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IN THE HIGH COURT OF NEW ZEALAND
HAMILTON REGISTRY

M.191/96

IN THE MATTER of the Trustee Act 1956

AND

IN THE MATTER of the estate of
MICHAEL JAMES O'DONOGHUE

Applicant

AND

IN THE MATTER of an application by
WALTER JOSEPH FARMER

Respondent

Hearing: 26 June 1997

Counsel:

Mr J E S Allen QC (for the applicant trustee)
Mr D J Taylor (for Health Waikato)
Mr H Roose (for the Te Aroha Charitable Trust) (and for certain local authorities who abide by the decision of the Court)
Ms J M Hardaker (for Ms O'Donoghue) (given leave to withdraw)
Mr C Q M Almao for the Attorney-General (given leave to withdraw)

ORAL JUDGMENT OF HAMMOND J

Solicitors: W G Broadbent & Co (for applicant)
Swarbrick Dixon, Hamilton (for Health Waikato)
Boot & Roose (for Te Aroha Charitable Trust)
McCaw Lewis Chapman (for Ms O'Donoghue)
Almao McAllen & Kellaway (for Attorney-General)

This is an application by a trustee for directions under s66 of the Trustee Act 1956.

Michael James O'Donoghue died on 12 December 1991. He left a last will dated 11 June 1979, and a first codicil dated 18 July 1983. Those testamentary dispositions were admitted to Probate on 23 December 1991. The trustee and executor is Walter Joseph Farmer, a retired Bank Manager of Waihou.

As at the date of his death, the assets in Mr O'Donoghue's estate were:

(a) Cash	168,200.67
(b) Furniture, effects, jewellery, private motor cars	25,000.00
(c) Farm stock, blood stock, farm implements, vehicles	2,300.00
(d) Real property	195,000.00
	$386,124.77

The scheme of the will was a series of specific bequests, followed by a bequest of the residue. There was a bequest of the deceased's life insurance policies to his sister; there was a gift of $10,000.00 to another person; and what was described as "the home farm," along with all the cows and equipment on that farm, were left to a third person.

The remainder of the estate (which included a second farm property of eighty-three acres at Waihou) devolved upon the trustee, with the usual direction to pay just debts and testamentary expenses and any duties, and to then hold the balance remaining:

> Upon trust for the Waikato Hospital Board for use by the said Board at its own discretion for the benefit of its geriatric hospital at Te Aroha. The receipt of the Treasurer of the said Board shall be a full and complete release to my Trustee.

It is common ground that, as at the date of the hearing, the value of the residue is approximately $700,000.00.

At the time of Mr O'Donoghue's death, the Waikato Hospital Board no longer existed. By operation of law, under the Area Health Boards Act 1983, all the assets of the Waikato Hospital Board had vested in the Waikato Area Health Board, from 1 June 1989. That was after the deceased had made the testamentary dispositions which have been admitted to Probate; but prior to his death.

The trustee was concerned that there might be an intestacy as to the residue. But, there also seems to have been a concern on the part of the trustee that the deceased's wish was that the residue of his estate be used for the benefit of a geriatric hospital, but that Health Waikato may have been intending to withdraw from the provision of geriatric services in Te Aroha, thereby frustrating what the trustee perceived to be the testator's wishes.

There was, therefore, an exchange of correspondence between the advisers to the Hospital enterprise (in its various legal forms) and the estate's solicitors. The Board's solicitors endeavoured to satisfy the trustee that Health Waikato was the legitimate statutory successor to the Waikato Hospital Board; and that the deceased's wishes were not in fact going to be thwarted.

The trustee was not satisfied. Health Waikato applied for summary judgment. That application was adjourned *sine die* when this application was brought by the trustee. The directions sought by the trustee are laconic, viz:

a) directions from this Honourable Court as to the destination of the residue of the deceased's estate;

b) an order that the applicant's solicitor and client costs in relation to these proceedings be paid out of the estate.

Notwithstanding the breath of the directions sought, it seems clear that there are two issues of concern to the trustee. The first is whether there is an intestacy as to residue insofar as it is suggested there is no statutory successor to the Waikato Hospital Board. The second is whether this charitable bequest is somehow "frustrated," to use Mr Allen's terminology.

Before I give my view of the legal position with respect to these questions, I should make plain the scheme whereby Health Waikato intends to employ these funds of several hundred thousand dollars. This scheme is fully attested to in the affidavits filed on behalf of Health Waikato.

Health Waikato argues that it is the statutory successor to the Waikato Hospital Board. It would, therefore, receive the $700,000.00, as trustee. There is an existing charitable trust associated with Health Waikato: the Health Waikato Charitable Trust. That is an umbrella trust for charitable purposes of a medical character in the Waikato. The funds of various bequests are kept separate and accounted for quite distinctly. By deed, the Health Waikato Charitable Trust would assume the role of trustee of the O'Donoghue bequest. No Court approval would be required for this. The Health Waikato Charitable Trust would then advance these funds to Health Waikato Ltd for capital improvements at the Te Aroha geriatric hospital. That would be within the objects of the Trust. Health Waikato Ltd will pay market interest to the Health Waikato Charitable Trust for the use of the funds. Health Waikato Ltd will lease the hospital to a community charitable trust, to run it at a market rental. In the event that the hospital is ever sold, the loan from that charitable trust to Health Waikato would then be repaid, and the capital would be returned to the Health Waikato Charitable Trust. It is quite unlikely that the hospital will be

sold in the near future. In the event that the O'Donoghue capital was returned to the Waikato Health Charitable Trust, it would be necessary to reapply it in a further scheme of a similar character to benefit this locality; and any such scheme would need to be approved by this Court.

Against this background, the legal position in this estate is very clear; and has been so since a very early date. A will speaks from the date of death. As at the date of his death, the testator had made a charitable bequest. The geriatric hospital it was intended to benefit was operating at that time, is operating now, and will continue to operate for the foreseeable future. The only question arising was whether there was a statutory successor to the Waikato Hospital Board. But even if there was not, the bequest would still not fail, for this Court will never allow a bequest of this kind to fail for want of a trustee.

The latter issue, however, in my view did not arise: for, on my reading of the legislation, it is quite plain that Health Waikato Ltd is the statutory successor to the Waikato Hospital Board. The relevant legislative chain is to be found in the Waikato Area Health District Order 1989 (SR 1980/22); the Area Health Boards Act 1983 (s7); the Health Reform (Transitional Provisions) Act 1993 (s5); the Health Reform (Transfer of Assets and Liabilities) Order 1993 (SR 1993/194) and the subsequent amendment No. 1 thereto (SR 1993/358).

I have no difficulty in finding that Health Waikato Ltd was the statutory successor to the Waikato Hospital Board, and that the bequest is in no way "frustrated". Accordingly, I make a declaration that Health Waikato Ltd is the statutory successor to the Waikato Hospital Board for the purposes of this bequest and is entitled to the residue of the estate of the late Mr O'Donoghue, on trust, for the stated purpose in the will.

The real difficulty in the case is that of costs. Mr Taylor has argued that this is one of those rare cases in which a trustee should not be entitled to indemnity for any costs in these proceedings out of the estate, but should have to bear them personally. Indeed, Mr Taylor goes further, and says that the trustee should pay the costs of Health Waikato, both in these proceedings and in the summary judgment proceedings (CP30/96 Hamilton Registry), and, perhaps, those of the other parties who have entered appearances. Mr Taylor concedes that the trustee was entitled to seek - as he did -particulars of the legislative title of Health Waikato; and to have assurances as to the future of the geriatric hospital in Te Aroha. But, he says,by (at least) the end of 1995 the trustee had had all the necessary information. And, there was no impediment to the distribution of the estate past (at least) September 1994.

Before turning to the facts of this particular case, I think it appropriate to set out the law, as I understand it to be, on this issue. It would be an unfair, and unworkable system of trustee law, if trustees were not permitted to recover out of pocket expenses incurred in the discharge of their duties. Since, at least, the decision of Lord Eldon LC in ***Worrall v Harford*** (1802) 8 VES 4 at 8; 32 ER at 250, it has been the law that, "it is in the nature of the office of trustee, whether expressed in the instrument or not, that the trust property shall reimburse him all the charges and expenses incurred in the execution of the trust. "

All Commonwealth jurisdictions now have an express statutory provision reflecting the concept originally evolved by Chancery Judges. In New Zealand that provision is s38(2) of the Trustee Act 1956 which provides:

> A trustee may reimburse himself or pay or discharge out of the trust property all expenses reasonably incurred in or about the execution of the trusts or powers; but, except as provided in this Act or any other Act or as agreed by the persons beneficially interested under the trust, no trustee shall be allowed the costs of any professional services performed by him in the execution of the trusts or powers

unless the contrary is expressly declared by the instrument creating the trust:

Provided that the Court may on the application of the trustee allow such costs as in the circumstances seem just.

The United Kingdom provision is s30(2) of the Trustee Act 1925, which provides, "A trustee may reimburse himself or pay or discharge out of the trust provisions all expenses incurred in or about the execution of the trust or powers."

The essential concept in both the United Kingdom, and New Zealand, is that of reimbursement. The trustee discharges costs, expenses and even liabilities and then recovers them from the trust property. This is not to suggest that a trustee must always meet these expenses; in practice trustees routinely make payments out of funds readily available from the trust. But of course, all such payments have to be justified on the indemnification principle. The consequence of this general principle is that it is the beneficiaries who are meeting the trustee's expenses. It follows that it is critical that there be a check on those expenses and costs incurred by a trustee.

The classical Chancery principle was, from the outset, that it is only expenses which are "properly incurred" which are the subject of a trustee's indemnity. The authority most often cited for this is *Re Beddoe* (1883) 1 CH 547 at 558; but the principle still obtains today - see *Holding & Management Ltd v Property Holding & Investment Trust PLC* [1990] 1 All ER 938 (CA). The direct consequence of this principle is that improperly incurred expenses fall upon a trustee personally. In that sense, a trustee is always at risk when he or she incurs expenses.

There is a respectable volume of case law authority around in the British Commonwealth as to what may be regarded as "not improperly incurred expenses". Necessarily, given the principle, these cases all appear to

be determinations on the factual position arising in a particular case. But the principle that expenses must be properly incurred necessarily requires a trustee, if called upon, to demonstrate that the expenses arose out of an act falling within the scope of his trusteeship; whether it was something that his or her obligations required the Trustee to undertake; and whether the expense incurred was, in all the circumstances," reasonable".

Support for this latter proposition appears directly from the authority of the very experienced chancery judges in ***Freeman v Parker*** (1895), 72 LT 67 (CA), which was cited to me by Mr Taylor. See, for instance, Lindley LJ at p68:

> The trustee may be honest, and yet, for over caution or some other cause, he may act unreasonably; and if, as in this case, his conduct is so unreasonable as to be vexatious, oppressive, or otherwise wholly unjustifiable, he thereby causes his cestuis qui trust expense which would not otherwise have been incurred, the trustee must bear such expense, and it ought not to be thrown on the trust estate or on his cestuis qui trust ...

The notion that a trustee must act "reasonably" is necessarily qualified in various ways. First, it has never been thought unreasonable for a trustee to hire a properly qualified person to carry out work which the trustee is not qualified to undertake. Second, the trustee does not have a limitless ability to resort to the law: his function is to assert the interest of the beneficiaries only to a point where there is a judicial ruling on something that is properly required, such as the construction of a fairly debatable point in an instrument, or whether the trustee ought to take a certain course. And, it has been said that a trustee has to have very good grounds before that trustee can justify an appeal, especially if costs were awarded against the estate in the court below (see for instance *Smith v Beale* (1894) 25 OR 368 (CA)). Third, a trustee is not entitled to expenses arising out of his own misconduct.

Finally, on the law under this head, it must surely be the case that where, on the face of things, the trustee's actions appear regular enough the burden of proving unreasonableness falls on the party alleging the same. There are cases in the books where the onus has been discharged. See, for instance, *Re Knox's Trusts* [1895] 2 CH 483. There, the English Court of Appeal thought the scheme of the particular estate was "a simple one, and the trustee ought to have concurred in it and not tried to thwart it" per Lindley LJ at 487.

In my view, the trustee has proceeded in an unreasonable manner in this estate, and in these proceedings vis a vis Health Waikato. If I had thought that there was a reasonably arguable case about the succession point, my view would likely have been different. But there was not. The legislation is quite plain. The trustee and his advisers could have done the exercise of locating the legislation for themselves. They had a duty to: a trustee must properly inform himself. But they did not: they asked to be spoon-fed by the Hospital's advisers. Then, even when chapter and verse were rehearsed, they still declined to move. Why?

The reason is quite plain: the trustee did not trust Health Waikato. He says as much in his own affidavit in these proceedings. He formed the quite unfounded and irrational view that Health Waikato might, having got its hands on the funds, abandon the geriatric hospital. This, of course, is simply nonsense. A trustee has an obligation to inform himself of the relevant law: Mr Farmer must have been advised that Health Waikato had an obligation to act in terms of the trust which devolved upon it. And, there are ample mechanisms in our trustee law to ensure that it does so. This, then, is a case in which a trustee has acted from an improper collateral motive. As such, he cannot claim indemnity, and, perhaps, should reimburse those to whom he has caused loss.

For completeness, I must add that Mr Allen was well aware of the nature of Mr Taylor's submissions on costs; they were circulated prior to the hearing. Yet, no affidavit or other evidence was forthcoming on this serious

issue on Mr Farmer's behalf to endeavour to persuade me to any other position. All that Mr Allen said in closing was "that he must resist any application for costs against the trustee." No reference was made to the facts; or any authorities. All he said was that this was not a simple case.

A court will naturally hesitate before leaving a trustee, who, after all, shoulders an onerous burden, to carry costs personally. But I am afraid that this is such a case: I can see no proper reason for the Trustee having adopted the obdurate position he did. He acted unreasonably in the sense that I can discern no proper justification, or even a reasonably arguable one, for his having persisted in forcing Health Waikato up to a full defended hearing, and a delayed distribution of some years of the estate. It cannot be right that he should then seek to off-load his costs of the proceeding onto the residuary beneficiary. There will, therefore, be an order that the trustee is not entitled to indemnity from the estate for his costs or disbursements in these proceedings.

Should he meet the costs of Health Waikato? There is no doubt the trustee has caused loss to Health Waikato (in the sense of legal costs, and the loss of use of the assets). But, the value of the estate has escalated sharply through a rise in land values in the Waikato. Health Waikato will receive that benefit. Although an order would be justified, I am left with a sense that at least some of the responsibility for this unfortunate chain of events rests with the advisers to the trustee. There will, therefore, be no order under this head in favour of Health Waikato. If I had made an order, it would have been for solicitor and client costs, as taxed.

As to the costs of the other parties, they will come from the estate. Counsel may submit memoranda, within fourteen days of today's date.

If there is any difficulty in settling an order, counsel can see me in chambers.

It ought not be necessary, but I remind the trustee that he now has a distinct responsibility to distribute the residue promptly. The hospital is beingkept out of its money.

B. Hammond.