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Business Succession and Estate Planning Bulletin

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- **The need for care in providing family-assisted housing for the elderly**

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Be wary of saying "this will all be yours one day"

Background

1. Over recent years we have been commenting on senior State Court cases¹ around the country which have had to consider whether a promise made by mum or dad about the ultimate inheritance of the family business or rural property compromises the terms of any will made by mum or dad.
2. At a practical level, some disinherited beneficiaries, or beneficiaries disappointed with the terms of mum's or dad's will, have taken action against the estate claiming that they had acted on an earlier promise made by mum or dad about the ultimate ownership of the business or property which conflicts with the terms of the will.
3. This is a growing area of the law as more and more cases come before the courts with such claims as the basis for action. Lawyers refer to such arguments as "*equitable estoppel arguments*".

What is equitable estoppel

4. In an estate planning context, the main equitable estoppel argument is what is called "estoppel by encouragement".
5. Estoppel by encouragement requires the following 3 elements to be proved; namely:
 - (1) the party alleged to be estopped has encouraged or induced an expectation of a future transfer of an interest in property;
 - (2) there has been reliance on that expectation in the form of a change of position by the party seeking to establish the estoppel; and
 - (3) there has been (or will be) an identifiable detriment to the recipient of the assurance as a result of the change of position if the expectation is not fulfilled.
6. In a practical sense, these 3 elements tend to overlap but are informed by the overarching legal principle that it would be unconscionable in all the circumstances of the particular case to permit a departure from the encouraged expectation. It follows that the doctrine is directed to preventing an unfair departure from an expectation induced or encouraged by a person (usually mum or dad) which has been relied upon by another (usually a child) and that that will cause considerable detriment to the child if their expectation has not been fulfilled.
7. To establish if the 3 elements of estoppel are shown, the important test is to understand what the child understood the position to be and not what mum or dad may have been thinking. This is the estate planning "\$60,000 question" because mum and dad may not have realised the effect of things said, possibly many years prior.
8. The principle demonstrates how important it is to understand the factual dynamics in a family because the principle, as a number of recent cases show, can undermine mum or dad's ultimate estate planning strategy.

¹ See for example the article in our February 2018 bulletin dealing with the West Australian Supreme Court case of *Browne -v- Browne*

9. The legal principle of estoppel is closely aligned with another equitable principle that is often argued as an alternative to estoppel by inducement; that of a constructive trust.
10. The elements of equitable estoppel and constructive trust are different although the similarity comes down to a common thread which is that the law says that it will prevent someone from asserting or exercising a legal right in circumstances where the assertion constitutes unconscionable conduct i.e. it is unconscionable in all the circumstances for one party to assert beneficial ownership of property against the rights of another.
11. In applying these principles it is important to understand that unconscionability does not equal fairness; it is something more than that.

Recent cases

12. Whilst we had provided a summary of the facts in the *Browne & Browne* case earlier in our February bulletin this year, we set those facts out again for convenience.

(1) Facts

- (a) Mr Browne was a successful farmer. He had a number of children, including 4 boys, all of whom worked on the family farming properties for different periods of time. Steven, the eldest son, had devoted most effort to the farming operations having commenced fulltime work on the property after his first year of university.
- (b) Steven married in 1985 and initially lived in a donga on one of the properties owned by Mr Browne. Subsequently, at his father's encouragement, Steven and his new wife moved to another family property and built their family home on that property.
- (c) The various properties were owned in different structures – predominantly trusts and were farmed through a partnership comprising Mr and Mrs Browne and the 4 boys.
- (d) As frequently occurs, the boys wanted to be responsible for their own property (a problem where there simply isn't enough land to support viable living units after subdivision). Nevertheless, Steven subsequently worked the property on which his house had been built, "Burracoorong", and he had access to infrastructure (yards, sheds and other equipment) on a nearby property.
- (e) There was some dispute about whether Mr Browne had made specific representations about "Burracoorong" being transferred to Steven but what was not in dispute was that Mr Browne had told each of his sons on several occasions that all farming land would ultimately be transferred to the boys by will.
- (f) Arrangements were made between the children for Mr and Mrs Browne to retire to Perth and arrangements for annuity/rental payment for property leases was agreed to be paid. Indeed, Mr Browne worked for Steven on "Burracoorong" for many years after his "retirement".

- (g) Mr Browne had provided security to Steven to finance infrastructure improvements to "Burracoorong". But after relations had broken down between father and son, he put pressure on the bank to withdraw facilities and that put the viability of Steven's farming operation into jeopardy and triggered the Court action.

(2) **Steven's claim**

Steven claimed that his father had at various times promised that Mr Browne would gift "Burracoorong" to him – either before or on his father's death and that his father would support his farming operations by allowing access to infrastructure on the nearby property and also by facilitating Steven's borrowing facilities with the bank.

(3) **Legal principles**

- (a) Steven's claim against his father was based on proprietary estoppel. In this case, estoppel by encouragement.
- (b) Estoppel by encouragement comprises 3 essential elements; namely:
 - (i) the party alleged to be estopped (in this case Mr Browne) has encouraged or induced an expectation of a future transfer of an interest in property (in this case the transfer of "Burracoorong" to Steven);
 - (ii) there has been reliance on that expectation in the form of a change of position by the party seeking to establish the estoppel i.e. Steven; and
 - (iii) there will be an identifiable detriment to the recipient i.e. Steven, if the expectation is not fulfilled i.e. if "Burracoorong" does not ultimately pass to Steven.
- (c) The Court said that the test in substantiating an estoppel claim was not whether the person making the claim (Steven in this case) would have acted differently if his father had not encouraged his assumption (that "Burracoorong" would be transferred to him) but whether he was influenced in a way such that the representation was a contributing cause to his conduct. It boils down to the single test: *would it be unconscionable for Mr Browne not to see through with the representation?*

(4) **Arguments by Mr Browne**

- (a) One of the arguments by Mr Browne was that he should not be held to a promise that effectively meant he had lost the freedom to make his will as he chose. It was argued that being obliged to draft his will in a certain way could well prejudice the rights of his other children.
- (b) However, the Court did not accept that argument. Indeed, the Court said that an equitable claim could in fact impose a clear obligation on someone to make their will in a certain way; and that if that meant there may be claims by other family members after death by way of a family provision application, then that needs to be dealt with at that

time. In saying this, the Court made a distinction between "a promise to leave property by will" as sufficient to found an estoppel on the one hand and an "intimation of intention to make a will coupled with the disclaimer of an intention not to revoke it" on the other. The latter is not binding on a person.

(5) **Decision**

- (a) There was significant discussion in the judgment about the evidence that had been adduced. In particular, the Court was very critical of the evidence given by Mr Browne - quite possibly a consequence of his age. Nevertheless though, the reliability of Mr Browne's evidence was a problem for him.
- (b) The Court said that, at least from the time that Steven and his wife built their house on "Burracoorong", Steven and his family had arranged their lives, work and resources on the clear expectation that one day Steven would be the owner of "Burracoorong". As a consequence of that, the Court said that Steven had incurred substantial financial and personal liabilities because of that expectation. This extended to extensive borrowing by Steven for further infrastructure improvement to "Burracoorong".
- (c) The Court went on to decide that Mr Browne should be held to his promises and representations and that the equity raised by Mr Browne's conduct can only be discharged by transferring legal title to "Burracoorong" to Steven.

Lessons to be learned

- 13. The *Browne* case and other recent Supreme Court decisions in all State jurisdictions show just how important it is for business owners to be very careful in the arrangements they make with their children or other family members about:
 - (1) working arrangements in the business whilst mum and dad are alive; and
 - (2) arrangements for ultimate transfer of ownership or succession of the business-owning structures.
- 14. It is just not good enough these days to adopt a casual approach to succession in business arrangements. The cases show clearly just how important it is to carefully document succession arrangements. It means that good professional advice should be sought and clients advised of the risk in representing to a child that "*this will all be yours one day*".
- 15. Where trusts or companies are involved as business-owning structures, consider succession of control – usually through the power of appointment or guardianship provisions for a trust.
- 16. For more complicated family holding arrangements, consider the use of a family agreement or family constitution – whether binding or not binding – to set out what mum and dad are wanting to achieve. Sometimes families are reluctant to be open about their succession plans. That is when it is always best that demons be confronted whilst parents are alive rather than leaving a mess after death.

17. Another matter that needs to be considered carefully is understanding what family assets are – business or on-farm assets – and those which are not. Strategies dealing with the 2 different types of assets can be an appropriate way of managing the expectations of those involved with the business and those who aren't. Families need to consider these sorts of issues:

- (1) can the business support more than one family;
- (2) the needs of parents as they age and capacity diminishes and so are unable to be involved with the business.
- (3) what the family as a whole wants to achieve;
- (4) strategies for moving mum and dad into aged care;
- (5) the need for independent/professional management;
- (6) the revenue implications of restructuring to allow easier succession arrangements.

The need for care in providing family-assisted housing for the elderly

Background

1. With rising costs of aged care, families are looking at alternative housing arrangements for loved ones.
2. The recent New South Wales decision of *Hanna -v- Raoul*² was a New South Wales Court of Appeal case that examined a gift of a home by an elderly person to a relative, in return for a life interest in that home, and the repayment of the elderly person's mortgage. It is a case that highlights some of the dangers with arrangements like this.

Facts

3. Mr Raoul was 79 years old, a widower and pensioner without immediate family members. Mr Raoul had previously obtained a loan and granted a mortgage over his home to assist one of his friends. The friend was unable to repay the loan and Mr Raoul was anxious about the mortgage. Mr Raoul's nephew, Mr Hanna came to the rescue.
4. They met with Mr Hanna's solicitor and they came to an arrangement whereby:
 - (1) Mr Raoul agreed to transfer his home to Mr Hanna;
 - (2) Mr Hanna paid out the mortgage;
 - (3) Mr Raoul was entitled to remain in the property for as long as he liked; and
 - (4) Mr Hanna would pay all rates, taxes, insurance premiums and maintain the land in good repair.
5. The mortgage was discharged by payment of \$200,509.00 and at that time the market value of the property was estimated to be \$675,000.00.
6. There were questions raised as to Mr Raoul's capacity.
7. The Court noted Mr Raoul was described as an eccentric even before he came to have capacity challenges. Throughout 2014 there were 6 solicitors who acted for Mr Raoul without (apparently) any determining that he did not have capacity to provide them with instructions. This would usually indicate he had full capacity, but capacity is a point in time test. In June 2014 a psychiatrist assessed him as having capacity to manage his own affairs.
8. In September 2014 the parties proceeded with their arrangement. You could be forgiven for thinking there could be little doubt as to the capacity of Mr Raoul given his dealings with multiple solicitors and assessment by a medical professional.
9. Mr Raoul obtained independent legal advice from a solicitor he met for the first time on that day, who went through the deed with him.

² *Hanna v Raoul* [2018] NSWCA 201

10. Sadly, Mr Raoul's home was destroyed by fire in January 2015. Later that year proceedings were begun by a tutor for Mr Raoul to recover the land from his nephew Mr Hanna on the basis that:
 - (1) Mr Raoul did not have capacity to enter the transaction; and/or
 - (2) the transaction was the result of unconscionable conduct by Mr Hanna; and/or
 - (3) the contract was an unjust contract within the meaning and purview of the *Contracts Review Act 1980*.

Held

11. The trial Judge of the Supreme Court, Lindsay J, found in favour of Mr Raoul, declaring that the land was held for him but with a charge of \$242,203.00 (being an allowance for Mr Hanna repaying the mortgage for Mr Raoul) in favour of Mr Hanna. However, there was some concern that Mr Hanna would not have financial resources to cover the potential costs order against him and so any amount owed to him was to be set off against his liability to pay Mr Raoul's costs prior to any amount being paid to Mr Hanna.
12. The Court found that the psychiatrist's report in 16 June 2014 was not a reliable guide for Mr Raoul's capacity to enter into the transaction on 16 September 2014.
13. The Court repeated the axiom that capacity is transaction specific. Having capacity for one particular transaction does not necessarily mean that person has capacity for a different transaction at the same time. The Court found that Mr Raoul's "*fixation on discharging the mortgage and his lack of appreciation of the extent of his future dependence on Mr Hanna, and importantly, his lack of appreciation that Mr Hanna had acquired a present interest in the land*" meant that Mr Raoul lacked capacity to enter into the transaction. The Court said that it was relevant to have regard to the provenance of the transaction for Mr Raoul. The Supreme Court therefore ruled the transaction was invalid.
14. Mr Hanna appealed to the Court of Appeal.
15. The appeal was dismissed. The Court of Appeal examined the evidence of advice provided by solicitors to Mr Raoul prior to him signing the deed and found Mr Raoul did have capacity to enter into the transaction.
16. This case sets a high standard for the understanding an elderly person must exhibit when entering into a life interest or right of residence transaction with a family member. The Court accepted that Mr Raoul had said "*I give Mr Hanna the house and he will pay all of my bills and I can live at the house until I die. When I die Mr Hanna will own the house.*" He had explained that he was not able to pay off the mortgage, but he wanted to continue living in the house.
17. This explanation is perfectly plausible. It explains his motivations and fits the context. He has no near relatives whom he wishes to benefit in his will and he has an immediate concern that can be satisfied by this transaction.
18. The Court of Appeal accepted that Mr Raoul understood the "*broad operation or general purport*" of the transaction i.e. Mr Raoul had the requisite capacity to enter into the transaction and overturned that aspect of the trial decision.

19. However, the matter did not end there because Court of Appeal found that the transaction was void for unconscionability.
20. For a transaction to be unconscionable, it must be shown that:
 - (1) the weaker party is at a special disadvantage;
 - (2) the other party is aware of the disadvantage, or reasonably ought to have been aware; and
 - (3) the other party takes advantage of that special disadvantage in a way which is in context unconscionable.
21. The Court cited with authority the following criteria for unconscionable conduct:

"whenever one party to a transaction is at a special disadvantage in dealing with the other party because of illness, ignorance, inexperience, impaired faculties, financial need or other circumstances effect his ability to conserve his own interest, and the other party unconscientiously takes advantage of the opportunity thus placed in his hands."
22. The Court was satisfied the transaction was unconscionable because:
 - (1) Mr Raoul had lost his recourse to the capital value of the house and had no resources to pay for entry into aged care;
 - (2) Mr Hanna was able to sell or mortgage his remainder interest in the property (i.e. his interest as remainderman under a life interest, being his right to receive the fee simple interest on Mr Raoul's death); and
 - (3) there is a significant value gap between what Mr Raoul received and what the land was worth, even after the mortgage repayment was taken into account.
23. It was clear to all that Mr Raoul was at a special disadvantage. The Court of Appeal noted the following things indicated his disadvantage:

"He was elderly and frail. He was under extreme personal and financial stress. He wished to continue living in his home but had no means of paying the mortgage on his property and there was a real likelihood of a mortgagee sale. Mr Raoul's mental health was deteriorating... and the medical and other evidence clearly established that he was highly suggestable, that his memory was failing him and that he was confused about relevant details of his personal and financial circumstances."
24. Mr Hanna was not able to demonstrate that the transaction was fair and reasonable. The fact that Mr Raoul had received advice from an independent solicitor did not *"transform the relevant transaction into one that was fair just and reasonable"*. The Court levied some criticism at the apparent inadequacy of the solicitor's advice and the failure of Mr Raoul to obtain independent financial advice.
25. The Court contemplates a high bar for solicitor's advice to their clients about to enter into these types of transactions. Whilst the Court was apparently satisfied that the solicitor had satisfied himself that Mr Raoul had capacity and understood the contents of the deed, it found that was still insufficient because Mr Raoul was unable to properly protect his own interests *"even if the deed reflected what he said he wanted"*.

26. This case goes close to being authority for the proposition that an elderly frail person with some capacity issues, but otherwise being found by lawyers and medical practitioners as having capacity to enter into financial/legal transactions, cannot enter into a transaction at less than market value which will be binding on that elderly person.

27. So, what do you do if you have a client who is elderly and frail, with some medical issues, who wishes to give his or her property to a family member in exchange for a right of residence? This is not uncommon and comes across our desk quite frequently. How do we ensure that all the parties to this transaction are bound to the transaction?

It is difficult.

28. As a minimum, the following steps should be taken where possible (and we say *where possible* because clients are independent of their lawyers and will do as they please even after receiving advice):

- (1) the elderly client should obtain independent legal advice, preferably from the same solicitor they have used for many years, and that advice should be provided much earlier than the day of signing the transaction documents;
- (2) the elderly client should obtain financial advice from an accountant or financial advisor;
- (3) the advice from the solicitor and accountant or financial advisor would need to include a consideration as to whether it was in the objective best interests of the elderly client to go ahead with the transaction. It is not enough that it appears that the elderly person desires to proceed with the transaction; you need to discuss whether a third party would consider it in their best interests. This, concerningly, risks decreasing the agency of the client on the basis of their age and frailty, and in other circumstances this approach this would be properly criticised and avoided;
- (4) the transaction should not be rushed and would preferably take place over at least 2 to 4 weeks;
- (5) on the basis of this judgement, the transaction should provide a clear financial mechanism for the elderly person to have recourse to a substantial cash fund to provide for their aged care if necessary; and
- (6) if the transaction takes place for market value consideration, there is substantially lower risk of the transaction being unconscionable but also there is little incentive for a party to challenge the transaction. So these issues generally only arise if the transaction does not take place at market value.

29. This is the real difficulty of the lessons from this case, because of the way property markets have operated in capital cities and elsewhere in Australia in the last 20 years. It is often difficult for a person who did not get into the property market before the current long-sustained price rise to be able to afford to pay market value for a property from their parent or grandparent. Combine this financial disparity with the fact that elderly people will want to obtain security of accommodation for themselves whilst benefiting others makes under-market value transactions a common reality. Therefore we need to find a way to proceed with under-market value transactions in a

way which meets the needs of the elderly client and is enforceable for all parties to the transaction.

30. It would seem practical and reasonable that part of the equity of the property can be unlocked to provide resources for aged care for the elderly person.

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