

Maori land and governance

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reviews a significant Maori Land Court decision

The Maori Land Court in *The Matter of Tauhara Middle 15 Trust* (87 Taupo MB 107, 30 July 2008, Judge Harvey) emphasises the need for governors of Maori land trusts (and other organisations constituted pursuant to Te Ture Whenua Maori Act 1993) to have due regard to a range of governance issues when performing their obligations. In particular, governors of trusts must:

- prudently exercise their governance responsibilities;
- address real and potential conflicts of interest when making decisions;
- carefully consider the recommendations of professional advisers; and
- understand that owners' resolutions are not binding on trustees.

THE FACTS

The background to this decision features a web of overlapping relationships common to many Maori land organisations (pp 109–110). In June 2007 the trustees of an ahu whenua trust, Tauhara Middle 15 Trust (T15) and the trustees of the Opepe Farm Trust (OFT) acquired the Tauhara North Block (the North Block) for \$5m from Hikuwai Hapu Lands Trust (HHLT) (a private trust created to secure lands becoming available for sale by Landcorp).

T15 contributed \$1m for a 20 per cent interest and OFT contributed \$4m for an 80 per cent interest. There was no agreement on the precise terms of the relationship between T15 and OFT. HHLT facilitated the acquisition (as part of a wider series of transactions) by purchasing the North Block from Landcorp Farming Ltd, on-selling to T15 and OFT, and taking "facilitation" fees for its role.

T15 raised its \$1m contribution through:

- cash reserves;
- mortgaging its own land for \$450,000 to the Bank of New Zealand; and
- an unsecured, interest payable only when demanded, loan from the Tauhara 4A2A Trust (T4A2A) – a Maori reservation trust which shared three of its trustees (Messrs Wall, Clarke and Tahau) with T15 and HHLT.

In separate owners' meetings prior to the acquisition of the North Block, the T15 owners purportedly:

- endorsed the purchase of the interest in the North Block and approved T15 providing HHLT with, in effect, an unsecured amount of \$240,000 to assist with a deposit on the North Block to be followed by further advances (December 2006); and
- approved the use of \$240,000 as part of an overall investment of \$1m for a 20 per cent interest in the North Block (April 2007).

Although T15 has over 3650 owners, there were fewer than 30 votes cast on resolutions at the December 2006 meeting, and approximately 50 votes cast at the April 2007 meeting.

All the T15 trustees except one supported the proposal for T15's acquisition of an interest in the North Block. The exception was the respondent in the proceedings (Harvey Karaitiana), who opposed the proposal and refused to sign mortgage documents for the loan, as the BNZ had raised concerns regarding risk to T15's assets.

T15's lawyer advised the trustees not to proceed with the proposal as the loan was not permissible under the existing trust order, and recommended that directions be sought from the Maori Land Court because of potential conflicts of interest with the various trustees. The trustees then changed lawyers to use the same lawyers as HHLT who were predictably more supportive of the purchase. For conveyancing, the trustees (except Karaitiana) instructed another law firm, which also advised the trustees not to proceed without approval from the court. A third lawyer was then engaged to complete the conveyancing.

In two earlier decisions the court confirmed that the trustees could act by majority to effect the BNZ mortgage, but dismissed an application by the applicants to remove the respondent as a trustee for T15 (*In the Matter of Tauhara Middle 15 Trust* (85 Taupo MB 225, 29 June 2007, Judge Harvey and 315 Rotorua MB 50, 1 August 2007, Judge Harvey)). The Court also directed the trustees to answer the five questions outlined below.

MAORI LAND COURT'S QUESTIONS

1. Should the trustees have entered into the initial unsecured loan with HHLT for \$240,000 given the ability of HHLT under the deed of loan to terminate its obligations without penalty, and does this action constitute a breach of trust?
2. What issues of conflict of interest arise between the trustees of HHLT and T15 and have these been successfully waived by the meetings of beneficial owners and, if not, how does this affect the validity of the agreements?
3. What is the effect of the resolutions of the meetings of beneficial owners in law on the trustees' decision making, taking into account the trust order?
4. In committing their available funds, a significant portion of their future income and using their assets as a security, are the trustees acting prudently and consistently with their duties as set out in the trust order and according to general trust law principles?
5. Should the trustees have entered into the sale and purchase transaction without first agreeing the precise terms of its relationship with OFT? (see p 111)

The Court added two final questions in the event that the T15 trustees had not acted prudently and in the absence of any positive defence:

6. If there are breaches of trust, what is the effect of those breaches on the trust?
7. If the trustees have breached their duties, has the trust suffered any loss as a result of that conduct and if so can the trustees avoid liability by successfully claiming relief under s 73 of the Trustee Act 1956?

The trustees who authorised the decisions in support of the financial transactions between T15 and T4A2A, and then between T15 and HHLT and OFT, were the applicants in the hearing while Mr Karaitiana was the sole respondent.

THE LAW

After establishing the factual background and reviewing the financial statements for T15 and T4A2A (together with HHLT referred to as the Tauhara Trusts), the Court explored the law concerning trustees and investments and the powers of the Court around trusts and the removal of trustees.

The Court noted that trustees have a principal “duty of protecting trust capital so that an income may be derived for beneficiaries into the future” (p 132). Trustees were unlike ordinary business persons and were not free to select investments of a speculative or hazardous kind, but rather “were restricted to essentially conservative investments with an emphasis on capital security” (p 132). Long-standing case law encapsulating the prudence test was referred to, and the Court set out s 13B of the Trustee Act:

Subject to ss 13C and 13D of this Act, a trustee exercising any power of investment shall exercise the care, diligence and skill that a prudent person of business would exercise in managing the affairs of others (p 133).

The Court emphasised that trustees have a duty to act with due diligence and prudence in the discharge of their duties and that, where doubts exist as to the particular course that trustees may wish to take with investments, the correct approach is to seek directions from the court (pp 133–134). The court has a guardianship role in respect of trusts. The prerequisite for removal of trustees under s 240 of the TTWM Act is not simply a failure or neglect of duties but a failure to perform them satisfactorily. Therefore, assessment of trustees’ performances was essential when the court was considering whether to remove trustees (p 134).

While recognising the boldness of the wider HHLT proposal to acquire lands for hapu, the Court highlighted that ahu whenua trusts like T15 have a defined purpose under the TTWM Act and must operate according to the trust’s particular trust order. The trustees were under a duty to obey the terms of trust because the custodianship of the existing corpus lands remained paramount.

The Court then outlined the fundamental question:

Did [the trustees] act prudently by participating in the Hikuwai venture to purchase the 20 per cent interest in the Tauhara North lands with Opepe in the manner [they] did? (p 136)

A CLOSER LOOK AT THE ISSUES

Question 1

The Court found that entering into the initial unsecured loan with HHLT was in plain breach of cl 3(b)(vii) of the trust order (providing that the trustees can lend trust funds “upon any securities” which trust funds may be invested in accor-

dance with the Trustee Act or upon appropriate mortgages). The T15 trustees were repeatedly warned by lawyers that there was a risk lending unsecured monies to HHLT. This decision exposed the bulk of T15’s cash assets with the additional problem that there was no formal agreement with HHLT or corresponding obligation on HHLT to account for these monies. The Court expressed surprise and concern with T15’s argument that, even if the funds were lost, such loss would be permissible as a Maori community purposes distribution, dismissing the submission as an “argument of convenience” (p 139). The submission that “as this was a Maori community purpose transaction the requirement to act prudently was not relevant” was branded “equally inexplicable” (p 139). Putting trust funds at risk in such a way, regardless of the circumstances, was wrong, reckless, and in breach of the trust order. Even if the trustees acted honestly (which the Court did not explicitly accept) the Court did not accept that they acted reasonably.

Question 2

The Court raised two preliminary points before responding to the question on conflict of interest. First, the three trustees who had duties to three sets of beneficiaries, the beneficiaries of HHLT, T15 and T4A2A, needed to disclose to the T15 owners any payments the three trustees received from HHLT when the land purchase was completed. Second, while the ownership of T15 and T4A2A was similar, the trusts were separate and had to act as individual trusts. The two trusts “cannot shift assets and liabilities between themselves simply on the basis of common ownership and trustees”, although they can work together provided their respective trustees “act in the best interests of each trust and according to fundamental trust law principles” (p 140).

The same lawyers advised each of the Tauhara Trusts on whether to enter into the North Block purchase. The three conflicted trustees persuaded the other T15 trustees (except Karaitiana) to make the unsecured loan to HHLT, and again persuaded themselves as trustees of T4A2A to make an unsecured loan of \$310,000 to part fund the purchase. They then decided as trustees of T4A2A to use a further \$140,000 from T4A2A to guarantee the debts of T15 to the BNZ – security for which remained unclear to the Court.

The Court quickly dismissed the applicant’s arguments and confirmed (pp 142–143):

- where there are six trustees and three are interested, then the trustees should apply to the Court for directions (as recommended by lawyers to T15);
- there had been no majority of trustees who did not have an actual or potential conflict so the payment to HHLT could not have been validly authorised; and
- simply declaring a conflict at a meeting or attempting to have it waived by the meeting of owners is insufficient (unless all owners were present and agreed).

The Court concluded that because the trustees had put the trusts in a position where the legitimacy of their authority to proceed was questionable, there were concerns as to the trustees’ competence to continue as trustees.

Question 3

The Court affirmed the principle that owners’ meetings cannot bind the trustees in the absence of an express provision in the trust order (and in the case of T15 there was no

such provision). The trustees are responsible for making decisions concerning trust business and can neither be dictated to by the owners nor delegate decision-making responsibility to a vote at an owners' meetings. No T15 owners' hui could be used to waive any actual or potential conflict of interest (pp 145–146).

Question 4

The Court found that the trustees did not act prudently when committing all the available funds from both T15 and T4A2A and a significant portion of their future income, and used the assets of both trusts as security for the purchase of a 20 per cent interest in the lands. T15's interest only obligations to the bank required interest payments amounting to more than half of that trust's current income – and no principal was being repaid. There was no provision for T15 to repay even interest on the unsecured T4A2A loan. "This is not a situation that prudent trustees should find themselves in" (p 147). Given the circumstances, which included the HHLT deed of trust's explicit provisions regarding investment (and additional provision setting aside the statutory prudent person obligations in the Trustee Act), and the repeated advice not to proceed, the finding that the trustees actions were not prudent was a simple one. The trustees had "a duty to read the deed of trust and familiarise themselves with its terms", and did not appear to have fulfilled that duty (p 147).

Question 5

According to the Court, the trustees should not have entered into the sale and purchase of the North Block without first agreeing to the terms of its relationship with OFT. Even the HHLT lawyer, although acting for all three Tauhara Trusts at the same time, had apparently advised this course. It was "an extraordinary suggestion in any business context, let alone one involving trust funds" that trustees would hand over \$1m before defining the terms of the arrangement with OFT (p 148). The Court noted that "to do anything less was inconsistent with the trustees' duty to protect the trust's assets – to say nothing of acting prudently" (p 148).

Question 6

The Court concluded that the trustees had acted imprudently, sufficiently to warrant their removal, and arguably in "wilful default" of their responsibilities (p 149). The T15 trustees acted inappropriately in a number of ways including:

- committing the trust to a single investment;
- investing all surplus funds and the bulk of future income into the investment before protecting their owners' interests;
- using another trust's assets and income to secure the single investment; and
- failing to agree on a relationship with OFT.

The test for prudence is one of process and not outcome, and "in this case the process followed by the trustees was not prudent" (p 150). The trustees should have understood what constituted an effective majority, and what conflict of interest issues were arising. They should have also known that an owners' meeting could not waive a conflict of interest, and acquainted themselves more thoroughly with their terms of trust and duties. The Court considered that it was concerning the chair of the trust had not studied the 2008–2009 budget

provided by the trust's accountant when deciding on the viability of the land purchase and that this (financial) aspect of the proposal was "beyond him" (pp 150–151).

Question 7

Section 73 of the Trustee Act provides an effective defence for a trustee who has acted honestly and reasonably, and ought fairly to be excused for a breach of trust and omitting to obtain the directions of the Court.

The Court noted that two independent lawyers advised the T15 trustees not to proceed and instead to seek the Court's approval or directions on the agreement. The fact that the trustees did not seek directions when advised was "both unreasonable and inexplicable" (p 156). The trustees had failed "to realise that the conflicted trustees could not participate in the decision or be counted toward the quorum" (p 156). In this instance, it was unreasonable for the trustees to fail to follow their lawyers' advice to seek directions. Section 73 could not therefore be used to "forgive their imprudence and breach of trust" (p 156). Although the venture might ultimately be successful, some of the trustees' actions were inexcusable but, to some extent, understandable.

ADDITIONAL COMMENTS

The applicant's lawyers argued that the trustees had acted consistently with their duties since they had an overarching obligation to apply trust funds according to the notion of Maori community purposes, overriding any application of the orthodox test to act prudently. The Court dismissed this argument by noting that there was no express or implied statutory provision setting aside the prudence test, there was nothing in the trust order displacing the prudence test, and there was no authority for counsel's proposition which incidentally ran "contrary to several centuries of settled law" (pp 152–153). The submission was essentially seen as "another argument of convenience" (p 153).

Upon allegations concerning the HHLT having a conflict of interest, the Court observed that the matter was being dealt with by the appropriate authorities: the respondent had submitted complaints to the Wellington District Law Society regarding same alleged conflict (p 144).

The Court suggested that the actions of the trustees of T4A2A appeared inconsistent with the trustees' duty to act prudently and to preserve the assets of the trust. The Court directed the Registrar to arrange a fixture to hear any further evidence and submissions on the issue of the unsecured loan and deposit offset from the T4A2A trustees (pp 158–161).

THE RE-ELECTION OF TRUSTEES

The Court required all the trustees to retire from their positions as trustees, and directed the Registrar to convene a special general meeting of the owners for the purpose of electing new trustees. The former trustees were allowed to stand for re-election (p 157).

The Court observed that trustees are entitled to dissent but are not able to take disagreement with the trustees beyond the confines of their meetings and degrade the reputation of the trust. The actions of the respondent in publishing material calling for the abolition of Maori land trusts was inconsistent with his position as trustee, and he too would be required to retire and seek re-election. (p 158)

The Court then directed the Registrar to:

- convene a special general meeting of the owners for the election of trustees within 30 days;
- arrange an independent chairperson and minute taker for the hui;
- produce minutes of the hui within 14 days of the hui;
- later (and subject to any further directions) arrange a fixture to hear an application for the appointment of trustees; and
- arrange with counsel a different fixture to hear any further evidence and submissions on the issue of the unsecured loan and deposit offset from the T4A2A trustees in the context of acting prudently (p 160).

SUBSEQUENT DEVELOPMENTS

A special general meeting of owners of T15 was conducted on 28 September 2008 and three of the former trustees were re-elected. However, the meeting and elections gave rise to further allegations by owners of impropriety on the part of trustees and lawyers. The Maori Land Court directed counsel and affected persons to file responses to any material before the Court on various matters (including the T4A2A specific matters and election issues). (See for example *In the Matter of Tauhara Middle 15 Trust* (87 Taupo MB 297-303, 17 October 2008, Judge Harvey)). The Court subsequently decided that the meeting on 28 September 2008 had numerous procedural irregularities and defects, and directed that another general meeting be held for the election of trustees to T15 (*In the Matter of Tauhara Middle 15 Trust* (88 Taupo MB 6272, 18 December 2008, Judge Harvey)). The Court directed that a separate meeting be held on the same day for the election of trustees for T4A2A. The current trustees were directed to stand down from their positions although were free to offer themselves for nomination (p 69). The Court may then appoint up to five responsible trustees for each trust and may also appoint advisory trustees.

LESSONS LEARNED

This decision provides definitive guidance around basic governance standards for trustees of Maori land trusts including:

- As trustees of T15 the applicants had acted in breach of the law, the trust order, and common sense. Notwithstanding the recommendations of several independent lawyers to the trustees to refer to the Maori Land Court for guidance, a number of “red flags” could have forewarned the trustees of the potential issues arising. The offering of substantial monies without security and the conflict of interest implications suggested that the trustees needed to be extra careful to adhere to proper process around decision-making.
- Given the nature of the relationships between the owners of these organisations and their appointed/elected governors, numerous governors of Maori land trusts and other such organisations consider that the effect of an owners’ resolution is binding. The judgment reiterates that, with trusts, this is definitely not the standard position. However, in the case of a Maori incorporation the owners’ resolutions can be binding (see, eg, s 277 of the TTWM Act (appointment of auditor)). Individuals serving on Maori organisations should ensure that they understand where owners’ resolutions are binding and where they are not binding on the governors. It may be useful for governors to familiarise

themselves with the relevant legislative and constitutional documents for their organisation when attending owners’ meetings.

- The need for agreement on the terms of a relationship with any commercial partner is a commonsense step for trustees of Maori land trusts. The Court was clearly concerned with the T15 trustees’ actions in handing over \$1m without definition of the relationship with OFT. Trustees (and all governors) of Maori land organisations would be wise to ensure a diligent and no-nonsense approach to business.
- That three of the trustees were subsequently re-elected after this judgment implies that there is degree of forgiveness amongst the owners voting for these trustees. It is likely that there will be further judicial comment on these circumstances.

As a result of this judgment, however, trustees of Maori land trusts may exhibit greater reluctance (and therefore potentially less prudence) to take investment risks — without having to resort to judicial guidance around what is or is not a commercially prudent investment. This judgment could contribute to the strangling of Maori land development through the perception of enhanced judicial oversight. There are already significant controls over Maori land, and the impediments set out in the judgment could be seen as paternalistic and have a deleterious effect on “good” risk-taking as well as “bad” risk-taking.

Governors and owners of smaller land blocks are also potentially further disadvantaged by the governance requirements outlined in this judgment. Most Maori land blocks simply do not have the financial capacity to instruct quality professional advisers and establish a diverse investment portfolio, although the governors and owners may still wish to ensure appropriate process (as outlined) is followed for pursuing an investment opportunity or acquiring the block next door. In that respect, the judgment should operate in a context whereby various options are available for governors and owners to compensate professional advisers, without having to resort to the Maori Land Court for confirmation of investments.

The selection of trustees by the Court in these circumstances may be a judicial step too far for some Maori land owners. It remains to be seen whether the owners of T15 are in a better position than the Court to select the trustees. Subsequent developments however confirm that the Court will select and confirm the appointment of trustees. The recent judgment requiring another election process in accordance with the trust order and under independent supervision with more effective support from the Maori Land Court is almost certainly the best way to progress these matters.

The judgment represents a clear warning to all governors of Maori land organisations that the court is becoming more definitive about governance standards required in commercial dealings. Governors would be wise to engage professionals (who are not in a conflict of interest) to advise the governors and managers of their organisations, but ultimately need to weigh up professional advice with basic common sense and prudence. Advisers should also find the judgment instructive, especially around conflicts of interest in advising multiple organisations, and the need to ensure arguments of convenience are removed from submissions. □