

Trustee's minute of meeting evidences bad faith

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The failure of a discretionary trustee to give real and genuine consideration in their decision-making, and to act in good faith and for proper purpose, invalidated a distribution decision.

*Trani v Trani*¹ defies all odds. The legal principles are simple and yet rare to be applied successfully.

The facts are trite. Patrizia Trani lost control of a conventional discretionary trust to her brothers, Luciano and Marco Trani. The trust was passed to the siblings by their parents on the understanding that the trust benefit the three siblings equally. Following a disagreement, Luciano and Marco ejected Patrizia from control, liquidated the valuable real estate owned by the trust, and distributed the trust capital equally to themselves to the exclusion of Patrizia.

Private client advisers witness this scenario increasingly repeating itself in this era of entitlement and confidence.

The usual advice given to those in Patrizia's situation is two-fold.

First, unless there is a defect in the paperwork ejecting Patrizia from control or benefit, there is little that can be done to recover control or to include her in the distribution. Proving that there are defects in the paperwork is difficult and rather rare. Michael Norbury examined this in detail in the June issue of this journal,² so it is unnecessary to go over these principles again here.

Second, if Luciano and Marco, as fiduciaries, acted in bad faith or for an improper purpose in excluding Patrizia, she may be entitled to reinstatement or a share of the distribution. Even though this is almost always entirely true in every case (why else wouldn't Luciano and Marco give their sister a third of the proceeds like their parents intended), it is almost always entirely impossible to prove (because discretionary trustees have a right to confidentiality over their reasons for decisions).

Patrizia succeeded on both counts, but it was the latter that brought her a share in the distribution.

Key persons in the conventional discretionary trust

The Gino and Caterina Trani Family Trust was a conventional discretionary trust, of which Latina Investments Pty Ltd (Latina) was the trustee. Latina had wide and unfettered powers and discretions.

The siblings were:

- primary beneficiaries;
- appointers with the power to remove the trustee; and
- directors of Latina.

For reasons unknown, Luciano was the sole shareholder.

Ejecting from control and excluding from distribution

The first procedural step in divesting Patrizia of any control was taken by Luciano, as the sole shareholder of Latina, removing Patrizia as a director of Latina. This step could not be impeached by Patrizia.

Even though Patrizia was one of the appointers, she needed her brothers' consent in order to remove Latina as trustee. So, from that point on, Patrizia was powerless.

After that, in their capacity as the sole directors of Latina, Luciano and Marco liquidated all of the trust assets and resolved to distribute the trust fund equally to themselves as beneficiaries.

The affairs of the trust were then wound up, the trust vested, and Latina deregistered.

First, impeaching the paperwork

Patrizia was able to impeach some of the paperwork giving effect to these decisions. However, on Luciano and Marco's request, the court rectified the

clerical or administrative shortcomings of the paperwork based on the principles that rectification is available where the intention is clear. The rectification validated the acts, so Patrizia could not recover control of the trust or share in the trust fund on this basis. The first 60 pages of the judgment are about this.

Second, fiduciary breaches

Patrizia succeeded in her claim that her exclusion from distribution by Marco and Luciano was in bad faith and for an improper purpose, and, therefore, was a breach of Latina's fiduciary duties owed to Patrizia.

It was found that Marco and Luciano knowingly assisted Latina in its breaches of trust and fiduciary duty (ie caused Latina to do so) and received the funds from Latina with that knowledge, therefore, holding a third of the funds on trust for Patrizia.³

Hurdles overcome by Patrizia

The miracle of Patrizia's case was that she was able to prove bad faith and improper purpose based on circumstantial evidence only.

Latina, as a discretionary trustee, was entitled to immunity for its reasons in the making of the decisions.⁴ In other words, Latina could not be forced to disclose its reasons for, or the reasoning process in, deciding to exclude Patrizia from a benefit.⁵ No negative inference may be drawn from Latina's unwillingness to give up this immunity.

Not only are Latina's (like any discretionary trustee's) reasons and processes secret, but also the court role is not to review Latina's exercise of discretion where the trustees have acted "in good faith, upon real and genuine consideration and in accordance with the purposes for which

the discretion is conferred”,⁶ but only to review whether Latina actively examined the necessary information and whether the attitude applied to the analysis was open-minded and for the purpose imposed on it.

The court cannot examine the evidence to decide whether Latina’s decision was good or bad, fair or unfair, wise or unwise, reasonable or unreasonable. The existing authorities only impugn the exercise of trustee discretion for bad faith, arbitrariness, capriciousness, irrelevancy, mischievousness, recklessness or malice in respect of the settlor’s expectations.⁷ Patrizia had to impeach Latina’s discretionary decision relying on the following principles:⁸

- “(a) mere carelessness or honest blundering will not negative good faith;^[9]
- (b) a trustee is not required to observe the rules of natural justice;^[10]
- (c) a trustee must take an informed view of whether or not to exercise their discretion;^[11]
- (d) a trustee must not act irresponsibly, capriciously, or wantonly, or for any ulterior purpose;^[12]
- (e) while it is not the role of the Court to consider whether an exercise of discretion is fair or reasonable, a grotesquely unreasonable result may be evidence of a breach of duty;^[13]
- (f) the discretion must be exercised with an absence of indirect motive, with honesty of intention, and a fair consideration of the issues;^[14]
- (g) what amounts to bad faith includes, but goes beyond fraud, to include a refusal to make an informed decision, making a decision for an ulterior motive or purpose, and a failure to take relevant considerations into account;^[15]
- (h) the Court will presume that a trustee has exercised their discretion with propriety, and the onus of proving any bad faith on the part of a trustee rests with the party seeking to challenge the exercise of discretion;^[16] and
- (i) notwithstanding the above, the Courts may be prepared to review the exercise of a trustee’s discretion not only having regard to the reasons of the trustee (if available), but also the objective consequences of the decision upon the beneficiaries of the trust.^{[17]”}

Given these principles, only circumstantial evidence¹⁸ was available to Patrizia to prove that the decisions were made in bad faith and for an improper purpose. Because obtaining sufficient circumstantial evidence

is rare, cases challenging discretionary trustees’ exercise of discretion are rare, only a handful are reported judgments, and even fewer successful.

Circumstantial evidence of bad faith and improper purpose

Patrizia led extensive evidence about the irretrievable breakdown of the relationship between her, on the one hand, and her brothers, on the other. The relationship was damaged to such a point that the brothers were willing to hurt the trust and themselves just to hurt Patrizia. For example, the business of Patrizia’s de facto partner occupied one of the properties owned by Latina. The partner offered to buy the property from Latina for \$550,000, but this offer was rejected, and Latina later sold the property on the open market for \$100,000 less.

Apart from this example, there was other extensive evidence of the brothers’ unreasonable and detrimental conduct powered by animosity towards Patrizia.

Patrizia was able to show that, until the falling out in approximately 2013, the brothers had accepted that the trust was intended to benefit all three siblings as per the parents’ legacy.

So, although, Marco and Luciano had a right to and, in fact, did refuse to give reasons for why they exercised their discretion to exclude Patrizia,¹⁹ Patrizia’s evidence made it clear that there was no alternative view but to conclude that she had not been genuinely considered for a distribution and had been excluded from it because of the bad blood between the siblings. This was bad faith and exercise of discretion for an improper purpose.

A lot of time was spent at the trial examining the minute of the meeting which recorded Latina’s distribution decision. It was a short standard minute of the meeting completed by Latina’s accountant. Patrizia’s counsel cross-examined Marco and Luciano about the process of creation of the minute and the procedure followed at the meeting of directors of which the minute was meant to be an accurate record.

The minute appeared to be contrived; although it said all the right things, it did not actually reflect the decision-making process or what transpired at the meeting. Not only did Marco and Luciano make the decision to distribute to themselves to the exclusion of all others, well in advance of the meeting itself (despite the minute

saying that the decision was made at the meeting), but also Marco and Luciano never tabled or considered the trust deed or other beneficiaries of the trust (despite the minute saying that the directors had done that). The falsity of the minute brought into question whether Latina gave wide, real and genuine consideration to all of the issues which a discretionary trustee should give when making a decision to distribute the trust fund and wind up the trust.

Latina’s accountant gave evidence about the veracity of the resolution to distribute to Marco and Luciano. He was cross-examined about:

- the processes he followed at the meeting of the directors in creating the resolution and authenticating it with the directors;
- the clerical error in distribution amounts in the resolution and other oversights;²⁰ and
- whether he had asked Marco and Luciano to consider Patrizia (or anybody else) for a distribution.²¹

The accountant’s evidence was that the resolution was “simply read aloud at the meeting and that no actual discussion of the issues [such as who to distribute to and why] occurred at that time. The minute took only a couple of minutes”.²²

The court said:²³

“While I would not go so far as to describe the ... minute as a ‘ruse’, as was suggested by counsel for Patrizia, it is abundantly clear that the ... minute was prepared by lawyers sensitive to the obligations upon a trustee in the position and circumstances of Latina, in the event that the decisions made that day were later scrutinised (as they were). However, the attempt to convey an impression that a fulsome discussion about the decision to distribute the trust funds during the course of the meeting ultimately did not stand up to scrutiny.”

Moreover, the brothers damaged their own credibility by implausibly denying the animosity. The court also found that the brothers “were careful to avoid giving fulsome and meaningful answers to difficult questions. Luciano in particular gave evasive and at times self-serving evidence”.²³

The court also took into account the haste with which Marco and Luciano wound up the trust, which the court found was an indication of a guilty conscience.

Consequently, the court accepted that Latina failed “to give proper consideration

to the interests and entitlements of the other beneficiaries ..., especially Patrizia”²⁴ and that Latina’s decision to distribute the trust fund to “Marco and Luciano was motivated by [Marco and Luciano’s] animosity towards [Patrizia] and their desire to enrich themselves at her expense”.²⁴

This was sufficient for the court to find that Latina’s decision was made in bad faith and for an improper purpose,²⁵ and therefore invalid.²⁶ Applying the equitable principles (discussion of which is beyond the scope of this column), the court declared that Marco and Luciano hold a third of the trust fund on a constructive trust for Patrizia and were required to pay it over to her.

Conclusion

The judgment elucidates that discretionary trustees are not omnipotent, despite the popular misconception. Trustees are subject to onerous and honourable fiduciary duties and the court has an inherent jurisdiction to supervise and intervene. It is a reminder that trustees cannot be audacious or smug in their decisions or conduct.

The judgment is valuable to the future “Marcos” and “Lucianos”, as it may bring them to their senses.

For the future “Patrizias”, this case will assist in negotiations with the trustees to bring to their attention their duties and obligations, and that “Patrizias” sometimes do succeed in their claims and trustees held accountable.

The case is instructive to lawyers and accountants when drafting resolutions and minutes of meetings:

- the minute must be an accurate record of what transpired at the meeting and not in any way contrived;
- the meeting itself must cover the essentials of trustee duties and obligations. In other words, the trust deed and beneficiaries must be considered, a wide range of other information should be considered, and trustees must conduct themselves as fiduciaries;
- the reasons for decisions should not be recorded in the minute; and
- the minute must be carefully drafted — complying with legal principles, but also clerical error free.

The case also reminds estate planners to check the structure of the trust. Disaster could have been averted if the parents had

been properly advised at the time control of the trust was passed to the siblings or if the siblings checked the structure while everybody was getting on well. Luciano should not have been the sole shareholder. If he was, then an independent person should have been the appointer of the trust to monitor the activity of Latina.

Irreparable financial and emotional damage comes from bad planning or no planning.

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- 4 *Curwen v Vanbreck Pty Ltd* [2009] VSCA 284; *Mandie v Memart Nominees Pty Ltd* [2014] VSC 290; *Cohen v Amberley Corporation Australia Pty Ltd* [2016] VSC 140.
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- 6 *Trani* at [176].
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- 21 *Trani* at [91].
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- 26 *Trani* at [219].



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