Trustees – The Challenges of Incapacity

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Challenges when acting for a trustee/ appointor of questionable competence

From time to time lawyers will have trustee/ appointor clients who appear to be or becoming of diminished capacity. It is not uncommon for persons with diminished capacity to refuse to accept their state of mind. In some cases, the mere suggestion of a medical examination will be met with resistance. There is no one size fits all solution here. Each case will present its own unique facts and challenges.

The sorts of questions that should raise alarm bells for a legal advisor as to an appointor/ trustees capacity, might be as follows:

- The name(s) of the trust(s) of which he/she is a trustee;
- In general terms, the nature and extent of property of the trust(s);
- The name(s) of other trustees and the primary beneficiaries;
- An overview of the sort of decisions he/she may typically be called upon to make as a trustee; and
- Whether or not he/she wishes to resign so that another trustee may be appointed.

There can be serious ethical and professional challenges facing advisors in these circumstances. Not only is he/ she on notice to proceed with caution because of the possibility of diminished capacity, but also, in practical terms, how best to proceed if faced with a seemingly hostile trustee/ appointor. Absent that, obtaining a medical assessment is reasonably straight forward provided it is done properly. See below.

When faced with a hostile appointor / trustee, some comfort can be taken in the knowledge that, in limited circumstances, the rules of professional conduct will permit a lawyer to make disclosure to third parties (i.e. family and/ or health professionals), without risk that he or she may be in breach of standard professional obligations and responsibilities.

The Lawyers and Conveyancers Act (Lawyers: Conduct and Client Care) Rules 2008

Rule 8.2(b) of the Lawyers and Conveyancers Act (Lawyers: Conduct and Client Care) Rules 2008 ("**the Rules**"), ***requires*** that a lawyer disclose confidential information where, among other things:

> … the lawyer reasonably believes that a disclosure is necessary to prevent a serious risk to the health or safety of any person.

Rule 8.4(c) of the Rules ***permits*** disclosure of confidential information in circumstances where, among other things, it is necessary to protect the interests of the client in circumstances where, due to incapacity, the client is unable effectively to protect his or her own interests.

The role of health professionals

Where capacity is in question, a medical assessment should be sought, but to be meaningful, the process needs to be thorough. All too often requests for a certificate as to capacity result in a Doctor writing a letter or providing one of the standard certificates required under the PPPR

Act – neither is particularly helpful in relation to the question of competence to continue acting as an appointor / trustee. Where possible, a specialist assessment should be sought.

In the leading case of *Green v Green* **[already referred to by Juliet]** the plaintiff called three expert witnesses – two psychiatrists and a psychogeriatrician – about matters they considered relevant in determining Mr. Green's likely capacity during the critical period in question. Because there had been no medical assessment as to Mr. Green's medical capacity during critical periods of time, their evidence was based upon a reconstruction of his medical records, and in some cases, the observations of family members. At [190] Winklemann J said:[1]

> ***It would clearly have been prudent, as most of the medical witnesses conceded, to have organised an assessment of Hugh's capacity before he executed any document with legal effect.[2]***

Dr Bede McIvor, a consultant psychiatrist and psychogeriatrician - one of the three experts called to give evidence in the Green case - earlier opined at an NZLS Trusts Conference, that the legal test for "capacity" is comparable to the general medical concept of "competency". He said:

> ***The shared factors include communicating choices, understanding the situation, and foreseeing the consequences of the decisions in respect of the matters that the person must make decisions about.[3]***

At a seminar, held earlier this month, principally for lawyers, Dr Jane Casey, a leading psychiatrist and psychogeriatrician spoke to what doctors consider in the assessment of capacity[4]. She said that a capable person knows the ***context*** of the decision at hand, the ***choices*** available and appreciates the ***consequences*** of these specific choices. She went on to opine that the greater the complexity or conflict within the decision makers environment, the higher the level of cognitive function or emotional stability likely to be necessary for the person to be considered capable.

Albeit in the context of one's capacity to make a will, Dr Casey neatly summarized the position as follows, which, in my view, has equal application to assessing the capacity of an appointor/ trustee in the circumstances of Bob:

> ***"Can this particular person with their particular mental abilities, in this particular situation, make this particular Will at this particular time"***

In an ideal world, if Bob is willing to consent to a medical assessment, it would proceed as follows, according to Dr Casey:

i. First, in close proximity to the relevant decision(s) / task(s);

ii. Secondly, in circumstances where:

   (a) The subject person consents;

   (b) Is interviewed alone;

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[1] *Green v Green* [2015] NZHC 1218 at [190].

[2] *Woodward v Smith* [2009] NZCA 215.

[3] Dr Bede McIvor "The Medical Approach to the Assessment of Capacity" (paper presented to New Zealand Law Society Trusts Conference, June 2011).

[4] Wills and Estate Conference, Auckland, Thursday 6 September 2018 Legalwise, Pty Limited.

(c) There is transparency as to the assessment process and where all relevant information is made available to the assessor, including full medical history, mental and cognitive state examinations;

(d) Where the assessor is able to form an understanding of any conflicts/tensions in the subject persons environment – whether that be of a legal, personal or family nature; and

(e) Where there can be an assessment of the consistency or otherwise of the subject persons expressed wishes against the decisions/ tasks in question.

But real difficulties arise in circumstances where the subject person is hostile and refuses to be assessed much less accept the need to do so and/ or is being enabled by close family members, as is the position in the case study.

In these circumstances the specialist might be called upon to undertake a "virtual assessment" – one which involves no direct contact with the subject and limited or no contact with close family. The outcome may be poor, providing insufficient evidence to support an application to Court for removal. Each case will be assessed on its own merits and facts.

Indeed, it is quite possible that, in circumstances where there is hostility by a trustee appointor and his/her family to an assessment, the resulting deadlock will, in and of itself, likely support an application to Court for removal on grounds that the trust has become dysfunctional.

Power to appoint and remove with Court assistance

Application for directions – ss 66 and 69 Trustee Act

In circumstances where the trustees are in disagreement as to an appropriate course of action – as is the position in the case study - it would be prudent for the independent trustee/ advisor, who has concerns as to the appointor/ trustee's diminished capacity, to make an application to the High Court for directions under s 66 of the Trustee Act.

Section 66 provides that:

> ***"any trustee may apply to the Court for direction concerning any property subject to a trust or respecting the management or administration of any such property, or respecting the exercise of any power of discretion vested in the trustee"***

Section 69 provides that:

> ***"any trustee acting under any direction of the Court shall be deemed, so far as regards his own responsibility, to have discharged his duty as such trustee in the subject matter of the direction, notwithstanding that the order giving the direction is [subsequently] invalidated, overruled, set aside or otherwise rendered of no effect"***

It follows that an independent trustee/ advisor who brings an application for removal of a trustee, without the prior sanction of the Court, is taking a huge risk that he/ she will be exposed to personal costs by being deprived of the normal indemnity that would cover costs reasonably and properly incurred.[5]

Carmine v Ritchie is a good illustration of a case where an independent trustee/ advisor, Mr. Carmine, challenged the validity of a decision to remove him as trustee/ appointor, without first seeking the sanction of the Court to do so. He failed in his action and then sought to recover

[5] *Carmine v Ritchie & Ors* [2012] NZHC 2279.

his costs from the Trust assets. Correspondingly, the trustees sought costs against him. In its cost decision, the Court said:

> ***"A trustee should not actively challenge the validity of his or her removal unless directed to do so by the Court. A trustee who unsuccessfully runs and active case challenging his or her removal without the sanction of the Court is personally exposed to costs, even if he or she acts on counsel's opinion and in good faith. Such a trustee may not only be deprived of the benefit of the normal indemnity but may also be ordered to pay costs to the successful party or parties."***

In the event, the Court found that Mr. Carmine was not entitled to the protection normally afforded to trustees because he had not acted reasonably and properly in incurring the expense of the litigation without the sanction of the Court.

Once sanctioned (in the particular circumstances of the case study), a proceeding can issue for the removal of Bob under s 51 the Act.

Under s 51(1) the Act, the High Court may appoint a new trustee or trustees if:

(a) It is "expedient" to appoint a new trustee or trustees; and

(b) It is "inexpedient, difficult, or impractical" to do so without the assistance of the Court.

The relevant principles governing appointment under s 51 were discussed in *Attorney General v Ngati Karewa and Ngati Tahinga Trust:*

> The Court must be satisfied not only that there are grounds for the exercise of the discretion but also that "it is inexpedient, difficult or impracticable so to do without the assistance of the Court. That condition may be fulfilled where, for example, there is no or inadequate provision in the trust instrument for the appointment of trustees but may also apply even where such provision does exist. If, for example, the Court were satisfied that the power to appoint new trustees was unlikely to be exercised fairly and objectively having regard to the interests of all beneficiaries.[6]

In appropriate cases, where there is clear medical evidence and the family support an application for removal, the Court may deal with such applications on the papers and may dispense with service on the trustee/ appointor of diminished capacity. However, in the circumstances of the case study, it is likely that the proceeding would be fiercely contended – a factor to be taken into account by the independent trustee/ advisor at the outset when considering the overall position and the likely litigation risks.

One of the difficulties arising in the case study is the likely inability to access good evidence – medical and other – to support an application for Bob's removal. There are, of course, grounds in the inability of the trustee's to agree on the question of Bob's diminished capacity or otherwise and his hostility raises questions as to whether or not the trustees can continue to function.

Avoiding the pitfalls

Where a trustee is or becomes unfit to act, it is necessary to remove or replace that trustee. Trustees do not automatically cease to hold that office just because they are no longer competent to do so, unless the trust deed contains a clause to that effect.

At the 2017 Topical Trusts Seminar, I presented a paper on the Trusts Bill, which is presently before the House. The Bill arises out of the Law Commission's review of the law of trusts released in August of 2013. In its report, the Law Commission said that those provisions of the

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[6] *Attorney-General v Ngati Karewa and Ngati Tahinga Trust* (2001) 1 NZTR 11-012 (HC)*;* See also above n 4 at [598] – [607].

1956 Act relating to the appointment and removal of trustees was an area where "*great practical improvement can be made"*.

Not surprisingly therefore, the Bill makes substantial changes to the process of appointing and discharging Trustees. But interestingly, those changes would not have assisted the independent trustee and advisor in our case study. Court proceedings would have been necessary under the Bill regardless.

Given that the legislation currently and as proposed is imperfect when it comes to avoiding litigation, there is a real and practical need for those drafting Trust documents to anticipate circumstances of the sort that arise in our case study. One option is to include a clause that provides for an independent protector to have the power of appointment and removal of an appointor/ trustee in circumstances where the latter is either unable to act due to diminished capacity independently assessed by a properly qualified medical practitioner, or refuses to submit to a medical assessment, where serious questions as to capacity arise.

- This presentation was prepared and presented by Ross Knight for TGT Legal's topical trust issues seminar in September 2018.