

**IN THE COURT OF APPEAL OF NEW ZEALAND**

**CA115/2012  
[2012] NZCA 370**

BETWEEN                      KA NO 4 TRUSTEE LIMITED AND KA  
   NO 3 TRUSTEE LIMITED  
   Appellants

AND                              THE FINANCIAL MARKETS  
   AUTHORITY  
   Respondent

Hearing:            21 June 2012

Court:                O'Regan P, Arnold and White JJ

Counsel:            J A Farmer QC, J Long and I T F Hikaka for Appellants  
                                 K P McDonald QC, G H Allan and P H Courtney for Respondent

Judgment:        17 August 2012 at 11.30 am

---

**JUDGMENT OF THE COURT**

---

**A        The appeal is dismissed.**

**B        The appellants must pay the respondent costs for a complex appeal on a  
          band A Basis plus usual disbursements.**

---

**REASONS OF THE COURT**

(Given by O'Regan P)

## **Asset preservation orders**

[1] This appeal concerns the scope of the powers of the High Court to make orders preserving the assets of persons who may be liable to investors for breaches of the Securities Act 1978. These powers are contained in ss 60G to 60K of the Securities Act.

[2] The appellants challenge the refusal by the Chief High Court Judge, Winkelmann J, to strike out two aspects of the statement of claim of the respondent, the Financial Markets Authority (the FMA), seeking preservation orders in relation to the assets of trusts of which the appellants are trustees.<sup>1</sup> We will refer to the appellants and the trusts to which they relate as KA3 Trustee and KA3 Trust and KA4 Trustee and KA4 Trust respectively. We will refer to them collectively as the Trustees and the Trusts respectively.

## **Issues**

[3] The appeal is confined to two issues.

[4] The first relates to a pleading that the Trustees hold property on behalf of persons associated with Mark Hotchin. Mr Hotchin is under investigation by the FMA in connection with his role as a director of companies in the Hanover Group, a failed financing business. The FMA intends to make civil claims against him and his fellow directors. In anticipation of these civil claims, the FMA seeks an order under s 60H(1)(f) of the Securities Act requiring the Trustees to transfer the assets of each of the Trusts to a specified person to be held on trust pending determination of the civil proceedings against Mr Hotchin. The basis of this application is the FMA's pleading that Mr Hotchin's children, who are "associated persons" of Mr Hotchin under the Securities Act, are discretionary beneficiaries of the KA3 Trust and KA4 Trust. The FMA says the Trustees hold property "on behalf of" those associated persons and thus s 60H(1)(f) is engaged. The Trustees say that they do not hold assets "on behalf of" discretionary beneficiaries of the Trust.

---

<sup>1</sup> *Financial Markets Authority v Hotchin* [2012] NZHC 323 [High Court judgment].

[5] So the first issue is: is the FMA's pleaded claim that the Trustees hold the assets of the Trusts on behalf of associated persons of Mr Hotchin, namely his children, untenable?

[6] The second issue relates to the FMA's pleaded allegation that the KA4 Trust is a sham. The FMA pleads that the Trust was a sham from inception, and that the consequence of that is that property held by the KA4 Trustee subject to the terms of the KA4 Trust is in reality property of, or property held for the benefit of, Mr Hotchin. It seeks an order under s 60H(1)(a) prohibiting any dealing with the KA4 Trust property on the basis that such property is "controlled" by Mr Hotchin. The KA4 Trustee argues that this claim is insufficiently particularised and that, as stated in the most recent statement of claim, is untenable and should be struck out.

[7] So there are two components of the second issue, which relates to the claim for an order under s 60H(1)(a) on the basis that KA4 Trust is a sham. The first is: is the claim so inadequately particularised that it should be struck out as an abuse of process? The second is: is the claim of sham untenable?

### **The Trusts**

[8] The KA3 Trust was established by a Deed of Trust dated 23 December 1999. Mr Hotchin was the settlor. The initial trustees were Mr John Radley, an Auckland solicitor who has acted for Mr Hotchin and his interests, and Mr Michael Ward. The trustees changed over time, and since 18 December 2003 KA3 Trustee has been the sole trustee of the KA3 Trust. Since April 2010, Mr Tony Thomas, an accountant who has acted for Mr Hotchin and interests associated with Mr Hotchin for some time, has been the sole director and shareholder of KA3 Trustee. The discretionary beneficiaries of the KA3 Trust include Mr Hotchin, Mr Hotchin's children and his parents. Mr Hotchin's children are also the final beneficiaries, with a vesting day of 23 December 2079. There are no fixed beneficiaries.

[9] The KA4 Trust was established by a Deed of Trust dated 1 May 2003. Mr Hotchin was the settlor and was also initially the sole trustee. From 25 August 2005, Mr Hotchin and Mr Radley were the trustees of the Trust, and since 1 May

2009 KA4 Trustee has been the sole trustee of the KA4 Trust. Mr Thomas is now the sole shareholder and director of KA4 Trustee.<sup>2</sup> The discretionary beneficiaries of the KA4 Trust include Mr Hotchin's children, but not Mr Hotchin himself. Mr Hotchin's children are also the final beneficiaries with a vesting day of 1 May 2083. There are no fixed beneficiaries.

[10] Mr Hotchin had the power to appoint and remove discretionary beneficiaries and the power to appoint and remove trustees under both trust deeds. This changed on 14 June 2011, however, when his mother was appointed joint appointor. So from that date onwards, Mr Hotchin and his mother jointly had the power of appointment and removal of trustees under both trust deeds. The Trustees have unfettered discretion as to the exercise of their power. However, there is a self-dealing clause prohibiting trustees from distributing to themselves.

### **Relevant legislation**

[11] The relevant provisions of the Securities Act are s 60G, which sets out the circumstances in which asset preservation orders can be made, and s 60H, which specifies the types of order that can be made. The focus of the present case is on s 60H(1)(f) and s 60H(1)(a), which have been referred to above at [4] and [6] respectively. These provisions need to be seen in their legislative context and to facilitate that we reproduce the text of ss 60G and 60H in an appendix to this judgment.

[12] We now turn to the two issues identified above.

### **Is it reasonably arguable that the Trustees hold the assets of the trusts “on behalf of” the discretionary beneficiaries?**

[13] The procedural context in which this question arises is significant. The decision of the Chief High Court Judge was a refusal to strike out the claim of the FMA. That did not require her to resolve the claim, but rather to conclude that it was

---

<sup>2</sup> From 16 March 2009–16 September 2009 Mr Radley was also director. Until 29 April 2010 Mr Radley was also a shareholder.

reasonably arguable. There was no dispute between the parties about the test for strikeout: the cause of action must be so clearly untenable that it cannot possibly succeed.<sup>3</sup> The Chief Justice recently put the test in these terms: the Court should not strike out a claim summarily unless “the Court can be certain that it cannot succeed”.<sup>4</sup> An alternative expression of the test in the same paragraph of *Couch v Attorney-General* is that the case must be so certainly or clearly bad that it should be precluded from going forward. The position taken by the Trustees is that this claim is untenable, because it is based on a legally incorrect premise that the trustees of a discretionary trust hold the corpus of the trust “on behalf of” the discretionary beneficiaries. Accordingly, the Trustees say the Court does not have jurisdiction to make the order the FMA seeks.

[14] As mentioned earlier, the pleading in issue is a pleading supporting an application under s 60H(1)(f) that the Trustees be required to transfer the trust funds of the KA3 Trust and the KA4 Trust to a specified person to be held on trust pending the determination of the investigation and resolution of any criminal or civil proceedings against Mr Hotchin. Such an order is available only in relation to “any person holding money, securities or other property on behalf of the relevant person [Mr Hotchin] or an associated person of the relevant person [his children]”. There is no dispute that Mr Hotchin’s children are associated persons of Mr Hotchin.<sup>5</sup>

[15] For the Trustees, Dr Farmer QC emphasised that a discretionary beneficiary of a trust has no proprietary interest in trust property, but rather only an expectancy to be considered for distributions. Similarly, the fact that the children were final beneficiaries did not give them any present proprietary interests, but rather an interest that was contingent on the survival of the beneficiaries and the existence of trust property as at the vesting day. Thus, neither of the children could make and enforce a demand for the trust property, and the trust property could not therefore be said to be held on their behalf.

---

<sup>3</sup> *R v Lucas & Son (Nelson Mail) Ltd v O’Brien* [1978] 2 NZLR 289 (CA) at 294-295.

<sup>4</sup> *Couch v Attorney-General* [2008] NZSC 45, [2008] 3 NZLR 725 at [33].

<sup>5</sup> It appears that the KA3 Trustee and the KA4 Trustee are also associated persons of Mr Hotchin: paragraph (a) of the definition of “associated persons” in s 2(1) of the Securities Act 1978 and the definition of “relatives” in s YA 1(c)(v) of the Income Tax Act 2007.

[16] Dr Farmer placed particular emphasis on the discussion of the nature of the interests of discretionary beneficiaries in trust property in the decision of the Federal Court of Australia in *Re Richstar Enterprises Pty Ltd*.<sup>6</sup> In that case, French J was considering an application under s 1323 of the Corporations Act 2001 (Cth) which is the Australian equivalent of s 60H. French J considered a number of authorities dealing with the nature of the interests of a discretionary beneficiary and concluded that the beneficiary of a discretionary trust does not have any equitable interest in the trust income or property of the trust.<sup>7</sup>

[17] We have no doubt that French J was correct in his assessment, but his assessment was no different from that of the High Court Judge in the present case. Winkelmann J set out the orthodox position that a discretionary beneficiary has a “mere expectancy” and a final beneficiary only has a residual interest in trust property. Neither category of beneficiary can compel distribution of trust funds to them.<sup>8</sup> Counsel for the FMA, Ms McDonald QC, accepted that the High Court Judge and French J in *Richstar* were correct. So Dr Farmer’s argument did not take us further than the position already reached by the High Court Judge and accepted by the FMA.

[18] The issue we are required to resolve is whether, in light of the fact that discretionary and final beneficiaries do not have any right to demand distribution of trust funds to them, the trustees of such a trust can still be said to hold the trust funds “on behalf of” such beneficiaries for the purposes of s 60H(1)(f).

[19] In the High Court Winkelmann J referred to the purpose of the asset preservation provisions, namely to ensure that the rights of aggrieved persons to damages, compensation or restitution were not frustrated by the assets of a liable person being dealt with in a way that rendered them unavailable to meet claims. She found that, when s 60H(1)(f) was interpreted in the light of that purpose, then the interpretation contended for by the FMA prevailed.<sup>9</sup> She said this of s 60H(1)(f):<sup>10</sup>

---

<sup>6</sup> *Re Richstar Enterprises Pty Ltd* (ACN099 071 968); *Australian Securities and Investments Commission v Carey (No 6)* [2006] FCA 814, (2006) 233 ALR 475.

<sup>7</sup> At [29].

<sup>8</sup> High Court judgment at [22].

<sup>9</sup> High Court judgment at [25]–[26].

<sup>10</sup> High Court judgment at [24].

It is clear from the text, however, that the legislature has allowed a very wide net to be cast, sufficient to capture assets of the relevant person which are held or owned by others. Caught within that net are the assets of associated persons<sup>11</sup> and also assets held by the relevant person other than beneficially, for example, assets held by the relevant person as a trustee or in a fiduciary capacity.<sup>12</sup> These are not prima facie, assets available to meet a judgment against a relevant person. For this reason, the argument that the categories of s 60H should be construed as capturing only assets against which judgment against the relevant person could be enforced is unsustainable. Rather the scheme of the legislation seems to create a broad jurisdiction to grant preservation orders, leaving for the discretionary phase the issue of whether the assets are likely to be available to meet any judgment obtained by aggrieved persons against the relevant person. This analysis supports the construction of s 60H(1)(f) contended by the FMA.

[20] The Trustees took issue with that aspect of the High Court Judge's decision. They argued that her interpretation of the provision was inconsistent with the overall purpose of preserving property to which creditors or an aggrieved person can have recourse in the event their claim succeeds. They said the Judge's interpretation added a "punitive element" to the statute, leading to property being frozen merely because the holder of the property had some association with the relevant person. They supported their arguments by reference to the New Zealand Bill of Rights Act 1990, although that argument had not been raised in the High Court and was not developed in oral submissions by Dr Farmer.

[21] The Trustees argued that the Judge was wrong to draw support from the fact that assets that are held by a relevant person other than beneficially, for example, assets held by a relevant person as trustee or in a fiduciary capacity, are covered by s 60H, even though they are obviously not available to meet creditors of the relevant person. They said that the Judge was referring here to s 60H(1)(e) and (g), which are extended by s 60H(2). But the Trustees said these should be seen as special cases and exceptions to the general principle, rather than illustrative of the ambit of s 60H generally. We think that this submission misunderstands the point made by the Chief High Court Judge, which was simply that Parliament has expressly included within the net of s 60H assets that are not prima facie available to creditors of the relevant person. That must necessarily undermine any argument that s 60H is limited to

---

<sup>11</sup> Securities Act 1978, ss 60H(1)(c), (d), (e) and (f).

<sup>12</sup> Securities Act 1978, ss 60H(1)(e), (g) and s 60H(2).

situations where the property subject to the preservation order will be available to creditors of the relevant person.

[22] Nor do we see any substance in the Bill of Rights argument, to the extent that it is still pursued. The essence of this argument was that an asset preservation order is an unreasonable search and seizure under s 21 of the Bill of Rights. That is predicated on the false assumption that the preservation order is “unreasonable”. It is also predicated on an assumption that s 21 is a measure for the protection of property rights, which appears to run counter to the views expressed by both the Chief Justice and Blanchard J in *Hamed v R* that s 21 is essentially a measure for the protection of privacy rights.<sup>13</sup>

[23] We can see no error in the approach taken by Winkelmann J. She correctly stated the purpose of the Securities Act provisions and, in our view, she correctly concluded that the legislature had allowed a very wide net to be cast in the asset preservation provisions. The words “on behalf of” must be interpreted in the context in which they appear, and in light of the clear protective purpose of s 60H. The fact that assets held in a discretionary trust are not able to be demanded by the discretionary beneficiaries or final beneficiaries is not determinative.

[24] Section 60H creates a protective regime that is designed to preserve matters pending the outcome of the substantive criminal or civil proceeding against the relevant person. Whether assets held by the trustees of a discretionary trust become available to the relevant person may depend on complex transactions involving other trusts and other persons, and may not be apparent at the time the orders under s 60H are applied for.

[25] It would be surprising if a protective regime such as the provisions in issue in this case left outside of its net any assets held in discretionary trusts. Such vehicles are often established for the express purpose of placing assets beyond the reach of creditors, and can be vulnerable to successful challenges on the basis that the intention of their establishment was to defeat creditors.

---

<sup>13</sup> *Hamed v R* [2011] NZSC 101, [2012] 2 NZLR 305 (SC) at [10], [11], [161] and [163].



[26] If the Trustees' contention was correct, that would mean that trustees of a discretionary trust would not hold assets on behalf of anyone for the purposes of s 60H(1)(f), even though it could be readily foreseen that distributions could be made to discretionary beneficiaries which would end up in the effective control of the relevant person. That could be the case where the principal discretionary beneficiaries are the relevant person's young children, as is the case in relation to the KA4 Trust. We do not consider it likely that Parliament would have intended that outcome.

[27] One can envisage a case where the only discretionary beneficiaries or final beneficiaries of a discretionary trust are associated persons of the relevant person, in which case one can be sure that the assets of the trust will end up in the hands of associated persons of the relevant person sooner or later. In such a case, it is difficult to see why the assets of the trust would not be considered to be held on behalf of the discretionary beneficiaries for the purpose of s 60H(1)(f). If that is accepted, it is equally difficult to see why the fact that some of the discretionary beneficiaries of a trust are not associated persons would change that conclusion.

[28] In our view, it would be premature to strike out the FMA's pleading at this stage. Rather, the matter should proceed to discovery and to a substantive hearing, so that the High Court can make a fully informed assessment of the interests of the beneficiaries, the need to protect the position of aggrieved persons and the likelihood or otherwise that such protection will yield any ultimate benefit to aggrieved persons, before deciding whether the order under s 60H(1)(f) should be made. That assessment can also take into account the ongoing supervision of such orders, which can lead to the modification of them if subsequent events show they serve no real purpose or unduly disadvantage the beneficiaries of the Trusts.

**Is it reasonably arguable that the KA4 Trust is a sham and is the claim sufficiently particularised?**

[29] In the High Court the FMA argued that the Trusts were set up to conceal Mr Hotchin's continued enjoyment of the trust property. In its counsel's submissions to the High Court the pleadings then before the Court were enlarged upon

considerably. The High Court Judge criticised this. But she considered the factors identified in submissions by the FMA in support of its sham argument. These were:<sup>14</sup>

- (a) The structure of the trust deeds gave significant control to the settlor.
- (b) At the time the KA4 Trust was established, Mr Hotchin was the settlor and sole trustee.
- (c) Since May 2009 for KA4 Trustee, and April 2010 for KA3 Trustee, the sole shareholder and director has been Mr Thomas. Mr Thomas is used by Mr Hotchin as a director and shareholder in many companies associated with Mr Hotchin.
- (d) There is an absence of evidence of “push back” by Trustees. The FMA had found only one incident where the Trustees declined to do what Mr Hotchin had wanted with the assets of the Trust.
- (e) There are instances where the Trustees have acted purely in Mr Hotchin’s interests, seemingly at his discretion. In particular, the FMA pointed to the “Matapana Road transaction”. The Matapana Road property is a consolidation of four properties on Waiheke Island, purchased by interests associated with Mr Hotchin for development as a beach house. The Matapana Road transaction involved the transfer by the KA4 Trust of one of the four Matapana Road properties to KA3 Trust in exchange for a forgiveness of debt owed by KA4 Trust to KA3 Trust. KA3 Trust then provided an indemnity to support certain of Mr Hotchin’s obligations in relation to one of the restructurings of the Hanover Group. The Matapana Road property was used in support of that indemnity.
- (f) The FMA also pointed to dealings in respect of a property at Paritai Drive, Auckland. This is a consolidation of three residential

---

<sup>14</sup> These points are taken from the High Court judgment at [52].

properties, on which a large and very expensive residence is partially constructed. Although the property is owned by the KA4 Trust, Mr Hotchin personally spent \$12 million on the construction of the house on the property. There was no formal documentation as to the basis upon which this was occurring, or even initially any informal understanding with the Trust. Then when Mr Hotchin ran out of money to fund construction, KA3 Trust advanced KA4 Trust \$2.5 million, on the basis of an understanding reached with KA4 Trust that:

- (i) the KA4 Trust would grant Mr Hotchin and his family a long term lease of the Paritai Drive property; and
- (ii) if, when the property was sold, the value of the house was less than the total cost of its construction, the amount of the loan by KA3 Trust to KA4 Trust would be reduced by the difference between valuation and cost.

[30] Winkelmann J held that, in the case of the KA4 Trust, there were sufficient particulars to support an arguable case of sham.<sup>15</sup> The Trust was set up with Mr Hotchin as the sole trustee, and aspects of how it operated, particularly in relation to Paritai Drive, suggested the trust assets had been allowed to be treated as Mr Hotchin's. The strike out application was declined, on the condition that the FMA file an amended pleading that reflected how it had formulated its case in oral submissions in the High Court. The Judge said the written pleadings were inadequate and it was not until oral argument that the FMA's pleading became clear.

[31] The sham pleading in respect of the KA3 Trust was struck out. The settlement of the KA3 Trust involved trustees other than Mr Hotchin. There was no allegation or evidence that those trustees were party to any intention to set up the Trust as a sham. The Matapana Road transaction and the indemnity were entered into by the KA3 Trust for the benefit of Mr Hotchin, but he is one of the discretionary beneficiaries of that trust. The absence of push back by the Trustees

---

<sup>15</sup> At [53].

was not significant because the property transactions seemed relatively conventional. There was no appeal against this aspect of the High Court decision.

[32] The Trustees submit that the fourth amended statement of claim (that was filed after the High Court judgment) still does not sufficiently particularise or establish the claim that KA4 Trust is a sham. There are two broad grounds of appeal:

- (a) the pleading is an abuse of process as it is not properly particularised;  
and
- (b) there is no evidence that could support a reasonable argument of sham.

[33] We will consider each in turn.

*Inadequate particulars*

[34] The Trustees emphasise that a pleading of sham is a pleading of fraud. Therefore, the FMA has an obligation to provide clear and sufficient evidence to establish a prima facie case of fraud. It is not appropriate to fish for evidence by way of interrogatories and discovery. Where an allegation of fraud is brought, the party alleging fraud must produce full particulars of all elements that make up its claim. The Trustees submit that the claim is not properly particularised and should be struck out as an abuse of process because it is really a fishing exercise.

[35] The FMA denies any lack of particularity in its sham claim. It accepts that the Trustees are correct that allegations of sham must be fully particularised, but says this does not lower the threshold for strike out that the claim must be “certainly or clearly bad”.<sup>16</sup> The Court should be cautious in disposing of cases on a summary basis. In the area of preservation orders in particular, the logic of the governing legislation is that an application will be made before all information is available. The purpose of preservation orders is to preserve the status quo pending the outcome

---

<sup>16</sup> Using one of the statements of the test by the Chief Justice in *Couch*, above n 4, at [33].

of investigation. The Court should balance the need to avoid embarrassing a defendant through lack of particulars at trial against the need to preserve the assets of a relevant person at an early stage of proceedings.

[36] For the FMA, Ms McDonald argued that the need for particularity will differ depending on the seriousness of the alleged dishonesty, and the stage and nature of the proceedings. She drew support from the following observation in the judgment of this Court in *Price Waterhouse v Fortex Group Ltd*:<sup>17</sup>

What is required is an assessment based on the principle that a pleading must, in the individual circumstances of the case, state the issue and inform the opposite party of the case to be met. As so often is the case in procedural matters, in the end a common-sense and balanced judgment based on experience as to how cases are prepared and trials work is required. It is not an area for mechanical approaches or pedantry.

[37] Ms McDonald emphasised that the requirement for particularity needed to be considered in the context of a protective legislative scheme, designed to allow for orders to be made in advance of the resolution of substantive proceedings to ensure that those who stood to benefit from those substantive proceedings were not deprived of the benefit of their successful claim. This was a point made by the New South Wales Supreme Court in *Australian Securities and Investment Commission v Krecichwost*.<sup>18</sup> Ms McDonald said that the strike-out discretion needs to be exercised in a way that balances the need to avoid embarrassing a defendant at trial against the clear concern of Parliament that, when it comes to the assets of relevant persons, what is ostensible may well be deceptive. She said if this approach is taken to the present case, then the Court should find that the particulars supplied by the FMA are adequate in the circumstances of the case, given the reality that discovery has not yet occurred and the preliminary nature of the asset preservation order regime.

[38] The pleading now before this Court, the fourth amended statement of claim, has been amplified by particulars provided by the FMA to the appellants. The

---

<sup>17</sup> *Price Waterhouse v Fortex Group Ltd* CA179/98, 30 November 1998 at 19.

<sup>18</sup> *Australian Securities and Investment Commission v Krecichwost* [2007] NSWSC 948, (2007) 64 ACSR 411 at [46].

pleading broadly follows the line of argument highlighted by Winkelmann J and reproduced above.<sup>19</sup> The substance of the claim is as follows:

- (a) Mr Hotchin executed the trust deed for the KA4 Trust not intending to divest himself of the beneficial interest in the assets ostensibly subject to that trust thereafter.<sup>20</sup>
- (b) Particulars are given as to the settlement of the KA4 Trust by Mr Hotchin, the fact that he was the sole initial trustee from the time of settlement until 25 August 2005 and other details along the lines described above.<sup>21</sup>

[39] It is also pleaded that Mr Hotchin's intention not to divest himself of the beneficial interest in the assets ostensibly subject to the KA4 Trust continued after Mr Radley was appointed a trustee on 25 August 2005, and subsequently when KA4 Trustee was appointed as trustee on 1 May 2009. It is pleaded that the Trustees did not consider the merits of individual transactions relating to the interests of ostensible beneficiaries and the purpose of the KA4 Trust. Rather, it is claimed that Mr Hotchin has administered the assets ostensibly subject to the KA4 Trust as his own, and that first Mr Radley and subsequently Mr Radley and Mr Thomas as directors of KA4 Trustee made themselves "an amanuensis" for Mr Hotchin.

[40] The particulars refer to a number of transactions said to support this claim, particularly the Paritai Drive and Matapana Road transactions described in the High Court judgment.<sup>22</sup> Further details were given in the particulars provided to the solicitors for the appellant in early June 2012, but Dr Farmer argued that even these particulars were inadequate. He pointed to the particulars provided in support of the pleading that the intention of Mr Hotchin not to divest himself of the beneficial interest in the assets ostensibly subject to the KA4 Trust continued after Mr Radley was appointed trustee. In response a request for particulars as to how it was

---

<sup>19</sup> At [29].

<sup>20</sup> The initial settlement was \$10, so the argument appears to be that this affected later transfers of assets to the KA4 Trust. It is not, however pleaded that the contracts by which these assets were transferred to the KA4 Trust were themselves sham transactions. It appears that the argument is that a transfer to a sham trust is of no effect, because the transferee is a sham entity.

<sup>21</sup> At [9]–[10].

<sup>22</sup> See [29](e) and (f) above.

contended that this intention was continued, the FMA provided the following particulars:

FMA alleges that Mr Hotchin's apparent beneficial enjoyment and control of all assets ostensibly owned by the KA4 Trust was undisturbed by Mr Radley's assumption of responsibility for administration of those assets as a second trustee.

FMA does not yet know whether this continuing state of affairs resulted from express agreement between Mr Radley and Mr Hotchin (oral or otherwise) or from tacit acquiescence in Mr Hotchin's continuing intention.

[41] Similar particulars are given in relation to the allegation that the intention continued after the appointment of the KA4 Trustee.

[42] Dr Farmer argued that it was unacceptable for the FMA to say that it did not know whether there was an express agreement between Mr Radley and Mr Hotchin or merely acquiescence by Mr Radley and Mr Hotchin's continuing intention. He said it was not good enough for the FMA to say that it "does not yet know" when it is making what is effectively an allegation of fraud.

[43] We do not accept Dr Farmer's submission. In our view the FMA's particulars are sufficient given the current stage of the proceedings and the fact that discovery has not yet occurred. This is not a case where the allegation of sham has been lightly made.<sup>23</sup> Sufficient particularity is provided to the KA4 Trustee to answer the FMA's claim. That claim would be stronger and easier to prove if some actual agreement could be established, but we do not think it would be right to rule out the possibility of a successful claim based on acquiescence at this stage of the proceeding. In short, we agree with Winkelmann J that the present pleading provides sufficient particulars to support an arguable case of sham. We will come back to the substance of the claim when considering the second aspect of the Trustees' attack on the sham argument, namely that there is an insufficient evidential basis for it.

[44] The Trustees also argued that the alternative pleading of sham in the fourth amended statement of claim is insufficiently pleaded. That is a pleading that Mr Hotchin, as guardian of the beneficiaries of the KA4 Trust, released Mr Radley

---

<sup>23</sup> *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2008] NZSC 115, [2009] 2 NZLR 289 at [39].

and, subsequently, the KA4 Trustee from administering the KA4 Trust for the benefit of the ostensible beneficiaries. However, the only particular sought in relation to that pleading was the nature of the guardianship arrangement alleged in the relevant paragraph of the fourth amended statement of claim and that particular has been provided.

### **Is there an arguable case of sham?**

[45] The essence of the FMA's sham argument is that the KA4 Trust was set up by Mr Hotchin to conceal his continued enjoyment of the incidents of ownership in respect of the property ostensibly held subject to the KA4 Trust and that Mr Hotchin maintained full and effective control over those assets.

[46] Dr Farmer accepted that, if the FMA could establish those assertions, an arguable case of sham existed. But he argued that the pleading that Mr Hotchin executed the KA4 Trust not intending to divest himself of the beneficial interest in the assets ostensibly subject to the KA4 Trust was a mere assertion and there was no evidential basis for it. Winkelmann J accepted that evidence of transactions subsequent to the settlement of the trust could support the allegation about the intention of Mr Hotchin as settlor and trustee at the time of the execution of the KA4 Trust Deed. Dr Farmer argued that evidence of subsequent conduct could not support the allegation of sham, but we disagree. In a situation where the same person is the settlor and the sole trustee, it is the unilateral intention of that person that will be critical in establishing the sham allegation.<sup>24</sup> In the absence of an admission of such an intention by the settlor and trustee, a party alleging a sham trust will need to point to evidence of actions subsequent to the establishment of the sham trust to demonstrate that the settlor has implemented an intention to maintain personal control of the assets ostensibly in the trust. That is the nature of the FMA's pleadings of subsequent conduct in this case. Ms McDonald pointed out that, while this Court in *Official Assignee v Wilson* stated that caution needs to be exercised in

---

<sup>24</sup> There was no dispute that where the settlor and sole trustee are the same person, the requirement that the settlor and trustee(s) have a common intention to create a sham is satisfied by the unilateral intention of the single holder of both roles. See *Official Assignee v Wilson* [2007] NZCA 122, [2008] 3 NZLR 45 at [51].



determining whether post-settlement acts or omissions provide evidence of sham, it acknowledged that in some cases post-settlement evidence could do so.<sup>25</sup>

[47] As already mentioned, Mr Hotchin's position as sole trustee changed later when Mr Radley became a trustee, and later still when the KA4 Trustee took over as trustee. Mr Radley and Mr Hotchin then ratified the purchase arrangements for the Matapana Road and Paritai Drive properties. Dr Farmer argued that the introduction of independent professional trustees who could be expected to know and comply with their legal obligations as trustees changed the picture. Even if Mr Hotchin had the pleaded intention of maintaining his personal control and enjoyment of the trust assets when the trust deed for the KA4 Trust was signed, that intention could not have continued beyond the appointment of independent persons as trustees who did not also have that intention. The pleadings seek to respond to this by arguing that the subsequent trustees (and in the case of the KA4 Trustee, its director, Mr Thomas) acted as amanuenses of Mr Hotchin. While we have found that this is an adequate pleading, that is quite a different thing from proof of the claim.

[48] Dr Farmer argued that any question of sham was effectively removed by the introduction of independent trustees, but that does not seem to us to necessarily follow. If the KA4 Trust was, when established, a sham, it is not clear to us that subsequent actions taken pursuant to the sham trust deed could convert a sham into a valid trust. It could be argued that only a fresh declaration of trust, not tainted by the intention of the original settlor/trustee that made the trust a sham in the first place, would be required. However, there is English authority supporting Dr Farmer's position.<sup>26</sup> This has not been the subject of argument before us and we think it preferable to leave the matter to be resolved at trial.

[49] It needs to be remembered that the FMA's allegation is that the KA4 Trust was a sham from its inception, and that the post-settlement conduct supports that proposition. The FMA is not arguing that a valid trust became a sham because of the

---

<sup>25</sup> *Official Assignee v Wilson* at [77]. See also Matthew Conaglen "Sham Trusts" (2008) 67 CLJ 176 at 193 and Andrew Butler *Equity and Trusts in New Zealand* (2nd ed, Brookers, Wellington, 2009) at [15.3.3] and [41.4.2] and John Brown *New Zealand Master Trusts Guide* (3rd ed, CCH, Auckland, 2011) at [4.20] ff.

<sup>26</sup> *A v A* [2007] EWHC 99 (Fam), [2007] 2 FLR 467 at [47]–[49].

way it was operated, sometimes referred to as an emerging sham.<sup>27</sup> The argument on behalf of the KA4 Trustee appears to be the converse of the emerging sham: even if the KA4 Trust was a sham from inception, the introduction of independent and uninvolved trustees converts it into a valid trust.

[50] In effect, the KA4 Trustee argues that where the settlor and sole trustee of an ostensible trust are the same person, and there is evidence that that person had the intention that the trust be a sham, in order for the sham to continue when a new trustee is appointed the new trustee must share the intention that the trust not actually be a trust. Their argument is that, in order for the sham to continue after the appointment of a new trustee, an agreement or evidence of common intention to maintain the sham is required between the settlor and the new trustee. It is not necessary for us to rule on that definitively in this context, but we would not be prepared to say that the opposite contention, that a sham remains a sham notwithstanding the introduction of an uninvolved trustee in the absence of a fresh declaration of trust, is so unlikely to succeed that a claim relying on that proposition should be struck out. If the argument that once a trust is established as a sham it remains a sham in the absence of a fresh declaration of trust is correct, then much of the argument about the actions of Mr Radley and the KA4 Trustee fall away.

[51] The FMA pleads that if its sham claim is successful, then the KA4 Trust property is held by the KA4 Trustee on trust for Mr Hotchin as settlor of an invalid trust.<sup>28</sup> The Trustees dispute this: they argue that if the trust is invalid, the trust property would be held on a resulting trust for the contributor of those funds. They point out that the Trust was settled with a payment of \$10.00, and that other property was transferred into the KA4 Trust from other entities including the KA3 Trust. The Trustees argue that, in that situation, the trust property should be held on a resulting trust for the contributor. Whether that is the case would depend on the intention of the contributor, in particular whether the contributor shared the intention alleged to have been held by Mr Hotchin as settlor and initial trustee that the property should

---

<sup>27</sup> See *Official Assignee v Wilson* at [57], where this Court rejected that concept, and Brown, above n 25, at [4.21].

<sup>28</sup> See Butler, above n 25, at [15.5]. Where the settlor is the donor of the property of the trust, a resulting trust in favour of the settlor would be the most appropriate way of dealing with the property said to be held on a trust that is found to be a sham. That was the situation in *Official Assignee v Wilson*, but it is not the situation here.

continue to be held for Mr Hotchin's benefit. We accept that the pleading is simplistic and needs amplification and refinement, but we do not see this as a reason to strike out the sham pleading in its entirety. It may be that, if the pleading remains as is, any order made under s 60H(1)(a) in respect of assets held by the KA4 Trustee will be limited to assets in respect of which the Court is satisfied a resulting trust in favour of Mr Hotchin should be imposed.

[52] The FMA also supports its sham argument by reference to the terms of the trust deed for the KA4 Trust, which gave Mr Hotchin a large degree of control over the property. When the KA4 Trust was established, Mr Hotchin was the settlor and sole trustee, and he had the power to appoint and dismiss trustees and beneficiaries (since 14 June 2011 Mr Hotchin has jointly held the power of appointment and removal of trustees with his mother). While the deed restricted the exercise of trustee powers by prohibiting a sole trustee from exercising any power or discretion other than the appointment of a new trustee, Mr Hotchin disregarded this restriction for the first two years after establishment of the trust.<sup>29</sup> We agree that the existence of these powers and their being held by one person may provide some support for the FMA's argument. We also recognise that when sham is alleged, the Court may look at the substance of the transaction and not just its form.<sup>30</sup> We need go no further.

## **Conclusion**

[53] We conclude that the High Court Judge was correct not to strike out the sham pleading. We acknowledge, however, that the pleading with respect to the consequences of a finding of sham will need to be amended.

## **Overlap of claims**

[54] This conclusion means that in relation to the KA4 Trust two separate claims by the FMA remain on foot. The first is the claim for an order under s 60H(1)(f) requiring the KA4 Trustee to pay or transfer money or property (being the property

---

<sup>29</sup> That is, until the appointment of Mr Radley as co-trustee on 25 August 2005.

<sup>30</sup> *NZI Bank Ltd v Euro-National Corporation Ltd* [1992] 3 NZLR 528 (CA) at 539; *Colonial Mutual Life Assurance Society Ltd v CIR* (2000) 19 NZTC 15,614 (CA) at [32].

of the KA4 Trust) to a specified person to be held on trust pending determination of the substantive proceeding. The second is an order under s 60H(1)(a) prohibiting Mr Hotchin, as the party said to be effectively in control of the property of the KA4 Trust by virtue of its being a sham, from transferring, charging or otherwise dealing with property purportedly held subject to the KA4 Trust. It is not clear to us that the latter order would add anything to the former. If the order is made under s 60H(1)(f), it is hard to see why an order under s 60H(1)(a) would be necessary or, indeed, whether it even ought to be made given that the property to which it is said to relate would be held by a specified person under s 60H(1)(f).

### **Result**

[55] The appeal is dismissed.

### **Costs**

[56] The FMA has been successful in resisting the challenge to the decision of the High Court and costs should follow the event. We order that the Trustees pay the FMA costs for a complex appeal on a band A basis plus usual disbursements.

Solicitors:  
Lee Salmon Long, Auckland for Appellants  
Crown Law Office, Wellington for Respondent

## APPENDIX

### Relevant provisions from the Securities Act 1978

#### **60G When Court may prohibit payment or transfer of money, securities, or other property**

- (1) This section applies if—
  - (a) an investigation is being carried out under the Financial Markets Authority Act 2011 in relation to an act or omission by a person that—
    - (i) constitutes or may constitute a contravention of this Act; or
    - (ii) constitutes or may constitute a contravention of any other financial markets legislation in connection with an offer of securities to the public or securities offered to the public; or
    - (iii) may result in a prosecution or civil proceedings of the kind referred to in any of paragraphs (b) to (d) being begun against the person; or
  - (b) a prosecution has begun against a person for a contravention of—
    - (i) this Act; or
    - (ii) any other financial markets legislation in connection with an offer of securities to the public or securities offered to the public; or
  - (c) civil proceedings have begun against a person under, or in respect of,—
    - (i) this Act; or
    - (ii) any other financial markets legislation in connection with an offer of securities to the public or securities offered to the public; or
  - (d) civil proceedings have begun against a person, being proceedings that, in connection with an offer of securities to the public or securities offered to the public, seek damages or other relief for fraud, negligence, default, breach of duty, or other misconduct.
- (2) The Court may, on application by the FMA or by an aggrieved person, make 1 or more of the orders listed in section 60H if the Court considers it necessary or desirable to do so for the purpose of protecting the interests of an aggrieved person.
- (3) In this section and section 60H,—

**aggrieved person** means any person to whom a relevant person is liable

**civil proceedings** means proceedings in a court (other than criminal proceedings)

**financial markets legislation** has the same meaning as in section 4 of the Financial Markets Authority Act 2011

**liable** means liable, or may be or become liable, to pay money (whether in respect of a debt, by way of damages or compensation, or otherwise) or to account for securities or other property

**relevant person** means a person referred to in subsection (1).

#### **60H What orders may be made**

- (1) The orders that may be made under section 60G are—
- (a) an order prohibiting the relevant person from transferring, charging, or otherwise dealing with money, securities, or other property held or controlled by the relevant person:
  - (b) an order prohibiting a person who is indebted to the relevant person or to an associated person of the relevant person from making a payment in total or partial discharge of the debt to, or to another person at the direction or request of, the person to whom the debt is owed:
  - (c) an order prohibiting a person holding money, securities, or other property, on behalf of the relevant person, or on behalf of an associated person of the relevant person, from paying all or any of the money, or transferring, or otherwise parting with possession of, the securities or other property, to, or to another person at the direction or request of, the person on whose behalf the money, securities, or other property, is or are held:
  - (d) an order prohibiting the taking or sending out of New Zealand by a person of money of the relevant person or of an associated person of the relevant person:
  - (e) an order prohibiting the taking, sending, or transfer by a person of securities or other property of the relevant person, or of an associated person of the relevant person from a place in New Zealand to a place outside New Zealand (including the transfer of securities from a register in New Zealand to a register outside New Zealand):
  - (f) an order requiring the relevant person, or any person holding money, securities, or other property on behalf of the relevant person or an associated person of the relevant person, to pay or transfer money, securities, or other property to a specified person to be held on trust pending determination of the investigation, prosecution, or civil proceeding:
  - (g) an order appointing,—

- (i) if the relevant person is a natural person, a receiver or trustee, having any powers that the Court orders, of the property or of part of the property of that person; or
  - (ii) if the relevant person is a body corporate, a receiver or receiver and manager, having any powers that the Court orders, of the property or of part of the property of that person:
- (ga) an order—
- (i) removing a person from being a manager of a scheme to which the investigation, prosecution, or proceedings referred to in section 60G(1) relates; and
  - (ii) appointing another person as the manager of the scheme (with any powers that the court orders):
- (h) if the relevant person is a natural person, an order requiring that person to deliver up to the Court his or her passport and any other documents that the Court thinks fit:
- (i) if the relevant person is a natural person, an order prohibiting that person from leaving New Zealand, without the consent of the Court.
- (2) A reference in subsection (1)(e) or (g) to property of a person includes a reference to property that the person holds otherwise than as sole beneficial owner, for example,—
- (a) as trustee for, as nominee for, or otherwise on behalf of or on account of, another person; or
  - (b) in a fiduciary capacity.
- (3) An order may be expressed to operate for a specified period or until the order is discharged by a further order under this section.