australia had requested that the trustee provide details of each specified beneficiary of the trust. The judge found that the May Declaration had been made in the context of the need 'to provide an authoritative statement' to the government regulator;[21] it had sought to identify, with ample clarity, those persons who were no longer beneficiaries of the trust.

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[21] *Mandie v Memart Nominees Pty Ltd* [2018] VSC 719, [146].

The Court of Appeal, constituted by Tate, Niall and Emerton JJA, considered the issue in light of the applicable authorities including McGarvie J's dicta in *Karger v Paul*. Their Honours noted:

(1) '[t]he exercise of a trust power for an improper purpose may, but need not be, accompanied by bad faith' and that 'consciousness of wrongdoing on the part of the trustee is not essential';[22] and

(2) '[i]t is not necessary that the improper purpose be the only or dominant purpose' but it should be 'an operative or actuating purpose, one without which it cannot be said the [exercise of the power or decision] would have been made'.[23]

Their Honours differed to the trial judge in their interpretation of the May Declaration and held that the unavoidable effect of its wording was that it had sought to exclude Ian and Stephen as Specified Beneficiaries. Looking at the content in which the declaration had been made but reaching a different conclusion to the trial judge, it was of some importance to their Honours' conclusion that the declaration had been intended to convey certain matters to the Western Australia regulator; it was 'apt to convey an operative decision to remove *any entitlement* … as both General Beneficiaries and as Specified Beneficiaries'.[24] Because it had sought to do so, the May Declaration had been made beyond power.

Notwithstanding that finding, the Court did not conclude that the trustee's directors *knew* that the May Declaration had been made beyond power at the time or that it had been designed to target or prejudice the applicant grandchildren. In other words, it had not been made for the particular improper purpose which the applicants had alleged. Instead, the Court inferred from the surrounding circumstances that:

> The most likely explanation is that, in making the May Declaration, the Trustee was concerned to satisfy the requirements of the WA regulator and it deferred dealing with the interests of the grandchildren. The evidence does not support the proposition that by making the May Declaration the Trustee was laying the groundwork for the exclusion of the grandchildren from the Trust.[25]

The Court noted that the applicants had 'sought to make a case of deliberate and conscious wrongdoing'.[26] In doing so, the applicants arguably had set a high bar for themselves; as the Court

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[22] *Mandie* (n 3) 569.

[23] Ibid 570, citing *Curwen* (n 15) 352.

[24] *Mandie* (n 3) 571–2 (emphasis added).

[25] Ibid 573.

[26] Ibid 570.

observed, such an allegation would require a *Bringinshaw*-esque degree of persuasiveness.[27] The principle in *Briginshaw v Briginshaw*, I note, provides that the strength of evidence necessary to satisfy the civil burden of proof — the balance of probabilities — may be greater for certain types of allegation;[28] as Dixon J held in obiter in that case:

> The seriousness of an allegation made, the inherent unlikelihood of an occurrence of a given description, or the gravity of the consequences flowing from a particular finding are considerations which must affect the answer to the question whether the issue has been proved.[29]

In conclusion, the Court in *Mandie* held that while the text of the May Declaration went beyond the power conferred on the trustee it had not been made for the alleged improper purpose. The first basis was enough to have the declaration set aside but, in the circumstances, it was of no consequence; the May Declaration did not affect the grandchildren, and since Ian and Stephen had already disclaimed their interest in the trust those two individuals could not be said to have been prejudiced.

Challenging the September Declaration

The September Declaration sought to exclude persons, including the applicants, 'for all purposes from the class of General Beneficiaries and from the date of [the] Declaration none of them shall have any interest as a General Beneficiary, or otherwise, under the Deed of Settlement'. The applicants sought to have the September Declaration set aside on grounds of bad faith and/or an improper purpose. The applicants also sought to appeal from the trial judge's refusal to allow them to amend their pleadings and make submissions at trial to the effect that the September Declaration also had been made beyond power. I examine the latter point first.

Had the September Declaration been made beyond power?

On appeal, the Court held that the trial judge had erred in refusing to hear submissions as to whether the September Declaration had been made beyond power. Among other things, the Court considered that both the arguments and the factual matrix relating to the September Declaration would have been similar to those regarding the May Declaration.[30]

Their Honours went on to hold that the September Declaration had been made beyond power. In doing so, the Court focused in particular on the use of the words 'or otherwise' in the declaration. The

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[27] Ibid.

[28] (1938) 609 CLR 336.

[29] Ibid 362.

[30] *Mandie* (n 3) 580.

Court disagreed with the trustee's submission that such wording was intended simply to reflect Ian's and Stephen's disclaimers; their Honours held that the inclusion of those words sought to 'make it clear that, by reason of that declaration, the named General Beneficiaries have no entitlements at all under the Deed'.[31] There was no direct evidence about the trustee's intention in including the particular formulation of words (and I discuss this issue below). In the absence of such evidence, their meaning was left to the Court's inference and their effect, ultimately, to the Court's determination.

Despite concluding that the declaration had been made beyond power, their Honours rejected the applicants' submission that it had the effect of destroying the 'substratum of the trust' so as to effectively constitute a new settlement. The Court noted that the trustee's power to exclude General Beneficiaries was broad and that '[t]he exercise of the exclusion power inevitably reduces the pool [of beneficiaries]'.[32] Moreover, there was nothing in the wording of the trust deed to signal an intention that any particular beneficiary or beneficiaries should necessarily benefit; since the applicants had not necessarily stood to receive anything, they could not be deprived of anything. Their Honours also rejected the applicants' submission that the trustee's power should be read down so as to only be warranted in response to some 'disentitling conduct' of a beneficiary.[33]

Had the September Declaration been made for an improper purpose?

In alleging an improper purpose, the applicants submitted that the September Declaration had been made with a view to ensuring that some beneficiaries benefitted from the trust to the exclusion of the applicants. Their Honours found that although the September Declaration indeed had this effect there was nothing improper about it doing so; 'the exercise of a power of exclusion necessarily has the potential to prejudice the excluded party'.[34] This appears to be consistent with the Court's comments to the effect that there was nothing in the trust deed to signal that any beneficiary should necessarily benefit. This demonstrates the difficulty in attempting to colour a trustee's decision as prejudicial to a beneficiary if there is in fact nothing compelling the trustee to cater for that beneficiary in the first place.

Had the September Declaration been made in bad faith?

Reflecting on the use of the expression 'or otherwise' in the September Declaration, the Court held that although this demonstrated that the declaration had been made beyond power — see the discussion earlier in this paper — there was no sufficient basis to find that the trustee had deliberately

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[31] Ibid 581.

[32] Ibid 582.

[33] Ibid 583.

[34] Ibid 590.

or knowingly gone beyond its power. There was, therefore, no element of bad faith. Their Honours noted that there might have been various explanations for the inclusion of the words 'or otherwise' in the declaration, some of which may have been innocent, some of which may have been mistaken, and one of which might have represented 'a deliberate ploy to impermissibly remove the applicants from the Trust entirely'.[35] The evidence, however, did not point to one conclusion or another.

The lack of evidence in support of the applicants' claims was in many ways symptomatic of their case. At trial, the trustee did not call its directors to give evidence on the reasons for making the declaration. The applicants submitted that the trial judge should have drawn an adverse (*Jones v Dunkel*[36]) inference against the trustee on the basis the directors' evidence would not have assisted the trustee's case. The Court noted that a trustee is not obliged to provide reasons for its decision and that no adverse inference could be drawn against the trustee in *Mandie* for not doing so.

In summarising what appears to have been a difficulty inherent in the applicants' case, the Court stated:

> The applicants' case is circumstantial. It is made more difficult by the nature of the discretionary power to exclude and the fact that the Trustee is not required to give reasons for a decision. As this Court explained in *Curwen*, no adverse inference of any improper purpose can be drawn from the non-disclosure of the Trustee's reasons or from the fact that the directors did not give evidence as to their purpose in making the September Declaration.[37]

The High Court refused the applicants' subsequent application for special leave to appeal.[38]

Observations

I make the following observations about the decision in *Mandie.* First, the case demonstrates that except in perhaps the most obvious or egregious situations it will be difficult to impugn the decision of a trustee to remove beneficiaries under a discretionary trust. As the Court elsewhere held in *Wareham v Marsella*, the broader the discretion the more difficult to establish that it has been exercised in bad faith, beyond power, and/or for an improper purpose.

It also seems that, of those three qualities, bad faith may be the most difficult to prove. This is particularly the case due to the strength of evidence needed to substantiate an allegation of that sort. It

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[35] Ibid 591.

[36] (1959) 101 CLR 298.

[37] *Mandie* (n 3) 592.

[38] *Mandie v Memart Nominees Pty Ltd* [2021] HCASL 88.

may be less difficult, on the other hand, to demonstrate that a decision has been made beyond power, particularly where the relevant express terms of the trust deed are clear.

Second, there may be difficulties in mustering the kind of evidence needed to overcome the relatively high burden in challenging a trustee's decision. The fact that a trustee is not obliged to provide reasons for a decision, coupled with the corresponding inability for a court to draw an adverse inference where no reasons are provided, together make it difficult to square up a good case against a trustee. This especially is the case where a trustee is given absolute discretion. That being said, there may be in-roads in a case where the terms of the trust prescribe certain matters a trustee is to take into account when exercising its discretion; a court can review the material a trustee would be expected to take into account.

Third, and if the above barriers can be overcome — including, for example, in a scenario where a trustee *does* give reasons for its decision — it is important to look not only to the terms of the power conferred on the trustee but also to the context of the exercise of that power. In *Mandie*, when ascertaining whether the May Declaration had been made beyond power, the Court considered the fact that it had been made in response to regulatory requirements and had sought to convey to a third party certain matters to that end. It was from this context, and despite the absence of any direct evidence from the trustee as to the reasons for its decision, that the Court could draw inferences about the trustee's (constructive) purpose in making the declaration.

Appointment and removal of a trustee

There are a number of bases on which trustees can be removed and appointed. In Victoria, for example, the Supreme Court has the inherent jurisdiction to do so.[39] There is also a basis in statute.[40] Elsewhere, the power to appoint or remove a trustee typically is set out in a trust deed. The terms may identify the person — usually an appointor — who can exercise the power. The deed may also prescribe the process and requirements for a valid appointment or removal of a trustee. The relevant terms of the deed must be followed lest the decision be void and of no effect. The primary way in which the exercise of such power can be challenged, therefore, is where it has occurred contrary to the terms of the trust deed.

Besides the express terms of the trust, the law contains principles restraining the exercise of such power by an appointor. Even where there has been compliance with the terms of the trust deed, the appointment or removal of a trustee can be challenged under to the doctrine of 'fraud on a power'. Despite the terminology, 'fraud on a power' does not refer to conduct that is fraudulent, dishonest or

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[39] *Sinnott v Hockin* (1882) 8 VLR (E) 205; *In the Will of Tunstall* [1921] VLR 55.

[40] *Trustee Act 1958* (Vic) s 48(1). Similar provisions exist in other jurisdictions: see, eg, *Trustee Act 1925* (NSW) s 70(1); *Trusts Act 1973* (Qld) s 80(1).

immoral in the usual sense.[41] In *Vatcher v Paull*,[42] Lord Parker held that the doctrine applies where 'the power has been exercised for a purpose, or with an intention, beyond the scope of, or not justified by, the instrument creating the power'.[43]

Case study

The case of *Baba v Sheehan* involved a challenge to the validity of a decision to remove and appoint a trustee.[44] According to the facts of the case, the second appellant, Mr Baba, together with Messrs Carney and Sheehan, the first respondent, ran an optometry practice. The practice was conducted under a trust deed. The deed issued units to Mr Baba's wife and to companies controlled by Messrs Carney and Sheehan. (Although the facts of the case involved a unit trust, the Court on appeal referred to legal principles, discussed in this paper, which apply equally to *discretionary* trusts.) Messrs Baba, Carney and Sheehan were directors and shareholders of the corporate trustee, Smart Street Optical Pty Limited.

The trust deed allowed Mr Sheehan to appoint and remove a trustee. Clause 2.1 of the trust deed provided:

> The Appointor and on the death of the last surviving appointor or such other person as he shall have appointed to act as appointor and in default of appointment his legal personal representative shall be entitled by instrument in writing at any time and from time to time:
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> (i) to remove a trustee hereof;
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> (ii) to appoint any new or additional trustee or trustees;
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> (iii) to appoint a new trustee or trustees in the place of any trustee who resigns his trusteeship or ceased to be a trustee by operation of law.

Mr Sheehan, in his position as appointor, became concerned with two matters. First, he perceived there to have been certain distributions from the trust not in proportion to the unit holdings. Second, he had identified reference in an email between Mr Baba and the trust's accountant to a 'salary sacrifice' arrangement of which he previously had been unaware. In October 2016, and apparently in response to these concerns, Mr Sheehan proceeded to remove the existing trustee and appoint as new

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[41] *Mandie* (n 3) 569, citing *Vatcher v Paull* [1915] AC 372, 378; *Ngurli Ltd v McCann* (1953) 90 CLR 425, 438.

[42] [1915] AC 372.

[43] Ibid 378.

[44] [2021] NSWCA 58 ('*Baba v Sheehan*').

trustee Silktote Pty Limited — a company of which he and his wife were the only directors and shareholders.

The New South Wales Supreme Court dismissed a claim that the removal and appointment were void and of no effect.[45] The trial judge held that Mr Sheehan had exercised his power in good faith even if Mr Sheehan had not done so for entirely well-founded reasons.

The appellants sought to appeal on the sole ground that the judge had erred in failing to hold that the purported removal and appointment were void as a fraud on Mr Sheehan's power as appointor; Mr Sheehan's power, the appellants contended, had been exercised for an extraneous purpose.

On appeal

Emmett AJA, with whom Brereton JA and Simpson AJA agreed, dismissed the appeal. Their Honours found no basis to disturb the trial judge's finding of fact regarding Mr Sheehan's exercise of the power.[46] This was so despite the judge not finding Mr Sheehan's evidence as to his purpose to have been, as the judge put it, 'entirely satisfactory'.[47] Among other things, the judge did not consider that certain emails upon which Mr Sheehan had relied as justification for exercising his powers as appointor fairly reflected Mr Sheehan's concerns. Nonetheless, the judge found Mr Sheehan a credible witness in his account of the concerns which ostensibly had prompted him to act with a view to protecting his interest as a unitholder.

The Court of Appeal's refusal to overturn the finding of fact on the basis of Mr Sheehan's credit was determinative of the appeal. Nonetheless, their Honours went on to expound the requirements at law for the proper exercise of such a power. I explore their Honours' comments as follows.

<u>The judgment of Emmett AJA</u>

Emmett AJA,[48] having set out the background facts and the history of the dispute, began with the point that '[t]he purpose of a trust deed in conferring a power is to benefit the objects of the relevant trust' and that '[a] power will be exercised for a foreign purpose if it is exercised with the intention of

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[45] *Baba v Sheehan* [2019] NSWSC 1281.

[46] *Baba v Sheehan* (n 44) [18] (Brereton JA), [52], [57] (Emmett AJA), [58] (Simpson AJA).

[47] *Baba v Sheehan* [2019] NSWSC 1281, [54].

[48] Simpson AJA gave a brief judgment concurring with the reasons of, and orders proposed by, Emmett AJA.

benefiting someone who is not an object of the power'.[49] In the present case, Mr Sheehan's powers as appointor could only be exercised for the purpose of benefiting the unitholders of the trust.

So far as concerned Mr Sheehan's actions in substituting as trustee a company under his and his wife's control, Emmett AJA held that if 'the purpose and intention' of that appointment had been to deprive Messrs Baba and Carney of their involvement in the affairs of the trust then the actions would prima facie have been for a foreign purpose and therefore void.[50] If, on the other hand, Mr Sheehan had 'in good faith' formed a view that it was in the interests of *all unitholders* that the trustee be replaced because the incoming trustee could better manage the affairs of the trust this would not lend itself to such characterisation.[51]

On the question of good faith, Emmett AJA was mindful of the trial judge's approach to the evidence and assessment of Mr Sheehan's credibility. (A fact-finder's assessment of a witness' evidence, including the impression formed by the person's demeanour and overall performance as a witness, are not things easily challenged on appeal.) Mr Sheehan had expressed concern about the 'salary sacrifice arrangement' and had sought to protect his interest as unitholder. At trial, the case put against Mr Sheehan was that the sole and real purpose for his decision was to obtain control of the trust for himself. In assessing both documentary evidence (in the form of email correspondence) and Mr Sheehan's conduct under cross-examination, the trial judge found Mr Sheehan to have been a credible witness and his concerns to have been genuine. It was with that foundation of credibility that the judge was able to accept Mr Sheehan's denial that his *sole* motivation in replacing the trustee was to obtain control of the trust.[52]

Based on the judge's approach which the Court of Appeal upheld, it appears that provided the alleged foreign purpose is not the *sole* purpose it will be difficult to interfere with an appointor's decision. That is not to say that a decision cannot be impugned simply because the foreign purpose is one among several; in *Curwen*, the Victorian Court of Appeal held that '[t]here will be circumstances in which a fraud on a power can be found in the case of an appointment that has been made for a *combination* of proper and improper purposes'.[53] There, the Court stated:

> We find no support … for the proposition that the improper purpose must be the primary or dominant purpose. In our view, the improper purpose will constitute a fraud on the power if it be an *operative or*

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[49] *Baba v Sheehan* (n 44) [49].

[50] Ibid [50].

[51] Ibid.

[52] *Baba v Sheehan* [2019] NSWSC 1281, [60].

[53] *Curwen* (n 15) 352 (emphasis added).

> *actuating* purpose — one without which it cannot be said the appointment [or other relevant decision] would have been made.[54]

The judgment of Brereton JA

At the outset, Brereton JA distinguished the decision to appoint a new trustee — as was the case here — from a decision to appoint *trust property* to a particular beneficiary. His Honour noted that while the latter had a fiduciary quality it was 'open to serious doubt, at least as a general rule', whether the former did.[55]

In *Re Skeats' Settlement*,[56] Kay J held that the power of appointment was indeed subject to fiduciary principles; his Lordship stated:

> The universal rule is that a man should not be judge in his own case; that he should not decide that he is the best possible person, and say that he ought to be the trustee. Naturally no human being can be imagined who would not have some bias one way or the other as to his own personal fitness, and to appoint himself among other people, or excluding them to appoint himself, would certainly be an improper exercise of any power of selection *of a fiduciary character* such as this is. In my opinion it would be extremely improper for a person who has a power to appoint or select new trustees to appoint or select himself, for that principal reason.[57]

Brereton JA did not apply this principle and this seems to reflect his Honour's reservation in adopting such a 'blanket proposition'.[58] Similar reluctance has been expressed elsewhere,[59] including in *Australian Conservation Services v Liladel Holdings*,[60] a case involving what the Court there described as a trust 'where "the power of the appointor to remove and appoint trustees may be exercised for the purpose of controlling the trust estate for the appointor's benefit"'.[61] In that case, Mossop J analysed a number of authorities on the question of the nature of the exercise of the power and considered that

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[54] Ibid (citation omitted and emphasis added).

[55] *Baba v Sheehan* (n 44) [4].

[56] (1889) 42 Ch D 522.

[57] Ibid 527 (emphasis added).

[58] *Baba v Sheehan* (n 44) [27].

[59] See, eg, *El Sayed v El Hawach* [2015] NSWCA 26, [69]; *Scaffidi v Montevento Holdings Pty Ltd* [2011] WASCA 146, [149]; but see *Re Reserve Hotels Pty Limited* [2021] NSWSC 376, [131].

[60] [2017] ACTSC 162.

[61] Ibid [22], quoting *Scaffidi v Montevento Holdings Pty Ltd* [2011] WASCA 146, [151].

> what is of significance is whether there has been a fraud on the power rather than some blanket prohibition arising because of the fiduciary nature of the power.
>
> In my view it is appropriate to determine this case on the basis that the power of appointment must be exercised in good faith, consistently with the objects or purpose of the trust and for the benefit of the beneficiaries. In other words, it may be determined by asking whether or not the exercise of the power of appointment involved a fraud on that power. That avoids the necessity to reach a conclusion as to the appropriate character of the trust … . Approaching the case in that way, the appropriate question to ask is whether there has been a fraud on the power. It is not appropriate to apply an inflexible rule that the power cannot be exercised to appoint an entity controlled by the appointor.[62]

Whether or not it is proper to characterise the power of appointment and removal of a trustee as 'fiduciary', Brereton JA noted that 'it has been accepted that such a power is controlled by the doctrine of "fraud on a power", so that it must be exercised bona fide for the purpose for which it was conferred'.[63] Although the appellants contended that Mr Sheehan's sole purpose in his actions was to obtain control of the trust for himself, Brereton JA noted:

> I would not accept that a purpose of maintaining or exerting control of a trust is, absent any intention that the appointee act other than properly in accordance with its responsibilities as trustee, necessarily inconsistent with the purpose for which a power of appointment of this kind is created, particularly in the context of the modern discretionary trust. Usually, a significant if not dominant purpose of this type of power of appointment is to reserve to the appointor the ability to 'control' the trust by removing and replacing the trustee.[64]

In referring to a number of earlier authorities, his Honour noted that, without more, there was no mischief in the appointment of a trustee who would comply with the appointor's wishes — even if the new trustee was a company controlled by the appointor. His Honour stated:

> [E]ven if Mr Sheehan's sole motive was to obtain control of the trust, I am not persuaded that would have been 'improper' in the relevant sense, absent any intention that his appointee act other than properly in accordance with its responsibilities as trustee.[65]

Returning to the trial judge's reasoning, his Honour quoted from the decision of the judge the following:

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[62] *Australian Conservation Services v Liladel Holdings* [2017] ACTSC 162, [33]–[34].

[63] *Baba v Sheehan* (n 44) [5].

[64] Ibid [9].

[65] Ibid [18].

> My conclusion [about the proper exercise of the power of appointment] does not depend upon Mr Sheehan's concerns … having been well founded in fact. In my view it is sufficient that Mr Sheehan acted, as I have found, genuinely and in good faith.[66]

Brereton JA's summary of the principles applicable to the doctrine of fraud on a power has been cited with approval by the New South Wales Supreme Court in *Overdean Developments Pty Ltd v Garslev Holdings Pty Ltd [No 3]*,[67] a case involving such an allegation in the context of the exercise of a power of attorney.

Observations

In dismissing a claim that the appointor's power had been exercised for a foreign or extraneous purpose, the Court in *Baba v Sheehan* has provided guidance on the scope of trust powers and the importance of intention and good faith when ascertaining the validity of decision-making. In particular, the Court's decision demonstrates the high hurdle in seeking to impugn the exercise of a power to remove and appoint a trustee on the basis of it being for an extraneous purpose.

The judgments of Emmett AJA and Brereton JA suggest three ways in which an appointor can successfully ward off a challenge to the removal and appointment of a trustee. First, the institutional backdrop to the exercise of powers of removal and appointment — Brereton JA referred to it as 'the context of the modern discretionary trust' which, it seems, is a quality applying equally to a *unit* trust, as was the case in *Baba v Sheehan* — is favourable to an appointor. In essence, the underlying ethos of the power of removal and appointment is such that an appointor is permitted a good degree of control over the direction of the trust and any decision which reflects that control will not necessarily be unlawful.

Second, the standard to which an appointor is held appears to be at once both strict and forgiving. I say that because, as the decision in *Baba v Sheehan* shows, it will probably be enough for an appointor to have acted genuinely and in good faith — strict or high moral standards in their own right — even if not necessarily for well-informed reasons and, again, even if the action results in the appointor gaining greater control over the trust.

Third, an appointor's decision is unlikely to be overturned where the alleged foreign purpose — for example, motivation to gain control of the trust — is not the *sole* purpose and provided it is not the 'operative or actuating' purpose. Whether or not something constitutes the 'operative or actuating purpose' depends, in my view, on an overall assessment of the reasons for an appointor's decision. Such an assessment involves weighing the various factors informing the decision, with reference to

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[66] Ibid [17], quoting *Baba v Sheehan* [2019] NSWSC 1281, [61].

[67] [2021] NSWSC 1482, [707].

both the appointor's own (subjective) explanation for the decision as well as the (objective) material surrounding that decision.

Unlike decisions made by a trustee of a discretionary trust, there is no rule sparing an appointor from the need to give reasons for its decision. The reasons the appointor provides, and any evidence they give at trial, will be held up to scrutiny and, as the outcome in *Baba v Sheehan* demonstrates, an appointor's performance as a witness may sway the outcome one way or the other.

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