



## HONG KONG DISPUTE RESOLUTION E-BULLETIN

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It is a common mistake for people to think that trusts operate in the same way as companies. In fact, there are key differences which can trip up the unwary. Also, those who deal with trust property may find they have responsibilities of which they were unaware. At recent client briefings in Hong Kong and Singapore, Richard Norridge (Partner and Head of Private Wealth – Asia) and Joanna Caen (Registered Foreign Lawyer (New Zealand)) highlighted some of the risks.

#### INTRODUCTION

Although it may just seem like a legal nicety, the fact that a trust is not a legal entity has significant consequences. A trust is an arrangement whereby trustees have legal ownership of assets, but hold them for the benefit of another group of people (the beneficiaries). This structure can pose challenges for third parties in their interactions with the "trust". In particular, dealings are with the trustees in their personal capacity and a third party may have limited recourse to trust property. Trustees have strict fiduciary duties and a third party who assists the trustees to breach these duties may be liable for dishonest assistance.

All in all, a high degree of care is needed for all dealings with trustees and trust property. Some of the key issues are set out below.

#### COUNTERPARTY RISK

##### Who are you dealing with?

A trust cannot contract in its own right like a company can. Any contract is therefore made with the trustee(s) in their personal capacity.

##### What recourse will you have in the event of a default?

A counterparty will only have recourse to the trust fund in certain circumstances. If an agreement is not validly made and binding, it cannot be enforced against the trust fund (see the recent New Zealand decision in *WT Trustee Company Ltd v Cato* [2014] NZHC 994 in which a property contract could not be enforced because not all the trustees signed it).

In the event of a default, recourse will generally be against the trustee. A trustee may be entitled to be indemnified from the trust assets. However, this protection can be lost if the trustee breaches his obligations to the trust. In those circumstances the counterparty may

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Greater China

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not recover fully if the trustee does not have sufficient personal assets.

#### **What happens if the trustee acts outside his capacity or without authorization?**

The counterparty will need to consider whether or not the trustee has the capacity to enter into the agreement, both personally and under the trust deed. He will also need to consider whether the trustee was duly authorized to act as he did.

The unanimity rule is one example in this context. This requires trustees to act unanimously unless the trust deed provides otherwise. In *Fielden v Christie Miller* [2015] the trustees successfully resisted a claim for proprietary estoppel because of the unanimity rule. The Court agreed with the trustees that representations made by one trustee could not bind trust property because they were not made by or on behalf of all the trustees.

#### **And what about breach of equitable duties?**

Actions may also be invalid if they constitute a breach of equitable duties such as observing the reasonable prudent man of business rule. It can be very difficult for a counterparty to establish whether or not a trustee is acting in accordance with its equitable duty, and so there is a risk that even prudent counterparties could unwittingly find themselves in a position where they cannot enforce a contract.

A trustee will usually have an indemnity against the trust fund and in some circumstances creditors will have the right of subrogation, meaning that they can stand in the shoes of the trustee and have the same recourse to the trust fund. This will be useful if the trustee has limited personal assets. A lack of capacity or a breach of equitable duties will impair the trustee's right to access this indemnity. As under subrogation the creditor cannot be placed in a better position than the trustee, the creditor may be prevented from recovering as against the trust fund because of circumstances that may be completely unknown to them. This can create unjust outcomes whereby the beneficiaries benefit by a trustee's default and a creditor does not have recourse from the fund.

#### **DISHONEST ASSISTANCE IN A TRUST CONTEXT**

In order to prove dishonest assistance, the beneficiary must establish that: there was a trust in their favour; that there had been a breach of the trust; that defendant had assisted in the breach; and that it had acted dishonestly in so doing. This can cause significant risks for any person who facilitates a breach of trust by a trustee. Two recent cases illustrate this point.

#### ***Fletcher v Eden Refuge Trust CA 212/2010 [2012] NZCA 124***

##### **Can you be liable for dishonest assistance even if you don't personally benefit?**

There is no requirement that an advisor who facilitates a breach of trust must benefit from such breach to be found liable for dishonest assistance. *Fletcher v Eden Refuge Trust* concerned a solicitor. Charles Fletcher represented a trustee of a charity, Mr Hohepa. Mr Fletcher loaned trust assets to Mr Hohepa, even though Mr Fletcher knew that Mr Hohepa was struggling to pay basic bills and was out of the country. Mr Fletcher was found liable for dishonest assistance.

He appealed on the grounds that the judge had failed to consider his motivations for assisting Mr Hohepa and had failed to accept that as Mr Hohepa's lawyer he had a duty to follow his client's instructions. The Court dismissed the appeal. It held that the evidence established sufficiently strong suspicions of breach of trust by Mr Hohepa that it was dishonest of Mr Fletcher not to enquire into Mr Hohepa's application of trust property.

##### **What are the consequences of liability for dishonest assistance?**

Even though he had not personally gained, the personal consequences

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for Mr Fletcher were disastrous. He was suspended by the New Zealand Lawyers' and Conveyancers' Tribunal (who said that he only narrowly escaped being struck off). Indemnity costs were given against him even though they had not been sought. He had no insurance cover. His total personal liability totalled NZ\$1.3m (around HK\$7.3m). The case is an illustration of the risks of becoming involved in a breach of trust, even if the adviser has no personal interest in the misappropriated funds.

#### ***Nolan v Minerva Trust [2014] JRC078A***

#### **Can dishonest assistance arise in the context of a constructive trust?**

In *Nolan v Minerva Trust*, a fraudster (Mr Walsh) had absconded with funds belonging to the plaintiffs. Because Mr Walsh had absconded and the plaintiffs recognized that it was futile to pursue him, they brought a claim against his financial management company, Minerva. The plaintiffs alleged that Minerva had dishonestly assisted Mr Walsh in breaching a trust owed to them. They successfully proved the necessary elements in respect of some of their claims.

#### **What is meant by dishonesty?**

The Court considered the requirement for dishonesty at some length. It applied *Cunningham v Cunningham* [2009] JLR 227 and held that the test for dishonesty was objective. In other words, it did not matter whether the defendant had considered his behavior to be dishonest. The key was that he was conscious of "*those elements of the transaction which made participation transgress ordinary standards of honest behaviour*".

Dishonesty was established on the basis that Minerva had blindly obeyed Mr Walsh's instructions. This had included misrepresenting the source of instructions; allowing expenditure from company accounts for Mr Walsh's personal benefit; keeping the fact and source of large sums of cash secret; accepting large sums on the basis of commercially implausible explanations; and following Mr Walsh's instructions not to provide the Nolans with documentation when the Nolans requested those documents.

#### **What were the consequences for Minerva?**

No individual at Minerva was found personally liable for dishonest assistance, but the company was liable to the plaintiffs in the amount of GBP 4,657,074.25 and EUR 8,398,000.

#### **CONCLUSIONS**

- Exercise caution when contracting with a trustee. Be aware that recourse against trust funds may be limited so further protections may be required such as taking a charge over trust property.
- There are potentially devastating consequences for advisers who facilitate a breach of trust. Always be conscious of the potential for and consequences of breach of fiduciary duties.

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