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Equity and Trusts

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This is one of a series of module guides published by the University. We regret that owing to pressure of work the authors are unable to enter into any correspondence relating to, or arising from, the guide.

University of London
Publications Office
Stewart House
32 Russell Square
London WC1B 5DN
United Kingdom

london.ac.uk

Published by: University of London

Contents

Module descriptor

GENERAL INFORMATION

Module title

Equity and Trusts

Module code

LA3002

Module level

6

Enquiries

The Undergraduate Laws Programme courses are run in collaboration with the University of London. Enquiries may be made via the Student Advice Centre at: https://sid.london.ac.uk/sid

Credit

30

Courses on which this module is offered

LLB, EMFSS

Module prerequisite

None

Notional study time

300 hours

MODULE PURPOSE AND OVERVIEW

Equity and Trusts is one of the seven foundations of legal knowledge that, among other things, must be completed as part of your law degree if you want to fulfil the academic component of Bar training in England and Wales.

This module deals with the rules and principles governing the creation and operation of trusts – a particular method of holding property that developed historically in the courts of equity. The syllabus focuses on three broad areas:

1. the requirements for establishing a valid trust (including express private trusts; charitable trusts; implied and resulting trusts; constructive trusts);
2. the powers and obligations of trustees under a valid trust;
3. the remedies available when trustees act improperly.

MODULE AIM

This module aims to provide students with an understanding of the fundamental principles of the modern law of trusts and the principles of equity, together with an appreciation of the controversies and difficulties that can be encountered in this area of law.

LEARNING OUTCOMES: KNOWLEDGE

Students completing this module are expected to have knowledge and understanding of the main concepts and principles of Equity and Trusts. In particular they should be able to:

1. Understand the modern law of trusts within its historical origins, together with the role of equity in modern law;
2. Compare and contrast types of trusts and explain their main distinctive features and purposes;
3. Identify and apply relevant statutory frameworks to the law of trusts;
4. Explain how breaches of trusts arise and identify and evaluate appropriate remedies;
5. Evaluate key issues in judicial decision making in the law of trusts and equity, including ethical and societal considerations, and demonstrate understanding of the wider academic debates.

LEARNING OUTCOMES: SKILLS

Students completing this module should be able to demonstrate the ability to:

6. Apply knowledge to complex practical problems and theoretical enquiries demonstrating the ability to think critically about the issues arising;
7. Synthesise key arguments advanced in judicial opinions and academic writings;
8. Distinguish lines of argument and analyse their relative strengths and weaknesses;
9. Use appropriate legal terminologies specific to the law of Equity and Trusts.

BENCHMARK FOR LEARNING OUTCOMES

Quality Assurance Agency (QAA) benchmark statement for Law 2019.

MODULE SYLLABUS

(a) Definition and distinction from other legal concepts. Classification of trusts. Equitable rights and remedies.

(b) Express private trusts. Statutory requirements for creation. Secret trusts. Incompletely constituted trusts. Certainties of a trust. Discretionary trusts. Purpose trusts.

(c) Trustees' powers and duties. Delegation of trustees' powers and discretions.

(d) Charitable trusts. Definition. Distinctions from private trusts. Classification of charitable trusts. Doctrine of *cy près*.

(e) Resulting trusts. Purchase in the name of another. Joint purchase and joint accounts. Contributions to purchase price. Beneficial interest not completely disposed of.

(f) Constructive trusts. General nature. Types of constructive trusts, including the contractual vendor as a constructive trustee. Constructive trusts of wrongful enrichment and unjust enrichment.

(g) The appointment, retirement and removal of trustees.

(h) Remedies for breach of trust. Trustees' liability to account. Equitable compensation. Exemption clauses. Trustees' right of indemnity or contribution. Dishonest assistance. Knowing (unconscionable) receipt.

(i) Claims based on tracing. Tracing rules. Trusts, liens, and subrogation.

LEARNING AND TEACHING

Module guide

Module guides are the students' primary learning resource. The module guide covers the topics in the syllabus and provides the student with the grounding to complete the module successfully. The Module Descriptor sets out the learning outcomes that must be achieved. The guide also includes the core, essential and further reading and a series of activities designed to enable students to test their understanding

and develop relevant skills. The module guide is supplemented each year with the pre-exam update, made available on the VLE.

The Laws Virtual Learning Environment

The Laws VLE provides one centralised location where the following resources are provided:

- a module page with news and updates;
- a complete version of the module guides;
- mini lectures;
- pre-exam updates;
- past examination papers and reports;
- discussion forums where students can debate and interact with other students;
- quizzes – multiple choice questions with feedback are available for some modules.

The Online Library

The Online Library provides access to:

- the professional legal databases Lexis+ and Westlaw;
- cases and up-to-date statutes;
- key academic law journals;
- law reports;
- links to important websites.

Core text

Students should refer to the following core text. Specific reading references are provided for this text in each chapter of the module guide:

- **Penner, J.E. *The law of trusts*. (Oxford: Oxford University Press, 2022) 12th edition [ISBN 9780192855008].**

ASSESSMENT

Learning is supported through formative activities in the module guide, which include self-assessment activities with feedback. The activities allow students to make an assessment of their knowledge and understanding and also help them to develop the relevant skills. The formative activities prepare students to achieve the module learning outcomes tested in the summative assessment.

Summative assessment is through a timed unseen examination. Students are required to answer three questions out of six. Please be aware that the format and mode of assessment may need to change in light of events beyond our control. In the event of any change, students will be informed of any new assessment arrangements via the VLE.

Permitted materials

During the assessment for this module, you are permitted to access the following:

- ***Hart core statutes on property law 2023–24* (Bloomsbury).**

NOTES

1 Introduction

Contents

Introduction

The purpose of this module guide is to help you study the law of equity and trusts. Each chapter will take you through a programme of study. By working through this guide, including reading the cases and commentary indicated, you will gain a strong understanding of the subject, and one that will allow you to do well in the final examination.

LEARNING OUTCOMES

By the end of this chapter, you should be able to:

- **appreciate some of the challenges that arise when studying the law of trusts**
- **understand the role of case law in the development of the law of trusts**
- **identify the necessary sources of reading for studying this subject.**

1.1 Trusts: a difficult subject?

The law of trusts is often regarded as one of the more difficult subjects in the LLB syllabus. There are a number of reasons for this. One is the nature of the trust, which contains elements both of the law of contract and of the law of property. In some ways, trusts are like contracts but in other ways they mimic property relationships. A second reason is the complex fact patterns in the case law, especially those that involve commercial or financial arrangements. Finally, the law of trusts is not as susceptible to the sort of linear teaching programme as, say, the law of contract, because many concepts are interrelated. This means that, often, topics covered earlier in the module can only be fully understood once you have studied topics later in the module. While you will certainly gain a feel for the law of trusts as you work through this guide, at times you may feel frustrated, and that you do not 'get' what the law is. Be patient and persistent. In particular, while you should work through only one chapter at a time, if you review previous chapters that you have already completed on a regular basis you will start to see how everything really does 'fit together'. Consider each chapter in this guide as a piece of a puzzle. As you complete each chapter, you will add one more piece, and the whole picture will begin to take shape.

As with all LLB module guides, this one is not intended to be a substitute for reading cases, articles and textbooks. The core text, Essential reading and exercises set in each chapter must be taken seriously. Only by doing so will you obtain any genuine understanding of the law. Typically, the final examination will include a number of problem questions as well as essay questions and the only way you will be able to apply the law of trusts to new fact situations is to grapple with the reading and exercises and appreciate their demands.

Trust law cases

The law of trusts has developed primarily through judge-made law. That means that case law is the main source of law for this module, although you will also need to appreciate how statutes have modified, or codified, certain principles (for instance, in relation to the treatment of charities and the duties of trustees). There is a very large body of case law but to keep your studies manageable, we will focus on the leading cases and the important statutory provisions.

As noted above, trust issues arise in all sorts of situations and can involve some complicated fact patterns. There may be numerous legal issues raised in a given case, including in relation to other areas of the law with which you may not be familiar, such as succession, taxation and commercial law. This can make it difficult to understand some cases but these areas are not included in the examination. For trickier cases, our suggested approach is to:

- Start with the relevant section of the module guide to give you an idea of the key points to look for. Take one section at a time. Do not try to digest several in one go.
- Read the textbook passages about the case. These passages will generally describe the facts in a way that is accessible and provide a brief explanation of any surrounding law necessary for picking out and understanding the trust issues.
- Read the case itself (whether in whole or in part), bearing in mind the tips below.
- Read the further reading or readings recommended on the VLE.
- There is no substitute for reading the case yourself. Not only will this give you a deeper understanding of the case but it will allow you to draw your own conclusions about the legal issues in dispute, the structure and logic of the reasoning, whether there are issues with the decision and so forth. The use of secondary materials (this guide, textbooks, cases and materials books, etc.) should supplement and not replace your reading of the primary materials.
- When studying leading cases, take notes so that you retain a grasp of what the case was about, how the judge(s) approached the law and key elements of the reasoning. Make a special effort to remember the correct names of the parties, the

court that decided the case (particularly if it is a decision of the Supreme Court, House of Lords, Court of Appeal or Privy Council) and any other important features, such as the presence of dissenting judgments, the overruling of previous authority and apparent inconsistency with other cases.

- Read the textbook and module guide passages and ask yourself whether those interpretations of the cases accord with your impressions of them. If not, one possibility is that you have missed or misunderstood something, meaning that you may wish to go back to the case and reread some elements. However, you should also be aware that authors of trusts textbooks often have strong views on the nature and operation of trusts, meaning that you may wish to consult more than one textbook to get a sense of different perspectives. You may find that certain authors or texts have views more in keeping with your own. A textbook is an opinion rather than a statement of truth.
- The law of trusts can sometimes be unsettled and, for some areas, there are cases going in different directions. If this is so, be prepared to take a measured stance as to which is the better view of the law and to defend your view of the cases, or the views of one author over another, in the examination. You will **not** lose marks for preferring one view but it is important to show that you realise when the law is unsettled or that a question or opinion is regarded as controversial. It is important to recognise uncertainty when it exists and not pretend that the law is more settled than it is.

The vast majority of cases cited in this guide can be accessed through the Online Library.

1.2 Sources

CORE TEXT

- **Penner, J.E. *The law of trusts*. (Oxford: Oxford University Press, 2022) 12th edition [ISBN 9780192855008] (referred to in this guide as 'Penner').**

Detailed reading references in this module guide refer to the edition listed above. Use the detailed chapter and section headings and the index to identify relevant readings. Also check the virtual learning environment (VLE) regularly for updated guidance on readings.

Penner is the core text for this module. It is an accessible, shorter textbook which will introduce the topic of the chapter but at the same time discuss it in sufficient detail for you to gain a good sense at the outset of what the topic is about and the various difficult issues you will have to confront in order to master it.

In view of this, the statement of learning outcomes that immediately follows will be comprehensible and you will be able to begin to organise your thoughts about what seems to you straightforward in the topic, and what will need concentrated effort to understand. In certain chapters, the Essential reading will also instruct you to revise one or more of the previous chapters of this module guide. This does not mean, of course, that you should work through that chapter a second time but it does mean you should spend at least half an hour going over that chapter and your notes and answers to questions to re-familiarise yourself with that topic. It is essential that you do this, so that you see the connections between chapters and see how the different 'pieces of the puzzle' come together.

Towards the end of some chapters in this guide, there is another Essential reading, section. It will typically list cases and relevant statutory provisions.

Complete the Essential reading before attempting the sample examination questions at the end of each chapter, which have been written on the basis that you have done so.

The core text is not the only reading available on the various topics covered and occasionally chapters may indicate some Further reading. These texts will broaden your

knowledge of the chapter topic. At the end of each chapter of Penner, further reading is indicated, and you may use this as a guide for further reading where none is indicated in the module guide. Do not attempt the further reading until you have tackled the core text and Essential reading and have a solid understanding of the subject. Many of these texts are available through the Online Library, or on the VLE.

There are numerous other books that you can consult as part of your studies. However, three other recommended books are:

- **Davies, P.S. and G. Virgo *Equity & trusts: text, cases, and materials*. (Oxford: Oxford University Press, 2019) third edition [ISBN 9780198821830].**
- **Virgo, G. *The principles of equity and trusts*. (Oxford: Oxford University Press, 2023) fifth edition [ISBN 9780192857170].**
- **McFarlane, B., C. Mitchell and J. Hudson *Hayton, McFarlane and Mitchell: Text, cases and materials on equity and trusts*. (London: Sweet & Maxwell, 2022) 15th edition [ISBN 9780414103801].**

The first two books (Davies and Virgo, and Virgo) are well written and, like Penner, are accessible to students who are new to trusts.

The third book, commonly called 'Hayton and Mitchell', is written slightly differently from Penner and gives a different angle on many of the topics. Both Hayton and Mitchell, and Davies and Virgo contain extracts of many of the cases you will be reading as you progress through the module guide. They also contain useful commentary on those cases that may help you to understand them better.

1.3 Learning outcomes, self-assessment questions and activities

A number of learning outcomes are listed at the beginning of each chapter. Each list provides guidance about the key topics or questions that the chapter will address. But be mindful of the fact that understanding any branch of law is about 'knowing how', not just 'knowing that'. It is not just about acquiring knowledge; you must learn to apply that knowledge, both to practical problems and to theoretical enquiries. In other words, you will be expected to be able to think about what you know and to write critically about it. That is why many of the learning outcomes are stated in the form of 'knowing how' to do something, or being 'able to explain' how the law in a particular area works.

To help you acquire this **'knowledge'**, you will come across activities, self-assessment questions and sample examination questions throughout this guide. It is important that you tackle these conscientiously. Doing so will help you to remember and understand the content of the module, and will also give you practice in writing in plain English and formulating arguments that will help you when it comes to the examination.

Self-assessment questions require no feedback. They are designed for you to confirm to yourself that you have identified and understood the issues which have been discussed in the text. In addition to these questions, there are activities which usually have some form of feedback. You can undertake all of these activities working alone, but it is always useful to tackle questions with a group of fellow students if possible, so as to promote discussion and debate.

Sample examination questions are included at the end of each chapter (except this one). These questions will help you to synthesise and apply your legal knowledge and (in particular for essays) to think critically about the law. It is advisable to attempt at least some of these questions in circumstances that approximate those in the final examination (e.g. under a time limit and without consulting your notes or the module guide). Taking this approach will help you develop your ability to think critically and construct a persuasive answer in exam conditions.

The structure of each chapter

All the chapters follow a similar format, although some chapters may deviate from this structure when certain more specialised areas of the law are considered. In general, each chapter will contain, in this order: contents; introduction; core text; Essential reading; learning outcomes; the main text broken into the various sub-topics, in which are interspersed self-assessment questions, activities with feedback and summaries of material covered; Further reading; and sample examination questions with feedback.

1.4 Advice on the examination

Important: the information and advice given here are based on the examination structure for the session 2023–24. We strongly advise you to always check both the current Regulations for relevant information about the examination and the VLE. You should also carefully check the rubric/instructions on the paper you actually sit and follow those instructions.

At the end of the module there will be an unseen examination. You will be required to choose **three** questions from a total of **six**. The choice is unrestricted in that there are no compulsory questions. The paper will be made up of a mixture of essay questions and problem questions. You should note that in a six-question examination, not every topic can or will be examined, and you should therefore not pin your hopes on finding a question on a particular topic.

ACTIVITY 1.1

The trust is an equitable instrument and therefore some knowledge of the history and function of equity is helpful to understand the development of the trust. You will already have come across equity in your studies. For instance: certain remedies for breach of contract are equitable in nature (e.g. specific performance); equity may allow for the rescission of a contract for misrepresentation or mistake; and equitable property rights exist in land law. We discuss equity in Chapter 2. You may wish to read that section before attempting the following two activities.

CORE COMPREHENSION – THE COMMON LAW AND EQUITY

Using the Online Library resources, research the following journal article:

- **Hayton, D. 'The development of equity and the "good person" philosophy in common law systems' (2012) *Conveyancer and Property Lawyer* Editorial (available in Westlaw via the Online Library).**

You can complete this learning activity by reading pp.263–65.

COMMON LAW

a. **Identify the broadest meaning of the 'common law'.**

b. **Identify a narrower meaning of the 'common law'.**

c. **Identify the narrowest meaning of the 'common law'.**

d. **Which function does equity perform in relation to the common law?**

e. **In which court did the common law develop?**

EQUITY AND TRUSTS

f. **Which role in dispute resolution did the King's Chancellor play?**

g. **From the example of land law disputes, explain (i) why equity intervened and (ii) how equity intervened in the example of the trust.**

Activity 1.2

Core comprehension – is equity efficient?

Using the Online Library resources, research the following journal article:

- **Duggan, A.J. 'Is equity efficient?' (1997) 113 *LQR* 601–36 (available in Westlaw via the Online Library).**

You can complete this learning activity by reading the section entitled 'I Introduction', pp.601–03.

a. **How is 'common law' defined for the purposes of this discussion?**

b. **How does Maitland define equity?**

c. **Identify the distinctive historical origins of the rules of the common law and equity.**

d. **Using the example of Australia, identify three substantive areas of law in which equity doctrines have informed reform.**

e. **Which five arguments underpin the emergence of the 'new equity rhetoric'?**

f. **According to Duggan, how can equity respond to changing values in society in a way that the common law cannot?**

g. **Identify how equity functions in a way which upholds ethical behaviours.**

NOTES

2 Trusts – the basics

Contents

Introduction

In this chapter, we address a number of fundamental matters about equity and trusts. This discussion will provide important context for the analysis in the subsequent chapters. Those chapters commence with an examination of the types of trust that can exist and the nature of the trust relationship (Chapters 3 and 4). After that, we look at the requirements of a valid trust, considering issues of certainty, formalities, constitution and promises to create trusts (Chapters 5–8). We then look at charitable and non-charitable purpose trusts, unincorporated associations, resulting trusts, constructive trusts and secret trusts (Chapters 9–14). This is followed by the administration of the trust and the appointment, retirement and removal of trustees (Chapter 15). We then turn to examine the equitable wrongs of breach of trust and breach of fiduciary duty (Chapters 16 and 17). Finally, we look at claims based on tracing (Chapter 18).

In this chapter, we look at three things. First, we provide an overview of some key ideas in relation to equity. Second, we explore the nature of the trust and why people create them. Finally, we explore how trusts differ from other related concepts. Understanding these topics is essential to understanding this whole subject.

CORE TEXT

- **Penner, Chapter 1 'Historical origins of the trust'.**

LEARNING OUTCOMES

By the end of this chapter and the relevant readings, you should be able to:

- **explain in outline what a trust is, and why people create them**
- **explain the difference between law and equity and the role of equity in the enforcement of trusts**
- **explain how trusts differ from other concepts that perform similar functions to trusts.**

2.1 Equity

You need to know about the system of law called equity. From your study of the English legal system, you may already be familiar with the fact that English law comprises two systems of case law: common law and equity. An understanding of this division is essential to an understanding of the nature of trusts. The rules of equity are those rules which, prior to the passing of the Judicature Acts 1873–75, were administered by the Court of Chancery. Until that time, there were separate courts of common law and equity, each applying their own rules. Sometimes those rules were the same, but often they were different. Today there are no separate courts of law and equity and every High Court judge is empowered to administer the law of both jurisdictions. For the sake of convenience, however, many actions which would have formerly been heard in a court of equity are now assigned to the Chancery Division of the High Court of Justice.

Although the law of trusts is part of the law of equity, equity's jurisdiction is not limited to trusts. You will, for example, have had some contact with equity in your study of the law of contracts and in land law. One example is the doctrine of promissory estoppel in the law of contract, through which equity can enforce a gratuitous promise that has been relied upon to the detriment of the promisee. Another example is in the range of responses available for breach of contract. The common law provides only damages, while specific performance and injunctions are available in equity. In land law, equity has provided us with the principles of proprietary estoppel through which property rights are recognised, even if not created with proper formality. Although the rules that govern the law of trusts are drawn exclusively from equity, at times some knowledge of particular areas of the common law will be needed, most particularly the rules of common law relating to the transfer of personal and property rights. Those rules will, however, be explained as we go along.

2.1.1 Conflicts between law and equity

Given that the rules of common law and equity are sometimes different, situations are bound to arise where there is a conflict between the answer given to a dispute at common law and that given in equity. A conflicts rule was therefore needed for such situations, and it was held as long ago as 1616 in the *Earl of Oxford's case* that where the rules of common law and equity were in conflict, the rules of equity prevail. That is still the law today: Senior Courts Act 1981, s.49. This does not mean that the rules of common law are redundant. As a matter of history, the common law predated equity by many years, and the reason why rules of equity arose was to deal with situations in which the common law was unable to give relief to a claimant. The rules of equity do not, therefore, comprise a complete system of law. Rather, they presuppose the existence of the common law, acting as a gloss or supplement to it in certain well-defined circumstances. The common law is a complete system and could survive (although not very well) without equity. But, as Maitland in *Equity – A Course of Lectures* (1909) famously explained:

> At every point equity presupposed the existence of common law...Equity without common law would have been a castle in the air, an impossibility.

Fusion

As we have seen, the separate courts of common law and equity were merged in the latter half of the 19th century. It has been a controversial question ever since whether that merger was merely one of administration, with the different rules being left intact and only the power to enforce them now being vested in all the judges, or whether there was a merger of substance, with the result that we no longer have separate rules of law and equity but simply rules of law. This is the fusion debate. One view, captured by Ashburner, is that 'the two streams of jurisdiction, although they run in the same channel, run side by side, and do not mingle their waters'. This was the view taken by Lewison LJ in *Brake* v *The Chedington Court Estate* [2022] EWCA Civ 1302, where he made it clear that, while a court could exercise both a common law and equitable

jurisdiction, the substantive principles of the common law and equity had not merged. But, even if this is correct descriptively, it leaves open the question of the degree to which there **should** be differences in how law and equity respond to similar fact patterns. Are there areas in which such differences are unprincipled?

The content of equity

Given its history, it may appear that equity is synonymous with fairness or justice, and that the rules of equity are simply what any given judge thinks is a fair or just response to particular facts. This could not be further from the truth. Indeed, were that so, the rules of equity would have no substantive content and would raise concerns that they were contrary to the rule of law (in terms of being unpredictable, idiosyncratic, etc.). It is therefore vital to emphasise that equity is a system of rules in exactly the same way as the common law and that it has a system of precedent that is exactly the same as that operated at law. The legal method employed by the equity judges is no different from that employed when they wear their common law hats. Although equity started out as providing ad hoc responses to common law injustices, it soon settled down to become a coherent system of rules, the content of which did not alter with the identity of the particular judge. As long ago as 1818, Lord Eldon, one of the greatest equity lawyers, in one of his last judgments before retirement, responded to such a criticism by saying:

> Nothing would inflict on me greater pain in quitting this place than the recollection that I had done anything to justify the reproach that the equity of this court varies like the length of the Chancellor's foot. (See *Gee* v *Pritchard* (1818) 2 Swan 402, 414.)

As you will see in later chapters, this desire that equitable rules be predictable and coherent has led to criticism of the use of 'unconscionability' as a touchstone for equitable intervention: for examples, see *Bank of Credit and Commerce International (Overseas) Ltd* v *Akindele* [2000] EWCA Civ 502, [2001] Ch 437; *Pennington* v *Waine* [2002] EWCA Civ 227, [2002] 1 WLR 2075; *Pitt* v *Holt* [2013] UKSC 26, [2013] 2 AC 108. The central concern is that 'unconscionable' is not properly defined and expresses a conclusion rather than a reasoning process. On the other hand, it may be argued that certain fact patterns are hugely variable, and that justice is better done through open-textured balancing tests rather than a bright-line rule. As you are studying this module, it is worth being alert to when and how 'unconscionability' is used, so that you may bring your own views to this debate.

Equitable maxims

You will from time to time come across a number of equitable maxims such as 'equity considers that done what ought to be done', 'equity will not assist a volunteer' and 'he who comes into equity must come with clean hands'. The use of maxims in law is an ancient one, and the common law knew its fair share. Although no one would nowadays spend time discussing common law maxims, students of trusts are introduced to the equitable maxims. Equitable maxims should, however, be treated with caution as they are general statements of principle that help explain judicial reasoning and do not have any standalone weight. Rules should instead be taken from cases, just as with the common law.

Activity 2.1

Read *Cowcher* v *Cowcher* [1972] 1 WLR 425.

a. What were the facts and decision of the case?

b. What were the judge's reasons for rejecting the argument that equity was synonymous with 'fairness'?

2.2 What is a trust?

There are a number of different types of trust and, for ease of explanation, it is useful to start with those that are set up intentionally (**express trusts**). Broadly speaking, an express trust is a way of holding assets for the benefit of another individual or group of people or for a charitable purpose. So, for instance, you may have heard of: property being held in family trusts; employees contributing to pension schemes in order to receive an income during retirement; debates around the taxation implications of companies transferring assets to offshore trusts; or of charities explaining how they have spent the money they manage.

The legal definition of the trust adds further detail: a trust is an arrangement in which **property**, either personal (e.g. a right to be repaid by a borrower) or proprietary (e.g. a fee simple or leasehold estate in land) and, whether legal or equitable, is held by one person for the benefit of another or for a charitable or 'public' purpose. As will be seen later, trusts for non-charitable purposes are generally void and may not exist. The person creating the trust is called the **settlor**, the person holding the property is the **trustee** and the person or persons for whom that property is held or the purposes for which it is held is the **object**. The property being held in trust is often called the **subject matter** of the trust. They may be referred to as the trust '**property**' or trust '**assets**'.

2.2.1 Why create a trust?

One way to answer this question is by asking why someone might not want to give property to another person outright (i.e. without the interposition of a trustee between that person and the property or right). There are a number of reasons, including the following four.

First, the intended recipient could be incapable of managing property. I might, for instance, want to give company shares to a child. Although there is no legal impediment to me doing so, such an action might be very foolish, for the child may have no idea of the value of what they have received. Instead, it might be better to give the shares to a trustee to manage on the child's behalf. For charitable trusts, the situation is even more stark: property cannot be given to a purpose, meaning that it must be held by an entity with legal personality in order to carry out the purpose.

Another reason is the flexibility that trusts can provide. For example, by the use of a discretionary trust (discussed in Chapter 3), income or capital can be released to those members of a class of potential beneficiaries who have the greatest need. Similarly, trusts can provide for the enjoyment of property to be split over time. If I want my wife to receive the income from some investment throughout her life but to give the capital to my children, then the only way I can do so is by the use of a trust.

Third, it is said that trusts have benefits over outright individual ownership, for instance, because they allow the pooling of assets and the appointment of expert trustees, such as accountants, financial planners and lawyers.

Finally, trusts are often used to lower taxation liability and to protect assets from being claimed by creditors. This raises policy questions about the degree to which trusts should be used to minimise tax liability and to protect assets from creditors, which are largely outside the scope of this course.

REFLECTION POINT

As you read trusts cases, make a note of the reasons for which the trusts were formed, if this is known. Consider what this tells you about the requirements for, and possible problems with, trusts law.

2.2.2 Trusts arising by operation of law

Not all trusts are created by settlors. Sometimes, the law imposes trusts. One category of imposed trust is the **constructive trust**. The reasons why such trusts arise are various, and many are said to respond to or prevent some form of unconscionable conduct. We will explore constructive trusts and their possible legal (and policy) bases in Chapter 13. For now, consider the trust in *FHR European Ventures LLP* v *Cedar Capital Partners LLC* [2014] UKSC 45, [2015] AC 250. The claimants hired an agent to negotiate their purchase of a hotel unaware that he was also receiving a secret payment (or 'commission') from the vendor. Since this was a breach of the agent's fiduciary duty to loyally serve the claimants' interests, the agent held that commission on constructive trust for the claimant. Facts patterns like this may suggest that some constructive trusts are best characterised as being a type of proprietary remedy but, at least in the UK, this suggestion has been criticised by the courts.

A second type of imposed trust is the **resulting trust**. As we will see in Chapter 3, although the circumstances in which a resulting trust arises are fairly clear, there is ongoing scholarly debate about their characterisation and the precise role of the parties' intention in their formation.

2.2.3 The juridical effect of a trust

There is some debate around the legal effect of creating a trust. It is, for example, often said to involve the creation of a dual 'ownership', with equitable title passing to the beneficiary of the trust, and legal title to the trustee (where a person other than the settlor is to be the trustee). In truth, however, the property that the settlor had prior to the creation of the trust is transferred in its entirety to the trustee. At the same time, new rights are created in equity for the beneficiary of the trust, which, in the case of a trust for persons, enable the beneficiary to hold the trustee to account for the trustee's exercise of their duties in relation to the property. If, on the other hand, the trust is for a charitable purpose, rights of enforcement will be vested in the Attorney-General and other appropriate government agencies.

Before the trust was created, the settlor held the property outright and there were no equitable rights vested in others.

The clearest discussion of this issue is to be found in the Australian case of *DKLR Holding Co (No.2) Ltd* v *Commissioner of Stamp Duties* [1982] HCA 14, 149 CLR 431. A company, 29 Macquarie (No.14) Pty Ltd, was the registered proprietor of a title in land. It arranged with another company, DKLR Holding Co (No.2) Ltd, for the latter to hold the title in trust for the former once the title register had been changed. The question was how much stamp duty was payable on the transfer of the title to DKLR. DKLR argued that only nominal duty was payable, since all that it received was a bare title, with 29 Macquarie retaining the equitable interest. The argument was rejected in both the New South Wales Court of Appeal and the High Court of Australia. Speaking in the former, [1980] 1 NSWLR 510 at 519, Hope JA said:

> [A]n absolute owner in fee simple does not hold two estates, a legal estate and an equitable estate. He holds only the legal estate, with all the right and incidents that attach to that estate... [A]lthough the equitable estate is an interest in property, its essential character still bears the stamp which its origin placed upon it. Where the trustee is the owner of the legal fee simple, the right of the beneficiary, although annexed to the land, is a right to compel the legal owner to hold and use the rights which the law gives him in accordance with the obligations which equity has imposed upon him. The trustee, in such a case, has at law all the rights of the absolute owner in fee simple, but he is not free to use those rights for his own benefit in the way he could if no trust existed.

29 Macquarie did not therefore 'retain' an equitable interest; their equitable interest, (i.e. their interest under the trust), only arose on the transfer and the tax was therefore payable.

Similar views were expressed when the case reached the High Court of Australia, (1982) 149 CLR 431 at 474, where Brennan J said:

> An equitable interest is not carved out of a legal estate but impressed upon it. It may be convenient to say that DKLR took only the bare legal estate, but that is merely to say elliptically that 29 Macquarie transferred to DKLR the property in respect of which DKLR had declared that it would be a trustee. The charter of 29 Macquarie's interest was DKLR's declaration, not the memorandum of transfer; and DKLR's declaration was moved by the transfer to it of the property to be held on the trust declared.

An equally good metaphor is to see the interest of the beneficiary as being 'engrafted' on to the title or right held by the trustee. This is the language of McLelland J in *Re Transphere Pty Ltd* (1986) 5 NSWLR 309. Having referred to the judgment of Hope JA in *DKLR*, he said:

> Where a legal owner holds property on trust for another, he has at law all the rights of an absolute owner but the beneficiary has the right to compel him to hold and use those rights which the law gives him in accordance with the obligations which equity has imposed on him by virtue of the existence of the trust. Although this right of the beneficiary constitutes an equitable estate in the property, it is engrafted onto, not carved out of, the legal estate.

Such language received the approval of Lord Mance in *Akers* v *Samba* [2017] UKSC 6, where he said at [50]:

> The metaphor of a 'division' or 'split' of title needs to be approached with some caution. Burrows, *English Private Law*, para 4.149, speaks of:
>
> > the falsity of statements which talk in terms of a 'division' or 'separation' of rights when rights are held on trust, or even worse, of legal and equitable 'titles' existing before the creation of the trust.
>
> Burrows, citing Australian authority, suggests an analysis according to which an equitable interest is 'not carved out of a legal estate but impressed' or 'engrafted' onto it (para 4.150).

2.3 Comparison with other legal concepts

One of the best ways to understand something is to compare it with things which are different but closely related, thereby understanding the differences between them. If, for example, we want to understand what leopards are, we need to know how they differ from jaguars, tigers and the other big cats. So too with trusts. If we are to understand trusts, we need to know how they differ from a number of other similar legal relationships: agency, bailment, contract and debt.

2.3.1 Agency

Trustees are not, by virtue of their office, agents of the beneficiaries. When entering into contracts as trustees, the trustees incur the liability to perform them. The beneficiaries do not. If the trustees were agent of the beneficiaries, the beneficiaries too would become liable. That said, an agent may also become a trustee, although everything will turn on the terms of the contract of agency. Suppose that you are going abroad for a year and appoint an estate agent to let and manage your house. Whether the agent merely owes you the amount of rent received from your tenants or holds it for you on trust depends on whether the agreement between you provided for the creation of a trust. An example of a contract using the trust device is *Royal Brunei Airlines* v *Tan* [1995] UKPC 4, [1995] 2 AC 378 (discussed in Chapter 16), where a travel agent was appointed to sell tickets for the claimant airline on condition that all monies received by the agent were to be held for the airline on trust.

Reflection point

Why might the use of a trust device make a difference in such cases?

2.3.2 Contract

There is no clean division between contract and trust, although some judges have attempted to draw one (see e.g. *Re Cook's ST* [1965] Ch 902, discussed in Chapter 8). Indeed, there can be no hard and fast line between contract and trust because contract is a source of rights while trust is a way of holding rights. A simple example will illustrate. Suppose I open a bank account and pay in £1,000. I have a right born of contract that the bank repay me £1,000 on demand. If I then declare that I hold that money on trust for my children, it is impossible to say that this is now a case of trust and not contract, it is both.

The other point, of course, is that contract is an essentially consensual institution. Although some of the terms of a contract may be dictated by the law rather than the parties themselves, no one is ever forced to be a contracting party. This is not the case with trusts. As we have seen, although the vast majority of trusts are settlor-created, some are forced upon unwilling parties.

2.3.3 Debt

The distinction between trust and debt is more difficult. In the case of a trust for persons, the relationship between trustee and beneficiary is not one of debtor and creditor: the trustee does not owe the money to the beneficiary like I would owe you £100 if I borrowed it from you. The obligations of the trustee are more complex and sophisticated than that of a simple debtor.

Furthermore, it is clear that an agency relationship is a fiduciary one which imposes upon an agent many well defined duties in his dealings with and on behalf of his principal. But this description does not mean that in every situation where an agent collects money, he is a trustee of the money in his possession or deposited in his bank. In *Henry* v *Hammond* [1913] 2 KB 515 at 521, Channell J said:

> It is clear that if the terms upon which the person receives money are that he is bound to keep it separate, either in a bank or elsewhere, and to hand that money so kept as a separate fund to the person entitled to it, then he is a trustee of that money and must hand it over to the person who is his cestui que trust. If on the other hand he is not bound to keep the money separate, but is entitled to mix it with his own money and deal with it as he pleases and when called upon to hand over an equivalent sum of money, then in my opinion, he is not a trustee of the money. All the authorities seem to me to be consistent with that statement of the law.
>
> …In the case at bar there is no evidence that it was a term of the defendant's employment that he should keep the moneys he collected separate from his own. The letter appointing him agent does not touch the point…
>
> In the instant case the defendant was in my opinion the debtor of the plaintiff to the amount of the moneys collected less his commission. He was under no duty to keep this money separate from his own and the fact that he did so cannot alter what I find to be the basic relation between the parties.

Note: the '*cestui que trust*' is the beneficiary of the trust.

It has been held that it is possible for someone to be both a debtor and a trustee at the same time, with the borrower holding the money in trust for the lender until certain conditions are fulfilled: *Barclays Bank Ltd* v *Quistclose Investments Ltd* [1970] AC 567; *Twinsectra Ltd* v *Yardley* [2002] UKHL 12, [2002] 2 AC 164; *Ali* v *Dinc* [2020] EWHC 3055 (Ch). Once the condition is fulfilled, the trust ceases to exist and the debt continues. If the condition cannot be fulfilled, then the debtor as trustee must return the money to the lender as beneficiary, thus ending both relationships. For *Quistclose* trusts generally, see Penner 11.35–11.50; Swadling, W.J. 'Orthodoxy' in Swadling, W.J. (ed.) *The Quistclose trust – critical essays*. (Oxford: Hart Publishing, 2004) [ISBN 9781841134123] (available on the VLE).

Activity 2.2

Is it possible to maintain strict divisions between trust and agency, trust and contract, and trust and debt?

Self-assessment questions

1. **What are trusts and why are they created?**
2. **What is the relationship between the law of equity and the law of trusts?**
3. **What similarities are there between common law and equity?**
4. **What are the differences between the two?**
5. **What was the effect of the Judicature Acts 1873–75?**
6. **In a trust, who are (a) the 'settlor', (b) the 'beneficiary' and (c) the 'trustee'?**

Sample examination questions

No sample questions are given here because although the topics covered in this chapter are vital for an understanding of the law of trusts, they are not specifically examinable.

Reflect and review

Look through the points listed below.

Are you ready to move on to the next chapter?

Ready to move on = I am satisfied that I have sufficient understanding of the principles outlined in this chapter to enable me to go on to the next chapter.

Need to revise first = There are one or two areas I am unsure about and need to revise before I go on to the next chapter.

Need to study again = I found many or all of the principles outlined in this chapter very difficult and need to go over them again before I move on.

Tick a box for each topic.

	Ready to move on	Need to revise first	Need to study again
I can explain in outline what a trust is, and why people create trusts.	☐	☐	☐
I can explain the difference between law and equity and the role of equity in the enforcement of trusts.	☐	☐	☐
I can explain how trusts differ from other similar concepts.	☐	☐	☐

If you ticked 'need to revise first', which sections of the chapter are you going to revise?

		Must revise	Revision done
2.1	Equity	☐	☐
2.2	What is a trust?	☐	☐
2.3	Comparison with other legal concepts	☐	☐

3 Types of trusts

Contents

Introduction

There are several different kinds of trust, and learning what these are is to a large extent learning the meaning of the different terms used to classify trusts. This terminology is historical, and to some extent unsystematic and even contradictory. Nevertheless, grasping the different kinds of trust, and the various terms used to classify them, is vital for two reasons:

1. The first, practical reason is that if you do not get a grip on these terms you will not be able to understand most of what judges and lawyers say when they talk about trusts, and indeed you will have a difficult time understanding the rest of this module guide.
2. Just as importantly, understanding any area of law turns on being able to see the distinctions it draws and classifications it devises in an attempt (not always successful) to make itself comprehensible and coherent, so that justice is done and like cases decided alike.

Do not worry if everything is not entirely clear when you have finished working on this chapter. We will return to all of these issues throughout the guide. The main purpose of this chapter is simply to acquaint you with the language of the subject so that you can work through the other chapters with some measure of comprehension.

CORE TEXT

- **Penner, Chapter 2 'Express trusts: basic principles', Sections 'Express trusts and trusts arising by operation of law (TABOLs)' and 'The position of the settlor'; Chapter 3 'Trusts and powers', Sections 'Three basic building blocks: fixed trusts, discretionary trusts, and powers of appointment' and 'The variety of interests under express trusts'; Chapter 17 'Constructive trusts', Sections 'Varieties of constructive trust (CTs)' and '"Institutional"and "remedial" constructive trusts'; and Chapter 10 'Resulting trusts', Sections 'Resulting uses' and 'Resulting trusteeship'.**

LEARNING OUTCOMES

By the end of this chapter and the relevant readings, you should be able to:

- **explain what the terms 'express', 'fixed', 'discretionary', 'bare', 'simple', 'special', 'arising by operation of law', 'implied', 'constructive', 'resulting', 'testamentary', '*inter vivos*', 'purpose', 'charitable' and 'non-charitable' mean when used of trusts**
- **indicate where some of these terms may have several, perhaps conflicting, meanings**
- **outline the structure of the various kinds of trust to which these terms refer and be able to explain the bases upon which they classify trusts.**

3.1 Express trusts

The most common type of trust is the express trust. An express trust is one which is deliberately created by the holder of the property that will be held in trust. This person is called the 'settlor' because they 'settle' the property on trust, either declaring that they will henceforth hold some particular property on trust for specified persons (the beneficiaries), thus becoming a trustee for them, or by transferring the property to other persons to hold on trust for the beneficiaries. An express trust can also be created in the same way for charitable purposes. These are discussed at the end of this chapter. The expression of intent to establish a trust is known as a declaration of trust. The essential points to grasp about express trusts are the following:

1. Not every declaration of trust will be effective to create a trust. In order for it to have this effect, certain requirements must be satisfied. These requirements will occupy us in Chapter 5. You can think of them in much the same way that you understand the requirements for the successful formation of a contract. To take just one example, just as there must be an intention to create legal relations in the law of contract, so there must be an intention to subject the potential trustee to a duty to perform the trust. For that reason, we will see that 'precatory' words, those expressing merely a hope or desire that a potential trustee will act in a particular way, are not normally sufficient to bring a trust into being.
2. The ability of a person to create a trust reflects a principle of 'freedom of trust' similar to the principle in succession law of 'freedom of testamentary disposition' and the principle of 'freedom of contract' in the law of contracts. Settlors can, within the limits of the law, divide up the entitlements under the trust in almost any way they choose, providing different kinds of interests for different beneficiaries or different charitable purposes.

3.2 Discretionary and fixed trusts

The terminology of fixed trusts and discretionary trusts , which occurs only in the context of trusts for persons, classifies trusts according to the type of dispositive obligations of the trustee. In a fixed trust, the trustees have no choice as to how to distribute the trust property, this being specified in the trust instrument, and it is the trustees' duty to ensure that the correct distribution takes place. In a discretionary trust, the trustees themselves have the power of choice over the distribution of the trust property.

Applying this distinction in practice, a settlor can choose between dividing the interests of the beneficiaries according to a fixed plan, or taking a 'wait and see' approach, where the actual shares or interests that the beneficiaries will receive are decided later. For example, the settlor may want to create a trust for her children but leave it open as to how much each child will receive, so as to take account in later years of their differing circumstances.

1. A fixed trust is one in which the interests of all the different beneficiaries are determined at the outset and the trustees have no decisions to make as to how they should distribute the trust property.
2. A discretionary trust is one in which the trustees have such a dispositive discretion (i.e. a choice as to how to dispose of the trust property).

Discretions may be shaped in various ways, but the typical case is one in which there is a class of persons among whom the trustees may distribute the trust funds in such shares as they, in their absolute discretion, decide. Thus they can choose to distribute the property evenly or in unequal shares by giving some to all or only to one or a few of those in the class.

The fixed or discretionary nature of a trust therefore turns on whether the trustees have a discretion in their distribution of the trust property. Being fixed does not mean that the actual amount that a beneficiary will receive can be determined from the

outset. For example, in a trust of company shares where the income of the shares (the dividends) go to Paul as long as he lives and then the capital (the shares themselves) go to Peter, it is impossible to tell how much Paul will get at the outset, for that will depend on the value of the dividends on the shares over time and how long Paul lives. Nevertheless, the trust is still fixed because the trustees have **no choice** but to transfer that income to Paul.

Furthermore, a beneficiary may receive a contingent or defeasible interest under a trust. A **contingent interest** is one that will only arise if a certain event occurs. So, for example, a trust might provide that your daughter, Samantha, is to receive an income but only if she completes her law degree successfully. A **defeasible interest** is one which may come to an end upon the happening of a certain event. You might give Samantha an interest in income, which will terminate if she wins £1 million or more in a lottery. Although under both these kinds of interests, it is not certain at the outset what, if anything, Samantha will take under the trust, they are still classified as fixed because the trustees have no dispositive discretion.

A trust can include both discretionary and fixed elements. For example, you may settle a trust of company shares, with the income of the shares to be distributed as it arises among your children, Tom, Dick and Mary, in such shares as your trustees, in their absolute discretion, decide, and with the capital (the shares themselves) to be distributed in equal shares to Tom, Dick and Mary once the youngest turns 18 years of age. The distribution of income is discretionary, but the capital interests are fixed.

3.3 Bare trusts

A bare trust is one in which the terms of the trust are minimal. Under a bare trust, the trustees hold the trust property 'to the order' of the beneficiaries, which means that the trustees simply hold the property and do the bidding of the beneficiaries. In this respect, a bare trust is just the most minimal kind of fixed trust, under which trustees have no discretion. A distinction is sometimes drawn between simple (bare) trusts and 'special' trusts (with more or less complicated terms, fixed or discretionary). Why might someone set up a bare trust? In various circumstances, a bare trust can be very convenient. For example, you might transfer company shares to your stockbroker to hold on bare trust for yourself. The stockbroker will be able to engage in all the legal procedures to deal with the trust property, so you do not have to attend to that, and the stockbroker will just follow your instructions about the various transactions, which you might find convenient to give over the telephone, for example. For this reason, trustees under bare trusts are sometimes called 'nominees', to indicate that they hold the property in name only directly for another (the beneficiary), and the trust is called a 'nomineeship'.

ACTIVITY 3.1

Make a short spoken presentation explaining the difference between fixed and discretionary trusts, giving practical examples.

No feedback provided.

Summary

An express trust is one which arises in response to an effective manifestation of intention on the part of a settlor that a trust should arise. This manifestation of intention is known as a declaration of trust. Express trusts are therefore declared trusts. The simplest form of declared trust is the bare trust or nomineeship, under which the trustee holds property to the order of a beneficiary. However, interests under trusts are commonly structured by the use of contingent interests (which may arise or lapse on the occurring of events) and by providing the trustee with dispositive discretions (to allocate trust property among a class of persons). Trust provisions which incorporate dispositive discretions are termed 'discretionary', and those not incorporating such discretions are called 'fixed'.

Activity 3.2

You have just won £1 million in a lottery and decide to settle half of the money on your loved ones. Devise a trust, deciding how you wish to divide up the money among them, incorporating both fixed and discretionary elements, and, if you wish, contingent and defeasible interests.

3.4 Trusts arising by operation of law

3.4.1 How rights arise

Although the manifestations of consent underlying contracts, wills, deeds and declarations of trust are a common source of legal rights, rights can also arise in other ways. In private law, it is often thought that rights can also arise from the commission of a wrong (tort), by unjust enrichment and by various other events. A question for the law of trusts is when will these events trigger a trust, even though the trust is not created expressly. If such a trust arises, the rights of the beneficiary will go beyond merely personal rights to a money payment, injunction, or other remedy.

3.4.2 Statutory trusts

There are a number of situations in which the legislature has thought it convenient to use the trust device as a cure for certain problems. In such cases, the trust is a creature of statute. One of these is a central feature of English land law. If I attempt to transfer my title to land to Fred and Joe as co-owners, statute provides that the effect of my action is to convey the title to Fred and Joe as joint tenants on a statutory trust of land for themselves: ss.34 and 36 Law of Property Act 1925. In this module we are not concerned with statutory trusts, for they are used by the legislature on an ad hoc basis and only make sense when examined in context.

3.4.3 Constructive trusts

The term 'constructive' is ambiguous, but in the context of trusts, it means a trust which is 'constructed' by the law rather than by an individual through a declaration of trust. We came across an example of a constructive trust in the last chapter in *FHR European Ventures LLP* v *Cedar Capital Partners LLC*. The vital fact to realise about this case is that the trust arose even though there was no declaration of trust by anyone. Constructive trusts, therefore, have not been declared, but to say that they arise for reasons other than a declaration of trust is not particularly helpful. It gives only a negative description, telling us how the trust does not arise rather than why it does. One of the things that judges and commentators working in the area of trusts attempt to do is to come up with a typology of constructive trusts so that this question can be answered.

For example, the trust in *FHR European Ventures LLP* v *Cedar Capital Partners LLC* can be seen as a response to the commission by the agent of the wrong of breach of fiduciary duty (and see also the Supreme Court decision in *Crown Prosecution Service* v *Aquila Advisory Service Ltd* [2021] UKSC 49). An example of a constructive trust arising in different circumstances – in this example as a response to unjust enrichment – is *Chase Manhattan* v *Israel-British Bank* [1981] Ch 105. In that case, the claimant bank mistakenly paid US$2 million to the defendant bank. Although the defendant was personally liable at common law to repay the money, that was of little use to the claimant because the defendant became bankrupt. But property held by a trustee on trust for others does not form part of the trustee's assets available for distribution to his creditors and so the claimants argued that the mistaken payment was the subject of a trust. Goulding J held that, when money is paid by mistake, the recipient holds it on trust for the payer and so it never became part of the estate available for distribution to creditors. A third example is where a contract to sell an estate in land turns the seller into a trustee of that estate for the purchaser until the contract is completed by a proper conveyance of the estate. A fourth example of a constructive trust is where 'equity will perfect an imperfect gift' (e.g. *Re Rose* [1952] Ch 499). A final example (although there are others,

see Chapter 13) in which constructive trusts arise is where two people acquire a family home together. Ideally, they will declare in writing that they hold the home on trust for themselves but, if no trust is declared, then a constructive trust can arise in their favour based on their common intention. You will study this in property law, where you will see that the House of Lords and Supreme Court have dealt with this sort of trust in *Stack* v *Dowden* [2007] UKHL 17, [2007] 2 AC 432 and *Jones* v *Kernott* [2011] UKSC 53, [2012] 1 AC 776.

Constructive trusts can be divided into 'institutional' and 'remedial' trusts. There has been a great deal of academic debate in relation to this division, with some scholars fiercely critical of the very idea of a remedial constructive trust. The distinction is that institutional constructive trusts arise because of the application of legal rules, albeit rules developed incrementally by the courts, whereas remedial constructive trusts arise because an individual judge thinks it is fair that it should, even if the rules developed by the courts say that on the particular facts there should be no trust. Another distinction concerns the time at which the trust arises: institutional constructive trusts arise as the facts in question happen, the role of the court being to merely declare that the trust arose at some point in the past. However, remedial constructive trusts are dependent on the order of the court and will arise when the court says they do. It is debatable whether English law will ever recognise remedial constructive trusts. As noted in Chapter 2, so far the English courts have not been in favour of them: see *Angove's Pty Ltd* v *Bailey* [2016] UKSC 47, [2016] 1 WLR 3179.

What these cases reveal is that the crucial questions in all cases of constructive trusts are why the trusts arose and whether they should have arisen.

3.4.4 Implied trusts

On occasion, you might see reference to implied trusts. In law, 'implied' can mean at least two different things: (1) implied by law (i.e. imposed by law); or (2) implied in fact (i.e. inferred from the facts). However, whatever 'implied' means under the general law, it is a redundant category in the law of trusts. If it means a trust implied in law, then it is no different from a constructive trust. If it means a trust implied in fact, then it is no different from an express trust. Because of the ambiguity inherent in the words 'implied trust', the term should be avoided and, in that regard, it is notable that it is rarely used today.

Summary

Some trusts arise by operation of law, that is, for reasons other than a declaration of trust. In other words, the trust arises as an equitable response to certain factual circumstances. What is often lacking is a coherent explanation of why this is done.

3.4.5 Resulting trusts

The term 'resulting trust' comes from the Latin *resalire*, meaning 'to jump back'. There has been extensive academic debate in relation to why resulting trusts arise, how they ought to be classified within the law of trusts and whether they are susceptible to a coherent explanation. Some commentary has even expressed the view that the resulting trust is a redundant category and that resulting trust fact patterns could be subsumed within the categories of express and constructive trusts.

In contrast, there is a fairly consistent body of case law in relation to the situations when resulting trusts arise. These were identified by Megarry J in *Re Vandervell (No.2)* [1974] Ch 269, who divided such trusts into two categories: 'presumed' and 'automatic'. In his view:

- A 'presumed' resulting trust generally arises where A transfers property to B gratuitously (i.e. taking no payment of any kind in return, 'for no consideration') and there is no evidence of why A did so. Likewise, if A pays C to convey property to B then, in the absence of evidence of the manifested intentions of A and provided certain other conditions are met, B will hold the property on 'resulting' trust for A.

- An 'automatic' resulting trust is said to arise when a transfer is made on trusts which are either wholly or partially invalid. Thus, if A conveys property to B to hold on trust for C for life, but says nothing about how B is to hold it after C's death, the trust 'fails' so far as the remainder is concerned, and normally B will hold the property for C for life, remainder to A.

The cases in the first category involve what might be termed 'apparent gifts', while those in the second category involve 'failed trusts'. As discussed in Chapter 12, whatever might be said about the challenges of resulting trusts as a matter of classification, we can point to economic and policy reasons, which might help explain why resulting trusts arise in these circumstances. That said, questions of classification are important, especially if they suggest that resulting trusts should cover a broader range of circumstances. For instance, it might be argued that the mistaken overpayment in *Chase Manhattan* v *Israel-British Bank*, discussed above, is better viewed as giving rise to a resulting trust rather than a constructive trust.

Summary

Since *Re Vandervell (No.2)*, two kinds of resulting trust have been recognised: presumed resulting trusts and automatic resulting trusts. These correspond to two fact patterns, involving what might be termed apparent gifts, and property transferred under a trust that fails immediately or at a later time. There is ongoing scholarly debate about the classification of the resulting trust.

3.5 Testamentary and *inter vivos* trusts

A testamentary disposition is a gift made in the donor's will, which only takes effect when the donor dies. A person who dies leaving a will is called a testator. Someone who dies without disposing of all their property by will has died intestate, either wholly or partially. Normally, a testamentary trust is an express trust which is set out in a person's will, and comes into operation when the testator dies and the estate is administered by their executors. Typically, the executors are also the first trustees of any trust which arises under someone's will. By contrast, an *inter vivos* ('among the living') trust is one that takes effect during the settlor's life.

Self-assessment questions

1. **Define:**
   a. **an express trust**
   b. **a discretionary trust**
   c. **an automatic and a presumed resulting trust**
   d. **a constructive trust**
   e. **an implied trust**
   f. **an *inter vivos* trust**
   g. **testamentary trust.**
2. **What is 'fixed' in a fixed trust?**

3.6 Purpose trusts

Every express trust exists for a reason, in the sense that a settlor creates it with some purpose in mind. The same is true of constructive trusts that arise by operation of law to fulfil the reason for which that legal rule was created. A purpose trust, properly so called, is one that is devoted to the carrying out of some purpose, for example, to devise a 40-letter alphabet for the English language (the facts in *Re Shaw* [1957] 1 WLR 729). While it might be true that a great many individuals could benefit from such a trust, purpose trusts do not have beneficiaries as such. Importantly, trusts for non-

charitable purposes are usually void (they cannot exist). This means that if a settlor tries to create a purpose trust, then normally the trust will fail at the outset **unless** the purpose is charitable.

A number of questions arise in relation to trusts for charitable purposes. One relates to enforcement, given the lack of any human beneficiaries with a defined interest in the trust or the right to enforce the trust against the trustee. The answer is that the Charity Commission for England and Wales has the power to enforce such trusts on behalf of the Crown (acting via the Attorney-General): Charities Act 2011, ss.13–15. By way of contrast, purpose trusts that are not accepted by the law as charitable are often called 'private purpose trusts'.

As we have seen, the basic rule is that private purpose trusts are void. There is, however, a small number of exceptions, all of which are testamentary trusts. These are trusts for the provision and upkeep of graves and monuments, the care of the testator's animals or for private masses for the better repose of the testator's soul. The enforcement mechanism is peculiar and fragile, as we shall see in Chapter 10. As we shall also see in Chapter 10, certain recent cases may appear to have further weakened the rule against private purpose trusts.

Summary

Purpose trusts are those in which funds are devoted to the carrying out of a purpose rather than conferring beneficial rights on people. Such trusts have no beneficiaries, and for this reason, among others, most non-charitable purpose trusts are invalid. Charitable purpose trusts are valid and are enforced by the Charity Commission and the Attorney-General, acting on behalf of the Crown.

ACTIVITY 3.3

Review the following trusts and explain which of the following terms can be applied to them: 'express', 'fixed', 'discretionary', 'bare', 'constructive', 'resulting', 'testamentary', '*inter vivos*', 'purpose', 'private', 'public' and 'charitable'.

a. **Under her will, A provided £1 million to be held on trust, the income to be distributed for a period of 21 years to her children and grandchildren in such shares as her trustees shall in their absolute discretion decide, although any child or grandchild will lose any further possibility of receiving money if they establish a residence outside the UK. At the end of the 21-year period, the capital is to be paid to the British Red Cross.**

b. **Fred transferred £50,000 to trustees on trust to build a 'useful memorial to myself'. (See *Re Endacott* [1960] Ch 232.)**

c. **Arthur transferred £10,000 to trustees on trust for 'such objects as I shall declare in writing'. Arthur died before declaring any such objects.**

d. **Beatrice transferred 100 shares in Super plc to her infant niece Florence and later died. There is no evidence that she spoke to anyone about the transfer (see *Re Vinogradoff* [1935] 179 LT Jo 274 (available in HeinOnline via the Online Library)).**

e. **In compliance with their contract to pursue the purchase of land for commercial development, Fred and Bill each transferred £100,000 to a solicitor to complete the purchase. The solicitor wrongfully paid £10,000 of this to his nephew as a birthday present.**

SAMPLE EXAMINATION QUESTION

How does the law classify trusts? Are there any ambiguities and inconsistencies in the classifications?

Advice on answering the question

This is a wide-ranging topic which can be addressed in different ways. However, the two different parts should each receive sustained attention. The law classifies trusts in different cross-cutting ways for different purposes. The distinction between fixed and discretionary trusts is based on the structure of the trust (i.e. the terms of the trust which determine how the rights are to be distributed). It distinguishes cases where the trustee has no dispositive discretion (i.e. where the trust instrument dictates the distribution), from cases where the trustee has significant control by way of his discretion over distribution. The distinction between express and constructive trusts focuses on how trusts arise. Express trusts arise because settlors intentionally create them. Constructive trusts, by contrast, are imposed by operation of law. The category of implied trust is probably redundant. Purpose trusts are distinguished from trusts for people, and may be divided into private purpose trusts (generally void) and valid charitable purpose trusts. The distinction between testamentary and *inter vivos* trusts is straightforward, reflecting the way in which a different area of law (the law of succession) interacts with the law of trusts. Some academics argue that the special identification of resulting trusts, although a traditional classification, is problematic, given both that it covers two cases of trust arising for seemingly different reasons, and because the term can refer broadly to cases outside these two categories.

The second point to be addressed focuses on the problems of the classifications the law has traditionally adopted. Implied trusts and resulting trusts might be discussed; implied trusts as a classic example of an ambiguous term, and resulting trusts for the uncertain scope of the term, and the difficulty of finding a unifying feature of the two cases of trust typically referred to by the phrase 'resulting trust'. The category of constructive trusts has also historically been used to group particular sorts of trust together which have a wide range of rationales and bases. An answer with respect to constructive and resulting trusts will be enriched by the study of these trusts in depth in later chapters.

Reflect and review

Look through the points listed below.

Are you ready to move on to the next chapter?

Ready to move on = I am satisfied that I have sufficient understanding of the principles outlined in this chapter to enable me to go on to the next chapter.

Need to revise first = There are one or two areas I am unsure about and need to revise before I go on to the next chapter.

Need to study again = I found many or all of the principles outlined in this chapter very difficult and need to go over them again before I move on.

Tick a box for each topic

	Ready to move on	Need to revise first	Need to study again
I can explain what the terms 'express', 'fixed', 'discretionary', 'bare', 'simple', 'special', 'arising by operation of law', 'implied', 'constructive', 'resulting', 'testamentary', '*inter vivos*', 'purpose', 'private', 'public' and 'charitable' mean when used of trusts.	☐	☐	☐
I can indicate where some of these terms may have several, perhaps conflicting, meanings.	☐	☐	☐
I can outline the structure of the various kinds of trust to which these terms refer and am able to explain the bases upon which they classify trusts.	☐	☐	☐

If you ticked 'need to revise first', which sections of the chapter are you going to revise?

		Must revise	Revision done
3.1	Express trusts	☐	☐
3.2	Discretionary and fixed trusts	☐	☐
3.3	Bare trusts	☐	☐
3.4	Trusts arising by operation of law	☐	☐
3.5	Testamentary and *inter vivos* trusts	☐	☐
3.6	Purpose trusts	☐	☐

4 The express trust relationship

Contents

Introduction

This is the widest-ranging chapter in this module guide, for it covers a number of essential aspects of the express trust. Although charitable trusts are also express trusts, the focus of this chapter is on express trusts for persons. It is best to look at their essential aspects together, because they are closely related. We will begin by examining the way in which express trusts might be said to be a legal concept generating both personal and proprietary rights. We will then focus on the powers and duties of the trustee and others under the trust, and consider in some detail the trustees' powers of maintenance and advancement, duty of investment, and power of delegation. We will then focus on the rights and powers of the objects of the trust, in particular the beneficiaries' rights to information and their power to collapse the trust under the rule in *Saunders* v *Vautier* (1841) 4 Beav 115.

CORE TEXT

- **Penner, Chapter 3 'Trusts and powers' and Chapter 8 'The trust up and running'.**

LEARNING OUTCOMES

By the end of this chapter and the relevant readings, you should be able to:

- **describe the structure of the typical express trust for persons by setting out the rights the beneficiaries have, and the powers and duties that the trustees, and others, may have**
- **explain in outline the beneficiaries' rights to follow and trace rights held on trust that have been transferred in breach of trust**
- **set out the typical sorts of administrative and dispositive powers and duties a trustee will have**
- **describe the law governing the powers of maintenance and advancement, the duty of investment and the power of delegation**
- **explain the rights of objects to information and their power to collapse the trust under the rule in *Saunders* v *Vautie*r.**

4.1 Introduction to rights and duties

The trust is arguably a combination of personal and property rights and duties. What is the difference between a personal right and property right? The basic distinction is that a personal right is a right enforceable only against specific persons (e.g. a right to the performance of a contract). If I contract with you that you will paint my house, I cannot sue your brother or sister simply because you breach your promise. The only person liable to perform is you. By contrast, a property right is one in respect of a specific thing which can be enforced against any number of people so long as that thing itself is still in existence. Consider a physical book, such as this module guide. You have a right to exclusive possession of this guide (as it is a chattel), a right that the common law compendiously calls 'title' (from en**title**ment). Although that right was transferred to you by the University of London, it binds strangers to the relationship between you and the university. It is a property right and can therefore be enforced against anyone into whose hands the guide may come without your consent.

Under a trust, the trustee owes a number of personal obligations to the beneficiaries, such as the duties to:

- keep the trust accounts (i.e. proper records of the trustees' dealings with the trust)
- distribute the property according to the trust's terms
- invest the trust funds.

If the trustees breach any of these duties so as to cause a diminution in the value of the trust fund, they will be personally liable at the suit of the beneficiaries to be ordered to restore that value. However, equity also holds that the beneficiaries have rights with respect to the trust property itself, rights that can bind third parties. Some care is needed here as these rights are (arguably) not orthodox property rights. (Whether they are orthodox or not depends on one's definition of property.) The beneficiaries do not have direct rights of possession over that which is held in trust. So, for example, if a title to this module guide were being held on trust for you, it is the trustees, not you, who have the title (i.e. the right to exclusive possession). You have no right to exclusive possession, even in equity. You do not therefore have a property right in the traditional sense of the word. Similarly, if company shares are held on trust for you, it is the trustees who will have the rights to receive dividends, vote at shareholder meetings and share in the company's assets on dissolution. They must, however, exercise those rights in your interests and not for their own benefit. Although you have a right to call them to account for their management of the property they hold on your behalf, you do not hold the property itself. If a dividend, for example, is declared and not paid, you have no right to sue the company itself; only the trustees can do that.

Most of the beneficiaries' rights are enforceable only against the trustees. However, there are some rights that can be enforced against strangers to the trust relationship. These arise when the trust property is transferred by the trustee in breach of trust to someone who is not a *bone fide* purchaser for value of a legal title and without notice that the disposition was in breach of trust (see Section 4.1.1). Although third-party recipients will not be subject to all the normal duties of trustees (e.g. to invest), and will not have the dispositive powers of trustees, they will be obliged to return the trust property at the beneficiaries' suit. These rules apply equally to express, constructive and resulting trusts. They also apply when a sole trustee dies and the trust property is transferred via her or his estate. The trustee's personal representatives (i.e. the executors or administrators of the trustee's estate) can be obliged to return the trust property at the suit of the beneficiaries, and so too is anyone who receives that property under the trustee's will or upon the trustee's intestacy. Similar thinking explains what happens when trustees become bankrupt. In such a case, the statutory bankruptcy regime provides that property held on trust does not vest in their trustees-in-bankruptcy, as do almost all their other rights, with the result that they will not be available to satisfy their creditors' claims against them. It will be recalled that this was the reason the claimant bank in *Chase Manhattan* was arguing for a trust.

As will be seen in Chapter 16, third parties may also incur liability for dishonestly assisting the trustee to commit a breach of trust, for inducing the trustee to commit a breach of trust, and for knowingly receiving property dissipated in breach of trust. In many ways, such liabilities are analogous to the common law economic torts (e.g. inducing breach of contract).

4.1.1 *Bona fide* purchasers

The law has different rules for different kinds of property rights when it comes to the enforcement of those rights over the property against others. In the case of chattels or goods (such as a laptop) the rights are very robust. The holders of title to goods can in general enforce their rights to exclusive possession (their 'title') against anyone who receives those goods without their consent, including an honest buyer who paid money for them to someone who stole them, with no reason to suspect they were stolen. There are some limited exceptions to that rule, but the dominant approach is that the buyer acquires only the thief's inferior title, which the thief obtained by taking possession, and that the victim of the theft's better title is not destroyed by that sale. The Latin expression for this rule is *nemo dat quod non habet* (no one gives what he or she does not have).

The protection of rights under trusts is not as strong. The beneficiaries' rights to recover the trust property can be enforced:

- against a donee (sometimes called a 'volunteer', who is someone who receives the property as a gift)
- against the trustee's trustee in bankruptcy, in whom, as we have seen, the property does not vest
- against the trustee's personal representative on death

but not against the innocent purchaser for value of the trustee's legal title, assuming, of course, that the trustee had a legal rather than an equitable right. The effect of such a sale is to destroy the beneficiaries' right to a reconveyance of the trust property, with the result that the recipient takes them free of the trust. This does not leave the beneficiaries without a remedy, as they may (i) have personal claims against the trustees for conveying the property in breach of trust, or (ii) be able to adopt the transaction and treat the proceeds of sale as within the subject matter of the trust. But any recourse against the trustees may be worthless if the trustees have already dissipated any proceeds and are insolvent. It is for this reason that claims against third parties can be attractive.

As stated above, the trust cannot be enforced against someone who acquires legal title trust property as a *bona fide* purchaser for value without notice. This is usually called the defence of *bona fide* purchase or, somewhat quaintly, it is said that the recipient is 'equity's darling'. There are four separate elements that must be satisfied:

- *bona fide*: the recipient acted in good faith
- purchaser: the recipient acquired a legal and not merely an equitable right
- for value: the recipient gave good 'consideration' (i.e. money or money's worth) in exchange for the legal title
- without notice: the recipient did not have notice that the rights were transferred in breach of trust.

The question of good faith will normally be satisfied by showing lack of notice, but it is possible for a person to act in bad faith even without notice of the breach (e.g. if the purchase was part of an illegal transaction).

It may seem like the requirements of 'purchase' and 'for value' are one and the same but this is not quite true. 'Purchase' is an old term for the acquisition of a right by consent rather than by operation of law. An example of someone who is **not** a purchaser would be one taking under the rules of intestacy rather than under a duly executed will. This is why we talk of a purchaser 'for value'.

A person who obtains only an equitable right is not entitled to the defence even if they gave full value in good faith without notice.

Most cases concerning the operation of the *bona fide* purchase defence turn on the question whether the recipient had notice of the breach of trust at the time title was acquired. Therefore, the defence is sometimes called the 'doctrine of notice', but this can be misleading since notice is irrelevant if any other element of the defence is not met. Notice may be actual, constructive or imputed:

- Actual notice: the recipient had knowledge of the breach or was at least alerted to the possibility of breach.
- Constructive notice: the recipient would have discovered the breach if the usual investigations had been made. For example, a purchaser will normally make extensive searches (through a solicitor) when buying a title to land and, if those searches would have revealed the existence of the trust and possibility of breach, the purchaser will have constructive notice even though they did not have actual notice.
- Imputed notice: when the recipient employs an agent (such as a solicitor) to help with the transaction, the agent's (actual or constructive) notice will be imputed to the recipient, even if the agent failed to inform the recipient.

In some cases, the *bona fide* purchase defence does not completely extinguish the beneficiaries' right to the trust property, but gives the purchaser priority over that property. For example, the defence applies not just to transfers of legal title, but also to grants of other legal rights, such as a legal mortgage or legal lease of land. If the *bona fide* purchase defence applies, the land will still be held in trust for the beneficiaries, though subject to the mortgage or lease.

It should be noted that the *bona fide* purchase defence does not apply to registered land (i.e. to titles to land registered under the Land Registration Act 2002). That Act contains its own rules for deciding whether someone who acquires a registered freehold or leasehold estate or registered charge (i.e. mortgage) takes it free of the trust. We are not here concerned with those rules, which you will study in the Property law module. However, it is worth noting that good faith and notice are not normally relevant when those rules apply. If persons acquire registered legal interests in land for value, then normally they take them free of any trusts unless the beneficiaries' interests are 'protected' by either an entry on the register or as an overriding interest.

4.1.2 Following and tracing trust property

Following and tracing are discussed in detail in Chapter 18; however, it is worth signposting that discussion now, as it is relevant to the beneficiaries' ability to make a claim when the trust assets change hands (**following**) and/or change form (**tracing**). Thus, when the beneficiaries bring claims for the reconveyance of property transferred in breach of trust to third parties, they are said to 'follow' that property. However, the beneficiaries may also be able to make a claim in relation to substitute property. Imagine that company shares were transferred in breach of trust to a donee (D), who then sold them to a *bona fide* purchaser for £1,000. The beneficiaries' right to the shares would be extinguished as against the *bona fide* purchaser. However, the beneficiaries would be able to trace the value of the shares into the £1,000. They could then make a claim in relation to that money (as D is a volunteer) in which they asked for it to be conveyed to the persons appointed as trustees to receive it. Tracing can be used multiple times whenever the trust property is exchanged for something else. Returning to our example, if the £1,000 received in exchange for the shares was then used by D to purchase a car, the beneficiaries could elect to treat the car as trust property. This ability to 'trace' will be lost only when the thing over which the right exists is destroyed (for example, the car is destroyed by fire and there are no insurance proceeds) or there is no exchange product (for example, trust money is spent on a round-the-world cruise).

4.1.3 Personal actions for breach of trust

In cases of breach of trust, the beneficiaries will also have personal rights against the defaulting trustees. The trustees can be sued personally to make good losses to the trust that have occurred because of their breach, and, unless there is an exemption clause in the trust instrument on which they can rely (see Chapter 16), will be strictly liable for breach, in the same way that a contracting party is strictly liable for breaches of contract. Moreover, as touched on above, third-party recipients of trust property may also be personally liable to restore what they received to the trust, and third parties who dishonestly assist the trustee in a breach of trust will also be personally liable to make good the loss. The liability of these third parties is also discussed in Chapter 16.

ACTIVITY 4.1

Review Chapter 2 and Chapter 3 of this guide.

Read Penner Chapter 2 'Express trusts: basic principles' and Chapter 3 'Trusts and powers', Sections 'Three basic building blocks: fixed trusts, discretionary trusts, and powers of appointment' and 'The variety of powers and duties under a trust'.

Explain how the configuration of personal rights and proprietary rights under a trust differs from those in the case of:

a. **an agency under which P's agent collects rent for him without holding the money he collects on trust**

b. **a debt.**

4.2 Powers and duties of trustees and others

The structure of express trusts can be complicated. In Chapter 3, we saw how an express trust can incorporate different elements, some fixed, some discretionary and some contingent. There we dealt only with dispositive duties and discretions, because the character of distributive duties under a trust has been regarded as an important basis upon which to classify trusts. Here we elaborate on the structure of trusts, taking trustees' powers into account. Furthermore, we must notice that it is possible and common for people other than the trustee to have powers or duties under the terms of the trust. To take a typical example, the settlor of a trust may give himself a power to revoke it, so that the trust property then comes back to him.

As we have already seen, 'dispositive' powers and duties are those that concern the distribution of trust property to beneficiaries. 'Administrative' powers and duties concern dealings with the trust property without their distribution, such as investing the trust property, insuring it or using it to pay fees to solicitors and accountants.

Trustees' duties and powers are the best example of fiduciary duties and powers. 'Fiduciary' refers to those duties and powers which people must exercise in the best interests of others and not for their own benefit. Fiduciaries must avoid conflicts of interest. Thus, express trustees must perform their duties and exercise their powers only with the interests of the beneficiaries in mind and, in particular, not so as to serve their own interests or the interests of non-beneficiaries such as their own friends and relations who they might otherwise be prone to favour.

A power that is not fiduciary is, in the context of trusts, called a 'personal' power, which means that the holder can exercise it, within its proper limits, with their own interests in mind. Fiduciary powers are subject to fiduciary duties that require the holder of the power to use it only for the purposes for which it was granted. In a trust for persons, this normally means that the powers may only be exercised to further the best interests of the beneficiaries. It is very rare for a trustee to hold any personal powers under a trust, for trustees are typically only appointed to carry out the trust for the benefit of the beneficiaries alone; but it is possible for the powers of others under a trust to be personal. For example, the settlor's power of revocation, mentioned above, may well be personal. In some special cases, the settlor can revoke the trust and obtain a retransfer of the remaining trust property because it is in their own interests to do so. It would be

odd to think that the settlor would hold such a power as a fiduciary for the beneficiaries (rather than personally), for in what circumstances would it be in their best interests to have the trust, and thus their rights under it, revoked?

The overarching dispositive duty is, of course, to distribute the trust property according to its terms. But under the terms of the trust, there may be additional dispositive powers (i.e. powers to dispose or deal with the property), in respect of which there may or may not be duties. The four most typical dispositive powers are:

- power of appointment
- power to appoint individuals to a class of beneficiaries
- power of maintenance
- power of advancement.

Persons who might obtain some distribution from the trust only if a discretion is exercised in their favour are generally called the 'objects' of the power or discretionary trust.

Power of appointment

A power of appointment is a power to distribute property, but normally with no duty to do so. The person to whom the power is granted is called the donee of the power, and the persons to whom that property may be distributed are called the objects of the power. When a power of appointment is included in a trust, it is usually the trustees who have the power to exercise it, but powers to appoint trust property can also be granted to donees other than the trustees. A general power is a power to distribute the property (appoint) to any object (i.e. anyone) in the world, including the donee of the power him or herself. A special power is a power to appoint to a specific group of objects or a specified class of objects (e.g. all of the employees of Widgets Ltd). A hybrid or intermediate power is a power to appoint to anyone except a specific group or specified class (e.g. to anyone except the settlor, his or her spouse and the trustee or employees of the trustee).

Sometimes, the holder of a power is under a duty to exercise it, in which case it is the same as a dispositive duty. For example, a trust might provide that Alexa is entitled to the income generated by the trust property for life, 'with power by will to appoint the capital among her children in such shares as she in her absolute discretion thinks fit'. On the proper construction of the document, it may be determined that Alexa was obliged to appoint the capital by her will. Note that there is still a discretion here since it is up to Alexa to decide how much each of the children gets, but she is nonetheless obliged to appoint. As a result, this is properly understood as a trust to distribute with a discretion to determine individual shares, and is known as a '*Burroughs* v *Philcox* trust', after a case where such a trust arose. If Alexa dies without exercising the power, the court will direct the distribution of the rights evenly among the objects of the class.

On the other hand, a power may be construed to be exercisable only at the option of the holder. If the power is personal, the holder may exercise it or not as he sees fit and it will lapse on his death if not exercised. Moreover, the donee of the power is entitled to release the power, so bringing it to an end, even before he dies. By contrast, if the power is subject to a fiduciary duty, the donee must from time to time consider whether and how to exercise it with the best interests of the beneficiaries in mind and cannot release it.

Power to appoint individuals to a class of beneficiaries

A power to appoint individuals to a class of beneficiaries entitles the holder to add a named individual to a group which potentially benefits by a distribution of trust property. For example, a trust instrument might provide for a discretionary trust of income for the settlor's children, with a power granted to the trustees to appoint any of the settlor's nephews and nieces to that class.

Power of maintenance

A power of maintenance gives trustees the ability to apply the income generated by the trust property for the benefit of an infant beneficiary (i.e. a beneficiary under the age of 18). This power is provided by s.31 of the Trustee Act 1925, unless it is expressly or implicitly excluded by the terms of the trust. Alternatively, it may be expressly conferred by the trust instrument, which will determine how it may be used.

Power of advancement

A power of advancement allows trustees to pay or apply capital for the benefit of a beneficiary who is an infant or merely has a future or contingent interest. As with maintenance, the power may be created expressly, or trustees may rely on the statutory power in the Trustee Act 1925, s.32 unless that power is excluded by the trust instrument.

The powers of maintenance and advancement are related. The power of maintenance relates to income while the power of advancement relates to the capital. They are always held by trustees and are therefore fiduciary.

ACTIVITY 4.2

Review Penner, Chapter 2 'Express trusts: basic principles', Section 'The position of the trustee' and try to compose a definition of 'fiduciary duty'.

No feedback provided.

ACTIVITY 4.3

Read *Vatcher* v *Paull* [1915] AC 372. What is a 'fraud on a power'? Make a short (not more than two minutes) spoken presentation in answer.

4.3 Typical administrative powers and duties

Trustees must keep the trust property separate from their own and keep trust accounts (i.e. maintain proper records of their transactions with the trust property). Trustees typically also have a power to invest the trust property and to exchange cash and other trust property such as shares to achieve a portfolio of property, which will produce a reasonable return at a reasonable risk. If so, they also have a duty to invest with due care, exercising or drawing upon investment expertise. Trustees typically have the power and duty to insure property held by the trust. They usually have the power to delegate their administrative functions to agents for the better administration of the trust but have a duty to monitor their agents' performance. Trustees may have powers to appoint new trustees (see Chapter 15), to seek the variation of a trust and to 'export' the trust to other jurisdictions (usually for tax reasons). Trustees have a general duty to apply to the court whenever there is a problem with the administration of the trust which cannot be resolved without the court's assistance.

Persons other than trustees may have administrative duties. Settlors might give themselves or others a power to replace the trustees, to change the jurisdiction in which the trust is administered, or to veto certain investments. Such powers tend to be seen as fiduciary for the beneficiaries, whether the holder is a trustee or not, on the basis that administrative powers are to be exercised for the better administration of the trust, and the trust is to be administered for the benefit of the beneficiaries.

4.4 Investment

If the trustees have a power to invest trust property, this carries with it the duties (a) to preserve the overall value of those rights and (b) to be 'even-handed' between the different classes of beneficiaries. In many trusts, there will be income beneficiaries and capital beneficiaries.

4.4.1 Even-handedness

Some investments (such as gold and antiques) produce no income, although they may themselves increase in capital value. Other investments will be designed deliberately to generate income. Clearly, a trustee may favour beneficiaries entitled to the income at the expense of beneficiaries entitled to the capital, or vice versa, by making particular kinds of investments. Equity imposes a duty of even-handedness, which requires the trustee to balance these interests fairly when making investment decisions.

4.4.2 Risk versus return in investment choices

The two chief characteristics of any investment are risk and return. These are often directly related: the greater the risk of loss, the greater the percentage return on capital any investor will demand. Traditionally, equity favoured safety over high return. Trust instruments themselves almost always empower the trustee to invest in a wide range of more or less risky investments. Historically, investment clauses were interpreted restrictively, but now are given their plain meaning: *Re Harari's Settlement Trusts* [1949] All ER 430. If there is no express investment clause, the statutory regime provided by the Trustee Act 2000 governs the trustee's investments.

4.4.3 The Trustee Act 2000

Prior to 1 February 2001, the Trustee Investments Act 1961 governed the trustee's duty of investment unless the trust instrument provided otherwise, and it imposed inconvenient restrictions upon investment. The Trustee Act 2000 now governs unless the trust instrument provides otherwise. It (a) gives the trustees very broad powers of investment, but (b) imposes on them a duty of care to ensure that the power is used prudently.

Section 3 of the Act provides a general power of investment by which a trustee may make any kind of investment that they could make if they were absolutely entitled to the trust property. That is, they may make any investment they could make if the property were held by them outright.

However, the trustees' power 'to make investments in land other than in loans secured on land' is restricted by s.3(3) and s.8 to the acquisition of land in the UK, unless the trust instrument provides otherwise: ss.6(1), 9.

Section 8 gives the trustee a power to acquire titles to land in the UK, even if the land is not to be used to generate rental income but to provide a home for one or more of the beneficiaries. This separate treatment of land is a reaction to the past. In *Re Power* (1947), trustees were barred from buying land to provide a house in which the beneficiaries could live.

Section 1 of the Act provides for a general duty of care applicable to trustees, and by schedule 1, this duty applies to the trustee when exercising any power of investment, either under the statute or conferred by the trust instrument (although the duty of care may be ousted by the trust instrument). Section 1 provides that the trustee must exercise:

> such care and skill as is reasonable in the circumstances, having regard in particular to (a) any special knowledge or experience that he has or holds himself out as having, and (b) if he acts in the course of a business or profession, to any special knowledge or experience that it is reasonable to expect of a person acting in the course of that kind of business or profession.

Section 4 requires the trustee when exercising any power of investment to have regard to the 'standard investment criteria', and to review the investments from time to time with these criteria in mind. The standard investment criteria are (a) the suitability of particular kinds of investment for the trust, and (b) the need for diversification of the trust investments.

Section 5 of the Act also requires the trustee, before exercising any power of investment, to take advice from someone the trustee reasonably believes is able to provide proper advice of this kind by virtue of their ability and experience in such matters, unless it would be reasonable in the circumstances to forgo such advice. (Presumably it would be reasonable not to seek advice in the case of a trust with very limited funds, or a trust of short duration, for which the only sensible option might simply be to put the money in a bank.)

4.4.4 The standard of prudence in making trust investments

A standard of prudence, just like the standard of care in the law of negligence, cannot be spelt out in advance by a set of rules, but dictates reasonable behaviour in the circumstances.

ESSENTIAL READING

- **Trustee Act 2000, ss.1–10.**
- ***Speight* v *Gaunt* (1883) 9 App Cas 1; *Re Whiteley* (1886) 33 Ch D 347; *Bartlett* v *Barclays Bank Trust Co Ltd* [1980] Ch 515; *Nestle* v *National Westminster Bank* [1994] 1 All ER 118; *Cowan* v *Scargill* [1985] Ch 270.**

FURTHER READING

- ***Harries* v *Church Commissioners for England* [1992] 1 WLR 1241.**

ACTIVITIES 4.4–4.6

4.4 Read the cases of *Speight* v *Gaunt* (1883) 9 App Cas 1, *Re Whiteley* (1886) 33 Ch D 347, and *Re Chapman* [1896] 2 Ch 763 and explain how the standard of prudence applied to the trustees' actions in those cases.

4.5 Read *Bartlett* v *Barclays Bank Trust Co Ltd* [1980] Ch 515. Do any special considerations apply to the management of investments when the trust has a large or majority shareholding in a particular company?

4.6 Read *Nestle* v *National Westminster Bank* [1994] 1 All ER 118. Why did Miss Nestle's claim fail? What did the court say about the duty of 'even-handedness'? In the light of this, is the duty of investment an administrative duty, a dispositive duty, or something of both?

4.4.5 Social or ethical investing

Cowan v *Scargill* (1985) concerned a dispute among the trustees of the National Coal Board pension fund for miners. Those trustees appointed by the union refused to consent to an investment plan which included overseas investment and investment in industries in direct competition with the coal industry. Megarry V-C held that the refusal of the union trustees was in breach of trust:

> When the purpose of the trust is to provide financial benefits for the beneficiaries, as is usually the case, the best interests of the beneficiaries are normally their best financial interests. In considering what investments to make, trustees must put to one side their own personal interests and views. Trustees may have strongly held social or political views.
>
> They may be firmly opposed to any investment in South Africa or other countries, or they may object to any form of investment in companies concerned with alcohol, tobacco, armaments or many other things. In the conduct of their own affairs, of course, they are free to abstain from making any such investments. Yet under a trust, if investments of this type would be more beneficial to the beneficiaries than other investments, the trustees must not refrain from making the investments by reasons of the views that they hold.

Cowan v *Scargil*l remains the leading case in this area and means that it will be difficult for trustees to choose investments based **purely** on their social or ethical value, rather than their financial value to the trust. However, trustees are not excluded from considering ethical or social issues in all situations. This is an area of the law that is developing – see Thornton, R. 'Ethical investments: a case of disjointed thinking' (2008) 67(2) *Cambridge Law Journal* 396–422.

Activity 4.7

Read *Cowan* v *Scargill* [1985] Ch 270.

Critically examine the circumstances in which a trustee can engage in social or ethical investment.

Summary

The Trustee Act 2000 has greatly simplified the law on the investment of trust funds (although professionally drawn trust instruments are likely to continue to provide the trustees with wide investment powers). First, it provides extremely wide scope for investment in terms of the sorts of investment a trustee may undertake, but controls this by imposing a general duty of care on investing, appropriate to the expertise of the trustee. Trustees may not let their own ethical or political views govern their advice of investments.

4.5 Power of delegation

By s.11(1) and (2) of the Trustee Act 2000, trustees may collectively delegate any of their functions to an agent except:

- any function relating to whether or in what way any trust property should be distributed
- any power to decide whether any fees or other payment to be made out of trust property should be made out of income or capital
- any power to appoint a person to be a trustee of the trust, or
- any power conferred by any other enactment or the trust instrument which permits the trustees to delegate any of their functions or to appoint a person to act as a nominee or custodian.

The trustees may delegate tasks to one of themselves (s.12(1)), although not to any trustee who is also a beneficiary (s.12(3)). By s.15, where the agent is to carry out any 'right management functions', such as investment, the trustees must first provide a written 'policy statement' to guide the agent's exercise of their powers in the best interests of the trust, for example, that the investments provide sufficient income to meet the level of provision the trustees intend for the income beneficiaries. By s.22 the trustees are required to review any delegation arrangements, and to consider revising the policy statement. By Schedule 1, para.3, the s.1 duty of care applies to the trustees' appointment of agents and their review of them under s.22.

By s.25 of the Trustee Act 1925 any individual trustee may, by power of attorney, delegate any or all of their duties, powers or discretions, whether administrative or dispositive, for up to 12 months. Under s.25(4), the trustee must inform in writing any person entitled to appoint new trustees under the trust and all the other trustees, which allows them to consider whether the delegation trustee should be replaced. The trustee is liable under s.25(7) for all acts and defaults of their delegate by power of attorney as if they were their own acts or defaults.

Essential reading

- **Trustee Act 2000, ss.12, 15, 22–27.**

Activity 4.8

Make a spoken presentation on the following:

'Under what circumstances would it be prudent, as a trustee, to delegate one's power of investment?'

Summary

The Trustee Act 2000 gives to trustees wide powers to delegate their 'administrative' functions, although not their dispositive discretions or other powers which would

appear to require the judgment of a trustee as to what is in the best interest of the beneficiaries as a whole, for example, the appointment of successor trustees. By s.25 of the Trustee Act 1925, a trustee may delegate their rights, duties and powers as a trustee for a limited time.

4.6 Interests of beneficiaries and objects of powers

The right of a beneficiary under a fixed trust is a right that can be assigned and will vest in the beneficiary's trustee-in-bankruptcy in the event of the beneficiary's insolvency (except in the case of protective trusts: Penner, 3.24–3.26). By contrast, discretionary trust beneficiaries have no right to receive anything at all, and so have nothing to assign. They have only a hope (*spes*) of receiving some of the trust property. They do, however, have a right to be considered and a right to due performance of the trust, which they can enforce against the trustees. In the case of general or hybrid powers, the objects have no rights whatsoever, since the class of objects amounts, essentially, to the whole world, or in the case of hybrid powers, the whole world minus a few. Those entitled in default of appointment will only have the right to ensure that the power is not improperly exercised. The individual objects of special powers are in a similar position to the objects of a discretionary trust. They can enforce the power by ensuring no invalid appointments are made, and where the power is fiduciary (as when held by a trustee), they can insist upon the trustee properly considering its exercise, although they cannot, of course, insist upon any appointments.

4.6.1 Rights and powers of objects

The ability of the beneficiaries (or the Charity Commission in the case of trusts for charitable purposes) to require trustees to perform the trust is essential for the existence of an effective trust. As Millett LJ said in *Armitage* v *Nurse* [1997] EWCA Civ 1279, [1998] Ch 241 at 253:

> There is an irreducible core of obligations owed by the trustees to the beneficiaries and enforceable by them which is fundamental to the concept of a trust. If the beneficiaries have no rights enforceable against the trustees, there are no trusts.

The beneficiaries are able to require the trustees to carry out the trust properly according to its terms, and can sue the trustees for breach of trust or third parties who knowingly receive trust property dissipated in breach of trust or dishonestly assist in or induce a breach of trust.

4.6.2 Beneficiaries' right to be informed of their interests under the trust

According to *Hawkesley* v *May* [1956] 1 QB 304 beneficiaries whose interests are vested rather than contingent on the happening of a certain event have a right to be informed of the fact that they have a right under the trust, and it is within the court's discretion in an appropriate case (namely, where it is reasonable to assume that such beneficiary had a genuine likelihood or expectation that a dispositive discretion might be exercised in their favour) to require settlors to provide the names and addresses of trustees even to a discretionary beneficiary: *Murphy* v *Murphy* (1998).

4.6.3 Beneficiaries' right to information

In order to monitor the trustees' conduct of the trust and hold them to account if they breach the trust, the beneficiaries must be able to obtain information about the running of the trust from the trustees. It is now generally accepted that beneficiaries, whether of a fixed or discretionary trust (*Chaine-Nickson* v *Bank of Ireland* [1976] 1R 393; *Spellson* v *George* [1987] 11 NSWLR 300), and perhaps even of a contingent interest (*Armitage* v *Nurse* [1998] Ch 241 per Millett LJ) are entitled to copies (made at their own expense) of the trust accounts and all trust documents and such rights cannot be limited by contrary provisions in the trust instrument on pain of rendering the trusts in their favour invalid (on *Armitage* principles, above). On the other hand, it has been asserted that objects of powers of appointment (i.e. powers that the donee is

under no duty to exercise, whether fiduciary or personal) are not entitled to see the trust documents. The Privy Council advised in *Schmidt* v *Rosewood Trust* [2003] UKPC 26, [2003] 2 AC 709 that the objects' rights to information reflect equity's insistence that the trust is properly administered. Whether discretionary beneficiaries or objects of powers have rights to information will turn on the circumstances of the case, in particular, on the likelihood of enforcement by other categories of beneficiary or object under the particular trust. In *Re Londonderry's Settlement* [1965] Ch 918, the Court of Appeal held that beneficiaries, while entitled to see all other trust documents which record the trustees' dealings with the trust property, are not entitled to see documents which disclose their reasons for exercising a dispositive discretion in favour of one or some beneficiaries rather than others, as this would inhibit them in taking such decisions, and might lead to strife among the beneficiaries.

4.6.4 Beneficiaries' powers under the principle in *Saunders* v *Vautier*

The beneficiaries, if of full age and sound mind, may consent to the trustees acting outside the terms of the trust (i.e. doing what would otherwise be a breach of trust), and may consent to the variation of the terms of the trust if they are minded so to do. The principle, named after the case of *Saunders* v *Vautier* (1841), although much older, is the logical extension of this fact and may be stated as follows: a beneficiary with an absolute interest under a trust, who is *sui juris* and of sound mind, may call for a transfer of the trust property and the trustees are obliged to transfer it to the trustee; if the trustee is a sole beneficiary, this will result in the complete execution of the trust and the trust will end. Thus, if under a trust, Amy is to receive the income generated by trust property until she is 30, at which time she is to receive the capital, she can demand a transfer of the property as soon as she reaches 18.

Under fixed trusts, the right of *sui juris* beneficiaries to call for a transfer of trust property is subject to a general limitation that such a transfer must not result in the devaluation of the other beneficiaries' shares.

As Walton J said in *Stephenson* v *Barclays Bank Trust Co Ltd* [1975] 1 WLR 882 at 889–890:

> When the situation is that a single person who is *sui juris* has an absolutely vested beneficial interest in a share of the trust fund, his rights are not, I think, quite as extensive as those of the beneficial interest holders as a body. In general, he is entitled to have transferred to him … an aliquot [i.e. 'proportionate'] share of each and every right of the trust fund which presents no difficulty so far as division is concerned. This will apply to such items as cash, money at the bank or an unsecured loan, Stock Exchange securities and the like. However, as regards land, certainly, in all cases, as regards shares in a private company in very special circumstances … the situation is not so simple, and even a person with a vested interest in possession in an aliquot share of the trust fund may have to wait until the land is sold, and so forth, before being able to call upon the trustees as of right to account to him for his share of the rights.

In the case of discretionary trusts, the principle only operates when all of the discretionary beneficiaries together call for the property that, taken together, is held on trust to be distributed among them: *Re Smith* [1928] Ch 915. In other words, such beneficiaries may together call upon the trustees to transfer the trust property to them as co-owners. Following *McPhail* v *Doulton* (1970), the law has allowed settlors to create discretionary trusts where the class of beneficiaries is so large as to make it impossible to compile a complete list of all the beneficiaries (for example, 'all the employees and ex-employees of the University of London and their relations'), and in these cases it is obvious that all the objects of the discretionary trust will not be able to combine to call for the execution of the trust.

Summary

The beneficiaries are entitled to enforce the trust against the trustees. This necessarily means that the beneficiaries have a right to be informed that they are beneficiaries, and to information from the trustee as to the carrying out of the trust. However, not all beneficiaries or objects of the trust of whatever kind of interest (discretionary,

contingent and so on) have equal rights to information, and the advice of the Privy Council in *Schmidt* v *Rosewood Trust Ltd* indicates that much depends on the circumstances of the particular trust, although the court will insist that sufficient access to information be granted to allow the trust to be enforced. Under the principle of *Saunders* v *Vautier*, beneficiaries may call for a conveyance of trust property, although only collectively in the case of discretionary trusts, and in every case only where to do so would not detrimentally affect the interests of the other beneficiaries.

Activity 4.9

Core comprehension – Trustee Act 2000: duty of care of trustees

Go to www.legislation.gov.uk and research 'Trustee Act 2000'. Answer the following questions using the Explanatory Notes to inform your responses.

a. **According to the Explanatory Notes, what is the purpose of the new, precisely defined statutory duty of care as related to the Act?**

b. **Explain how the skill and knowledge of trustees contribute to the standard of care expected from them in the exercise of their duties.**

c. **Which aspects of any given trust inform decisions on the exercise of reasonable care?**

d. **Identify the scope of the applications of the duty of care.**

Activity 4.10

Applied comprehension – ethical investment: exceptions to the rule

Using the Online Library resources, research the following journal article:

- **Thornton, R. 'Ethical investments: a case of disjointed thinking' (2008) 67 *CLJ* 396–422, Section V: Ethical decision making: the exceptions to the rule.**

a. **State the general rule of ethical decision making for trustees.**

b. **Outline how perceptions of the concept of benefit may play a role in creating an exception to the general rule.**

c. **Why do some commentators view the exception created in *Evans* to be only available in extremely limited circumstances? Paraphrase a response in 60 words or less.**

d. **How has *Harries* contributed to the development of the third exception to the general rule within the context of charitable trusts? Give an example to illustrate the point.**

e. **In *Cowan* v *Scargill* under which narrow circumstance could an investment for social or political reasons be difficult to criticise?**

f. **Paraphrase in 50 words or less Thornton's criticism of this exceptional rule.**

g. **In *Harries*, which rigidly constrained policy proposed by Harries, the Bishop of Oxford, was rejected by the Court?**

h. **How has *Harries* contributed to development of a fifth and implied exception to the general rule?**

i. **Identify Thornton's main criticisms of the fifth exception.**

Activity 4.11

Applied Comprehension – ethical investment

Using the Online Library resources, research the following journal article:

- **Thornton, R. 'Ethical investments: a case of disjointed thinking' (2008) 67 *CLJ* 396–422.**

Introduction

a. Which two descriptors are given to types of investment which reflect the impact of different industries and individual enterprises on their workforce, consumers and the environment?

b. Identify the source of the empirical data that Thornton uses to evidence the exponential growth of the ethical investment industry?

c. Based on the statistics provided, outline the relationship of the total fund value of ethical retail funds in 2005 to the total fund value of socially responsible investment rights held by churches, charities, pension funds and insurance companies in 2001.

d. What type of conscience considerations usually guide ordinary citizens when they make decisions about investments?

Guiding principles of trustee investment

e. Outline the basic principle guiding trustee decision making as stated by Sir Robert Megarry V-C in *Cowan* v *Scargill*.

f. As expressed by Lord Murray in *Martin* v *City of Edinburgh District Council*, which maximisation goal of investment requires trustees to override personal opinions and preferences?

g. Paraphrase (in fewer than 40 words) the benefit of the application of current portfolio theory.

Sample examination questions

Question 1 Tim and Toby are the trustees of a large trust fund held on behalf of the Evangelical Christian Church of Yorkshire. The trust originated informally, and there is no specific provision in the trust terms concerning investments. Tim and Toby propose the following investment plan: (1) to put half the funds in a building society account; (2) to purchase a 50 per cent stake in a local computer technology company of which Tim has heard good things; and (3) to invest the rest in a financially stretched company which produces Christian literature. Advise Tim and Toby.

Question 2 'The range of sound investments available to trustees is so extensive that very frequently there is scope for trustees to give effect to moral considerations ... without thereby prejudicing beneficiaries' financial interests. In practice, the inclusion or exclusion of particular investments or types of investment will often be possible without incurring the risk of a lower rate of return or reducing the desirable spread of investments. When this is so, there is no reason in principle why trustees should not have regard to moral and ethical considerations, vague and uncertain although these are. The trustees would not be departing from the purpose of the trust or hindering its fulfilment.' Lord Nichols (1995), speaking extra-judicially. Discuss.

Question 3 'The beneficiaries' rights to inspect trust documents are now seen to be better based not on equitable proprietary rights but on the beneficiaries' rights to make the trustees account for their trusteeship.' (Hayton, quoted in *Re Rabaiotti's 1989 Settlement*.) Discuss.

Question 4 What are the principles governing the trustee's power to delegate under the Trustee Act 2000?

Question 5 'There is no point in speaking in general terms about the "beneficiary's rights" under a trust – it all depends what specific position the beneficiary is in.' Discuss.

ADVICE ON ANSWERING THE QUESTIONS

Question 1 The first thing to note is that the investment of the trust property will be governed by the Trustee Act 2000, as there is no specific investment provision. A good answer will go through the relevant provisions of the Act, in particular the need for diversification and the duty to seek investment advice. As to the specific provisions of Tim and Toby's plan, the whole looks very poorly diversified.

1. Does not look to provide a good return, but may be justified if the trustees foresee drawing on the fund in large amounts in the near future.
2. Looks hazardous, and the case law concerning trustees' duties where the trust holds a controlling interest in a company must be considered.
3. Raises the issue of 'ethical' investing by a charity, and *Harries* v *Church Commissioners* (1992) and the surrounding academic debate on ethical investing is relevant.

Question 2 This question deals with 'ethical' (or 'social') investment of trust funds. *Cowan* v *Scargill* must be discussed to reveal the background principles of law upon which Megarry V-C relied in opposing the application of ethical standards to trustee investments. Lord Nichols appears to suggest that there ought to be a limited scope for such investing, investing ethically only to the extent that the risk and return profile of the trust fund is not imperilled. Is this a practicable stance to take? Why should the trustee have the power to choose the ethical standards to apply (as opposed to the settlor, who can include them if they want when they create the trust, or the beneficiaries, who can, if of full age, consent to departures from the trust instrument)? (See Penner, Chapter 8 'The trust up and running', Section 'The duty of investment'.) Whether similar considerations ought to apply to charitable trusts given their special function might be discussed, and if so, *Harries* v *Church Commissioners for England* (1992) must be considered.

Question 3 A good answer must discuss the relevant case law, both with respect to which possible objects of a trust have a legitimate right to see the 'trust accounts' and the 'trust documents', and with respect to which documents beneficiaries are entitled to see, with regard to beneficiaries of a fixed or discretionary interest: *Chaine-Nickson* v *Bank of Ireland* (1976), *Spellson* v *George* (1987); with regard to those with contingent interests: *Armitage* v *Nurse* (1998) per Millett LJ; with regard to objects of mere powers: *Schmidt* v *Rosewood Trust Ltd* (2003). The quotation states that the law has generally undergone a shift in regarding the beneficiaries' rights to information as flowing from their 'proprietary' interest in the trust to seeing such rights as flowing from their right to make the trustees account for their stewardship of the trust, which is one way of reading *Re Londonderry's Settlement* (1964); *Re Rabaiotti's 1989 Settlement* (2000). The first thing to note about this view is that the enforcement principle suggests that objects in different situations (e.g. discretionary beneficiary, income or capital beneficiary) should only be entitled to such information as is relevant to the enforcement of their own particular interest, and this appears to have been thought correct by Hoffmann J at first instance in *Nestle* v *National Westminster Bank* (1988), where the capital beneficiary was not entitled to see the accounts disposing of the income to income beneficiaries. You should consider whether *Re Rabaiotti's 1989 Settlement* takes the law in a different direction, from the principle that beneficiaries' rights in this respect arise so as to permit them to enforce their rights against the trustee, to the idea that beneficiaries should be entitled to such information only when it is 'in their best interests', and the facts of *Re Rabaiotti* should be discussed.

Question 4 A straightforward question requiring an outline of the principles upon which the Trustee Act 2000 empowers trustees to delegate their functions. Particular reference should be made to provisions concerning the trustee's duty of care in selecting and monitoring agents. Consideration should also be given to the rationale for the Act not permitting delegation of certain tasks, and to its more extensive directions concerning the delegation of the investment of trust funds. A good answer would review briefly the history of the law of delegation, in particular the perceived flaws in the provisions under the Trustee Act 1925, to provide a context for understanding the 2000 Act provisions.

Question 5 Another straightforward question, requiring a discussion of how the position of a beneficiary of a fixed interest under a trust, an object of a discretionary trust, and the object of a mere power differ with respect to: (a) their ability to enforce the trust against the trustees; (b) their rights to information; (c) their *Saunders* v *Vautier* powers, and whether these differences are coherent and justifiable. A good answer would consider the case of discretionary trusts where it is impossible or impractical to compile a complete list of the trust objects. A very good answer will also consider the question of which beneficiaries have 'vested' interests under the trust for various purposes in law, such as the law of taxation – see *Gartside* v *IRC* [1968] AC 553; *Re Weir's Settlement* [1969] 1 Ch 657; *Sainsbury* v *IRC* [1970] Ch 712; *Re Trafford's Settlement* (1915).

Reflect and review

Look through the points listed below.

Are you ready to move on to the next chapter?

Ready to move on = I am satisfied that I have sufficient understanding of the principles outlined in this chapter to enable me to go on to the next chapter.

Need to revise first = There are one or two areas I am unsure about and need to revise before I go on to the next chapter.

Need to study again = I found many or all of the principles outlined in this chapter very difficult and need to go over them again before I move on.

Tick a box for each topic.

	Ready to move on	Need to revise first	Need to study again
I can describe the structure of the typical express trust for persons by setting out the rights the beneficiaries have, and the powers and duties that the trustees, and others, may have.	☐	☐	☐
I can explain in outline the beneficiaries' rights to follow and trace rights held on trust that have been transferred in breach of trust.	☐	☐	☐
I can set out the typical sorts of administrative and dispositive powers and duties a trustee will have.	☐	☐	☐
I can describe the law governing the powers of maintenance and advancement, the duty of investment and the power of delegation.	☐	☐	☐
I can explain the rights of objects to information under the rule in *Saunders* v *Vautier*.	☐	☐	☐

If you ticked 'need to revise first', which sections of the chapter are you going to revise?

		Must revise	Revision done
4.1	Introduction to rights and duties	☐	☐
4.2	Powers and duties of trustees and others	☐	☐
4.3	Typical administrative powers and duties	☐	☐
4.4	Investment	☐	☐
4.5	Power of delegation	☐	☐
4.6	Interests of beneficiaries and objects of powers	☐	☐

5 Declarations of trust

Contents

Introduction

To create a valid express trust, the settlor must intend to create it and then do what is necessary to give effect to that intention.

In this chapter, we focus on certainty of intention, as well as two other aspects of the trust that must also be sufficiently certain for the trust to be valid: the trust property ('certainty of subject matter') and the objects ('certainty of objects'). Together, these are often referred to as the 'three certainties'. In the next two chapters, we consider the steps that are needed to give effect to that intention, which are said to require the settlor to observe certain formalities (Chapter 6) and to 'constitute' the trust (i.e. transfer the trust property to the intended trustees) (Chapter 7). It is important to keep the matters covered in this chapter separate from those in the next two chapters. A common mistake made by students is to confuse the three issues.

There are three points that need to be appreciated at the outset. The first is that only proven manifestations of intention count. The mere fact that someone has an unexpressed or secret intention to create a trust will not cause a trust to come into being. As Megarry J said in *Re Vandervell's Trusts (No.2)* [1974] Ch 269 at 294, 'the mere existence of some unexpressed intention in the breast of the owner of the property does nothing: there must at least be some expression of that intention before it can effect any result.' A similar point was made in *Byrnes* v *Kendle* [2011] HCA 26, 243 CLR 253.

The second is that the intention will probably only be found from words, either spoken or written, although this has never been decided as such. Although the expression of an offer and acceptance in the context of a contract can sometimes be deduced from mere conduct alone (e.g. where I walk into a shop and hand the shopkeeper cash in exchange for a newspaper, neither of us speaking any words), the concept of a trust is arguably too complex to be expressed otherwise than by words but it cannot be ruled out as a possibility where the conduct clearly demonstrates an intention to create a trust.

The third is that the test of construction of the manifested intent is objective. What is relevant is not what the speaker meant by the words but what a reasonable person hearing those words would have thought was meant.

The chapter assumes that you know by now the difference between a fixed trust, a discretionary trust and a power of appointment. These concepts were introduced in Chapter 3 and you may wish to review them before continuing.

Core text

- **Penner, Chapter 5 'Certainty'.**

Learning outcomes

By the end of this chapter and the relevant readings, you should be able to:

- **explain how the court determines whether a person manifested an intention to create a trust**
- **define the test for certainty of subject matter of a trust**
- **explain why the tests for certainty of objects are different for fixed trusts, discretionary trusts and powers of appointment**
- **explain the concept of administrative workability.**

5.1 Intention to create a trust

The first substantive requirement for a valid express trust is that the alleged settlor (i.e. the person who declared the trust) in fact had the intention to create a trust. This is a matter of construction of the relevant words and conduct, in which it is asked whether the alleged settlor intended to place the holder of the potential trust property (be it the settlor or the persons to whom those rights were transferred) under an enforceable obligation to use those rights for the benefit of another or for a purpose. The imposition of a moral (i.e. non-legal) obligation is not sufficient. As Christian LJ said in *McCormick* v *Grogan* (1867) 1 IR Eq 313, 'The real question is, what did [the settlor] intend to be the sanction? Was it to be the authority of a court of justice, or the conscience of the devisee?'

This issue usually arises on a gratuitous transfer of rights, where the question is whether the recipient was intended to take those rights absolutely (e.g. as a gift) or to hold them for another (i.e. as a trustee). In *Re Adams & Kensington Vestry* (1884) 27 Ch D 394 the testator left his whole estate to his wife 'in full confidence that she will do what is right as to the disposal thereof between my children, either in her lifetime or by will after her decease'. During her lifetime, the widow attempted to give some of the rights away outside her immediate family. The Court of Appeal held that she was entitled so to do. There had been no declaration of trust because the testator had not intended to impose any legally enforceable obligation on her. He had instead left the matter to her 'conscience'.

Likewise, the Court of Appeal in *Wilkinson* v *North* [2018] EWCA Civ 161 rejected an argument that a declaration of trust was made when the alleged settlor, an inventor called John North, entered into an agreement with an investor, Geoffrey Wilkinson, promising him:

> A five percent (5%), non dilutable, voting equity interest in the holding company, and/or any subsidiary company subsequently formed, heirs and/or successors of John North and Worldrill, will be made available to Geoffrey Wilkinson at the signing of this contract and demonstrated by the issuance of stock certificates. An additional non dilutable, three percent (3%) equity interest in all subsidiary or associated companies registered outside the UK, and/or a three percent (3%) profits interest in any UK company doing business outside the UK will be granted to GJW. The equity position will cover the activities of any company or corporate vehicle, trust, partnership or similar of John North, his heirs or successors.

Although the trial judge held that this amounted to a declaration of trust, the Court of Appeal disagreed. Although it was true that the word 'trust' did not need to be used, this agreement (which was not drawn up by a lawyer and which was described as bordering 'on the incoherent') did not purport to give immediate rights to the investor but was instead an agreement to form a company in which he would have a 5 per cent share.

Exactly the same question needs to be asked about situations in which it is alleged that someone made a self-declaration of trust. The cases show that a mere intention to benefit another person is not enough. In *Jones* v *Lock* (1865) LR 1 Ch App 25 a father handed a cheque for £900 (made out to himself) to his infant son, saying 'I give this to baby for himself'. The act was insufficient to transfer the right to sue on the cheque, for such a right only passed at that time by means of an endorsement to the cheque (in the son's name, in this instance). The father died soon afterwards, leaving all his personal rights to his family by his first marriage. On behalf of the infant, it was argued that the father had declared himself a trustee of the cheque, so that there was a trust created in favour of the infant during the father's lifetime. The argument was rejected. Lord Cranworth LC said (LR 1 Ch App 25 at 28–29):

> I should have every inclination to sustain this gift, but unfortunately I am unable to do so; the case turns on the very short question whether Jones intended to make a declaration that he held the [right] in trust for the child; and I cannot come to any other conclusion than that he did not.

As we shall see in Chapter 7, the same thinking applies when it is argued that failed attempts to transfer rights to others should be construed as self-declarations of trust. As both *Milroy* v *Lord* (1862) 4 De GP & J 264 and *Richards* v *Delbridge* (1874) LR 18 Eq 11 demonstrate, such arguments are usually rejected by the courts, unless there are exceptional circumstances (e.g. *Khan* v *Mahmood* [2021] EWHC 597 (Ch)).

What words then are most appropriate for expressing the intention to create a trust? As already noted, it must be shown that the settlor intended that the recipient (or the settlor in the case of a self-declaration of trust) be legally obliged to hold the rights in question for another. The clearest expression of such an intent will be found in the use of the word 'trust' ('I give all my estate to my wife to hold on trust for our children'). However, use of the word 'trust' is not essential and indeed it is not necessary that the settlor subjectively knew they were creating a trust. This is illustrated by *Paul* v *Constance* [1976] EWCA Civ 2, [1977] 1 WLR 527, where a trust was created through the words 'the money in the bank is as much yours as it is mine'. In the cases involving *Quistclose* trusts (see Section 2.3.3), it has likewise been held that a trust arises even if the transferor of money did not subjectively intend to create a trust – although it should also be noted that in English law, the *Quistclose* trust has been described as resulting rather than express: *Twinsectra Ltd* v *Yardley* [2002] UKHL 12, [2002] 2 AC 164 (*per* Lord Millett). Interesting questions arise as to why courts should recognise a *Quistclose* trust in the absence of a subjective intention to create a trust, bearing in mind that the parties to such cases are often well-advised commercial entities. That is, there may be good reasons to not expect the couple in *Paul* v *Constance* to have understood the details of trusts law. In contrast, *Quistclose* trusts are often pleaded by lenders in cases where the recipient of money has become insolvent and the trust will operate similarly to a security device. Should we allow the law of trusts to be used in this way? Although subjective intention to create a trust is not required, other features must be present – such as a restriction in how the recipient uses the loaned funds or property: for a summary, see the discussion of *Quistclose* trusts in *Ali* v *Dinc* [2020] EWHC 3055 (Ch) and *Prickly Bay Waterside Ltd* v *American Insurance company Ltd* [2022] UKPC 8.

In *Ong* v *Ping* [2017] EWCA Civ 2069, the Court of Appeal was willing to infer from correspondence between a woman in Singapore and her solicitor in England that she intended to create a trust of her title to a house in London. The problem was that though she signed a 29-page trust deed, the settlor did not complete the blank space on the form to indicate the subject matter of the trust. However, the Court of Appeal held that the correspondence mentioned above sufficiently identified the title to the house so as to make it a valid declaration of trust. Whether the letters from the solicitor should have been admitted as evidence is another matter, and is discussed in Chapter 6. Finally, we should note that failure to segregate alleged trust property from property of a similar type (e.g. an alleged trust of 10 shares from a block of 100 shares) does not **of itself** mean there is no intention to create a trust (*von Westenholtz* v *Gregson* [2022] EWHC 2947).

A borderline case?

A case taking a generous approach to the issue of finding a self-declaration of trust was *T Choithram Int SA* v *Pagarani* [2000] UKPC 46, [2001] 1 WLR 1. The deceased, a wealthy businessman, wanted to give his vast fortune to a 'foundation', which would then distribute it for various good works. However, no such body (perhaps taking the form of a corporation with charitable objects) was ever created. Instead, his legal advisers drew up the documentation for a trust, although the deceased continued to use the language of a foundation, the nearest equivalent to which in English law is an unincorporated association. His 'foundation' (trust) was to have seven directors (trustees), including himself. During his lifetime, he executed a deed by which he purported to create the 'foundation' (trust) and appointed himself a 'director' (trustee). Some of the other 'directors' also signed this document. The deceased later solemnly declared that he gave all his wealth to the 'foundation', but no transfer to the other 'directors' (trustees) was ever made. When he died, the question was whether the deceased had created an *inter vivos* trust. If he had not, then his fortune went to his widow under his will.

The courts of first instance and appeal held that there was no trust and that the widow therefore took because the donor had attempted but failed to make an outright gift. The Privy Council disagreed. Although the words used were of outright gift, in their context (i.e. that of an unincorporated association) they were words of gift to the trustees of the 'foundation' to be held by them on trust for the purposes of the foundation (see the discussion in Chapter 11). Where one of several intended trustees had the trust property vested in him, he was bound by the trust and under a duty to transfer the trust property into the names of all the trustees. Although the deceased had not vested the rights in all the trustees of the foundation, he could not withdraw from his declaration of gift to the trust that he had established and of which he had appointed himself a trustee.

The decision is a difficult one, and arguably places too generous an interpretation of the deceased's words. Even so, it is important to note that the Privy Council does not here see itself as creating an exception to the rule that equity will not perfect an imperfect gift (see Chapter 6), but merely finding, albeit somewhat generously, a self-declaration of trust in a novel circumstance.

What happens if it is not established that the supposed settlor intended to create a trust? If there has been a transfer, then the transferee will generally take the property outright: *Re Adams & Kensington Vestry* (1884) 27 Ch D 394. Where there is a failed allegation of a self-declaration of trust, then the alleged settlor simply remains absolutely entitled to the property in question. Do not be confused here. *Re Adams & Kensington Vestry* is not a case of a trust 'failing' because the husband used the wrong form of words. His expressed intention was not to create a trust at all, but that his wife should merely act according to her 'conscience'. There is no **trust** to fail in such circumstances, but merely an **allegation** that a trust was declared. Unfortunately, this is not always appreciated by judges and commentators.

Essential reading

- ***Milroy* v *Lord* (1862) 4 De GP & J 264; *Jones* v *Lock* (1865) 1 LR 1 Ch App 25; *Re Adams & Kensington Vestry* (1884) 27 Ch D 394; *Paul* v *Constance* [1976] EWCA Civ 2, [1977] 1 WLR 527; *Twinsectra Ltd* v *Yardley* [2002] UKHL 12, [2002] 2 AC 164.**

Further reading

- ***Lambe* v *Eames* (1871) LR 6 Ch App 597; *Richards* v *Delbridge* (1874) LR 18 Eq 11; *Re Schebsman* [1944] Ch 83; *Ali* v *Dinc* [2020] EWHC 3055 (Ch) (analysis of *Quistclose* trusts).**

Activity 5.1

Read and note the decision in *Paul* v *Constance* [1977] 1 WLR 527.

a. What was the claimant claiming?

b. What arguments did the defendant use to attempt to defeat that claim?

c. How were those arguments dealt with by the Court of Appeal?

Summary

A manifested intention to create a trust is the first substantive requirement for a valid declaration of trust. For a declaration to have occurred, it must be shown that the words used by the transferor evinced an intention that the recipient be legally obliged to hold the rights in question for another. This is different from the imposition of a moral obligation, which is insufficient to establish a trust. Unfortunately this distinction can cause difficulty. *Re Adams & Kensington Vestry* highlights this problem.

5.2 Identifying the trust property

5.2.1 Types of property

Almost any property can form the subject matter of a trust. Although it is not a matter to be analysed in this course, there is a great deal of academic debate about what 'property' means in this context. Some commentators therefore prefer to talk about 'trust rights' instead of 'trust property' in order to signify that whatever the nature of the 'property' itself, a trust may exist over real (e.g. land), personal (e.g. goods) property and over tangible (e.g. bottles of wine) and intangible property (e.g. shares, money in a bank account). In this guide, the common term 'trust property' is used, without meaning to limit the subject matter of a trust to any particular type of property.

5.2.2 Identifying the trust property

Given that a trust involves holding property on behalf of another, it follows that it must be possible to identify exactly what property is to form the subject matter of the trust. If we cannot do this, the trustees cannot do their job.

One challenge to 'certainty of subject matter' is where the subject matter of the trust forms part of a larger mass. Suppose, for example, I have 100 bottles of wine in my cellar and declare that I hold my titles to 50 of them on trust for you. There can be no trust until I have identified exactly which bottles I am talking about. Until that is done, if a bottle breaks, is stolen or goes off, it is impossible to say whether it was a bottle the title to which I held on trust for you or was held by me absolutely for myself. For this reason, a claim to be the beneficiary of a trust to bottles of wine failed in *Re London Wine Co (Shippers) Ltd* [1986] PCC 121. Also see *Re Goldcorp* [1994] UKPC 3, [1995] 1 AC 74.

But what if the relevant mass comprises all the same bottles of wine? Could it be argued that it is not necessary for each individual bottle to be identified as subject matter of the trust or as owned by me? Such arguments were made in relation to shares in *Hunter* v *Moss* [1993] EWCA Civ 11, [1994] 1 WLR 452 (leave to appeal dismissed [1994] 1 WLR 614 (HL)). The defendant, Moss, made a voluntary (i.e. gratuitous) declaration that he held 5 per cent of the issued share capital of Moss Electical Ltd (MEL) on trust for the claimant. One thousand shares had been issued and Moss held 950 of those shares. Moss failed, however, to identify which 50 were held on trust. The total shareholding was later sold for approximately £3 million and the claimant argued he was entitled to 5 per cent of the purchase price. Moss argued that there was no valid trust due to lack of certainty of subject matter. However, it was held by the Court of Appeal that it was not necessary for Moss to specify the particular share numbers:

> Just as a person can give, by will, a specified number of his shares of a certain class in a certain company, so equally, in my judgment, he can declare himself trustee of 50 of his ordinary shares in MEL or whatever the company may be and that is effective to give a beneficial proprietary interest to the beneficiary under the trust.

The reasoning in *Hunter* v *Moss* has come under criticism. For instance, it has been said that the analogy with testamentary gifts is misplaced because executors are under a duty to segregate the shares in question from the larger fund and effect the requisite transfers. This is not so with a voluntary self-declaration of trust. In addition, *Hayton* (1994) 100 LQR 335 has asked:

> If Moss subsequently sells 50 shares how do the Revenue know whether he is selling his own shares, so that he is chargeable to capital gains tax, or if he is selling Hunter's shares so that Hunter is so chargeable? If the proceeds of sale are profitably or detrimentally reinvested does the new investment belong in equity to Hunter or Moss, bearing in mind that it is only if Moss is acting wrongfully in respect of specific shares that Hunter can take advantage of the equitable tracing rules to apply whichever of them suits him best? Can Hunter obtain an injunction to prevent Moss selling or mortgaging any shares or only more than 900 shares?

Dillon LJ's judgment did not deal with this question. One answer is the 'proportionate share' explanation in *Pearson* v *Lehman Brothers Finance SA* [2010] EWHC 2914 (Ch) at [227]–[248] affirmed [2011] EWCA Civ 1544 at [69]–[77]. There Briggs J stated at [232] that:

> The difficulty with applying the Court of Appeal's judgment in *Hunter* v *Moss* to any case not on almost identical facts lies in the absence of any clearly expressed rationale as to how such a trust works in practice. There has not been unanimity among those courts which have followed *Hunter* v *Moss*, nor among the many academics who have commented upon it, as to the correct approach. The analysis which I have found the most persuasive is that such a trust works by creating a beneficial co-ownership share in the identified fund, rather than in the conceptually much more difficult notion of seeking to identify a particular part of that fund which the beneficiary owns outright.

Under this approach,

> a trust of part of a fungible mass without the appropriation of any specific part of it for the beneficiary does not fail for uncertainty of subject matter, provided that the mass itself is sufficiently identified and provided also that the beneficiary's proportionate share of it is not itself uncertain [Briggs J at [225]].

Applied to *Hunter* v *Moss*, this approach says that the plaintiff's declaration of 50 of his 950 shares for the defendant created a trust of all 950 shares for both parties as tenants in common in the proportions of 50/950 for the defendant and 900/950 for the plaintiff.

Although the proportionate share approach would seem to also be applicable to physical things that are fungible (also see s.20A Sale of Goods Act 1979), thus far this reasoning has been limited to intangibles such as shares, seemingly on the basis that physical identity cannot be guaranteed. To return to the wine example, although each bottle may look the same, they may be different, for instance if one has gone bad.

A second challenge for certainty of subject matter relates to conceptual certainty. This is illustrated by *Palmer* v *Simmonds* (1854) 2 Drew 221, a case involving an attempted testamentary trust of the 'bulk' of the testator's estate. The reason this trust failed was uncertainty as to the meaning of the word 'bulk'. It is different from the example of the wine bottles where, although we know what titles to 50 bottles mean, we do not know which 50 are referred to.

Palmer v *Simmonds* should be contrasted with *Re Golay's WT* [1965] 1 WLR 969, which upheld a testamentary trust to provide a 'reasonable income' to a beneficiary during her lifetime. The difference here was that the court was able to determine what was reasonable by reference to objective considerations.

A common error students make with regard to certainty of subject matter is in relation to a testator's residuary estate. There is nothing uncertain about a residuary estate, which is simply everything left after the creditors and taxes are paid and the specific gifts in the will made. That which is **capable** of being ascertained, even though not **currently** ascertained, is not uncertain. A testamentary trust takes effect after the estate has been administered and the executors (or administrators) allocate the rights to the trust, at which time the subject of the trust will be certain. Since they are under a duty to constitute the trust according to the testator's instructions, there is no problem with certainty of subject matter, so long as the testator's instructions are clear.

5.2.3 Future property

It is not possible to create a trust of property that the settlor does not currently have. Thus, I cannot today create a trust of the property I expect to receive under my father's will. A trustee must hold property for another and, if there is no property, there can be no trust. Property that I do not have yet but hope to have in the future is known as 'future property', which of course is not my property at all! It is possible to promise to settle (i.e. create a trust of) property if and when it is received but that is something different again (we study this in Chapter 8).

5.2.4 Consequences of inability to identify trust property

If the intended trust property cannot be identified, the effect of the attempt to create a trust will depend on the facts. If there was a self-declaration of trust, nothing happens when a settlor fails to identify which property is subject to the trust. Everything remains as before. Where there is a transfer, the position is more difficult. In *Palmer* v *Simonds*, the court held that the recipient took the property outright. The thinking here is that uncertainty as to subject matter feeds back into uncertainty as to intention to create a trust in the first place. This will not always be the case.

ESSENTIAL READING

- ***Re Golay's WT*** **[1965] 1 WLR 969; *Hunter* v *Moss* [1993] EWCA Civ 11, [1994] 1 WLR 452; *Re Goldcorp Exchange Ltd* [1994] UKPC 3, [1995] 1 AC 74.**

FURTHER READING

- ***Palmer* v *Simmonds*** **(1854) 2 Drew 221; *Re Ellenbrough* [1903] 1 Ch 697.**

ACTIVITY 5.2

Read *Hunter* v *Moss* [1993] EWCA Civ 11, [1994] 1 WLR 452.

a. **On what grounds did the court distinguish *Re London Wine*?**

b. **Is that distinction valid for all possible cases?**

c. **What explanations have been put forward to cope with the problem of dealings by the 'settlor' with part of the bulk?**

No feedback provided.

Summary

The subject matter of a trust can consist of any type of property. However, it must be possible to clearly identify what property is subject to the trust otherwise the trust cannot function, as shown by *Re London Wine* and *Re Goldcorp* – although greater leniency seems to be given to intangible subject matter, as seen in *Hunter* v *Moss*. 'Conceptual uncertainty' can mean there is no valid declaration of trust, as was seen in *Palmer* v *Simmonds*. However, where a court can determine an appropriate meaning of the terms in the trust, the declaration of trust will be valid, as *Re Golay's WT* illustrates; and a testator's residuary estate is always certain. It is everything left after the satisfaction of specific legacies in the will. A trust of property, which the settlor does not at that moment have, cannot be created.

5.3 Identifying the beneficiaries

5.3.1 A non-charitable trust must have beneficiaries

A trust must have beneficiaries, unless it is for a charitable purpose (see Chapter 9) or for one of the anomalous non-charitable purposes which are permitted in English law (see Section 10.4). This is said to be one of the most fundamental principles of trusts law. In *Re Endacott* [1960] Ch 232, a testator left his residuary estate to the North Tawton Parish Council on trust 'for the purpose of providing some useful memorial to myself'. The Court of Appeal held that the trust failed because the testator had not identified any person or group of persons who were to be the beneficiaries of the trust. Instead of a trust for persons, the testator had attempted to create a trust for a purpose, and, since the purpose was not charitable, it was void. Lord Evershed MR said:

> No principle perhaps has greater sanction or authority behind it than the general proposition that a trust by English law, not being a charitable trust, in order to be effective, must have ascertained or ascertainable beneficiaries.

We will return to the topic of non-charitable purpose trusts in Chapter 10, where you will see that some cases have departed from this rule.

5.3.2 The beneficiaries must be identified

It is not enough that a trust has beneficiaries. If the trustees are to perform their functions under the trust, it must be possible to know who those beneficiaries are. This is the requirement of **certainty of objects**. The tests for certainty differ according to whether the trust is fixed or discretionary, plus there are also rules in relation to powers of appointment. The key to understanding the various tests for certainty is to appreciate that they are not arbitrary inventions of the judges. If they are not met, the trust (or power) could not function. However, it is important to understand that the problem of uncertainty only arises where the settlor uses a generic term to describe the class (for example, my children, my relatives or my friends). Where the beneficiaries are individually named, no question of uncertainty of objects arises because, of course, the beneficiaries are named! The whereabouts of such individuals may be unknown, but that is not something which will cause the potential trust to be adjudged invalid.

Fixed trusts

As you know, in a fixed trust the settlor decides in advance the extent of the interest each beneficiary is to receive. An example would be a trust for 'my children in equal shares'. The test for certainty of objects for fixed trusts is that the trustee must be able to determine the identity of all members of the class. This is sometimes called the 'complete list' test. The obvious reason for this is that the trustee cannot distribute a single penny unless the identity of all members can be known; the amount each is to receive depends upon the trustee first making a complete list of every member of the class: 'there can be no division in equal shares amongst a class of persons unless all the members of the class are known' (*IRC* v *Broadway Cottages Trust* [1955] Ch 20, 29 (Jenkins LJ)).

Discretionary trusts

You also know that in a discretionary trust (once confusingly called a 'trust power') the trustee has a discretion to choose how to distribute the trust property among the potential objects. Since the trustee is not required to distribute income or capital equally to all, the share each person will receive is not contingent on the number of people in the class. There is therefore no need for the trustees to compile a complete list of all potential beneficiaries to make any distribution: *McPhail* v *Doulton* [1970] UKHL 1, [1971] AC 424. The trustees do, however, need to be able to tell whether a potential object is or is not a member of the class, for they (and the court) need to know whether the proposed distribution is authorised by the terms of the trust. This test for certainty of objects is generally called the 'is or is not' or 'any given postulant' test.

If, for example, I give my trustees a discretion to distribute income from a trust fund to 'tall students of the University of London', the test of validity is whether they are able to tell which students are tall and which are not, for otherwise they may stray outside the terms of their discretion and thereby commit a breach of trust. Since neither they nor the court can tell where 'tall' starts and 'not tall' ends, such a trust would fail for 'conceptual' uncertainty. According to Sachs LJ in *Re Baden's Deed Trusts (No.2)* [1973] Ch 9, it is different where we know what the defining term means but do not have enough evidence to determine whether a particular person is or is not a member of the class, what he called a case of 'evidential uncertainty'. There, the burden of proof is on the postulant, the person claiming to be in the class and if the person does not prove that they are, then they are not.

In contrast, Megaw LJ held that too much emphasis should not be placed on the words 'or is not', and that the test was satisfied:

> if, as regards at least a substantial number of objects, it can be said with certainty that they fall within the trust; even though, as regards a substantial number of other persons, if they ever for some fanciful reason fell to be considered, the answer would have to be, not 'they are outside the trust', but 'it is not proven whether they are in or out.' What is a 'substantial number' may well be a question of common sense and of degree in relation to the particular trust: particularly where, as here, it would be fantasy, to use a mild word, to suggest that any practical difficulty would arise in the fair, proper and sensible administration of this trust in respect of relatives and dependants.

You should ask yourself whether the different formulations of Sachs and Megaw LJJ lead to different results in certain cases.

It is a difficult question whether conceptual uncertainty can be cured by a term in the trust which makes a third party the decider: compare *Re Tuck's ST* [1978] Ch 49 with *Re Wright's WT* (1981) commentary in (1999) 13 *Trust Law International* 48.

Powers of appointment

Powers of appointment (or 'mere powers') are not trusts in themselves, but are often used in trust instruments. They also raise issues of certainty of objects, since powers may be created in favour of classes of people described only in generic terms, such as 'my children' or 'the undergraduates of the University of London'. Since there is no duty to appoint equally to all members of the class but merely to stay within the terms of the power, the same test for certainty of objects (the 'is or is not' test) also applies to powers of appointment as it does to discretionary trusts: *Re Gulbenkian's ST* [1970] AC 508. Indeed, it was from the law on powers of appointment that the test was taken in *McPhail* v *Doulton*.

Gifts subject to conditions

These are not trusts either, but because they are often phrased in generic terms, they raise similar issues to discretionary trusts. The question here is whether the same requirement of certainty of object is required, or whether it is enough to say of a particular candidate that they are or are not a member of the class: *Re Barlow's WT* [1979] 1 WLR 278; criticised by Emery (1982) 98 *LQR* 551.

5.3.3 Consequences of failure

An attempt to declare a trust with no certain beneficiaries will not create a valid express trust. The effect of this will depend on whether it was a self-declaration of trust or a transfer of property to a third party on trust. In the former case, nothing happens. However, if the property was transferred to a third party, an 'automatic' resulting trust will arise, with the third party as the trustee and the settlor as the beneficiary. This is discussed in Chapter 12.

ESSENTIAL READING

- ***Re Endacott* [1960] Ch 232; *McPhail* v *Doulton* [1970] UKHL 1, [1971] AC 424; *Re Baden's Deed Trusts (No.2)* [1972] EWCA Civ 10, [1973] Ch 9; *Re Tuck's ST* [1978] Ch 49; *Re Barlow's WT* [1979] 1 WLR 278.**

FURTHER READING

- ***IRC* v *Broadway Cottages* [1955] Ch 20; *Re Leek* [1969] 1 Ch 563; *Re Gulbenkian's Settlements* [1968] UKHL 5, [1970] AC 508.**

ACTIVITIES 5.3–5.5

Read and note the decision of the Court of Appeal in *Re Baden's Deed Trusts (No.2)* [1972] EWCA Civ 10, [1973] Ch 9.

5.3 How do the approaches of Megaw LJ and Sachs LJ differ on the question of certainty of objects? Try to formulate a set of objects which would be valid under one but void under the other.

5.4 Explain the difference between 'conceptual uncertainty' and 'evidential uncertainty'.

5.5 What is the effect of evidential uncertainty on (a) a fixed trust, (b) a discretionary trust, and (c) a power of appointment?

5.3.4 Certainty of beneficiary's interests

Even though the rights to be held on trust and the objects of that trust are sufficiently identified, it may be that the settlor has not identified the shares in which the beneficiaries are entitled under the trust. This is not a problem for a discretionary trust, since that will be determined by the trustees themselves. However, it can be a problem in a fixed trust, as in *Boyce* v *Boyce* (1849) 6 Sim 476, 60 ER 959, where one of two beneficiaries was given the task of allocating property between them but died without doing so. That was an unusual case. Normally, if a trust is silent on how property is to be divided among a list or class of beneficiaries, the beneficiaries will have equal shares.

5.3.5 Workability

It has been suggested that a trust with a certain class of objects may yet be invalid if the trust is 'unworkable'. This arises out of the abandonment of the 'fixed list' test and the adoption of the 'is or is not' test of certainty of objects for discretionary trusts and the consequent acceptance of the *prima facie* validity of conceptually certain classes as huge as 'relatives of X' or 'all the inhabitants of London'. The members of such classes cannot be surveyed one by one. It may be suggested that if there is a 'core' class of objects within the larger class to whom the trustees may primarily devote their survey of objects before making payments, then the trust will not be administratively unworkable, although no case has explicitly stated that the absence of a 'core class' is the basis for the finding of such unworkability. On the 'core class' view, 'relatives of X' is workable because a core class easily identifies itself (i.e. the close relatives of X as opposed to distant relatives). 'Residents of London' is not workable, because there is no such core class.

The problem is not size. 'Relatives of X' is a larger class than 'Residents of London'. (You may find this surprising, but in law 'relative' or 'relation' means descendant of a common ancestor, and so, counting back to more and more distant ancestors and then back down to living persons, everyone undoubtedly has many more relations than they could ever identify, and we are all related if we want to go as far back as the first humans to arise in Africa.) The problem is solely being able to identify a core class capable of being surveyed. In *Re Manisty's ST* [1974] Ch 17, Templeman J associated the concept of administrative unworkability with 'capriciousness', saying that a power of appointment given to a fiduciary in favour of the 'residents of London' was capricious because the terms of the power negated any sensible intention on the part of the settlor. However, in *Re Hay's ST* [1982] 1 WLR 202, Megarry J doubted that such a trust would be capricious if the settlor had been a former Chairman of the Greater London Council (and in such a case the power, although valid, would equally disclose no 'core class').

ESSENTIAL READING

- ***Re Manisty's ST* [1974] Ch 17; *Re Hay's ST* [1982] 1 WLR 202.**

FURTHER READING

- ***R* v *District Auditor*, *ex p W Yorks* [1986] RVR 24 ([1986] CLJ 391).**

ACTIVITY 5.6

Read and note the decision in *Re Hay's ST* [1982] 1 WLR 202.

a. **Within powers of appointment, why does it matter whether the power is held by a fiduciary?**

b. **On what basis does Megarry J suggest that 'intermediate' trusts are administratively unworkable?**

Summary

A fundamental principle of trust law is that a non-charitable trust must have beneficiaries. However, this is not sufficient. There must also be 'certainty of objects'. This problem potentially arises when a generic term is used to describe a class. The criterion for 'certainty of objects' differs depending on whether it is a fixed trust, on

the one hand, or a discretionary trust or power of appointment, on the other. In a fixed trust, a trustee must be able to compile a complete list of the beneficiaries; while in the case of a discretionary trust or power of appointment the trustee must be able to determine whether any given postulant is or is not a member of the class.

Apart from charitable trusts and a few anomalous exceptions, a trust cannot exist if it has no beneficiaries or the beneficiaries cannot be identified with certainty. Where the intended trust is self-declared, the invalid declaration of trust will mean that nothing has happened, and the would-be settlor will simply continue to hold the property concerned in the same way as before the invalid declaration. Where the would-be settlor transfers property to a would-be trustee and the declaration is invalid for failure to identify the objects, the would-be trustee holds them on 'automatic' resulting trust for the would-be settlor.

The requirement of administrative workability is unclear, although it may be given content by regarding the absence of a core class as rendering a trust administratively unworkable.

5.3.6 Perpetuity

CORE TEXT

- **Penner, Chapter 3 'Trusts and powers', Section 'Limits on duration of trusts'.**

This subject is not examinable, but its understanding will help you to appreciate why perpetuity can sometimes be problematic. Basically, the rule against perpetuities prevents settlors creating perpetual trusts. At some point, the beneficiaries must be free to wind up the trust and call for a transfer of the property to them. Before the introduction of legislation in 1964, a trust that violated the common law rule against perpetuities was void from the outset. Now, under the Perpetuities and Accumulations Act 2009, a trust that **might** violate the rule is valid for up to 125 years. There are exceptions (in s.2) for charitable trusts and pension schemes, to which no perpetuity period applies. The Lord Chancellor has the power (under s.3) to specify other exemptions.

ACTIVITY 5.7

CORE COMPREHENSION – CERTAINTY OF OBJECTS

Read the following journal article, which is available on the VLE.

- **Matthews, P. 'A heresy and a half in certainty of objects' (1984) *Conv* 22.**

You can complete this learning activity by reading pp.22–27.

INTRODUCTION

a. **On which basis does Matthews reject the assertion that the *McPhail* judgment made a 'revolutionary change' to the law on the test for certainty of objects?**

b. **According to prevailing orthodoxy, which two things are important when administering fixed trusts?**

DISCRETIONARY TRUSTS

c. **In *IRC* v *Broadway Cottages* which specific problem of 'conceptual' or 'linguistic or semantic' uncertainty arose?**

d. **Despite the use of conceptually certain expressions, which problem of evidential certainty arose regarding the class of the beneficiaries?**

e. **Paraphrase in fewer than 50 words how the Crown (IRC) succeeded in arguing that the trust in *Broadway Cottages* was void.**

FIXED TRUSTS

f. **Outline the orthodox view of the 'complete ascertainment' or 'list principle rule'.**

g. **Outline the difference between 'capability of ascertainment' and 'actual ascertainment'.**

Activity 5.8

Applied comprehension – *Pearson* v *Lehman Brothers*: certainty of subject matter

Using the Online Library resources, research the following judgment:

- ***Pearson* v *Lehman Brothers Finance SA* [2010] EWHC 2914 (Ch).**

You can complete this learning activity by reading the section entitled 'Certainty' [227]–[248], unless otherwise directed.

a. **From the 'Introduction' section, para.1, identify the central business activity of the parties and characterise the key event that happened on 15 September 2008.**

b. **As related to *Hunter* v *Moss*, which question did *Pearson v Lehman Brothers* raise? (para.36)**

c. **Identify Principle (iii) of the respondent's submissions.**

d. **In *Hunter* v *Moss* why were the shares held by the defendant capable of satisfying the trust although there was no identification of any particular 50 shares? Explain in your own words.**

e. **In *Re London Wine Co (Shippers) Limited* why was there no certainty of subject matter for the purchasers of specific quantities of wine of specific types and vintages?**

f. **In *Mac-Jordan Construction Limited* why was there no certainty of subject matter for the builder in the building contract?**

g. **Why is application of the *Hunter v Moss* judgment difficult in practice?**

h. **What is meant by the 'co-ownership approach'?**

i. **How does the law uphold the principle of legal certainty?**

j. **How was the principle applied to the circumstances of *Pearson* v *Lehman*?**

Sample examination questions

Question 1 Advise on the validity of the following provisions in Martin's will:

a. **£50,000 to my executors in trust for distribution among such loyal supporters of Manchester United Football Club as my executors think fit. In the event that there is a dispute as to whether any given person is a loyal supporter, the current captain of Manchester United to decide.**

b. **£50,000 to my executors on trust for distribution among such members of the Manchester United Supporters Club who are over six feet tall as my executor thinks fit.**

c. **£500,000 to my executors for distribution in equal shares among all persons listed in the Manchester telephone directory whose surname begins with Z.**

d. **My collection of Manchester United football programmes to be available for purchase at £1 each to any friends who travelled with me to matches.**

Question 2 Nigel has recently died. A week prior to his death, he declared in writing that he held 200 shares in Oilco plc on trust for Martin. At that point, Nigel held 1,000 shares in Oilco plc outright. By his will, Nigel left his residuary estate to his widow 'in the confident expectation that she will use it for the benefit of our children'.

Advise Nigel's children.

ADVICE ON ANSWERING THE QUESTIONS

Question 1 This question raises issues of certainty of objects and administrative workability in relation to trusts and gifts. Each part will be addressed in turn:

a. This is an attempt to create a discretionary trust, the objects of which are the 'loyal supporters of Manchester United Football Club'. The question is whether the class is defined with sufficient certainty. The answer should outline the content of that test, noting the different formulations of Megaw and Sachs LJJ in *Re Baden (No.2)*. It should then apply those formulations to the facts of the case. A further question, should the class be too uncertain, is whether that uncertainty can be cured by the provision that the team captain is to decide on membership.

b. This is again a discretionary trust, although with the difference that there is no uncertainty as to whether any given individual is or is not a member of the benefited class. The issue instead is one of administrative workability or capriciousness, the class as defined seeming to be an arbitrary collection of individuals.

c. This is a fixed trust, where the test for certainty of objects is different. Answers should state what that test is and whether it is satisfied in this case. There is then a question whether a requirement of administrative workability can apply in a case such as this.

d. This is not a trust but a gift subject to a condition precedent, to which Browne-Wilkinson J in *Re Barlow's WT* held that a less stringent test that the 'is or is not' test applied. Note, however, the trenchant criticism of this decision by Emery (1982) 98 *LQR* 551, 562–67.

Question 2 There are two issues which need to be discussed: the *inter vivos* declaration of trust in favour of Martin and the testamentary transfer to Nigel's widow. The children will want to argue that the *inter vivos* declaration of trust was of no effect, with the result that all 1,000 shares form part of Nigel's residuary estate. They will also want to argue that the transfer of the residuary estate to their mother was a transfer to her on trust for them rather than outright.

As to the first issue, although there is clearly an intent to create a trust and the identification of a beneficiary, the problematic area is that of the subject matter of the trust: Nigel has 1,000 shares and we do not know which of those shares are subject to the trust and which are not. While there is no doubt that such a problem would be fatal were we talking about rights to tangible things (e.g. bottles of wine: *Re London Wine*), the question is whether a different rule should apply to the case of shares. The discussion should therefore point out the differences between shares and wine and go on to discuss the case of *Hunter* v *Moss*. The question is essentially asking whether *Hunter* v *Moss* was correctly decided, so the discussion should cover not only what the Court of Appeal and subsequent cases held but also the academic criticisms (and defence) of *Hunter* v *Moss*.

The second issue raises questions of certainty of intention to create a trust. The question is whether the words used by the testator ('in the confident expectation that she will use it for our children's benefit') are sufficiently mandatory to create a trust, or, as in *Re Adams & Kensington Vestry*, simply express a preference by the testator as to what the recipient should do with the property. Note that there is no problem over certainty of subject matter with the gift of the residuary estate.

Reflect and review

Look through the points listed below.

Are you ready to move on to the next chapter?

Ready to move on = I am satisfied that I have sufficient understanding of the principles outlined in this chapter to enable me to go on to the next chapter.

Need to revise first = There are one or two areas I am unsure about and need to revise before I go on to the next chapter.

Need to study again = I found many or all of the principles outlined in this chapter very difficult and need to go over them again before I move on.

Tick a box for each topic.

	Ready to move on	Need to revise first	Need to study again
I can explain how the court determines whether the words expressed by a person manifested an intention to create a trust.	☐	☐	☐
I can define the test for certainty of subject matter of a trust.	☐	☐	☐
I can explain why the tests for certainty of objects differ between fixed trusts, discretionary trusts and powers of appointment.	☐	☐	☐
I can explain the concept of administrative workability.	☐	☐	☐

If you ticked 'need to revise first', which sections of the chapter are you going to revise?

		Must revise	Revision done
5.1	Intention to create a trust	☐	☐
5.2	Identifying the trust property	☐	☐
5.3	Identifying the beneficiaries	☐	☐

NOTES

6 Formalities

Contents

Introduction

There are three different topics discussed in this chapter. First, the rule that declarations of trust respecting land must be proved by signed writing, which is technically a rule of procedure rather than formality, although that is not important in this context. Second, the rules concerning testamentary trusts. Third, the requirement of signed writing for the disposition of an interest under a trust.

CORE TEXT

- **Penner, Chapter 9 'Formalities and secret trusts'.**

LEARNING OUTCOMES

By the end of this chapter and the relevant readings, you should be able to:

- **identify the difference between substantive requirements of a declaration of trust and procedural rules relating to its proof**
- **describe the origin and nature of these procedural rules**
- **identify the substantive rules relating to how dispositions of interests under trusts are made.**

6.1 Declarations of trusts of titles to land

When a case goes to court, one issue is the type of evidence admissible to prove the truth of allegations of the occurrence of an alleged event.

This applies of course to allegations that a property-holder has made a declaration of trust. In general, as you will have seen from your reading of Paul v Constance in Chapter 5, there is no objection to oral or other evidence being admitted to make good such an allegation. There are, however, two situations where oral or other evidence is not generally admitted to establish a trust. The first, which is dealt with here, concerns the making of declarations of trusts of land. The second, addressed below and in detail in Chapter 14, concerns testamentary declarations of trust.

6.1.1 The rule concerning trusts of land

Statute provides that declarations of trust with respect to land must be 'manifested and proved' by some writing signed by the person able to declare the trust. The rule is an ancient one, s.7 of the Statute of Frauds 1677 providing that:

> all declarations or creations of trust or confidences of any lands, tenements or hereditaments shall be manifested and proved by some writing signed by the party who is by law enabled to declare such trust, or by his last will in writing, or else they shall be utterly void and of none effect.

Section 7 was re-enacted as s.53(1)(b) of the LPA 1925 as follows:

> a declaration of trust respecting any land or any interest therein must be manifested and proved by some writing signed by some person who is able to declare such trust or by his will.

The reason for the enactment of s.7 in 1677 was to prevent fraud. To understand how it and its successor operate, we must determine the 'fraud' it was trying to prevent. Details of this can be found in the article by Youdan referred to below. Very briefly, the problem at that time was perjury, the giving of false evidence in court proceedings. The law of evidence in 1677 was in a primitive state, and it was consequently easy for fraudulent allegations to be accepted in court. The particular fraudulent allegation here was that the holder of a title to land had declared himself a trustee of his title for the claimant. The title-holder, of course, had done no such thing, but because of the then primitive state of the law of evidence, the court would often find as a fact that such declaration had been made and as a consequence order the title-holder to convey their title to the claimant. By this method, many title-holders effectively had their titles stolen from them. To stop this abuse, the legislature provided that such allegations could henceforth only be proved by written evidence bearing the signature of the person alleged to have made the declaration. Fraudulent allegations of self-declaration of trust were now much less likely to succeed.

Note that the statute says nothing about the time when the written evidence must exist. It is therefore no objection that it comes after the alleged declaration of trust itself. Thus, it is perfectly possible to adduce written evidence which came into being today to prove a declaration of trust made a year ago. This is in stark contrast to the writing requirement which concerns dispositions of equitable interests under trusts. Nor does the statute provide that the declaration itself be 'in' writing: it says it must be 'manifested and proved' by some signed writing (*Gissing* v *Gissing* [1970] UKHL 3). Section 53(1)(b), in other words, is a not a rule with which settlors must 'comply' (unlike s.53(1)(c)). This is an important point to grasp, for it is probably the most common mistake that students (and sometimes judges) make in this area.

6.1.2 Effect of oral etc. declaration

Since s.53(1)(b) LPA 1925 only states a rule of evidence ('manifested and proved'), an oral declaration of trust of a title to land or a declaration in unsigned writing will be valid. The problem will come in litigation if: it is denied that such a declaration was made; the claimant bears the burden of proof; the statute is pleaded; and there is no evidence sanctioned by the statute to prove that controverted fact.

It is often said of such a case that there is a 'valid but unenforceable' trust. This is an inaccurate description, although used commonly. Section 53(1)(b) is not concerned with enforceability but with proof, a logically prior question. If a declaration of trust is alleged to have been made but an application of the statute means that that allegation cannot be proved, there will, in the eye of the court, simply be no declaration of trust at all.

6.1.3 Exceptions to the rule requiring written evidence

The difficulty with a statute that excludes evidence because it is not of a particular type is that it necessarily excludes both true and false evidence. It might be thought that that was a price worth paying. It has, however, caused the courts to pause, and in certain circumstances they have been ready to admit evidence which the statute says they cannot. The leading case is *Rochefoucauld* v *Boustead* [1897] 1 Ch 196, where the Court of Appeal held that a statute designed to prevent fraud could not be used to perpetrate a fraud, and therefore admitted oral evidence to prove an allegation of a declaration of trust on the ground that the 'trustee' himself would commit a fraud were he allowed to shelter behind the statutory provision to assist his denial of the declaration of trust. You should ask whether the reasoning in *Rochefoucauld* is circular. It will only be a fraud for the defendant to plead the statute if he really is a trustee, but, at the point where the argument over admissibility is made, we do not yet have evidence proving that fact.

6.1.4 The type of trust enforced in *Rochefoucauld*

What type of trust is enforced in a case such as *Rochefoucauld* v *Boustead*? Logically, it must be an express trust, for the event that triggers the finding that a trust exists is a now proved declaration of trust. Indeed, this is exactly what the Court of Appeal held in *Rochefoucauld*, and as part of the *ratio* of the case. Other cases, however, have called it constructive (*Bannister* v *Bannister* [1948] 2 All ER 133; *Paragon Finance* v *Thakarer* [1998] EWCA Civ 1249; [1999] 1 All ER 400), though only in *obiter dicta*. However, as we saw in Chapter 3, a constructive trust normally arises for a reason other than a declaration of trust on the part of a title-holder. The trust in *Rochefoucauld*, by contrast, arose because of proof by evidence of a declaration of trust. The reason why the *Rochefoucauld* trust is often wrongly classified as constructive is no doubt a misunderstanding of s.53(1)(b). If that sub-section is seen as laying down a rule for the validity of the trust (which it does not), then the lack of signed writing will mean that the alleged trust is void and *Rochefoucauld* would establish a constructive trust arising by operation of law.

6.1.5 A statutory exception to the formality requirement

Section 7 of the Statute of Frauds was qualified by s.8, which read as follows:

> Provided always, that where any conveyance shall be made of any lands or tenements by which a trust or confidence shall or may arise or result by the implication or construction of law, or be transferred or extinguished by an act or operation of law, then and in every such case such trust or confidence shall be of the like force and effect as the same would have been if this statute had not been made; any thing herein before contained to the contrary notwithstanding.

Section 8 was re-enacted as the much shorter s.53(2) of the LPA 1925:

> This section does not affect the creation or operation of resulting, implied or constructive trusts.

Given that s.53(1)(b) is concerned with questions of the type of evidence admissible to prove that a declaration of trust was made, it makes sense to exclude from its operation those trusts which, for one reason or another, do not require proof by evidence of a declaration of trust. Constructive trusts, since they arise for a reason other than a declaration of trust, are clearly exempt. The same can be said for resulting trusts, bearing in mind the disagreement regarding how such trusts should be classified and the role of intention in their operation.

6.1.6 The family homes cases

There are a group of cases, the most of prominent of which are *Pettitt* v *Pettitt* [1970] UKHL 3, *Gissing* v *Gissing* [1969] UKHL 5, *Lloyds Bank plc* v *Rosset* [1990] UKHL 4, *Stack* v *Dowden* [2007] UKHL 17 and *Jones* v *Kernott* [2011] UKSC 53, that concern attempts to say there is a trust of the title to the family home. As noted in Section 3.4.3, you will study these cases in property law. Such trusts are often referred to as 'common intention constructive trusts'. Given that a constructive trust is one which normally arises for a reason other than of a declaration of trust by a title-holder, it may seem that the idea of a constructive trust based on an intention to create a trust is something of a misnomer. However, as Professor Birks said in *An introduction to the law of restitution*. (Oxford: Clarendon Press, 1985) [ISBN 9780198760740], p.65:

> There is a fine but important distinction between intent conceived as creative of rights, as in an express trust or a contract, and intent conceived as a fact which, along with others, calls for the creation of rights by operation of law.

The family home cases can possibly be understood as ones in which the intention to share the property is not sufficient on its own to create an express trust, but is a fact that calls for the imposition of a constructive trust. One approach might be to look for acts of detrimental reliance on that intention, similar to proprietary estoppel. This was the approach taken in *Lloyds Bank plc* v *Rosset*, where Lord Bridge said:

> Once a finding [of an agreement or arrangement to share] is made it will only be necessary for the partner asserting a claim to a beneficial interest against the partner entitled to the legal estate to show that he or she has acted to his or her detriment or significantly altered his or her position in reliance on the agreement in order to give rise to a constructive trust or a proprietary estoppel.

Some commentators have asked questions about the reasoning in *Jones* v *Kernott*, including the lack of any explanation of why an intention to share a home can give rise to a trust; nor how, if there was an expressed intention, it could be proved in the absence of s.53(1)(b) compliant evidence. It may be that, ultimately, courts have responded to the gap caused by a lack of legislative activity in relation to property rights of unmarried cohabitants, where there may be sound reasons of policy and economics to adjust such rights to reflect non-financial contributions and so forth (as already exists for married couples and civil partners).

Essential reading

- ***Rochefoucauld* v *Boustead* [1897] 1 Ch 196; *Gissing* v *Gissing* [1970] UKHL 3, [1971] AC 886.**

Further reading

- ***Bannister* v *Bannister* [1948] 2 All ER 133; *Paul* v *Constance* [1976] EWCA Civ 2; *Lloyds Bank plc* v *Rosset* [1990] UKHL 4, [1991] 1 AC 107; *Stack* v *Dowden* [2007] UKHL 17, [2007] 2 AC 432.**

Activity 6.1

Read and note the decision in *Rochefoucauld* v *Boustead* [1897] 1 Ch 196.

a. Why did the court decide that a trust existed?

b. What sort of trust was it?

No feedback provided.

6.2 Testamentary trusts

A testamentary trust is one that takes effect on the death of the settlor. Like most testamentary dispositions, it normally must be made in compliance with the Wills Act 1837, s.9, which states that:

> No will shall be valid unless –
>
> (a) it is in writing, and signed by the testator, or by some other person in his presence and by his direction; and
>
> (b) it appears that the testator intended by his signature to give effect to the will; and
>
> (c) the signature is made or acknowledged by the testator in the presence of two or more witnesses present at the same time; and
>
> (d) each witness either –
>
> (i) attests and signs the will; or
>
> (ii) acknowledges his signature,
>
> in the presence of the testator (but not necessarily in the presence of any other witness), but no form of attestation shall be necessary.

In the Wills Act 1837, s.1, 'the word "will" shall extend to a testament, and to a codicil, … and to any other testamentary disposition'. It should be noted that, at least on its face, s.9 concerns the manner in which wills are made. In this respect, it appears similar to s.53(1)(c) of the LPA 1925 and not merely an evidential requirement like s.53(1)(b). Nevertheless, as we shall see (in Chapter 14), courts have long been willing to give effect to secret trusts despite the failure to 'comply' with the Wills Act 1837. They do so by admitting evidence of a declaration of trust which does not take the form of signed, witnessed writing. In this respect, they appear to treat s.9 as a rule of evidence rather than validity.

It is important to note that the execution of a will in compliance with the Wills Act 1837 has no immediate legal effect. The testator is free to destroy, replace, or amend the will as he or she sees fit. It is only when the testator dies that the will takes effect.

Two further provisions of the Wills Act 1837 should be noted. First, in order to ensure the impartiality of the witnesses, s.15 provides that any 'beneficial devise' to an attesting witness or that attesting witness's spouse or civil partner shall be void. Note that a gift to an attesting witness does not make that witness incompetent to attest to the genuineness of the testator's signature; the only effect is that the gift to the attesting witness or their spouse or civil partner will be void. Second, s.20 provides that any alteration to the will (a codicil) must comply with the same formalities required of wills themselves (i.e. signed, witnessed writing).

ACTIVITY 6.2

Make a spoken presentation summarising the requirements for admission of evidence to prove a will.

No feedback provided.

6.3 Transfer of interests under trusts

This part of the chapter deals with a formality rule proper, namely, the formalities required to transfer an interest under a trust. In contrast to s.53(1)(b), it is a rule with respect to which it makes sense to talk about 'compliance'.

The beneficiary of a fixed (though not a discretionary) trust has a right that is capable of assignment (transfer) to others. Statutory rules have long said that only written assignments are possible.

The current rule is contained in s.53(1)(c) of the LPA 1925:

> a disposition of an equitable interest or trust subsisting at the time of the disposition must be in writing signed by the person disposing of the same or by his agent thereunto lawfully authorised in writing or by will.

While we saw that s.53(1)(b) of the LPA 1925 is evidential, s.53(1)(c) is dispositive. In other words, it is a rule of substantive law. What this means is that there is no question of an unwritten disposition being valid. There will instead, as *Grey* v *IRC* [1959] UKHL 2 demonstrates, be no disposition until the writing is executed.

6.3.1 What transactions are caught?

This all depends on what is considered a 'disposition'. The leading case is *Grey* v *IRC*. The House of Lords in *Grey* held that the word 'disposition' had a broad meaning. Therefore, a direction by a beneficiary to his trustees now to hold the property on trust for a third party was held to be covered by the wide wording of s.53(1)(c), with the result that there was no disposal by the beneficiary of his interest under the trust until he put his direction in writing. Other transactions which you need to consider are a direction by the beneficiary to the trustee to assign the right held by the trustee to a third party (*Vandervell* v *IRC* [1966] UKHL 3); a self-declaration of trust by the beneficiary (*Nelson* v *Greening & Sykes (Builders) Ltd* [2007] EWCA Civ 1358); a declaration of trust by the trustee for a third party with the consent of the existing beneficiary (*Re Vandervell's Trusts (No.2)* [1974] EWCA Civ 7); a contract by a beneficiary to assign their rights (*Oughtred* v *IRC* [1959] UKHL 3, *Neville* v *Wilson* [1997] Ch 144); a surrender of an interest under a trust (*IRC* v *Buchanan* [1958] Ch 289); and a disclaimer of an interest under a trust (*Re Paradise Motors Ltd* [1968] 1 WLR 1125).

6.3.2 The rationale of s.53(1)(c)

As a re-enactment of a provision of the Statute of Frauds (see s.9), the purpose of s.53(1)(c) must, like that of s.53(1)(b), be the prevention of fraud. But exactly what fraud is the provision trying to prevent? That question is discussed in *Vandervell* v *IRC*, the leading case on the topic. There, a beneficiary under a bare trust of shares gave an oral direction to his trustees to convey the shares to a third party, which transfer was then made. The beneficiary's intention was that the third party would hold the shares outright. However, the Inland Revenue argued that the third party was a trustee of the property, the beneficial interest still being vested in him because of his failure to comply with s.53(1)(c). The Inland Revenue argument was rejected by the House of Lords. Section 53(1)(c) was a provision designed to protect trustees, and in the situation where the property was no longer to be held on trust, there were no trustees to protect. The subsection did not therefore apply.

Thus, it is the trustees whom the provision is designed to protect, but from what do they need protection? The answer is false allegations by someone claiming to be an assignee of the beneficiary's interest. The difficulty for the trustee in such a case is that if they pay out to the false assignee they thereby commit a breach of trust (a wrong of strict liability) and consequently incur a liability to the true beneficiary to reinstate the trust fund. A requirement that assignments be made in writing protects the trustees because they can now, by demanding sight of the document of transfer, ensure they pay out only to genuine assignees.

In light of this, the question arises whether *Grey* needs to be revisited. It will be recalled that the trustees were there directed by the beneficiary, albeit orally, to hold the rights for a new set of beneficiaries. And because they received their instructions from the beneficiary himself, they knew it was genuine. Forcing the beneficiary to put his direction in writing would tell them nothing they did not already know. It is, of course, different with an assignment, where the claim for payment now comes from a third party, the putative assignee, and where the trustees are consequently vulnerable to fraud. But that concern is not present in a case like *Grey*. Were, therefore, the courts to adopt the purposive approach of *Vandervell*, it might also be said that in *Grey*, the subsection need not apply.

Core text

- **Penner, Chapter 6 'Formalities and secret trusts', Section 'Disposition of subsisting equitable interests: Law of Property Act 1925, s 53(1)(c)'.**

Essential reading

- ***Grey* v *IRC* [1959] UKHL 2, [1960] AC 1; *Oughtred* v *IRC* [1959] UKHL 3, [1960] AC 206; *Vandervell* v *IRC* [1966] UKHL 3, [1967] 2 AC 291; *Re Holt's ST* [1969] 1 Ch 100; *Re Vandervell's Trusts (No.2)* [1974] EWCA Civ 7, [1974] Ch 269; *Neville* v *Wilson* [1997] Ch 144 (CA); *Nelson* v *Greening & Sykes (Builders) Ltd* [2007] EWCA Civ 1358.**

Activity 6.3

Read and note the decision of the House of Lords in *Vandervell* v *IRC* (1966), though ignoring for now all discussion of the option to purchase and resulting trusts. We will return to them in Chapter 12.

a. **What, according to the arguments of the Inland Revenue, is the role of s.53(1)(c) in this case?**

b. **How successful is the Revenue's argument in the eyes of Lords Upjohn and Wilberforce?**

c. **According to Lord Upjohn, what purpose does s.53(1)(c) serve?**

No feedback provided.

Sample examination questions

Question 1 How, if at all, should s.53(1)(b) and s.53(1)(c) of the Law of Property Act 1925 be reformed?

Question 2 Alfred holds 10,000 shares on trust for Peter for life, remainder to Maud. Consider the effect of the following:

a. **Peter orally declares himself trustee of his interest for Carol.**

b. **Maud and Roger agree that Roger will exchange his unique stamp collection for Maud's remainder interest, and Roger delivers Maud his collection in furtherance of this agreement.**

c. **Alfred, on the oral instructions of Peter and Maud, transfers the shares to Brian, Peter and Maud having previously instructed Brian by telephone to hold them on trust for David.**

Advice on answering the questions

Question 1 Any question which asks about the reform of statutory provisions has to first ask what problem the statute was designed to solve and how successful the solutions were in tackling it. A specific issue here concerns the age of the statutory provisions, which date back to 1677. The question which must be asked is whether the problem is one peculiar to that time.

If we start with s.53(1)(b), the first thing which needs to be done is to explain what the statute prescribes. Candidates should state that it is a provision designed to prevent fraud by excluding certain types of evidence being admitted to substantiate an allegation at trial that a declaration of trust was made and comment on how successful it was in meeting the problems of the time. They should also explain how the provision has caused courts problems, as witness the circular logic adopted by the Court of Appeal in *Rochefoucauld* v *Boustead*, and the total mess in which we currently find the matrimonial homes cases. They might also question whether the provision is needed today, the law of evidence having improved greatly over the last 300 and more years. Support for this proposition could be sought from the observation that there is no clamour to expand s.53(1)(b) to encompass allegations that declarations of trust were made in respect of rights other than property rights in respect of land. This could be said to show that the problems of perjury are not as great nowadays as they were in 1677. This would indicate that the best reform of s.53(1)(b) would be its abolition.

As for s.53(1)(c), candidates should once again start with its legislative history, explaining, by reference to *Vandervell* v *IRC*, the purpose of the provision. But since it is less about courts and more about trustees being deceived, the same call for abolition as made for s.53(1)(b) might not be appropriate. Indeed, if anything, the section might be strengthened. It might be worth considering whether to tighten it up by making it a condition of the validity of the disposition that it be notified to the trustee. A good analogy in this respect would be with s.136 of the LPA 1925, a provision concerned with the assignment of choses in action, where similar issues arise.

Question 2 The issue in every part of this question is the same: is the transaction in question a 'disposition of an equitable interest or trust' and thereby void because not made by signed writing? Each sub-part of the question should be taken in turn:

a. Although *prima facie* not caught by the rule, there is a danger that this could be seen as a disposition rather than a declaration because of the operation of the rule in *Grainge* v *Wilberforce*. They should, however, also note that the rule was not applied by the Court of Appeal in *Nelson* v *Greening & Sykes (Builders) Ltd* [2007] EWCA Civ 1358.

b. This part raises questions about the effect of a specifically enforceable contract and whether the sub-trust thereby arising will also amount to a purported disposition and be invalidated by s.53(1)(c). This issue was the subject of discussion in *Oughtred* v *IRC* and *Neville* v *Wilson*. One point which needs to be asked is whether the contract here is specifically enforceable, for if it is not, no question of a constructive trust arises. That will depend on whether the shares are in respect of a private or a public company.

c. This part is a cross between the facts of *Grey* and *Vandervell*. Although there is a direction to transfer the rights held by the trustees, as in *Vandervell*, there is no intent to vest them outright in the transferee. It might, therefore, be argued that *Grey* applies and that there is a consequent need to comply with s.53(1)(c). However, as noted in the text above, there is an argument that *Grey* should be reconsidered, and this would appear to be an ideal case in which to do so.

Reflect and review

Look through the points listed below.

Are you ready to move on to the next chapter?

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Tick a box for each topic.

	Ready to move on	Need to revise first	Need to study again
I can identify the difference between substantive requirements of a declaration of trust and procedural rules relating to its proof.	☐	☐	☐
I can describe the origin and nature of these procedural rules.	☐	☐	☐
I can identify the substantive rules relating to how dispositions of interests under trusts are made.	☐	☐	☐

If you ticked 'need to revise first', which sections of the chapter are you going to revise?

		Must revise	Revision done
6.1	Declarations of trusts of titles to land	☐	☐
6.2	Testamentary trusts	☐	☐
6.3	Transfer of interests under trusts	☐	☐

7 Constitution

Contents

Introduction

This chapter is concerned with the constitution of trusts, by which is meant the transfer to the intended trustees of the property intended to form the subject matter of the trust. There are three issues to discuss. First, how is such a transfer made? Second, what will the court do if the transfer is in some way defective? Third, because the same rules also apply to transfers pursuant to the making of a gift, it is helpful to ask what equity does about defective gifts and unperformed promises to make gifts. Strictly speaking, this is a diversion, for when the courts do intervene, they do so by imposing trusts. Since these trusts are constructive rather than express, the topic properly forms part of Chapter 13. It is dealt with here for reasons of convenience. A related topic is that of unperformed promises to create trusts. These are dealt with in Chapter 8.

CORE TEXT

- **Penner, Chapter 6 'Constitution', Section 'Equity will not assist a volunteer' and 'Perfecting an imperfect gift'.**

LEARNING OUTCOMES

By the end of this chapter and the relevant readings, you should be able to:

- **identify the different ways in which a trust can be constituted**
- **describe and analyse the situations in which a court may make perfect a defective gift.**

7.1 Constituting a trust

7.1.1 The requirement of constitution

A trust will be constituted where the property in question is vested in the intended trustees. This involves a transfer of that property to the trustees, save where the settlor himself is to be the sole trustee, where no transfer is required. There are never issues of constitution in self-declaration cases.

Assume, therefore, that we are dealing with the (more usual) case of a settlor who wants other people to act as the trustees. How the settlor manages to transfer the property to the trustees depends on the nature of that property. These rules are the same whatever the context of the transfer, whether it be a transfer on trust or one for any other reason.

- For a registered title to **land**, the disposition is one which is required to be completed by registration in the Land Registry. The settlor should complete a Land Transfer Form, hand it to the trustees, who should then present it to the Land Registry for registration. Only when the register is altered by the Land Registrar will title pass. If the title to the land is unregistered, then the transfer will trigger compulsory registration under the Land Registration Act 2002. Previously, it was possible to transfer titles to land which were unregistered unilaterally, by execution of a deed: s.52(1) LPA 1925.
- For a title to **chattels (including goods, documents and cash)**, title will have to be conveyed by delivery (i.e. a physical handing over of the thing) or deed (i.e. a document that is validly executed as a deed; see the Law of Property (Miscellaneous Provisions) Act 1989, s.1).
- For a **chose in action** (e.g. a right to sue on a debt or company shares) then the rules differ as between the different types of choses in action. Shares in a private company can only be transferred by the making of an entry in the company's books by the company secretary. In the case of public companies traded on stock exchanges, there are now computer-automated systems for the transfer of shares. A debt can only be transferred at law by signed writing: s.136 LPA 1925. Intellectual property rights have their own rules.
- For interests under trusts, as seen in the last chapter, these must be assigned in writing signed by the assignor: s.53(1)(c) LPA 1925.

It should be stressed that these methods (formalities) describe the ways in which the relevant property needs to be transferred to the intended trustees. They do not apply to self-declarations of trust, for which a transfer is not required and consequently to which no formalities apply.

It is also important to note that constitution is not normally a problem for testamentary trusts, which are created by the settlor's will. When the settlor dies, their property will be transferred by operation of law to the executors or administrators of the estate. Such persons have a duty to administer the estate, including the constitution of any trusts set out in the will. In many cases, the executors will also be the trustees of those trusts and so will already have the trust property vested in them when the administration is complete and the trusts are to take effect. A problem can arise if there is insufficient property in the estate, because the estate debts must be paid first. All or some of the property that was supposed to be settled in trust might have had to be used to pay those debts.

As already noted, the methods described above are also those which need to be used to make outright gifts of the various types of property and other transfers.

7.1.2 The effect of constitution

Once a trust is constituted, the beneficiaries of that trust can enforce it against the trustees, whether or not they have given value to anyone in exchange for its creation. Like an outright gift, a settlor cannot revoke a perfectly constituted trust on the

ground that the beneficiaries gave nothing in return. In other words, it matters not in the case of a constituted trust that the beneficiaries are donees (i.e. volunteers). The point only becomes contentious where there is some defect of constitution.

ESSENTIAL READING

- ***Milroy* v *Lord* (1862) 4 De GP & J 264; *Paul* v *Paul* (1882) 20 Ch D 742.**

7.2 Defective constitution

7.2.1 The general rule

The general rule, set out in *Milroy* v *Lord*, is that equity will not assist a volunteer to perfect an imperfect trust. This is consistent with the general attitude of both the common law and equity to the enforcement of gratuitous promises which you saw when studying the law of contract. Consistently with this approach, *Milroy* v *Lord* further holds that an imperfect attempt to create a trust with other persons as trustees will not be interpreted as a declaration by the settlor of the settlor as trustee. As the court there pointed out, an intention to constitute others as trustees is inconsistent with any argument that the settlor intended himself to be the trustee: *Deslauriers* v *Guardian Asset Management Ltd* [2017] UKPC 34.

Exactly the same thinking means that a donor who tries but fails to make an outright gift will not be seen as having declared himself a trustee: *Richards* v *Delbridge* (1874) LR 18 Eq 11. As was pointed out in *Milroy* v *Lord*, if that were possible, there would, in effect, never be an imperfect gift.

7.2.2 Departures from the general rule

As we have seen, the general rule is that if the settlor has not managed to create a perfect trust, the courts will not intervene to create one for him. Any intervention by the court, as *Milroy* v *Lord* and *Richards* v *Delbridge* demonstrate, would be to create a trust that was not intended by the settlor or donor. However, as demonstrated we will see that the courts do sometimes intervene and impose a trust on the purported donor in favour of the donee. Indeed, there are six situations in which courts have departed from the rule in *Milroy* v *Lord*. It should be asked whether any of these departures is justified.

ACTIVITY 7.1

What limits does *Milroy* v *Lord* place on what (a) settlors and (b) the courts can do in respect of constituting a trust?

1. Detrimental reliance

Where there is an imperfect gift or trust, there may be detrimental reliance on the part of the intended donee/beneficiary. For example, the intended donee of a gift of a title to land might detrimentally rely on the supposed validity of the transfer by expending money building a house on that land. Detrimental reliance may lead the court to order the perfection of the imperfect gift or trust: *Dillwyn* v *Llewelyn* (1862) 4 De GF&J 517; *Pascoe* v *Turner* [1978] EWCA Civ 2; *Gillet* v *Holt* [2001] Ch 210. This process is called 'proprietary estoppel' (which is similar to, but different from, 'promissory estoppel' studied in the law of contract).

2. The rule in *Re Rose*

Where a donor or settlor requires the assistance of a third party to perfect a gift or trust (which happens in cases where the transfer must be completed by registration of title to land or to shares in a private company), there will be a gap between the time at which the donor does everything within their power to perfect the gift or trust (i.e. fills in and provides the donee with the relevant transfer request forms) and the time when it is actually perfected by the change of the entry in the register. The

question that arose in *Re Rose* [1952] EWCA Civ 4 was whether an intended gift and trust could be said to be perfect at the first stage. The Court of Appeal held that the donor/settlor was a constructive trustee of the rights at this point. The reason, said the court, was to be found in notions of 'common sense', which, of course, is no reason at all. Note that there was no detrimental reliance in this case; nor can it be explained by an application of the magic formula that 'equity looks upon that as done which ought to be done', for there was no 'ought' here. There is no duty in English law to make gifts or create trusts.

3. The rule in *Strong* v *Bird*

At common law, the appointment of a debtor to be the creditor's executor erased the debt, on the ground that it was not possible for the executor to sue himself to recover it. Equity very soon intervened to correct what was seen to be an unjust rule and held that a liability still existed in equity. In *Strong* v *Bird* (1874) LR 18 Eq 315 the testatrix purported to release a debt during her lifetime. That release was invalid, however, since it was not made by deed, and therefore nothing more than a bare promise not to sue to recover the debt. However, because there was an intention to relieve the debt which continued until the testatrix's death, the court refused to intervene in its usual manner. Technically, this might not be seen as the court perfecting an imperfect gift, for all it did was decline to interfere with the common law position. However, later cases extended the rule beyond the release of debts to imperfect transfers of all types of property: see *Re Stewart* [1908] 2 Ch 251. It has even been used in the case of imperfect *inter vivos* gifts to administrators: *Re James* [1935] Ch 449. Once again, there is no requirement of detrimental reliance.

4. The rule in *Re Ralli*

This looks similar to the rule in *Strong* v *Bird* but seems to form a separate rule (albeit *obiter* in a first instance case) because it applies even though there is no continuing evidence of an intention to give. Indeed, given that the case involved an unperformed promise to give rather than a failed donation, any talk of a continuing intention is inaccurate. In *Re Ralli* [1964] Ch 288, a promise by deed (covenant) to create a trust had not been performed during the lifetime of the promisor. The promisee was appointed executor of the promisor's will, and on the latter's death, received the promised property by virtue of that office. Buckley J held, *obiter*, that this was enough to constitute the covenanted for trust. The fact that the executor came by the property fortuitously was irrelevant. The decision is difficult to fit with the earlier decision of *Re Brook's ST* [1939] Ch 993, which was not cited to the judge.

5. *Donatio mortis causa*

A *donatio mortis causa* is a gift made in contemplation of the donor's death conditional upon that death. A typical case is where I hand you my watch and tell you that, if I do not survive the dangerous operation I am about to undergo, the watch is yours to keep. In *Re Beaumont* [1902] 1 Ch 889 at 892, Buckley J said:

> A *donatio mortis causa* is a singular form of gift. It may be said to be of an amphibious nature, being a gift which is neither entirely *inter vivos* nor testamentary.

It does not have to satisfy the normal requirements for making either form of gift. It is sufficient if the donee merely acquires control over the intended gift so that the donor can no longer deal with it freely. If the donee does not obtain legal title by delivery, the donor's executors or administrators will hold title on constructive trust for the donee: *Duffield* v *Elwes (Hicks)* (1827) 1 Bli NS 497; *Sen* v *Headley* [1991] EWCA Civ 13. The conditions for the operation of the rule are laid down in *Cain* v *Moon* [1896] 2 QB 283 and discussed in *Davey* v *Bailey* [2021] EWHC 445 (Ch). They were strictly applied by the Court of Appeal in *King* v *Dubrey* [2015] EWCA Civ 581, where a full history of the rule can be found.

6. Unconscionability

A further dilution of the *Milroy* v *Lord* principle occurred in *Pennington* v *Waine* [2002] EWCA Civ 227, where the Court of Appeal said of an imperfect gift of shares, that the donor need not even have done everything necessary to perfect the gift. What mattered instead was whether it would be 'unconscionable' for her to resile from her gift. On the facts of this particular case, it was said to be 'unconscionable' for the donor to resile as she had told the donee that the gift was perfect. Why this makes it 'unconscionable' was not explained: see *Zeital* v *Kaye* [2010] Civ 159 at [40]. Moreover, no member of the court seems to have noticed that this is precisely what happened in *Milroy* v *Lord*. The court relied on *T Choithram* v *Pagarani Int SA* [2000] UKPC 46 as authority, although that was, as we saw in the previous chapter, a case of an express trust, where it would of course be 'unconscionable' to resile from a perfectly valid trust: see *Paul* v *Paul*. *Pennington* v *Waine*, on the other hand, was a case of a constructive trust, for, whichever way one views it, the purported donor did not make a self-declaration of trust. It is also important to note that the result cannot be defended through an application of the doctrine in *Re Rose*, since the donor had not done all she needed to perfect the gift; nor can it be justified on the basis of detrimental reliance on the part of the purported donee. Although such reliance may well have been present, this was not the basis on which the case was reasoned. It was on this ground, however, that Briggs J in *Curtis* v *Pulbrook* [2011] EWHC 167 (Ch) explained the decision. The reasoning of *Pennington* was applied without criticism in *Khan* v *Mahmood* [2021] EWHC 597 (Ch) to perfect the imperfect gift. Smith J appears to regard *Pennington* as no longer an exception but as a general modification of the rule in *Milroy* v *Lord* permitting the imposition of a constructive trust in failed transfer cases whenever there is unconscionability. This is controversial.

Essential reading

- ***Milroy* v *Lord* (1862) 4 De GP & J 264, 45 ER 1185; *Re Stewart* [1908] 2 Ch 251; *Re James* [1935] Ch 449; *Re Rose* [1952] EWCA Civ 4, [1952] Ch 499; *Re Ralli's WT* [1964] Ch 288; *Mascall* v *Mascall* [1984] EWCA Civ 10, 50 P & CR 119; *Sen* v *Hedley* [1991] EWCA Civ 13, [1991] Ch 425; *T Choithram Int SA* v *Pagarani* [2000] UKPC 46, [2001] 1 WLR 1; *Pennington* v *Waine* [2002] EWCA Civ 227, [2002] 1 WLR 2075.**

Further reading

- ***Duffield* v *Elwes (Hicks)* (1827) 1 Bli NS 497, 4 ER 959; *Dillwyn* v *Llewelyn* (1862) 4 De GF & J 517, 45 ER 1285; *Richards* v *Delbridge* (1874) LR 18 Eq 11; *Strong* v *Bird* (1874) LR 18 Eq 315; *Cain* v *Moon* [1896] 2 QB 283; *Re Beaumont* [1902] 1 Ch 889; *Pascoe* v *Turner* [1978] EWCA Civ 2, [1979] 1 WLR 431; *Re Basham* [1986] 1 WLR 1498; *Thorner* v *Major* [2009] UKHL 18, [2009] 1 WLR 776; *Zeital* v *Kaye* [2010] EWCA Civ 159, [2010] 2 BCLC 1; *Curtis* v *Pulbrook* [2011] EWHC 167 (Ch); *Khan* v *Mahmood* [2021] EWHC 597 (Ch).**

Self-assessment questions

1. **When is a trust constituted?**
2. **What are the 'constitution' requirements in the case of a self-declaration of trust?**
3. **What means must be used to transfer the following to a third-party trustee:**
   a. **title to land**
   b. **shares in a private company**
   c. **the benefit of a debt.**
4. **What is the general rule contained in *Milroy* v *Lord*?**
5. **What is a *donatio mortis causa*?**
6. **What is the closest that English law comes to the continental European notion of a 'foundation'?**
7. **What is a 'perfect' gift?**

Activity 7.2

a. Assume that you want to make a settlement of some shares and your title to a painting in favour of a friend. Give a short spoken explanation of the different ways in which that settlement can be made. Which is the simplest to effect?

b. Read the decision of the Court of Appeal in *Re Rose*. Is it really true that it presents no conflict with the same court's earlier decision in *Milroy* v *Lord*?

c. Does the law in this area teach us anything of the meaning of 'unconscionability'?

Summary

'Equity will not assist a volunteer to perfect an imperfect trust/gift' is the general rule contained in *Milroy* v *Lord*. However, it has been shown that the courts have departed from this rule and intervened in six situations:

1. detrimental reliance
2. the rule in *Re Rose*
3. the rule in *Strong* v *Bird*
4. the 'rule' in *Re Ralli*
5. *donatio mortis causa*
6. unconscionability.

The effect of the courts' intervention has been to effectively confer an intended right on a donee despite the donor failing to comply with the necessary legal requirements. In each case, one should question whether these interventions can be justified; first, as a matter of principle; and second, in light of the general rule laid down in *Milroy* v *Lord*.

Sample examination questions

Question 1 How far is it true to say that equity will not perfect imperfect gifts?

Question 2 Sarah owns 500 shares in a private company. She executes an instrument of transfer of the shares in the form required by the company's Articles, and hands it, together with the share certificates, to Daphne, to whom she has promised them as a gift. Sarah dies before the share transfers are registered by the company.

By her will, Sarah appoints Bernard her executor, leaving all her real and personal property to Jacob who, immediately on her death, cancels the instrument of transfer.

Advise Daphne. How, if at all, would your answer differ if Daphne rather than Bernard had been appointed Sarah's executor?

Go to the VLE and read 'Share transfers and the complete and perfect rule' by L. McKay.

Advice on answering the questions

Question 1 A good answer would start by outlining what is meant by a perfect gift, explaining that there are broadly three methods of giving, either through an outright transfer, a transfer on trust, or a self-declaration of trust. It would then explain that the possibility of an imperfect gift only arises in the first two cases, and that the imperfection would be caused by an ineffective attempt to transfer the property that is to form the subject matter of the gift or trust. No question of an imperfect gift could arise in the case of the third method, for no transfer of anything is necessary.

The next question is whether a court will intervene to force the perfection of the imperfect gift by imposing a trust on the donor of the property in question for the putative donee/beneficiary. The answer given by the Court of Appeal in *Milroy* v *Lord* and *Richards* v *Delbridge* was that it would not. Nor would it reinterpret what had happened as a self-declaration of trust by the donor/settlor, for in neither case had the donor/settlor ever made a self-declaration of trust. Indeed, the evidence of the failed gift contradicts such an interpretation of events.

Having stated the general rule, the answer would go on to detail the situations in which departures from this rule have been made. A good answer would notice that in only one instance is any detrimental reliance required, and ask how those in which it is not can be squared with the rule that courts will not assist volunteers to perfect imperfect gifts.

Question 2 A good answer would start by explaining why this gift is problematic and explaining what steps Sarah should have taken to perfect it. The answer would outline the general rule in *Milroy* v *Lord* (as per Question 1), noting that the facts here might fall within the exception in *Re Rose*. In that respect, there are essentially two issues to consider: (i) whether on these facts the rule in *Re Rose* will apply; and (ii) if so, whether the rule is open to challenge. Finally, the answer should consider the application of the rule in *Strong* v *Bird* in the event that Daphne is appointed executor.

Reflect and review

Look through the points listed below.

Are you ready to move on to the next chapter?

Ready to move on = I am satisfied that I have sufficient understanding of the principles outlined in this chapter to enable me to go on to the next chapter.

Need to revise first = There are one or two areas I am unsure about and need to revise before I go on to the next chapter.

Need to study again = I found many or all of the principles outlined in this chapter very difficult and need to go over them again before I move on.

Tick a box for each topic.

	Ready to move on	Need to revise first	Need to study again
I can identify the different ways in which a trust can be constituted.	☐	☐	☐
I can describe and analyse the situations in which a court may make perfect a defective gift.	☐	☐	☐

If you ticked 'need to revise first', which sections of the chapter are you going to revise?

		Must revise	Revision done
7.1	Constituting a trust	☐	☐
7.2	Defective constitution	☐	☐

NOTES

8 Promises to create trusts

Contents

Introduction

This chapter is concerned with promises to create trusts which have not been performed. The starting point is to appreciate that a bare promise is unenforceable in English law. This is the view of both the common law and of equity. There are only three types of promise that courts will enforce:

- promises in deeds
- promises given for consideration (i.e. contracts)
- promises detrimentally relied upon.

It is not, however, enough to decide that a particular promise is enforceable. We must also ask who it is who wishes to enforce it.

This chapter builds on work done in Chapter 7, and you should review that chapter before embarking on this topic. It also requires knowledge of the contractual rules of privity and of consideration, and you should go back over the work you did on those topics in the law of contract.

CORE TEXT

- **Penner, Chapter 6 'Constitution', Sections 'Covenants to settle' to end of chapter.**

ESSENTIAL READING

- **Review Chapter 7 'Constitution' of the module guide.**

LEARNING OUTCOMES

By the end of this chapter and the relevant readings, you should be able to:

- **state the circumstances in which promises to create trusts will be enforced**
- **identify the persons who can enforce such promises**
- **describe how promises to create trusts are enforced**
- **critically appraise those decisions which deny the enforcement of promises.**

8.1 Promises in deeds

8.1.1 The basic rule

A promise contained in a deed is called a covenant. Where a promise is contained in a deed it can be enforced by those who are party to it. Thus, if I execute a deed by which I promise you that I will give you £10 for your birthday, you can sue me at law for damages if I do not make good my promise. It does not matter that you gave no consideration in return, or, in other words, that we are dealing with a 'voluntary covenant'. Thus, in *Cannon* v *Hartley* [1949] Ch 213, a father promised his daughter by deed that he would pay her any sum exceeding £1,000 which he received under his own father's will. When he failed to do so, she successfully sued him at law for the amount she would have obtained had he kept his promise. However, we should note that though equity will enforce some promises if made for consideration, it will not enforce a promise merely because it is made by deed. In such a case, equity leaves the covenantee to their remedy at common law.

Even at common law, it is not enough to show that the promise is contained in a deed. There is the further issue of privity. Is the person seeking to enforce the promise a party to the deed? Suppose, for example, that I make a promise by deed to your brother that I will make a gift to you of £10. Only those to whom the promise was made can enforce it, and you are not such a person. Note that this rule was not changed by the enactment of s.56 of the LPA 1925, which simply redefines who counts as a party to the deed.

The typical scenario

The typical case involving trusts is where S (the settlor) promised T (the trustee) by deed that they would transfer property to S for T to hold on trust for B (the beneficiary). There are two separate issues. First, is the promise enforceable, and second, by whom? We need to consider these questions from the point of view of enforcement by both T and by B. For reasons which will become apparent later, it is best to begin with B.

8.1.2 Enforcement by the intended beneficiary

The immediate problem for B is that he is not party to the deed. In other words, the promise was made to T, not B. However, there are three situations in which B will be able to enforce the promise.

a. B is made party by statute

If the Contract (Rights of Third Parties) Act 1999 applies to voluntary covenants (which is uncertain because they may not be a 'contract'), then assuming the requirements of the Act are satisfied, B would be able to sue at law and obtain damages for non-performance. However, the covenant would still not be enforceable in equity via an order for specific performance. This might make a difference in the event of S's insolvency (see below).

b. B is within the marriage consideration

The word 'consideration' nowadays has a technical meaning in the law of contract of *quid pro quo*. It originally meant the reason for doing something. The consideration for a promise was the reason for a promise. This old meaning still lingers on in the case of marriage settlements (described in Penner, Chapter 6 'Constitution', Section 'Covenants to settle'). Until the law was changed in 1882, it was traditional upon marriage for the bride's father to set up a trust for the husband and wife for their joint lives and the survivor for life, with the remainder for any children of the marriage and, if there were no children, for the wife's next of kin. The wife would also enter into a covenant whereby she promised to convey to the trustees any property she might later receive above a certain value from her father to be held on the same trusts. The parties to this deed would be the wife, her husband and the trustees. The reason this was done was to ring-fence the wealth of the wife's family, to which the husband would at most get a life interest. Without such marriage settlement, and because of the (now rejected) doctrine of unity of husband and wife, the husband would acquire all.

As the 'consideration' for the wife entering into such an arrangement was to provide for her family, any children or grandchildren were seen by courts of equity (although not the common law) as 'within the marriage consideration'. Accordingly, they were able to enforce the covenant, albeit only through a claim for specific performance and not damages (a common law response). Moreover, an application of the magic formula that 'equity looks upon as done that which ought to be done' meant that the wife was now a constructive trustee of any property she received. This would certainly have advantages if the wife became bankrupt (and also had implications for the running of limitation periods (i.e. the times when legal actions in respect of the property in question might lapse)). However, the wife's next of kin were not within the 'marriage consideration', and, not being parties to the covenant, they had no claim at law or in equity.

c. Trust of the right to sue on the covenant

T is, of course, the one person who does not suffer from problems of privity. Being a party to the covenant, he will have a right to sue S at common law for non-performance. An argument has sometimes been made that T holds that common law right to sue on trust for B. If this argument (the 'trust of the covenant' or 'trust of the promise' argument) is made out, then B can compel T to exercise the right and sue S. The assumption is that T would recover substantial damages at common law from S, which T would then hold on trust for B.

There are two difficulties standing in the way of this argument, both of which are illustrated by *Re Cook's ST* [1965] Ch 902. The first is that it will almost always be the case that the requisite declaration of trust of the right to sue will not be present on the facts (i.e. there will be no particular further intention than the one expressed in the deed). There are a number of academic authorities who argue that such an intention should be found from the mere fact that the promise to create a trust was contained in a deed, but it is difficult to see why the court should impose a trust, for that is what it would be. You should therefore ask yourself whether these views can be justified. The second objection is that the trust of the covenant argument has been said only to work in the case of property that the covenantor had at the time they made the covenant and not in respect of property to be acquired later (after-acquired property).

8.1.3 Enforcement by the intended trustee

Assume that none of the situations outlined above apply, with the result that B cannot enforce the promise to create a trust in his favour. We have already seen how T does not suffer from the cause of B's inability to enforce, a lack of privity, for the covenant was made with T. Therefore T undoubtedly has a claim at law for damages for breach of covenant, though he will not be able to enforce it in equity. The enforcement of this claim, however, is far from straightforward, for there are a number of decisions which say that T will be prevented by a court of equity from bringing his claim at law.

Go to the VLE and read 'The power of trustees to enforce covenants in favour of volunteers' by D.W. Elliott.

The authorities

In *Re Pryce* [1971] Ch 234 the trustees of a marriage settlement (T) sought the direction of the court whether they were bound to sue the wife (S) for non-performance of her covenant. There were no children of the marriage, so the only person who could possibly benefit was the wife's next of kin (B). Eve J directed the trustees that they ought not to sue, because to do so would give B by indirect means what B could not obtain directly. In saying this, Eve J arguably went beyond the rule we encountered in Chapter 7, that 'equity will not assist a volunteer to perfect an imperfect gift or trust'. The trustees were not asking for equity's assistance, merely a ruling on whether they were required to sue. However, the case was followed by Simonds J in *Re Kay* [1939] 1 Ch 329 and Buckley J in *Re Cook's ST*. These cases have never been overruled, although it should be noted that they are only decisions at first instance.

Go to the VLE and read 'Trusts of voluntary covenants' by W. Meagher and J.R.F. Lehane.

Substantial or nominal damages?

Even if a court were to accept that these authorities were wrongly decided, there is the further question of what damages T would recover by suing S at law. Are they substantial or only nominal? The normal measure of damages will be measured by the loss of the expectation (i.e. substantial damages). There is an argument which says that T suffers no loss of expectation, because, had the covenant been performed, T would be a trustee and a trustee makes no personal gain from their trusteeship. T is therefore no worse off because of the non-performance. The person who has lost out is B, and T cannot recover for B's losses. All that B is entitled to is an order for nominal damages and for this reason (although not those given in the case) Eve J was correct in *Re Pryce* to deny to T the ability to sue S at law.

The problem with this argument, however, is that it forgets that T's claim is being brought at law, and at law T would hold any property transferred to him in performance of the covenant for himself, not for B, for the common law does not recognise trusts. Thus, in the common law's eyes – and those are the only eyes that matter for the moment – T has suffered a substantial loss of expectation and so should recover substantial damages. While this seems correct, and we assume that T should be able to sue for substantial damages at law, this result leads to a further difficulty.

Even if T were to recover substantial damages, would T necessarily hold them on trust for B? There is an argument which says that T would in fact hold the damages on resulting trust for S, and would therefore be immediately liable to repay it to S, the person T had just sued to recover it. This circularity of action is in nobody's interest, and so the decision of Eve J in *Re Pryce* is ultimately correct (although again not for the reasons there stated).

The argument proceeds as follows:

1. Going back to our discussion of the question whether B could enforce the covenant in B's own right, we said that one situation in which B could was where there was found to be a trust of the benefit of the covenant in B's favour.
2. But to get to the point at which we are now, we have assumed that this option is not available on our particular facts.
3. It is then argued that, the trust of the benefit of the covenant in favour of B having failed, there must be a resulting trust of the benefit of the covenant in favour of S.

We will encounter resulting trusts again in Chapter 12 and you would do well to return to this part of the syllabus when you know what resulting trusts are and when they arise. For the moment, we need know only that they are trusts under which the rights are held on trust for the person who provided those rights to the trustee, and that one instance in which they arise is where rights are transferred on trusts which fail, for example, for uncertainty of objects. The trust of the covenant here having failed, it is argued there is a resulting trust of the right to sue on the covenant in favour of the transferor, S. Since the right to sue is held on trust for S, so will be any damages acquired through the exercise of that right.

The difficulty with this argument is that any trust in favour of B cannot be said to have 'failed' at all. It was simply the case that no trust in favour of B arose because there was no declaration of trust in B's favour. In other words, it was not the **trust** which failed, but only the **argument** that there was a trust. As we saw in our discussion of *Re Adams & Kensington Vestry* in Chapter 5, it is wrong to talk of a trust failing in circumstances where there is simply no declaration of trust at all. A transfer which is not a transfer on trust is an outright transfer, not a failed trust. If we do not find a trust in favour of B, therefore, T will hold the right to sue absolutely, not on resulting trust for S. Any damages T receives when suing under the covenant would not be held on trust for S either. They will instead be held by T on trust for B, for the damages are simply the law's substitute for performance of the covenant.

ESSENTIAL READING

- ***Fletcher* v *Fletcher* (1844) 4 Hare 67; *Re Pryce* [1917] 1 Ch 234; *Re Kay* [1939] 1 Ch 329; *Re Cook's Settlement Trusts* [1965] Ch 902.**
- **Contracts (Rights of Third Parties) Act 1999.**

FURTHER READING

- ***Davenport* v *Bishopp* (1843) 2 Y & CCC 451; *Lloyds* v *Harper* (1880) 16 Ch D 290; *Re Plumptre's Marriage Settlement* [1910] 1 Ch 609; *Re Ellenborough* [1903] 1 Ch 697; *Pullan* v *Koe* [1913] 1 Ch 9; *Re Cavendish-Browne's Settlement Trust* [1916] WN 341; *Re Schebsman* [1944] Ch 83; *Cannon* v *Hartley* [1949] Ch 213.**

ACTIVITY 8.1

Make a short spoken presentation explaining why some commentators consider that the cases of *Re Pryce*, *Re Kay* and *Re Cook's ST* are wrongly decided.

SELF-ASSESSMENT QUESTIONS

1. **What is a covenant?**
2. **What is a deed?**
3. **What is 'marriage consideration'?**
4. **What is the trust of the covenant argument? What are the views for and against it operating to allow the beneficiary to sue on a covenant?**
5. **What are the arguments for and against saying that Eve J's decision in *Re Pryce*, that a trustee will be directed not to sue on a gratuitous covenant to settle, was correct? (Remember to consider how the question, for whom does a trustee who successfully sues and gets substantial damages hold them, bears on the issue.)**

Summary

A covenant is a promise contained in a deed. Unless made for consideration, it can be enforced only at common law and only by those party to it.

Where S (settlor) gratuitously covenants to transfer property to T (the trustee) on trust for B (the beneficiary), B can enforce the covenant where B is privy to the covenant, or is made privy under the Contract (Rights of Third Parties) Act 1999 (although it is doubtful whether the statute applies to voluntary covenants), or where B is within the 'marriage consideration' in the case of marriage settlements. Where T holds the right to sue on trust for B, then B can direct T to sue S. However, a trust in such circumstances is unlikely to be found. First, the requisite intention, whatever that might be, is generally missing and difficult to conceive in any case; and second, there is authority that this concept cannot apply to after-acquired property.

T, of course, is a party to the covenant and so can enforce it at common law. However, T may be barred from doing so by the *Re Pryce* line of cases, and even if successful in their action for substantial damages, it is not clear whether equity will require T to hold them on trust for B rather than on resulting trust for S.

8.2 Promises for consideration

If consideration in the normal contractual sense has been given in exchange for the promise to set up a trust (or to make a gift), and that promise has not been performed, the promise will be enforceable at law through a claim for damages or, if damages are thought to be an inadequate response, by an award of specific performance in equity. There still, of course, remains the problem of privity, for the promisee might not be the intended beneficiary or donee. Thus, in *Re Cook's ST*, the court held that it did not help someone in the position of B to show that consideration for S's promise had been given by T, for it may not be lacking in conscience in relation to B sufficient to allow B to enforce. *Re Cook's ST* was of course decided before the enactment of the Contract (Rights of Third Parties) Act 1999, and it should now be asked whether s.1 of that Act might give the beneficiary/donee a right to sue in their own name.

Essential reading

- ***Re Cook's ST*** **[1965] Ch 902.**

8.3 Promises and detrimental reliance

Although there are no cases on this topic, there are some concerning promises of outright gifts and it is probable that a promise to create a trust will be treated in the same way. Normally, the promisee will have no redress if the promise is not performed but it will be different where the promisee has detrimentally relied on the promise (i.e. changed their position to their detriment in the reasonable belief that the promise would be performed). In such a case, equity (although not the common law) may compel the promisor to perform their promise. There is no guarantee, however, that the courts will hold the promisor to their promise and a money award may be made instead – see *Jennings* v *Rice* [2002] EWCA Civ 159 and *Guest* v *Guest* [2022] UKSC 27. This topic is covered in more detail in the Property law module.

Essential reading

- ***Re Basham*** **[1986] 1 WLR 1498.**

Further reading

- **Barton, J.L. 'Trusts and covenants' (1975) 91 *LQR* 236.**
- **Hornby, J. 'Covenants in favour of volunteers' (1962) 78 *LQR* 228.**

Activity 8.2

Read *Re Basham*. What role did detrimental reliance play in that case?

Sample examination questions

Question 1 The rule is: 'Equity will not assist a volunteer to perfect an imperfect gift', not: **'Equity will stand in the way of a volunteer suing for non-performance of a promise to give'.**

Discuss.

Question 2 Toby covenants that he will convey £10,000 from the £100,000 currently in his account with the London Bank plc and any winnings he might receive from next week's lottery draw to Ella to hold on trust for James. Although he subsequently wins £1 million on the lottery, Toby fails to do either of these things.

Advise James. Would it help him if he could persuade Ella to sue Toby?

Advice on answering the questions

Question 1 This question is directed to the attitude of the courts to the enforcement of promises to create trusts. Specifically, it is directed to the judgment of Eve J in *Re Pryce*.

A good answer would begin with a discussion of equity's attitude to imperfect trusts/gifts, pointing out the general rule in *Milroy* v *Lord* and the various exceptions to it. It would not, however, be appropriate in this question to examine those exceptions in detail, merely to note their existence.

Having outlined Equity's negative approach to imperfect trusts/gifts, the situation where Equity could be said to stand in the way of the enforcement of a promise to give should be described. The case in which this happened was of course *Re Pryce*, and the facts of that case should be recounted, along with a general discussion of the enforcement of promises to settle. The main question is whether the decision in *Re Pryce* was correct, either on its own reasoning or for reasons which are not contained in the judgment. At this point, the wealth of academic literature on this topic should be discussed.

Question 2 We need to consider the position of both Ella and James with regard to the enforcement of this promise. It is best to start with James, the putative beneficiary, and only then go on to consider the position of Ella, the putative trustee.

James will only be able to enforce this covenant in three circumstances:

a. he is privy to the covenant

b. it is a marriage settlement and he is within the marriage consideration

c. the right to sue on the covenant is held for him on trust.

We will consider each in turn.

Privity

Since the covenant is made with Ella and not James, James is not a party to the covenant made by Toby. It might be the case, however, that he is given the rights of a party by the Contracts (Rights of Third Parties) Act 1999, which abolished one limb of the privity rule in contract, viz. that a third party could not take a benefit under a contract. Whether this Act confers on James the right to sue depends on two things:

a. whether the Act applies to voluntary promises in deeds, and

b. if it does, whether this covenant is caught by s.1 of the Act.

Whether the Act applies depends on how the word 'contract' in the 1999 Act is interpreted. Understandably, the Act gives no definition of what is meant by this word. Generally, however, a contract is a bargain, an exchange of promises for consideration. This is not what we have here. We have only a unilateral promise for no consideration. On that basis, it is arguable that such a promise, although enforceable at common law, is not a contract. There is no authority on this question. If, contrary to this argument, voluntary covenants were to be considered as species of contracts, then it would have to be asked whether the specific provisions of the 1999 Act applied. Given that the deed does not expressly give James the right to sue, the question will be whether, under s.1(1)(b), the term purports to confer a benefit on him. It clearly does and there seems to be nothing in the deed to show that James was not intended to be able to enforce the promise: s.1(2). There is then the further question what response James will get. The answer is that he will be able to enforce the promise in the same way as if he was named as a party: s.1(5). And although he will be able to claim common law damages for loss of expectation, he will not be entitled to specific performance, as equity always refuses to grant specific performance of a voluntary covenant.

Marriage settlement

If this is a marriage settlement (we are not told either way) and James is within the marriage consideration (again we are not told), then James can enforce the promise in equity. In the meantime, applying the maxim 'Equity regards as done that which ought to be done', Toby will hold the rights on constructive trust for James.

Right to sue on the covenant held on trust

There is no doubt that a chose in action can form the subject matter of a trust. There is no doubt also that Ella has the benefit of a chose in action, the right to sue Toby under the covenant. The question is whether we can say that Ella holds her right on trust for James. The problem is that there was no declaration of trust by Toby to this effect. Note the academic arguments which say that a trust, presumably some sort of constructive trust, should always be found in such cases. Note the further difficulty that Buckley J said in *Re Cook* that a trust of the right to sue is only possible in the case where the covenant relates to present rather than future rights, and that the money won on the lottery was not a present right at the time the covenant was made. You should discuss whether Buckley J was right in his view.

On the assumption that none of these exceptional cases avail James, he will not be able to enforce the covenant. Then comes the question whether Ella will be allowed to do so. She, of course, is party to the deed, so would seem to have an unquestionable right to sue at common law. The problem is that three cases from equity, *Re Pryce*, *Re Kay*, and *Re Cook*, stand in her way. You should discuss the reasoning in *Re Pryce*, with the aim of showing that it cannot stand. Further discussion should then be made concerning the question whether the decision can be defended on other grounds, those being: (i) that any damages Ella could recover from Toby at law would be nominal; and (ii) even if they were substantial, they would be held on resulting trust for Toby. Arguments as to why both those propositions are false have been rehearsed above.

Reflect and review

Look through the points listed below.

Are you ready to move on to the next chapter?

Ready to move on = I am satisfied that I have sufficient understanding of the principles outlined in this chapter to enable me to go on to the next chapter.

Need to revise first = There are one or two areas I am unsure about and need to revise before I go on to the next chapter.

Need to study again = I found many or all of the principles outlined in this chapter very difficult and need to go over them again before I move on.

Tick a box for each topic.

	Ready to move on	Need to revise first	Need to study again
I can state the circumstances in which promises to create trusts will be enforced.	☐	☐	☐
I can identify the persons who can enforce such promises.	☐	☐	☐
I can describe how promises to create trusts are enforced.	☐	☐	☐
I can critically appraise those decisions which deny the enforcement of promises.	☐	☐	☐

If you ticked 'need to revise first', which sections of the chapter are you going to revise?

		Must revise	Revision done
8.1	Promises in deeds	☐	☐
8.2	Promises for consideration	☐	☐
8.3	Promises and detrimental reliance	☐	☐

NOTES

9 Charitable purpose trusts

Contents

Introduction

The question addressed in both this chapter and the next is whether it is possible to have a trust, not for persons, but for a purpose. It is long established that where the purpose is recognised by the law to be charitable, then it is indeed possible to have such a trust. The difficult question is to determine what amounts to a charitable trust. In this chapter, we will consider the various types of charitable purposes, the over-arching requirement of public benefit and elements of a purpose that may contaminate it, rendering it not exclusively charitable. We will then consider the *cy-près* rule, which applies on the failure of a charitable purpose. The Charities Act 2011 now contains much of the modern law of charity. The Charities Act 2022 does not affect the definition of a charitable purpose and deals with various technical issues in the law governing charities. Non-charitable purpose trusts are the subject of Chapter 10.

CORE TEXT

- **Penner, Chapter 18 'The law governing charities'.**

LEARNING OUTCOMES

By the end of this chapter and the relevant readings, you should be able to:

- **differentiate between purposes that are *prima facie* charitable and those that are not**
- **explain how a *prima facie* charitable object might nevertheless be disqualified from charitable status**
- **explain the 'public benefit' requirement**
- **explain the requirement that a valid charitable trust must be exclusively charitable, and discuss the factors that may prevent it from being so**
- **explain the operation of the *cy-près* doctrine**
- **outline why particular areas of charities law raised calls for reform, and the advantages and disadvantages of the enacted reforms.**

9.1 Charitable status

9.1.1 A benefit to society

Trusts have for centuries been an important vehicle by which charitable works are carried out. However, it is important to realise that charitable work does not depend on the use of trusts. Most large charitable organisations, such as universities, operate as corporations, not trusts. Most of the law you will study in this chapter will be the law of charity as it applies to all kinds of charitable organisations. In particular, you will be trying to grasp what the law regards as a charitable purpose. Because charitable works are regarded as beneficial to society as a whole, a distribution of funds or an ongoing activity that counts as charitable is typically given preferential treatment under the law, especially in terms of the payment of taxes.

9.1.2 Relaxation of trust rules to benefit charities

A number of rules affecting the validity of a trust are relaxed in the case of trusts for exclusively charitable objects as follows.

The beneficiary principle

A charitable trust has no beneficiaries. This is true even where the individuals who in fact benefit from the trust are clearly ascertainable, say in the case of a residential home for the blind. The residents of the home are not beneficiaries of the trust in any legal sense, so they cannot enforce the trust nor call for a transfer of the trust property under the *Saunders* v *Vautier* principle. That trust, like all charitable trusts, can only be enforced by the Charity Commission and the Attorney-General, who act on behalf of the Crown: s.13(3) Charities Act 2011.

Certainty of objects

The requirement of certainty is relaxed in the case of a charitable trust in the following sense: so long as it is clear that the settlor intended to devote funds to charity, it matters not whether the particular charitable purposes the settlor intended are clearly defined; the court will devise a scheme for the charitable use of the funds. So, for example, a trust simply 'for charitable purposes' will be perfectly valid.

The rule against perpetual duration

A charitable trust may last forever. Where charitable trust funds remain, but the particular charitable purpose can no longer practically be carried out, the *cy-près* doctrine will be applied to determine a new, workable, charitable purpose for the funds (see **9.5** below).

The rule against remoteness of vesting

This rule does not apply to a gift over from one charity to another. For example, where a charitable trust is established for a particular residential home for the blind 'so long as it is situated in Tavistock Square', and then to the Royal National Institute for the Blind, the shift of funds to the RNIB will be perfectly valid whenever the defeating condition (i.e. the home no longer being located in Tavistock Square) occurs.

The rules of taxation

There are substantial fiscal advantages, in the form of reduction or exemption from various taxes and charges. The specific details of these tax advantages is not within this module but you should recognise their practical importance to the particular charities and the wider issues raised by this form of tax relief for any purpose falling within the legal definition of charity. There is no agreement among the judiciary whether issues of taxation should affect their decision as to what purposes count as charitable.

With the broad scope of charity currently in place, there may be a concern that not all charitable purposes are equally deserving of the fiscal advantages that charitable

status confers. There have been suggestions that special tax privileges for charities should be abolished and replaced by direct government grants to those charities which serve more important or vital public services. The chief concern with this idea is that it would reduce the independence of charities from the government of the day, causing them to tailor their activities to please the government; it would also inevitably involve charities devoting a greater portion of their funds and time to political activity, such as lobbying for grants.

ESSENTIAL READING

- **Charities Act 2011, ss.13–16, 84, 85.**

ACTIVITY 9.1

Look again at the four ways in which charitable trusts have special status, and write brief summaries of each.

No feedback provided.

ACTIVITY 9.2

Based on your reading and your general sense of politics and what counts as a public good, write a brief essay (300–400 words) discussing:

a. **Why does the state allow fiscal privileges to charities?**
b. **Given the existence of fiscal privileges, is it appropriate for courts to determine, without the benefit of a statute, which private bodies should receive relief from normal taxation?**
c. **If fiscal privileges were withdrawn, should the courts be prepared to widen the category of valid purpose trusts?**

9.2 The meaning of 'charity'

ESSENTIAL READING

- **Charities Act 2011, ss.1–6.**
- ***Income Tax Commissioners* v *Pemsel* [1891] UKHL 1, [1891] AC 531; *Gilmour* v *Coats* [1949] UKHL 1, [1949] AC 426; *McGovern* v *A-G* [1982] Ch 321; *Oppenheim* v *Tobacco Securities Trust Co Ltd* [1950] UKHL 2, [1951] AC 297; *National Anti-Vivisection Society* v *IRC* [1947] UKHL 4, [1948] AC 31; *Dingle* v *Turner* [1972] UKHL 2, [1972] AC 601; *Independent Schools Council* v *Charity Commission* [2011] UKUT 421 (TCC), [2012] Ch 214; *A-G* v *Charity Commission for England and Wales* [2012] UKUT 420 (TCC), [2012] WTLR 977.**

FURTHER READING

- ***Williams Trustees* v *IRC* [1947] UKHL 1, [1947] AC 447; *IRC* v *Baddeley* [1955] UKHL 1, [1955] AC 572; *Incorporated Council of Law Reporting for England and Wales* v *A-G* [1971] EWCA Civ 13, [1972] Ch 73; *IRC* v *McMullen* [1980] UKHL 3, [1981] AC 1; *Guild* v *IRC* [1990] UKHL 10, [1992] 2 AC 310; *Helena Partnerships Ltd* v *HMRC* [2012] EWCA Civ 569.**

9.2.1 Charitable purposes

Whether a particular purpose is charitable or not is a question of considerable difficulty, and one which students can find very confusing. The best way to approach the issue is in two stages, asking the following questions:

- Is the purpose *prima facie* charitable?
- If so, is it for the benefit of the public?

These questions are now on a statutory footing in s.2(1) of the Charities Act 2011. The first is considered here and the second in Sections 9.3 and 9.4.

We begin with the first question. Is the purpose *prima facie* charitable? Prior to the Charities Act 2006 (now the Charities Act 2011) an important factor in determining whether a purpose was charitable was whether it fell within the wording of the Preamble to the Statute of Charitable Uses 1601, which provided as follows:

> Whereas lands, tenements, rents, annuities, profits, hereditaments, goods, chattels, money and stocks of money have been heretofore given, limited, appointed and assigned, as well by the Queen's most excellent majesty, and her most noble progenitors, as by sundry other well disposed persons; some for the relief of aged, impotent and poor People, some for Maintenance of sick and maimed soldiers and Mariners, Schools of Learning, Ports, Havens, Causeways, Churches, Sea-Banks and Highways, some for Education and Preferment of Orphans, some for or towards the Relief, Stock or Maintenance of Houses of Correction, some for Marriages of poor maids, some for Supportation, Aid and help of Young Tradesmen, of Prisoners or Captives, and for Aid or Ease of any poor Inhabitants concerning payments of Fifteens, setting out Soldiers and other Taxes; which Lands, Tenements, Rents, Annuities, Profits, Hereditaments, Goods, Chattels, Money and Stocks of Money, nevertheless have not been employed according to the charitable intent of the givers and founders thereof, by reason of frauds, Breaches of trust and Negligence in those that should pay, deliver and employ the same.

In *Income Tax Commissioners* v *Pemsel* (1891), Lord Macnaghten distilled the preamble down to four categories:

a. trusts for the relief of poverty
b. trusts for the advancement of education
c. trusts for the advancement of religion
d. trusts for other purposes within the 'spirit and intendment of the preamble'.

The most difficult head of charity – because it is the hardest to define – is the last. It is not enough simply to show that the purpose confers a benefit on the public – it must also be shown that the benefit conferred is within the 'spirit and intendment of the preamble': see *Williams* v *IRC* (1947).

Under the Charities Act 2011, s.3(1), these four heads are now 13 heads. There have been some new additions, but most of the extra nine were examples of Lord Macnaghten's residual fourth category:

a. the prevention or relief of poverty
b. the advancement of education
c. the advancement of religion
d. the advancement of health or the saving of lives
e. the advancement of citizenship or community development
f. the advancement of the arts, culture, heritage or science
g. the advancement of amateur sport
h. the advancement of human rights, conflict resolution or reconciliation or the promotion of religious or racial harmony or equality and diversity
i. the advancement of environmental protection or improvement
j. the relief of those in need because of youth, age, ill-health, disability, financial hardship or other disadvantage
k. the advancement of animal welfare
l. the promotion of the efficiency of the armed forces of the Crown or of the efficiency of the police, fire and rescue services or ambulance services
m. any other purposes—
    i. that are not within paragraphs (a) to (l) but are recognised as charitable purposes by virtue of section 5 (recreational and similar trusts, etc.) or under the old law

ii. that may reasonably be regarded as analogous to, or within the spirit of, any purposes falling within any of paragraphs (a) to (l) or sub-paragraph (i), or

iii. that may reasonably be regarded as analogous to, or within the spirit of, any purposes which have been recognised, under the law relating to charities in England and Wales, as falling within sub-paragraph (ii) or this sub-paragraph.

9.2.2 The prevention or relief of poverty

Trusts for the relief of poverty provide for those who are deprived of a reasonable standard of living. The intended recipients do not have to be destitute. The recipients do actually have to be poor, however, so in *Re Scarisbrook* [1951] Ch 622, a trust for an individual's 'poor relations' was charitable, but in *Re Sander's WT* [1954] *The Times* 22 July, one for the 'working classes' was not because not all those in 'the working class' are poor.

The Charities Act 2011, s.3(1)(a) adds 'prevention' to the traditional head of relief of poverty. This was considered by the Upper Tribunal (Tax and Chancery Chamber) in *Charity Commission for England and Wales* v *A-G* [2012] UKUT B19 (TCC) at [75]:

> [T]he prevention of poverty entails addressing the causes of poverty, while relief entails addressing the consequences of poverty. The prevention of poverty is recognised by section [3(1)(a)] as a stand-alone purpose which can be pursued, for example, by charities which provide money management advice… [W]e know of no authority which has considered trusts for the prevention of poverty.

This case is discussed further below in connection with the public benefit requirement.

ACTIVITY 9.3

Read *Re Niyazi's WT* [1978] 1 WLR 910 and explain why Megarry V-C thought the facts were 'desperately near the borderline'.

9.2.3 The advancement of education

Traditional forms of education and training clearly fall under this head, so trusts for schools, colleges, universities and so on are valid. 'Education', however, is much broader, covering research, the dissemination of useful knowledge (*Incorporated Council of Law Reporting* v *A-G* [1972] Ch 73), artistic education (*Royal Choral Society* v *IRC* [1943] 2 All ER 101), museums (*British Museum Trustees* v *White* (1826) 2 Sim & St 594), the promotion of culture (*Re Delius* [1957] Ch 299), school sports facilities (*Re Mariette* [1915] 2 Ch 284), and activities associated with education such as student unions (*London Hospital Medical College* v *IRC* [1976] 1 WLR 613) and professional bodies that advance education (*Royal College of Surgeons of England* v *National Provincial Bank Ltd* [1952] AC 631).

However, while courts are careful to ensure that this head is not used to provide charitable status for political purposes masquerading as education, such as the production and publication of propaganda or party political literature (*Re Hopkinson* [1949] 1 All ER 346), the mere fact that research, education, or the dissemination of knowledge concerns politically controversial issues does not disqualify it from charitable status (*Re Koeppler WT* [1986] Ch 423).

ACTIVITY 9.4

In his will, the famous writer George Bernard Shaw left money on trust for research into the development of a 40-letter alphabet for English. Do you think the trust was a valid charitable trust? Read *Re Shaw* [1957] 1 WLR 729 for the answer, and then read *Re Hopkins' WT* [1965] Ch 669. Were the decisions in these cases correct?

9.2.4 The advancement of religion

Religion comprises all the variety of religions human beings practise – the law takes the general view that any religion is better than none, but is neutral as between them (see *Neville Estates Ltd* v *Madden* [1962] Ch 832). But trusts for the promotion of ethical behaviour without a component of spiritual belief are not trusts for the advancement

of religion (*Re South Place Ethical Society* [1980] 1 WLR 1565), although such trusts may be charitable under the fourth head of charity.

The Charities Act 2011, s.3(2)(a) now provides that:

> 'religion' includes—
>
> (i) a religion which involves belief in more than one god, and
>
> (ii) a religion which does not involve belief in a god.

This confirms that faiths with multiple deities (e.g. Hinduism) or with no deities (e.g. Buddhism) are included in the definition of religion. In *R (Hodkin)* v *Registrar-General of Births, Deaths and Marriages* [2013] UKSC 77, [2014] 2 WLR 23, the Supreme Court decided that the Church of Scientology in London was a 'place of meeting for religious worship' within the meaning of s.2 of the Places of Worship Registration Act 1855, and therefore it could be used for marriage ceremonies. The court decided that Scientology was a religion within the meaning of s.3(2)(a) of the Charities Act 2011. This was not a decision concerning its status as a charity. Previously, the Charity Commission had decided that Scientology was not a religion for the purposes of English charity law, but this was before the new definition of religion in the Act. However, the Commission had also decided that the church was not established for the public benefit.

Activity 9.5

Consider whether a movement which claims that its members are able to 'raise their consciousness and realise their place in the Universe' by 'getting in touch with their inner child' is a religion under charity law. Then read *R* v *Registrar General, ex p Segerdal* [1970] 2 QB 697 and see if you would change your mind.

No feedback provided.

9.2.5 Other purposes beneficial to the community

This was always the most difficult category on which to set coherent boundaries, and it is here that reference was most often made to the Preamble of the 1601 Act. The essential point to grasp is that a trust is not charitable merely because it benefits some section of the public. As Viscount Cave said in *A-G* v *National Provincial and Union Bank of England* [1924] AC 262, 'it is not enough to say that the trust in question is for public purposes beneficial to the community; you must also show it to be a charitable trust'. It must be for the public benefit in a way which can be related to the purposes set out in the Preamble or to purposes which later courts have found to be analogous to those in the Preamble.

The 'relief of aged, impotent and poor' people was construed disjunctively; that is, a charity can be for the aged or the impotent or the poor and be valid – it need not be for people with all three misfortunes. 'Impotent' provided an explicit basis for trusts for the disabled (*Re Lewis* [1955] Ch 104; *Re Fraser* (1883) 22 Ch D 827), and for trusts for hospitals generally. These purposes continue under the Charities Act 2011, s.3(1)(d) and (j):

> (d) the advancement of health or the saving of lives;
>
> (j) the relief of those in need because of youth, age, ill-health, disability, financial hardship or other disadvantage.

Trusts for disaster relief are problematic. While trusts for the relief of victims of disasters are charitable (*Re North Devon and West Somerset Relief Fund Trusts* [1953] 1 WLR 1260), they are so only to the extent they provide benefits to the ill or disabled, relieve victims of poverty or fall under another recognised head of charity (e.g. rebuilding a school or church). The Charity Commission strongly encourages people to donate to, or work with existing charities rather than creating a new charity to respond to a particular disaster: see *Charity Commission guidance on starting, running and supporting charitable disaster appeals* (CC40).

While trusts related to school activities are charitable under the education head, trusts for sport or recreation outside the education context are not (*Re Nottage* [1895] 2 Ch 649). However, the provision of public facilities which can be used for recreation is

charitable (*Re Hadden* [1932] 1 Ch 133). This is now governed by the Charities Act 2011, s.5. It does not matter if the rich benefit from the recreational facility as well as the poor or deprived, so long as it is genuinely open to all members of the public, although it can be restricted to male or female members only.

The Charities Act 2011, s.3(1) now includes '(e) the advancement of citizenship or community development', '(g) the advancement of amateur sport', '(h) the advancement of human rights' and '(k) the advancement of animal welfare'. Would *Williams Trustees* v *IRC* (1947) now count as charitable? Would *McGovern* v *A-G* (1982) now be charitable, or would the fact that it purported to operate overseas still be problematic?

In *Incorporated Council of Law Reporting for England and Wales* v *A-G* (1971), the Court of Appeal decided that the publication of law reports at a moderate price was a valid charitable purpose for the advancement of education, but also under the residual category as purpose 'of general public utility', since it was necessary for the proper administration of justice. The concept 'of general public utility' was considered by the Court of Appeal in *Helena Partnerships Ltd* v *HMRC* (2012), where it decided that the provision of social housing did not qualify (per Lloyd LJ at [108]):

> In its nature, the benefit afforded by the provision of housing to the person who is thereby housed is of an altogether different order, as it seems to me, to the benefit afforded by the construction or maintenance of a road, a bridge or a sea-wall, or the maintenance of a fire brigade or a lifeboat service. The former provides direct benefits to the occupants of the accommodation which far outweigh the degree of indirect benefit that other members of the community may derive from the existence of the housing stock.

If the housing had been provided only to disadvantaged people in need of relief, due to poverty, old age, infirmity, etc., it would have qualified as charitable, but without such a restriction, it was not.

ACTIVITY 9.6

Consider whether each of the following purposes is charitable, read the case following to see how your views compare with those of the courts, and then consider how the Charities Act 2011 might apply.

a. **A gift on trust to establish and maintain an institute, to be known as the 'London Welsh Association', the purposes of which included maintaining an institute for the benefit of Welsh people in London, and promoting their language and culture (*Williams' Trustees* v *IRC* [1947] UKHL 1, [1947] AC 447).**

b. **The work of the National Trust for Places of Historic Interest or Natural Beauty (*Re Verrall* [1916] 1 Ch 100).**

c. **The work of the Society for the Prevention of Cruelty to Animals (*Tatham* v *Drummond* (1864) 2 Hem & M 262).**

d. **A gift for an animal sanctuary which specifically excluded humans so that the animals would not be molested (*Re Grove-Grady* [1929] 1 Ch 557).**

e. **A trust for the purpose of promoting athletic sports and general pastimes for the Glasgow police (*IRC* v *City of Glasgow Police Athletic Association* [1953] AC 380).**

f. **The provision of facilities for religious services and instruction and for the social and physical training and recreation of persons who would otherwise be deprived of these services and who were or were likely to become members of the Methodist Church (*IRC* v *Baddeley* [1955] UKHL 1, [1955] AC 572).**

No feedback provided.

Summary

There is a two-stage test to determine whether a particular purpose is charitable. Is the purpose *prima facie* charitable and if so, does it provide a public benefit?

There are 13 main categories of charity under the Charities Act 2011, which build on the four categories set out by Lord Macnaghten in *Pemsel* (1891). There remains a residual

category of other purposes beneficial to the community which is still difficult to define. Essentially, a purpose must benefit the public in a way which can be related to the purposes that courts have found to be analogous to those in the preamble.

9.3 The public benefit requirement

We need to distinguish between abstract benefit and actual benefit. A charitable purpose must be beneficial to the public, not detrimental. So far as the first three heads are concerned, it was often said to be a 'presumption' of public benefit. What seems to be meant by this is that it need not be shown how the particular purpose benefits the public, provided only that there is a sufficient element of the public who are 'benefited'. So, for example, in a trust for the saying of masses in public, it need not be shown how the public who attend such masses, or those who are edified by knowing that others do so, are benefited by that activity. If there was such a presumption, it appears to have been removed by the Charities Act 2011, s.4(2):

> In determining whether the public benefit requirement is satisfied in relation to any purpose falling within section 3(1), it is not to be presumed that a purpose of a particular description is for the public benefit.

In *Independent Schools Council* v *Charity Commission* [2011] UKUT 421 (TCC), [2012] Ch 214, the Upper Tribunal decided that there was no presumption of public benefit in relation to education and therefore the statute did not change the law. In *Charity Commission for England and Wales* v *A-G* [2012] UKUT B19 (TCC) at [39], it came to the same conclusion regarding trusts for the relief of poverty. However, in *Catholic Care (Diocese of Leeds)* v *Charity Commission* [2010] EWHC 520 (Ch) at [67], Briggs J suggested that the statutory provision might have some effect:

> [I]t is no longer to be presumed that any particular type of purpose is for the public benefit. Section 3 [now 4] therefore expressly contemplates that purposes commonly regarded as charitable, such as the advancement of religion or education, the relief of sickness or poverty, or the care of children in need, may not be for the public benefit, for example if they are sought to be achieved in a particular manner. It therefore admits of the possibility that the question whether a particular purpose which is within section 2(2) [now 3(1)] is charitable may require a weighing of the public benefits and dis-benefits associated with its implementation.

In any event, there was never any such 'presumption' in relation to Lord Macnaghten's fourth category, where it must be shown how the proposed charity will actually benefit the public. In such cases, the balance of benefit against detriment may be an issue. Thus, in *National Anti-Vivisection Society* v *IRC* (1947), the House of Lords held it imperative to decide whether the benefits to human beings of suppressing vivisection outweighed the benefits to medical science and research that depended on it. (See also *Re Foveaux* [1895] 2 Ch 501 where the court preferred to offer no opinion on the public benefit of abolishing vivisection.)

All four heads, however, are subject to the requirement that it be shown that a section of the public receives the 'benefit', and no 'presumptions' operate here. That said this requirement seems to be non-existent when it comes to trusts for the relief of poverty. A trust for one's poor relations is valid (*Re Scarisbrick* (1951)) even though only a private group of people in fact benefits. In *Charity Commission for England and Wales* v *A-G* [2012] UKUT B19 (TCC), the Upper Tribunal decided that the Charities Act 2006 (now 2011) had no effect on this aspect of the law, so that trusts for the relief of poverty are still capable of being charitable even though they are limited by relationships based on family, employment or membership in an unincorporated association.

Concerning the advancement of religion, in *Neville Estates Ltd* v *Madden* [1962] Ch 832 the court said it would assume that 'some benefit accrues to the public from the attendance at places of worship of persons who live in this world and mix with their fellow citizens.' However, if there is no engagement with the public, for example in the case of a contemplative order of nuns, there is no public benefit (*Gilmour* v *Coats* [1949] UKHL 1, [1949] AC 426).

Previously, it was assumed that fee-charging schools and hospitals were charitable, even though only those who can afford the fees can use them, so long as they are not profit-distributing. The Upper Tribunal decided in *Independent Schools Council* v *Charity Commission* (2011) that a trust that excludes the poor would lack the necessary public benefit to be charitable. This is due to its restriction on public access and not about the relief of poverty. Trusts for the education of children of one locality, such as university scholarships for children of Yorkshire, are valid. However, trusts restricted to children of a family or particular company are not, in particular where the 'educational trust' really amounts to a fringe benefit for employees (*Re Koettgen's WT* [1954] Ch 252; *IRC* v *Educational Grants Association Ltd* [1967] Ch 993), although this requirement gives rise to some difficult decisions for the courts (e.g. *Oppenheim* v *Tobacco Securities Trust Co Ltd* [1951] AC 297).

ACTIVITY 9.7

Consider whether the following meet the 'public benefit' requirement, and then read the relevant cases to see if the law agrees with you:

a. **A gift to train spiritual mediums (*Re Hummeltenberg* [1923] 1 Ch 237).**

b. **A trust to campaign for the release of prisoners of conscience in foreign countries (*McGovern* v *A-G* [1982] Ch 321).**

c. **A trust for the education of sons and daughters of coal miners (*Oppenheim* v *Tobacco Securities Trust Co Ltd* [1951] AC 297).**

No feedback provided.

9.4 Contaminating non-charitable elements

An otherwise valid charitable trust may fail because it contains one of a number of 'contaminating' elements.

Politics

Political purposes are not charitable.

Making or distributing profits

Charities may charge for the benefits they confer, as in the case of private hospitals and non-state schools, and charities may engage in fundraising activities which themselves make a profit, so long as the profit is turned to the charities' purposes and not distributed to private individuals.

ACTIVITY 9.8

Read *National Anti-Vivisection Society* v *IRC* [1948] AC 31 and *McGovern* v *A-G* [1982] Ch 321.

a. **What reasons do the courts give for denying charitable status to political purposes?**

b. **Are such reasons persuasive?**

c. **In what sort of limited political activities are charities allowed to engage?**

No feedback provided.

9.5 *Cy-près*

Cy-près is an Old French legal term meaning 'as near as possible'. Where a valid charitable purpose would fail because the means chosen by a testator for carrying it out are impractical or impossible, the court will apply the judicially developed *cy-près* doctrine, and more recently, ss.62 and 67 of the Charities Act 2011. These powers allow the court to order the trust fund to be applied to a different but similar purpose.

It must be noted that the *cy-près* doctrine is only available where the original trust is for a valid charitable purpose. Where a purpose trust is invalid because it is not charitable (e.g. because it is for a political purpose) the court may **not** apply the *cy-près* doctrine and devote the funds in question to some valid charitable purpose. In such cases there is no charitable trust at all, and the funds will be held on resulting trust for the settlor.

The first issue to determine is whether the trust has truly failed, for it is only then that *cy-près* may be invoked. If failure has occurred, it is then necessary to decide when that failure occurred. If it was an initial failure, the property will go on resulting trust unless the donor had a general, or paramount, charitable intention. In the case of subsequent failure (i.e. once property has been 'dedicated to charity'), *cy-près* applies regardless of the presence or absence of any 'general charitable intent'. *Cy-près* does not apply if there was a specific gift over to take effect in the event of failure of the gift to charity.

Essential reading

- **Charities Act 2011, ss.61, 62, 67.**
- **Charities Act 2022, ss.6 and 7.**
- ***Re Lysaght* [1966] Ch 191; *Re Faraker* [1912] 2 Ch 488; *Re Harwood* [1936] Ch 285; *Re Vernon's Will Trusts* [1972] Ch 300n; *Re Finger's Will Trusts* [1972] Ch 286; *Re Spence* [1979] Ch 483; *Re ARMS (Multiple Sclerosis Research) Ltd* [1997] 1 WLR 877.**

Activity 9.9

Bill dies, leaving by his will funds on trust 'for the Bermondsey Home for the Aged'. Consider what should happen to the funds in the following situations.

a. **There never existed a Bermondsey Home for the Aged or any similarly named institution.**

b. **A Bermondsey Home for the Aged existed until 1991, but its work was taken over by the local NHS hospital.**

c. **The Bermondsey Home for the Aged is the name of a charitable company which no longer operates a home but provides care in the community for the elderly.**

Read *Re Faraker* (1912), *Re Vernon's Will Trusts* (1972), *Re Finger's Will Trusts* (1972), *Re Spence* (1979) and *Re ARMS (Multiple Sclerosis Research) Ltd* (1997) and *Re Harwood* (1936) to see how the law deals with these cases.

Activity 9.10

Are the following trust purposes charitable under the present law, and if so, under what head?

a. **'To finance opposition to a proposed motorway through the Peak District which I regard as an area of outstanding beauty.'**

b. **'To support the private education of children of employees of the British Steel Corporation, with preference to families in needy circumstances.'**

c. **'To support a Marxist association in its research designed to prove that God does not exist and in campaigning against religion.'**

d. **'To the research unit of the Conservative Party for the advancement of learning in economic policy and electoral reform.'**

e. **'To finance the provision of new squash courts at London University that are to be open for use by members of the local police force as well as by members of the university.'**

f. **'To provide refurbishment funds for the Our Lady of Forest Hill Hospital' (a private hospital that is run by a religious order and charges fees).**

g. **'At such times and in such manner as my trustees in their absolute discretion think fit for the benefit of any of my relatives who, in the opinion of my trustees, lack ordinary comforts.'**

h. 'To campaign for the abolition of torture, capital punishment and corporal punishment.'

Activity 9.11

Core comprehension — Charity commission, 'public benefit: the public benefit requirement'

Read the following publication from the Charity Commission for England and Wales:

- 'Public benefit: analysis of the law relating to public benefit'.

See the Charities Act 2011.

You can complete this learning activity by reading limited materials from the identified sections.

Introduction

a. Identify the three main statutes which have contributed to the development of the modern legal concept of charity.

b. Identify the four principle classifications of charities which would fall within the legal meaning of 'charity' as adopted by Lord Macnaghten in *Income Tax Commissioner* v *Pemsel* (1891).

c. In *Attorney-General* v *National Provincial & Union Bank of England* how did Lord Cave clarify the difference between 'a trust which is for a purpose beneficial to the community' and 'a charitable trust'? Explain in fewer than 50 words, using the example of 'the provision of housing'.

The Charities Act 2011

d. Identify the statutory definition of 'charity' and 'charitable purpose'. How has the 2011 Act provided for continuity of the law on the meaning of 'charity', 'charitable purpose' and 'public benefit'?

e. List the 13 descriptions of purposes in the Act.

f. Explain in 50 words or less why the 'no presumption of public benefit' approach is necessary.

The two aspects of public benefit

g. Identify the two principal aspects of the concept of public benefit in the context of charities.

h. Explain the legal requirements which have to be satisfied to meet each of the two principal aspects.

Activity 9.12

Applied comprehension — Synge: the public benefit requirement and the poor

Using the Online Library resources, research the following journal article:

- Synge, M. '*Independent Schools Council* v *Charity Commission for England and Wales* [2011] UKUT 421 (TCC)' (2012) 75(4) *Modern Law Review* 624–39.

You can complete this learning activity by reading pp.624–29.

a. Why is 'the public benefit requirement' important and how is it defined?

b. What is meant by 'public benefit in the first sense'?

c. With regards to the 'second sense' of public benefit how is 'a sufficient class of the public' defined in *Oppenheim* v *Tobacco Securities*?

d. Which new interpretation is identified in the *Independent Schools Council* case?

e. Outline Synge's criticism of the Tribunal's interpretation of the *University College of Wales* case.

A trust which excludes the poor cannot be a charity

f. Identify the two approaches of the Tribunal to the issue of whether a trust excludes the poor.

g. In your own words, outline the core ambiguity of the law regarding the terminology of the 'poor' (60 words maximum).

h. How has the problem of defining who is poor and who is not produced an approach of considering issues of inclusion/exclusion in the context of charitable educational institutions? Explain in fewer than 80 words.

i. Using a case example, explain why the exclusion of the poor might contravene public policy as being capricious.

Activity 9.13

Applied comprehension – purpose trusts and the advancement of human rights

Using the Online Library resources, research the following judgment:

- *Human Dignity Trust* v *Charity Commission for England and Wales* 2014 WL 8663481.

You can complete this learning activity by reading the following sections: Introduction, Background, and Issues 3, 7 and 8.

Background

a. What are the purposes of the Human Dignity Trust?

b. Why did the Charity Commission refuse to enter the Human Dignity Trust on to the Register of Charities?

c. On which grounds did the Human Dignity Trust appeal the Charity Commission's decision?

d. Paraphrase in fewer than 60 words the type of strategic litigation which is central to the Human Dignity Trust's current activities.

Issue 3: The scope of 'human rights' in s.3(1)(h) of the Charities Act 2011

e. Why does the Tribunal reject the Charity Commission's submission that the term 'human rights' has a particular meaning in charity law?

Issue 7: Are the Appellant's purposes political?

f. In *McGovern* how was 'a political purpose' defined?

g. How did the HDT seek to distinguish its work from activities which would fall under the 'political purpose definition'? Give two examples.

h. On which grounds does the Tribunal distinguish the purposes of the Human Dignity Trust from the categories of activity in *McGovern*?

Issue 8: Are the Appellant's purposes for the public benefit?

i. Why are the authorities of *Bowman*, *National Anti-Vivisection Society* and *McGovern* of limited usefulness in the determination of the public benefit requirement?

j. Using the approach in the *ISC* case, which two questions did the Tribunal ask to determine the public benefit requirement for the purpose of the advancement of human rights?

k. Why is the conduct of the type of litigation which the Human Dignity Trust supports of public benefit?

Self-assessment questions

1. Who, if anyone, is the beneficiary of a charitable trust to, say, 'educate children in the principles of Buddhism'?

2. Who, if anyone, can enforce a charitable trust?

3. **What is *cy-près*?**
4. **When can *cy-près* be invoked?**
5. **Lord Macnaghten identified four categories of valid purposes for charitable trusts. What are they?**
6. **Which of the 13 categories in the Charities Act 2011, s.3(1) were not previously contained in Lord Macnaghten's four categories?**
7. **In what circumstances can the provision of facilities for sport and recreation be considered charitable?**
8. **What problem may arise with charitable trusts for disaster relief?**
9. **What might be the disadvantages of replacing tax relief for charities with direct government grants?**

SAMPLE EXAMINATION QUESTIONS

Question 1 Answer both parts

a. **On what basis does the law determine whether a proposed trust, which appears to provide for a novel purpose (i.e. one not found to be either charitable or uncharitable by a previous judicial decision) is charitable? Are any reforms of the law indicated?**

b. **Siegfried died, leaving in his will '£50,000 to the Stepney Grammar School for scholarships to deserving boys' and '£50,000 for the work of "Stepney Food for the Homeless"'. Stepney Grammar School, although it previously had only male pupils, is now mixed, and the current board of governors has advised the trustees that they would not administer a scholarship scheme for boys only. Stepney Food for the Homeless was a corporate charitable body which has since been wound up. Its work, however, was continued and is now carried on by East London Food for the Homeless. Advise the trustees.**

Question 2 Consider four **of the following** six **purposes, and discuss whether they are charitable in English law, and if not, whether they ought to be:**

a. **To provide scholarships to assist students to learn ballroom dancing while at university, with the condition that the trustees may, in applying up to 75 per cent of the income of the trust, give preference to children of employees of Capezio Ltd.**

b. **To campaign for a modern national health service in Erehwon, a country plagued by poverty and disease, where there are strong religious objections to medical procedures which involve any invasion of the body, such as surgery or vaccination by syringe.**

c. **To support the work of Osiris, a cult whose way of life and philosophy is based on an interpretation of ancient Egyptian supernatural beliefs, and whose doctrines require adherents to cut themselves off entirely from their families and retire to Osirian communities, where they make themselves available several times each month to discuss their faith with members of the public.**

d. **To provide funds to the Sisters of 2001, an association of Roman Catholic nuns whose sole activity is to persuade the Vatican to allow the ordination of women priests.**

e. **'£10 million to my trustees upon trust for the purpose of setting up an Olympic Sporting Institute, for the better training of Great Britain's most promising young amateur athletes.'**

f. **'£1 million for the provision of condoms and other means of birth control to students in schools in London.'**

Question 3 What is the 'public benefit' requirement? How, if at all, does it vary across the range of charitable purposes?

Question 4 Answer both parts:

a. **'Despite the enactment of the Charities Act 2011, the present definition of charity is still in need of reform because we must still rely on analogies that are haphazard and capricious. The statutory list should exclude purposes that are not genuinely altruistic, redistributive and socially useful.'**
Discuss.

b. **'It is of course unfortunate that the recognition of any trust as a valid charitable trust should automatically confer fiscal privileges, for the question whether a trust to further some purpose is so little likely to benefit the public that it ought to be declared invalid and the question whether it is likely to confer such great benefits on the public that it should enjoy fiscal immunity are really two quite different questions' (per Lord Cross in *Dingle* v *Turner* (1972)).**
Discuss.

ADVICE ON ANSWERING THE QUESTIONS

Question 1

a. An answer to this question will explain the 'growth by analogy' approach to novel purposes seen in *Scottish Burial Reform and Cremation Society* v *Glasgow Corp* (1968) and will compare it with the more broad-ranging 'public benefit' approach Russell LJ in *Incorporated Council of Law Reporting for England and Wales* v *A-G* (1972). You should consider possible reforms such as the provision of a statutory definition of charity, and consider both the advantages and disadvantages of particular proposed reforms.

b. These are cases of impracticality or impossibility of performance of a charitable purpose at the outset and the possible application of the *cy-près* doctrine. You should consider how the court would assess whether the apparent intention of the testator to determine whether the gift of scholarships to boys is an essential element of the gift, and whether the court could apply the funds *cy-près* to allow the fund to be used for scholarships for girls as well as boys. Consideration of *Re Lysaght* (1966) is essential. The second concerns the case of a charitable institution whose work is continued by another. Normally, the funds will be transferred to the continuing body, but this is not a case of *cy-près* – see *Re Farakar* (1912).

Question 2

a. While learning ballroom dancing may not appear to be particularly educational, such an activity could easily be regarded as ancillary to university education, and therefore a charitable purpose. However, the preference may well render the trust non-charitable (*Re Koettgen's WT* (1954), *IRC* v *Educational Grants Association Ltd* (1967)).

b. This would probably fail to be a valid charitable purpose, being tainted by politics under *McGovern* v *A-G* (1982) principles, even though the provision of healthcare in a poor country would count as charitable.

c. Whether Osiris's work is charitable under the head of religion will depend upon whether their way of life is 'religious', involving belief in a higher power, or merely moral or philosophical (*Re South Place Ethical Society* (1980), *R* v *Registrar-General* (1970)) and whether the extensive isolation of their members removes any public benefit (*Neville Estates* v *Madden* (1962)).

d. While this purpose is situated within a religious context, it is not clear that the activity is itself religious or a matter of church politics. As the Vatican is an independent state, the trust may raise some *McGovern* v *A-G* (1982) issues concerning politics. On the other hand, the purpose may be regarded as educational in the sense that it provides for the discussion of Church doctrine, although again the dissemination of research or activity which is organised to promote one side of a debate would appear to fail as charitable research.

e. This concerns the apparent prohibition on trusts for sporting activity not associated with traditional education (*Re Nottage* (1895), the *Birchfield Harriers* decision by the Charities Commissioners (Annual Report, 1989); this might appear unjustifiable if there is a public interest in Britain's achieving international sporting excellence; one might try to fit the 'training of Britain's most promising young athletes' under the education head, but this may seem somewhat strained given that the proposed institute is independent of any regular educational institution; the trust will not be validated under the Recreational Charities Act 1958, since this institute will not serve social welfare by improving the conditions of life of the athletes, and is not open to the public.

f. Concerns public benefit and possible public detriment; sex education might be education, but the mere provision of means of birth control is not; it might advance the health of students to the extent that unwanted pregnancies and sexually transmitted diseases are avoided; however, some might regard it as encouraging sex among the young, which is not universally regarded as beneficial.

Question 3 This question is straightforward, requiring a discussion of how the requirement applies to cases under each of the heads of charity, and in particular how the requirement may appear artificial in the case of religious charities and becomes problematic in the case of educational charities and charities under the fourth head when cases concerning employee 'fringe benefits' and fee-charging charities arise.

Question 4 Another straightforward question concerning the reform of charities, (a) being directed to the definition of charities, (b) regarding the automatic fiscal benefits accorded to charity. With regard to (a), criticisms of the current scope of charities should be identified and explained, and proposals for reform discussed. In particular, the difficulties in formulating a satisfactory statutory definition should be addressed, as well as any problems that might arise (e.g. the rendering non-charitable of long-standing charities). As to (b), Lord Cross's suggestion that fiscal benefit and charitable status be decoupled is a common one. A good answer would consider not only the reasons why it has often been thought a good way forward, but how a new regime of tax subsidy, or direct government grants might be structured, and the advantages and possible drawbacks of particular reforms.

Reflect and review

Look through the points listed below.

Are you ready to move on to the next chapter?

Ready to move on = I am satisfied that I have sufficient understanding of the principles outlined in this chapter to enable me to go on to the next chapter.

Need to revise first = There are one or two areas I am unsure about and need to revise before I go on to the next chapter.

Need to study again = I found many or all of the principles outlined in this chapter very difficult and need to go over them again before I move on.

Tick a box for each topic.

	Ready to move on	Need to revise first	Need to study again
I can differentiate between purposes that are *prima facie* charitable and those that are not.	☐	☐	☐
I can explain how a *prima facie* charitable object might nevertheless be disqualified from charitable status.	☐	☐	☐
I can explain the 'public benefit' requirement.	☐	☐	☐
I can explain the requirement that a valid charitable trust must be exclusively charitable, and discuss the factors that may prevent its being so.	☐	☐	☐
I can explain the operation of the c*y-près* doctrine.	☐	☐	☐
I can outline why particular areas of charities law raised calls for reform, and the advantages and disadvantages of the enacted reforms.	☐	☐	☐

If you ticked 'need to revise first', which sections of the chapter are you going to revise?

		Must revise	Revision done
9.1	Charitable status	☐	☐
9.2	The meaning of 'charity'	☐	☐
9.3	The public benefit requirement	☐	☐
9.4	Contaminating non-charitable elements	☐	☐
9.5	C*y-près*	☐	☐

10 Non-charitable purpose trusts

Contents

Introduction

In this chapter we look at the general prohibition upon settlors creating trusts for non-charitable purposes. This prohibition is generally said to relate to issues with enforcement. That is, the problem with non-charitable purpose trusts is not that we might object to the specific purposes for which trust property is being used but that it is not possible to utilise a trust for the carrying out of a non-charitable purpose unless there is someone who can enforce the trust. As seen in Chapter 9, for charitable trusts, this is undertaken by the Charity Commission.

As we will see, attempts have been made to circumvent the rule, and there are certain anomalous cases in which non-charitable purpose trusts have been upheld. Furthermore, we might ask whether objections to private purpose trusts are grounded only in the lack of human beneficiaries. If we could respond to this problem, for instance, through having a trust 'enforcer', would there nevertheless be reasons of law or policy to object to private purpose trusts?

CORE TEXT

- **Penner, Chapter 7 'The beneficiary principle', Sections 'The beneficiary principle and the invalidity of private purpose trusts', 'Anonymous valid purpose "trusts"', 'Powers for purposes' and 'An enforcer principle?'.**

ESSENTIAL READING

- **Review Chapter 5 'Declarations of trust' of the module guide.**

LEARNING OUTCOMES

By the end of this chapter and the relevant readings, you should be able to:

- **state the main objections to private purpose trusts**
- **discuss the interrelationship between the requirement of certainty of objects and the beneficiary principle, and how the beneficiary principle can be seen as a 'rights' principle or an 'enforcement' principle**
- **discuss cases in which apparent trusts for purposes were held valid and why this does not upset the beneficiary principle**
- **describe the few private purpose trusts that will nevertheless be upheld and how they are enforced**
- **explain why the trust validated in *Re Denley's Trust Deed* [1969] 1 Ch 373 might be seen as a problematic example of a private purpose trust.**

10.1 Objections to non-charitable purpose trusts

Non-charitable (i.e. private) purpose trusts pose difficulties for trusts law because they do not satisfy some of the traditional trust law rules. As a result, a trust that requires property to be used for a designated purpose which is not exclusively charitable may be void on one of a number of grounds.

10.1.1 Uncertainty of objects

A direction to carry out a purpose generally fails to indicate a clear class of individuals who will benefit if it is carried out, and so it is impossible to identify a class of beneficiaries: see, for example, *Re Astor's ST* [1952] Ch 534; *Morice* v *Bishop of Durham* (1804) 9 Ves 399, 32 ER 656 (Grant MR); affirmed (1805), 10 Ves 522, 32 ER 947 (Eldon LC).

10.1.2 Excessive duration

The rule is generally taken to be that a trust fails if it may last beyond the various perpetuity periods allowed by law. Trusts that require rights to be retained for a period in excess of any valid perpetuity period will clearly infringe the rule, and since purposes generally do not expire within a limited time, they tend to violate the rule: see, for example, *MacAulay* v *O'Donnell* [1943] Ch 435. If that is correct, then the rule was not applied strictly in *Mussett* v *Bingle* [1876] WN 170, where a trust to erect a monument was held not to be perpetuitous, even though there would have been some (remote) possibility that it would take more than the allowable defined period of 21 years to carry out the terms of the trust (see also *Re Lipinski's Will Trusts* [1976] Ch 235). In practice, a settlor could avoid infringing this rule by specifically stating a period for the operation of the trust within the periods allowed, rather than relying upon the limitless 'natural' lifetime of the purpose. According to s.18 of the Perpetuities and Accumulations Act 2009, 'This Act does not affect the rule of law which limits the duration of non-charitable purpose trusts.' So the trust would have to comply with the common law rule. However, such a solution to this perpetuity problem does not solve the more fundamental issue whether private purpose trusts *per se* are valid at all.

10.1.3 Lack of beneficiary

It is a core feature of the trust that it is enforced against the trustee by the beneficiaries and by no one else (including the settlor). It would therefore seem to follow that any effective trust must have beneficiaries, for only beneficiaries have the ability to enforce it against the trustee. (In the case of charitable or public trusts, the Charity Commission has this power.) This point has been dwelt upon in many cases: see, for example, *Re Astor's ST* [1952] Ch 534; *Re Shaw* [1957] 1 WLR 729, [1957] 1 All ER 745; *Re Endacott* [1960] Ch 232; *Leahy* v *A-G for NSW* [1959] UKPC 1, [1959] AC 457. In *Re Denley's Trust Deed* [1969] 1 Ch 373, this question was reduced by Goff J to one of 'standing', holding that the prospect of obtaining some 'factual benefit' from the performance of the trust was sufficient to give standing to enforce the trust. *Re Endacott*, a decision of the Court of Appeal, on the other hand, holds that it must be possible to point to someone with an equitable interest, and it is difficult to see how *Re Endacott* and *Re Denley* can be reconciled. See also Evans, J.M. 'Purpose trusts – further refinements' (1969) 32 *MLR* 96.

Activity 10.1

Make a spoken statement outlining the reasons why it is difficult to reconcile *Re Endacott* and *Re Denley*.

No feedback provided.

10.1.4 Excessive testamentary delegation

It is sometimes suggested that a testator creating a trust for a non-charitable purpose fails to exercise their testamentary power because they leave it to the trustee to decide whether or not the property will be so used: see *Leahy* v *A-G for NSW*. This objection is not strong. If someone with sufficient standing to enforce the trust is

available, then the trustee will be under an enforceable duty to carry out the purpose, whether or not to carry it out will not be a matter for their discretion. Thus this objection begs the question: if purpose trusts are valid, then testamentary purpose trusts will not represent a failure to exercise a testamentary power. If they are invalid, then they will *ipso facto* be invalid testamentary dispositions. Nothing in particular to do with testamentary dispositions affects the issue.

Clearly, objections 1 (uncertainty of objects) and 3 (lack of beneficiary) are the most crucial, and it is upon these that we will spend most of our time in the remaining sections of this chapter.

ACTIVITY 10.2

Devise two non-charitable purposes that you would like to see carried out, then list the people or sorts of people who would most likely benefit in fact from their being carried out. State whether those persons:

a. **would be likely to take the effort to enforce the purpose against a holder of funds for the purpose**

b. **should be allowed by law to enforce the purpose**

c. **should be allowed by law to come to an agreement with the holder of the funds to use the funds for some other purpose or to divide the funds up among themselves.**

Summary

A non-charitable trust is usually void and this may be explained on a number of grounds. The two most important are (1) uncertainty of objects, as a purpose trust does not clearly indicate a class of beneficiaries, and (2) the absence of any beneficiaries. A valid non-charitable trust must have at least one person who is able to act to enforce the trust. Furthermore, excessive duration may cause a trust to fail, if the trust purpose extends beyond the various perpetuity periods allowed by law.

10.2 The 'beneficiary principle'

The 'beneficiary principle' states that a valid trust must be for the benefit of ascertainable individuals (i.e. the trust must have beneficiaries) or be charitable. In consequence, the courts will not normally enforce a trust to carry out a non-charitable purpose since the benefits of carrying it out are not owed to any specific individuals. As Sir William Grant MR said in *Morice* v *Bishop of Durham* (1804) 9 Ves 399 at 405–406, 32 ER 656 at 658:

> There can be no trust, over the exercise of which this Court will not assume a control; for an uncontrollable power of disposition would be ownership, and not trust … There must be somebody, in whose favour the court can decree performance.

10.2.1 A 'rights' principle or an 'enforcer' principle?

The beneficiary principle can, from one perspective, be seen as a corollary of the certainty of objects requirement for a valid declaration of trust. If a declaration of trust expresses the trustee's distributive duties in terms of a purpose, then clearly there are no definite trust objects.

Further, since the execution of a trust must be under the control of the court:

> it must be of such a nature, that it can be under that control; ...unless the subject and the objects can be ascertained, upon principles, familiar in other cases, it must be decided, that the court can neither reform maladministration, nor direct a due administration. (*Morice* v *Bishop of Durham* (1805) per Lord Eldon LC).

Compare the following statement by Roxburgh J in *Re Astor's ST* (1952):

> The typical case of a trust is one in which the legal owner of property is constrained by a court of equity so to deal with it as to give effect to the equitable right of another. These equitable rights have been hammered out in the process of litigation in which a claimant on equitable grounds has successfully asserted rights against a legal owner or other person in control of property. *Prima facie*, therefore, a trustee would not be expected to be subject to an equitable obligation unless there was somebody who could enforce a correlative equitable right, and the nature and extent of that obligation would be worked out in proceedings for enforcement.

Together, these two passages express the beneficiary principle as a 'rights' principle: if there is no one with rights against the trustee, then there is no one who can enforce the trust and thus no trust. The problem with purpose trusts, on this view, is simply that expressing a trust in terms of a purpose confers no rights upon anyone in equity. Trusts (except for charitable trusts) are devices of private law after all, and for a private law transaction of whatever kind to have any legal effect, it must actually confer rights or powers, with corresponding duties or liabilities. Dedicating rights to a non-charitable purpose does neither.

However, some commentators have attempted to distinguish two aspects of the role of beneficiaries: first, they have equitable interests with regard to the trust property, and second, they have standing to enforce the trust. Of course, where a trust is for ascertainable beneficiaries, they should, for the most part, be the proper enforcers of their own rights. But why should a court of equity not validate a trust for beneficiaries where the settlor has nominated someone else to serve as the enforcer of those beneficiaries' rights? If this seems workable, why should a court of equity not validate a trust for a private, non-charitable purpose, where the settlor has nominated an enforcer, who can take the trustees to court if they fail to carry it out? On this reasoning, the 'beneficiary principle' should be regarded as an 'enforcer principle', and would state that a trust is only invalid where there is no one with standing to enforce the trust, either beneficiaries or nominated enforcers.

A number of responses have been provided to this argument. One is that the state has no interest in seeing trusts for private purposes enforced. Whether enforcement, or something else, occurs following the validation of these trusts by the court is a matter of the private rights of individuals. Remember that beneficiaries under a trust have no duty to enforce their rights against the trustee. The state does not require them to see that the trustee gives them any proper distributions under the terms of the trust. Indeed, beneficiaries can release them, or can assign them to the trustee if they are so minded (although the trustee will have the burden of showing that such an assignment was fairly and freely entered into, as discussed in Chapter 17). This ethos, that it is up to individuals themselves to enforce their private rights, must apply equally to the person nominated 'enforcer' of the purpose trust. If that person chooses not to enforce the trust against the trustee, or release their rights of enforcement, the state will not step in. And if that person comes to an agreement with the trustee to use the rights in other ways, or divide them up between themselves, this would be perfectly lawful, for there is no one else whose rights have been infringed.

If this is true, then how is this a trust to carry out a purpose, rather than just a trust with a particular distribution of rights and duties among individuals? In some jurisdictions where legislation has been enacted to permit non-charitable purpose trusts, the enforcer is under a statutory duty to enforce the trust (e.g. Cayman Islands Trust Law (2011 Revision), s.101; The Trusts (Guernsey) Law, 2007, s.12; Trusts (Jersey) Law 1984, s.13). Such enforcers can be regarded as quasi-public officials whose duties are imposed by public law. However, in the absence of such legislation, as in England and Wales, enforcers of private purpose trusts would have no similar public law duties.

ACTIVITY 10.3

a. **What does it mean to say that the beneficiary principle is a 'rights' principle rather than an 'enforcer' principle?**

b. **What flaw does there seem to be in the 'enforcer' principle in the case of private purpose trusts?**

No feedback provided.

10.2.2 Powers for purposes

While the orthodox principles of trust law seem to invalidate trusts to carry out private purposes, the grant of a power to a trustee to use trust funds to carry out a purpose appears to be perfectly valid. There is no similar problem of enforcement with respect to powers, for there is no duty to carry out powers and therefore no problem of non-performance. Regarding misfeasance (e.g. appointing outside the designated purpose), those who would take in default of appointment have the power to bring the trustees to account if they purport to exercise the power in a way which is outside its intended purpose. The court will not, however, validate invalid trusts for purpose by construing them as valid powers for purposes: *Re Shaw*.

Summary

Non-charitable purpose trusts are invalid under English law, but different explanations of why this is so have been offered. The essential problem appears to lie in the fact that unless there are beneficiaries to enforce the trust, no-one is bound to perform it. It has been said that the naming of an enforcer to enforce a purpose trust against the trustee does not solve the problem, for the enforcer can treat their enforcement rights as merely trust property they hold for their own benefit, so that they can depart from enforcing the trust and may release their rights or bargain with the trustee for a division of the trust property. In short, there is no duty to enforce the trust purpose that can bind an enforcer. Powers to carry out purposes are perfectly valid. Here there is no duty on the trustee to exercise the power to carry out the purpose, so no concern to find a mechanism to enforce that duty against the trustee.

REFLECTION POINT

Is there a case for making private purpose trusts valid in English law?

10.3 Trusts for persons limited by a purpose

There is a class of trusts which are often mistaken for true purpose trusts. These are trusts like *Re Sanderson's Trust* (1857) K & J 497, where the beneficiary's interest under the trust is determined by the provision of a certain benefit for him. So for example, trusts for the maintenance, advancement, or education of sons or daughters were popular in the 19th century. While these trusts are created to fulfil a purpose (e.g. to maintain Emily, advance Frederick or educate Rita), they are not purpose trusts without beneficiaries. Emily has a claim against the trustees for such amounts as are needed for her maintenance, Fred for as much as is needed to, say, buy a commission in the army, and Rita for as much as is needed to pay for her education. They are, in other words, trusts for people, in which the subject matter of the trust for the individual beneficiary is not determined by a straightforward allocation of a share of income or capital, but by the cost or expense of a particular benefit for the beneficiary. For this reason, the trust may exhaust all the funds set aside for it, or may fail to exhaust those funds.

It is often difficult to distinguish a *Re Sanderson*-type trust from a trust where the intention of the settlor is to give an entire fund to a beneficiary, but the settlor expresses 'education' or some other expense as the motive for the gift. A mere expression of motive cannot limit a gift, and so in these latter cases, if the fund provided for the beneficiary is not exhausted by the expressed expense, this is of no matter, for the whole fund was held for the beneficiary from the outset. Where,

however, there is a true *Re Sanderson*-type trust, the beneficiary only has a right under the trust commensurate with the named expense, and any remaining funds must be disposed of by way of a gift over, or will otherwise go on resulting trust. *Re Abbott* [1900] 2 Ch 326 and *Re Andrew* [1905] 2 Ch 48 provide an interesting contrast between the two types of case. Both concerned funds raised by public subscription, to provide for two disabled ladies and a cleric's children, respectively. See also *Re Osoba* [1978] 1 WLR 791 varied [1979] 1 WLR 247 (CA).

Activity 10.4

a. What sorts of purposes typically defined the extent of a beneficiary's interest under a *Re Sanderson* type of trust?

b. Explain why the *Re Sanderson* type of trust is often difficult to distinguish from a trust of the whole of a fund with an expressed motive for the gift, and the practical difference between the two kinds of trust.

10.4 Anomalous valid non-charitable purpose trusts

A number of non-charitable purpose trusts have been upheld, despite infringing the beneficiary principle, and in *Re Dean* (1889) 41 Ch D 552, despite also infringing the rule against perpetuities. The categories, which are not to be extended (*Re Endacott*; *Re Astor*), are:

- reasonable provision for tombs and monuments (but not something more general, such as 'some useful memorial to myself', as in *Re Endacott* itself)
- the care of specific animals (*Re Dean*)
- the saying of masses (religious services in the Catholic Church) to the extent that these are not charitable in advancement of religion (*Bourne* v *Keane* [1919] AC 815; *Re Hetherington* [1990] Ch 1).

The furtherance of fox hunting was included in the list in *Re Thompson* [1934] Ch 342, but fox-hunting is now illegal in England and Wales: Hunting Act 2004. It should be noted that no real challenge to the validity of the trust was made in that case.

10.4.1 The *Pettingall* order and 'trusts of imperfect obligation'

Where an anomalous trust of one of these kinds is upheld, the court will make a *Pettingall* order (*Pettingall* v *Pettingall* (1842) 11 LJ Ch 176) under which the trustee or executor of the will undertakes to carry out the purpose, and the court grants leave to those persons who would receive the funds if the gift had been declared invalid to approach the court if the trustee or executor fails to carry out the purpose or misuses the funds. The *Pettingall* order is a judicial attempt to deal with the fact that these are 'trusts of imperfect obligation', so called because there are no beneficiaries and therefore no persons to whom any genuine duties are owed to carry out the trust.

Self-assessment questions

1. **What anomalous purpose trusts are allowed by law?**
2. **How does the court provide for their enforcement?**
3. **What is testamentary delegation?**
4. **What is the beneficiary principle?**
5. **Who, if anyone, has a duty to enforce a private purposes trust?**
6. **What is a true *Re Sanderson*-type trust?**

10.5 Departures from the beneficiary principle

10.5.1 *Re Denley's Trust Deed* (1969)

In *Re Denley*, Goff J upheld a trust under which a title to land was held on trust for the purpose of providing a recreation ground for the employees of a particular company. Goff J regarded the employees as persons so directly benefitted by the purpose that (1) the purpose was not of such an abstract kind as to fall foul of the beneficiary principle, and (2) that the employees had standing to enforce the purpose against the trustees.

Subsequent commentary has tended to treat the case as merely one of a particular kind of discretionary trust (*Re Grant's Will Trusts* [1980] 1 WLR 360) or as a trust for persons, with the purpose being treated merely as a superadded direction or motive for the gift (*Re Lipinski's Will Trusts* [1976] Ch 235). In other words, the case appears to have been read so as to deny that it represents a departure from the beneficiary principle. *Re Denley* was applied without explanation in *Gibbons* v *Smith* [2020] EWHC 1727 (Ch) to validate a trust of land held by an unincorporated association.

In any case, the class of beneficiaries must, it is assumed, comply with the certainty requirements laid down in *McPhail* v *Doulton* [1970] UKHL 1, [1971] AC 424. *R* v *District Auditor ex p West Yorkshire MCC* [1986] RVR 24, noted by Harpum [1986] *CLJ* 391, is of relevance on this point. There, a trust for purposes benefiting the residents of West Yorkshire was invalid both because the class of 'indirect' beneficiaries was not sufficiently ascertainable, and more simply, it was a non-charitable purpose trust.

ACTIVITY 10.5

Consider whether it is really necessary for all non-charitable trusts to have a beneficiary and, if so, why?

Is the relevant objection adequately met by the presence of persons benefiting from the carrying out of the purpose as in *Re Denley*?

Should the law in this area be reformed?

ESSENTIAL READING

- ***Re Astor's ST* [1952] Ch 534; *Leahy* v *A-G New South Wales* [1959] UKPC 1, [1959] AC 457; *Re Endacott* [1960] Ch 232 (CA); *Re Denley's Trust Deed* [1969] 1 Ch 373.**

FURTHER READING

- ***Re Sanderson's Trust* (1857) 3 K&J 497, 69 ER 1206; *Re Lipinski's WT* [1976] Ch 235; *Re Osoba* [1978] 1 WLR 791; varied [1979] 1 WLR 247 (CA).**

SAMPLE EXAMINATION QUESTIONS

Question 1 'No principle has perhaps greater sanction of authority behind it than the general proposition that a trust by English law, not being a charitable trust, in order to be effective, must have ascertained beneficiaries' (per Lord Evershed MR in *Re Endacott* (1960)).

How accurately does this statement represent the present law relating to the dedication of property to private purposes?

Question 2 The following provisions are found in Samantha's will:

a. **'£20,000 on trust to care for my two favourite horses, Stan and Oliver, for the rest of their lives but for no longer than a period of 21 years.'**
b. **'£100,000 on trust to provide a stained-glass window in my honour in my parish church of St. Cuthberts, depicting me as Mary Magdelene.'**
c. **'£50,000 for the organisation and funding of an annual fête at Oak Farm school for 20 years following my death' (assume this is not a charitable purpose).**

Advise Samantha's executor.

Advice on answering the questions

Question 1 This is a general survey question of this area of law, focusing on the correct interpretation of the beneficiary principle. A good answer will consider whether a beneficial interest under a trust is required to enforce a trust, or whether an 'enforcer' of some kind is sufficient. The view of judges in the leading cases, *Re Astor*, *Re Leahy* and *Re Endacott*, should be discussed. *Re Denley*, as a possible departure from the principle, and its interpretation in subsequent cases, should receive attention, and the existence of anomalous testamentary purpose trusts should be briefly mentioned, along with the oft-expressed judicial view that the categories of valid testamentary purpose trusts are not to be expanded.

Question 2

a. This is valid as an anomalous private purpose trust (*Re Dean*) properly limited to a valid perpetuity period.

b. This is very similar to the facts in *Re Endacott* and is therefore almost certainly invalid as was the trust in that case.

c. The facts here are similar but not identical to those in *Re Denley*; although no specific class of factual beneficiaries is named, the students of the school might be interpreted to be an appropriate and ascertainable class. On this reading, *Re Denley* and subsequent cases need to be discussed. However, notice that the word 'trust' is not employed in this provision; it may merely give a power to spend the money in this way, in which case the power would be valid (*Re Shaw*).

Regarding both (b) and (c), you might briefly advise the executor that the current limitations upon purpose trust remain to an extent controversial, and if the views of a commentator such as Hayton were to persuade a court, an action seeking a declaration that either or both were valid might be appropriate.

Reflect and review

Look through the points listed below.

Are you ready to move on to the next chapter?

Ready to move on = I am satisfied that I have sufficient understanding of the principles outlined in this chapter to enable me to go on to the next chapter.

Need to revise first = There are one or two areas I am unsure about and need to revise before I go on to the next chapter.

Need to study again = I found many or all of the principles outlined in this chapter very difficult and need to go over them again before I move on.

Tick a box for each topic.

	Ready to move on	Need to revise first	Need to study again
I can state the main objections to private purpose trusts.	☐	☐	☐
I can discuss the interrelationship between the requirement of certainty of objects and the beneficiary principle, and how the beneficiary principle can be seen as a 'rights' principle and/or an 'enforcement' principle.	☐	☐	☐
I can discuss cases in which apparent trusts for purposes were held valid and why this does not upset the beneficiary principle.	☐	☐	☐
I can describe the few private purpose trusts that will nevertheless be upheld and how they are enforced.	☐	☐	☐
I can explain why the trust validated in *Re Denley's Trust Deed* [1969] 1 Ch 373 might be seen as a problematic example of a private purpose trust.	☐	☐	☐

If you ticked 'need to revise first', which sections of the chapter are you going to revise?

		Must revise	Revision done
10.1	Objections to private purpose trusts	☐	☐
10.2	The 'beneficiary principle'	☐	☐
10.3	Trusts for persons limited by a purpose	☐	☐
10.4	Anomalous valid private purpose trusts	☐	☐
10.5	Departures from the beneficiary principle	☐	☐

11 Unincorporated associations

Contents

Introduction

An unincorporated association is a group of people who act together to achieve some purpose, often social, such as games clubs and student law societies. How do such associations hold property? How, for example, does a student law society hold the funds that it acquires through the collection of dues or the profits from the events it organises? As the society is not incorporated, it has no legal personality in itself and so cannot hold property in the way that a company can. These are the questions this chapter addresses. Once properly understood, the problem of how property is held by unincorporated associations can be seen typically to employ trusts in a straightforward fashion.

Two topics in particular must be addressed:

- the proper construction of gifts and other transfers to an unincorporated association, and
- the destination of such property when the association dissolves.

Although the two are inextricably linked, sometimes they are dealt with separately in the standard textbooks.

Core text

- **Penner, Chapter 11 'Bare trusts subject to contractual obligations and agent's instructions', Section 'Unincorporated association trusts (UATs)'.**

Essential reading

- **Review Chapter 10 'Non-charitable purpose trusts' of the module guide.**

Learning outcomes

By the end of this chapter and the relevant readings, you should be able to:

- **explain why gifts and other transfers to unincorporated associations give rise to problems of construction for the courts**
- **describe the different constructions a court might place on such a gift or other transfer**
- **explain the contract-holding theory and why holding rights that way does not offend the rule against private purpose trusts**
- **explain what happens to rights given to an unincorporated association when the association is dissolved.**

11.1 Transfers to unincorporated associations

Although the unincorporated association itself is not a legal person, and so has no capacity to hold property, people nevertheless insist on trying to transfer property to it, either by way of gift or pursuant to some contract which they believe they have with the association. It is then for the courts to try to make sense of what is, as a matter of law, a nonsensical act. Although courts could just say that such a transfer was void, as they would, for example, say of a transfer to a tree or to my pet cat, they try to find a way to validate the transfer. Their method is to say that even though the association itself has no legal personality, its members and officers do. The transfer is therefore to be construed as one to the members or officers of the association. The question then is the capacity in which those members or officers hold the property received.

11.1.1 A transfer to members

Traditionally, the courts took the simplest approach, and viewed such transfers as made to all the members personally (either directly as co-owners of the property or through the medium of a trust, the treasurer or other officers of the club acting as trustee for the members). This interpretation would allow each member of the association to claim their share of the property and use the money as they wished, even though this might be contrary to the intentions of the donor.

11.1.2 A purpose trust

Probably in view of the last consideration, courts occasionally regarded the transfer as made to the members or officers of the association on trust, not for the members themselves, but for the purposes of the association. This would prevent individuals from claiming and taking away their individual shares, for they would not be beneficiaries under a purpose trust. But this approach is hazardous because it would generally invalidate the transfer as being a non-charitable purpose trust, unless the purposes were exclusively charitable (see *Leahy* v *AG for New South Wales* [1959] UKPC 1, [1959] AC 457) or perhaps saved by *Re Denley* (*Gibbons* v *Smith* [2020] EWHC 1727 (Ch)).

11.1.3 Contract-holding theories

A third, more recent, approach is to resort to contractual notions rather than the device of the trust. It takes advantage of the fact that unincorporated associations always proceed on the basis of explicit or implicit understandings between the members, which generally give rise to duties between them. As these understandings and obligations are mutual and consensual, in law they are normally contractual relations, even if informal. Of course, some clubs are very formal about their understandings. They produce constitutions and rules and organise themselves into committees and so on. But even the most informal association operates by contractual obligation. Recognising the existence of these contractual obligations expressed in the club rules, where possible, gifts and other transfers to such associations are construed as being transfers to the members, but subject to their contractual obligations *inter se* ('between themselves') to use the rights to promote the purposes of the association: *Re Recher's WT* [1972] Ch 526; *Re Lipinski's WT* [1976] Ch 235. The reason why this construction works is that it uses a contract to control the expenditure of the fund rather than the terms of a trust, so that the carrying out of the purpose is enforced by way of compliance with a contract, not by way of a private purpose trust. There are, however, two variants of this 'contract-holding theory': the 'bare trust/contractual mandate' solution and the 'purely contractual' approach.

A bare trust/contractual mandate solution

This solution recognises the contractual aspect of property-holding by unincorporated associations but also recognises that the contractual obligations of the members between themselves almost always work in combination with a trust, as follows. Recall the discussion of bare trusts in 3.3 of this guide. In such cases, the trustees hold the property to the order of the beneficiaries. At any one time, however, the trustees

may be given orders as to how to deal with the rights. These orders, sometimes called mandates, allow the trustees to deal with the trust property without acting in breach of trust. Without such a mandate, they would be acting in breach of trust. The way in which unincorporated associations take advantage of this is to control the giving of mandates to the trustees of the association by way of contract. The property of the association is held on trust by one or two members of the association (usually the treasurer and another officer) for all the members in equal shares. The association's rules provide the mandates authorising the trustees to use the property, perhaps directly but more likely by providing the procedures for making decisions, whether by committee, or by unanimous vote, etc. In this way, the property is held for the purposes to which the members want it put, not under a purpose trust, but as the result of their contract governing the way their own property, which is held under a bare trust, is dealt with.

A purely contractual approach

This 'bare trust/contractual mandate' interpretation of the situation is not the only one that might work, but it is the best. We can compare it to the 'purely contractual approach'. Under this, the members all individually hold the property as co-owners, so there is no trust but they are bound by their contract between themselves to deal with the property as decided by the association rules, etc. There are two problems with this solution. The first is that co-ownership without a trust is wholly impractical when there are more than three or four members. They cannot all be signatories of the association's bank account or parties to the lease or licence of its premises. To function properly, one or two members of the association will have to hold property in trust for the others.

The second problem is making sense of gifts (or other transfers) to the association. A person cannot give property 'subject to contract'. You cannot give a friend property to be held on the terms of a contract with another party, for a contract is a personal obligation between individuals, and you are not privy to their contract. In 'A problem in the construction of gifts to unincorporated associations' [1995] *Conv* 302, Matthews suggested that the members of an association could avoid this problem by incorporating in their rules a provision that any gifts or contractual payments (for example, money received for tickets to a dance that the association sponsors) received are taken by members individually but subject to their contract. While this could work – on this basis the members bind themselves by contract to treat transfers to them in a certain way – it is unlikely that many associations will have such rules.

Rather, the court reasons using the bare trust/contractual mandates approach as follows: when a donor makes a gift to an association, they make it on trust by making an addition to the current trust by which the trustees hold other property so given. Anyone can settle property by transferring it to trustees on trust to hold it in the same way as they hold other trust property. This happens, for example, when employers and employees make regular contributions to a pension fund. The trust upon which the additional funds are held is determined by reference to the already existing trust. This is how such gifts are treated as 'accretion to the funds' of the association (*Re Recher's WT*), with the court never bothering to enquire as to whether the rules of the fund provide for Matthews' purely contractual approach.

11.1.4 The construction of transfers to political parties

To achieve the bare trust/contractual mandate solution, the courts have been prepared to ignore words which in other contexts would suggest that a true purpose trust is intended (e.g. 'solely' in *Re Lipinski's WT*), although they will not construe a gift as one to the members where the members do not have complete control of the rules of the association: *Re Grant's WT* [1980] 1 WLR 360. This case concerned a local Labour Party constituency association, and the court held that it did not fulfil the requirements of an unincorporated association, but the reasoning is doubtful. In *Conservative and Unionist Central Office* v *Burrell* [1981] ECWA Civ 2, [1982] 1 WLR 522, the Court of Appeal held that political parties were 'political movements', not unincorporated associations, and so the bare trust/contractual mandate solution

could not work, since movements do not have the membership of an association (although it is not clear why political parties cannot be associations with a definite membership even if they are political). Instead, the court explained a gift to the political party in *Burrell* as given under an agency arrangement, with the treasurer to use the funds for the purposes of the party as the donor's agent. This construction is unsatisfactory in several ways, failing in particular to account for testamentary gifts (i.e. gifts made in a will) for when a will comes into operation the testator is dead, and a dead person cannot be a principal for an agent.

Self-assessment questions

1. **Why does an attempted transfer of property to an unincorporated association give rise to problems?**
2. **Why is a transfer to the members as co-owners outright likely to defeat the donor's purpose?**
3. **Why are such transfers not construed as transfers on trust for the purposes of the association?**
4. **What are the contractual obligations of the members? Give some examples.**
5. **What is a contract-holding theory by members of an unincorporated association?**
6. **What are the two different versions of the contract holding theory, and which is preferable?**
7. **How have the courts construed attempted transfers to political parties? What difficulties arise with this construction?**

Activities 11.1 and 11.2

Read *Re Lipinski's WT* [1976] Ch 235 and answer the following questions:

11.1 **What was the expressed purpose of the gift? On your reading, would you say that the settlor intended the money to be used solely for a particular purpose?**

11.2 **On what basis or bases did Oliver J hold the gift valid?**

11.2 The distribution of property upon dissolution

The correct assessment of how property was received and held by an unincorporated association will also explain what is to happen to any funds that remain when the association dissolves. While that is obviously correct, too often the case law decisions regarding the distribution of property on dissolution have proceeded on the basis that the association itself held that property in ways that would have been untenable, if that basis had been examined in terms of how gifts or other transfers were validly made to the association.

For example, on dissolution, the court might unwittingly proceed on the basis that the funds were given and held on non-charitable purpose trusts, which would have made those gifts invalid at the outset, given that non-charitable purpose trusts are invalid. It was only with the relatively recent development (from *Re Recher's WT*) of the bare trust/contractual mandate theory that clearer understanding of the issues has emerged and cases on the dissolution of unincorporated associations decided before *Re Recher's WT* must be read with care.

11.2.1 How was the property originally received?

The key question to ask here is how the property was received, for that will tell you how it was held to the time of dissolution. The question to then ask is how, if at all, dissolution has changed that entitlement. If the association's purposes were charitable, and the property was held by its officers/members on trust for charitable

purposes, the property will be applied *cy-près* to a similar purpose (see *Re Vernon's WT* and *Re Finger's WT*, discussed in **Section** 9.5). In the unlikely event that the property was held on trust for valid non-charitable purposes (recall that there are some valid non-charitable purposes, discussed in **Section** 10.4), then the trust should not fail, as the winding up of the association will not in itself be a winding up of the purpose. Unfortunately, most decisions in which the court takes the view that the property was held on purpose trusts regard the purpose, quite wrongly of course, as the purposes of the association, a purpose which then fails because of the dissolution of the association. On this interpretation, a resulting trust should arise in favour of those who originally contributed the property. Where the property was received under either version of the contract-holding theory elaborated above, it will simply be distributed among the membership existing at the time of dissolution, because under the contract-holding theories the members of the association hold the property outright. When the association dissolves, their contractual obligation to use the property in a particular way simply disappears, so that they can distribute the property to themselves in equal shares, or do anything else with it that they want.

11.2.2 Some inconsistent older cases

Re Printers and Transferrers Amalgamated Trades Protection Society [1899] 2 Ch 184 and *Re Hobourn Aero Components Ltd's Air Raid Distress Fund* [1946] Ch 194 concerned property collected to provide benefits to members of employees' associations. In both cases, when the associations dissolved, the court held that there was a resulting trust of the remaining property in favour of the members in proportion to their contributions. As this was a resulting trust, the court must have regarded the funds as held upon purpose trusts which failed when the associations dissolved. Such non-charitable purpose trusts, however, are invalid. On the contract holding theory, the result would, but only coincidentally, be essentially the same: on dissolution, the property would be distributed to the members, and presumably their individual shares would be determined by the terms of the association, even implicit terms, and shares proportionate to contributions might well have best reflected their mutual understanding.

Cunnack v *Edwards* [1896] 2 Ch 679 (CA) concerned an association that provided benefits to the widows of deceased members, paid from a fund to which the members contributed. Upon dissolution, the court reasoned that the members had received all they had contracted for (i.e. the provision of pensions for widows), so the surplus went to the Crown as *bona vacantia* (ownerless goods). As with the preceding two cases, the only possible basis for this finding was that the property was devoted to a private purpose trust, to provide pensions for members' widows, which failed upon dissolution. Yet the application of a kind of 'contract theory' to private purpose trusts (that donors donate to the purpose trust thereby contracting with the trustees to obtain a particular personal benefit out of the purpose), makes a nonsense of the idea that the money is held genuinely on purpose trust. This is an anomalous case, and it is difficult to put any reasonable construction on it.

Reflection point

Cases are sometimes wrongly decided. Why do wrong decisions occur? How much reliance can we place on judges' decisions? How does this relate to the doctrine of precedent?

11.2.3 Modern dissolution cases

Re West Sussex Constabulary's Widows, Children and Benevolent (1930) Fund Trusts [1971] Ch 1 and *Re Bucks Constabulary Widows' and Orphans' Fund Friendly Society (No.2)* [1979] 1 WLR 936 both addressed the dissolution of associations of members of particular police forces in England. *Re West Sussex* basically followed the earlier flawed cases, even drawing in part upon *Cunnack* v *Edwards*. *Re Bucks*, by contrast, applied the modern contract-holding theory and held that on dissolution, the property was held by the members of the association outright.

In *Hanchett-Stamford* v *A-G* [2008] EWHC 330 (Ch), [2009] Ch 173, Lewison J carefully reviewed and followed *Re Bucks* with one important exception. In *Re Bucks*, Walton J suggested (as *obiter dictum*) that property would become ownerless if the association ceased to exist and therefore become *bona vacantia*. In *Hanchett-Stamford*, an association (the Performing and Captive Animal Defence League) had ceased to exist when there was only one member left (since a single person cannot associate or make contracts with himself). She was held to be absolutely entitled to the property for her own benefit (which she then donated to the Born Free Foundation, a registered charity).

In *Gibbons* v *Smith* [2020] EWHC 1727 (Ch) the court applied the *Re Denley* principle to land given to an unincorporated association. It was decided that the land was originally held on trust within that rule (and so the trust was valid) and when the association ceased to exist, the land was directed to be sold and the proceeds divided among the members in existence at March 2013 (the last date on which the association clearly existed). The only explanation is that the court treated the trust (and *Re Denley* trusts in general) as not a purpose trust but an ordinary trust for individuals (as suggested in *Twinsectra* by Lord Millet). Hence the individuals were perfectly entitled to take the property when the trust ended.

11.2.4 A restitutionary solution in certain cases

It has been noted that while the contract-holding theories do provide for a workable legal construction for property given to unincorporated associations, such a construction does not necessarily ensure that donors who donate money to an association for the use of the association in its activities will get what they want, for the association may always change its rules or goals (as a contractual relationship it can always be varied by consent of the parties) and thus devote its funds to other activities. The members might even decide to disband the association and divide its remaining funds among themselves. In light of this, Swadling has proposed that a disgruntled donor could claim that their gift was made on condition that it be used for a specified purpose (Swadling, W.J. 'Property: general principles' in Burrows, A. (ed.), 2013). This is not a purpose trust, but a conditional gift recognised at common law. If this construction can be put on the gift, and the gift is not devoted to the purpose, the donor can bring a personal action under the law of unjust enrichment for restitution of an equivalent sum. As yet, there is little judicial discussion of this view.

Self-assessment questions

1. **What does it mean to say that an unincorporated association is dissolved?**
2. **How do the members' contractual relations change upon dissolution?**
3. **Under the contract-holding theory, how does the dissolution of an unincorporated association affect the members' rights in rights given to the association?**
4. **How is the law concerning conditional gifts relevant to the dissolution of an unincorporated association?**

Essential reading

- ***Re West Sussex Constabulary's Widows, Children and Benevolent (1930) Fund Trusts* [1971] Ch 1; *Re Bucks Constabulary Widows' and Orphans' Fund Friendly Society (No.2)* [1979] 1 WLR 936; *Hanchett-Stamford* v *A-G* [2008] EWHC 330 (Ch), [2009] Ch 173.**

Further reading

- **Swadling, W.J. 'Property: general principles' in Burrows, A. (ed.) *English private law*. (Oxford: Oxford University Press, 2013) third edition [ISBN 9780199661770].**

Activity 11.3

Read *Re West Sussex* (1971), *Re Bucks* (1979) and *Hanchett-Stamford* (2008).

Explain how these decisions differ in their approach to the way that property is 'held' by unincorporated associations, and which view is better.

SAMPLE EXAMINATION QUESTIONS

Question 1 How is property purportedly given to unincorporated associations held, and what rules govern the distribution of such property upon dissolution?

Question 2 In 1989, the 20 members of the Bloomsbury Rock-climbing Club each transferred £2,000 on trust to their trustee-treasurer to hold as the 'Accident Fund' pursuant to a resolution of their annual meeting. The minutes of the meeting disclose that the fund was to be invested, and money be paid out to a member or his or her surviving spouse on a certain payment scale should the member be injured or die as a result of a rock-climbing accident. Since that time, further contributions to the fund have been received from new members upon joining, and other funds have been added as a result of various fund-raising events. The payment scale has been updated from time to time, and one payment of £25,000 has been paid to the widower of a member who died climbing, and further amounts totalling £25,000 have been paid to members following non-fatal accidents. By January 2008, the club's membership had dwindled to three members, and two of these died in a rock-climbing accident, leaving only the treasurer trustee. Following payments to the surviving spouses, the funds stand at £43,000. Advise the trustee-treasurer as to how he should distribute these funds.

Advice on answering the questions

Question 1 A good answer will distinguish this situation from that of a purpose trust, and will explain the contract-holding theory and its consequences for the distribution of funds on dissolution. The prior law concerning the construction of gifts to unincorporated associations, in particular that the gift is a gift to members to take as co-owners outright, or is a gift on purpose trust, should be canvassed to show its weaknesses, and the two versions of the contract-holding theory should be explained.

Similarly, with the distribution of property on dissolution, a good answer would consider the earlier law leading up to *Cunnack* v *Edwards*, and then go on to consider the more recent developments in *Re West Sussex*, *Re Bucks* and *Hanchett-Stamford*, explaining why *Re Bucks* and *Hanchett-Stamford* express the better view. It would explain how the law concerning construction of gifts and other transfers to unincorporated associations must match up with the law concerning the distribution of property upon their dissolution.

Question 2 According to the modern law which embraces the contract-holding theory, there is no room for a purpose trust analysis here, although past case-law which seems to indicate this as the best analysis might be considered and shown to be flawed. A purpose trust construction is possible, although it would not seem that the setting up of this fund should be invalidated given the decision in *Re Lipinski*.

The issue is clearly that, as the sole remaining member of the club, the treasurer-trustee now holds the property outright on contract-holding principles: *Hanchett-Stamford*. This may appear unjust, although it must be remembered that such a result flows from the law, and it is not clear that any past member has any right to complain, for a contractual provision dealing with the situation might always have been made. Indeed, the **first** piece of advice to the treasurer-trustee is that the rules of the association, or common understandings as expressed in various minutes, should be examined to see whether any guidance on this situation can be given. If not, it would appear that the funds belong to the treasurer-trustee. The *bona vacantia* result as applied in *Cunnack* v *Edwards* has little to commend it. Lastly, the restitutionary approach might be considered. If the various contributions can be construed as conditional gifts (which appears most strained in the case of funds raised at events), then the treasurer-trustee might be bound to make restitution of the funds to past contributors on some sort of pro-rata basis.

Reflect and review

Look through the points listed below.

Are you ready to move on to the next chapter?

Ready to move on = I am satisfied that I have sufficient understanding of the principles outlined in this chapter to enable me to go on to the next chapter.

Need to revise first = There are one or two areas I am unsure about and need to revise before I go on to the next chapter.

Need to study again = I found many or all of the principles outlined in this chapter very difficult and need to go over them again before I move on.

Tick a box for each topic.

	Ready to move on	Need to revise first	Need to study again
I can explain why gifts and other transfers to unincorporated associations give rise to problems of construction for the courts.	☐	☐	☐
I can describe the different constructions a court might place on such a gift or other transfer.	☐	☐	☐
I can explain the contract-holding theory of right-holding and why holding rights that way does not offend the rule against private purpose trusts.	☐	☐	☐
I can explain what happens to rights given to an unincorporated association when the association is dissolved.	☐	☐	☐

If you ticked 'need to revise first', which sections of the chapter are you going to revise?

		Must revise	Revision done
11.1	Transfers to unincorporated associations	☐	☐
11.2	The distribution of rights upon dissolution	☐	☐

12 Resulting trusts

Contents

Introduction

This chapter is concerned with resulting trusts. You were introduced to them in Chapter 3, where a brief overview of the different types of trust was given. Broadly speaking, a resulting trust is one in which the property is held by a transferee on trust for the person who made the initial transfer, though, as will be seen, the so-called purchase-money resulting trust does not fit this fact pattern. The word 'resulting' comes from the Latin *resalire*, meaning 'to jump back'. It should, however, be noted that nothing literally 'jumps back'. Where A transfers property to B and B holds that property on trust for A, the property that A previously had is now vested in B, and the property A has as the beneficiary of the resulting trust is property A did not have prior to the transfer. This should be borne in mind in any discussion of resulting trusts, especially the so-called 'automatic' resulting trust.

A controversy in the scholarly literature exists as to why resulting trusts arise. For instance, one line of argument is that presumed resulting trusts arise because the law reacts to the proof by presumption of a declaration of trust by the transferor in his own favour. Others say that all resulting trusts arise because of a presumption of intent on the part of the transferor to create a trust for himself. Others still say it is because the law responds to the fact, howsoever proved, that the transferor did not intend to benefit the transferee. Finally, there is a school of thought which says that there is no unitary explanation, and that there are in fact at least two distinct reasons why resulting trusts arise. Before examining these theories, we need to ask when resulting trusts arise, for only then can we start to consider why.

CORE TEXT

- **Penner, Chapter 10 'Resulting trusts'.**

LEARNING OUTCOMES

By the end of this chapter and the relevant readings, you should be able to:

- **state the circumstances in which resulting trusts arise**
- **outline the competing theories of resulting trusts**
- **judge which theory best fits the incidence of resulting trusts.**

12.1 When do resulting trusts arise?

12.1.1 Express, constructive, implied and resulting trusts

We have already seen how resulting trusts do not fit into a logical series with express, implied and constructive trusts, for the word resulting tells us only who is the object of the trust and not – as the labels 'express', 'constructive' and 'implied' attempt to do – why the trust arises. That said, we can say with confidence that as a matter of accepted doctrine, resulting trusts have generally been limited to three main situations:

- 'voluntary conveyance' resulting trusts
- 'purchase money' resulting trusts, and
- resulting trust consequent on a 'failed trust'.

The first two categories arise because of the operation of a presumption at the trial of an action, and so are commonly called 'presumed' resulting trusts (PRT). The third are said to arise not because of the operation of any presumption but by operation of law and have therefore been described as 'automatic' resulting trusts (ART).

In addition to these two traditional categories of resulting trust (PRT and ART), it seems to be accepted routinely by English courts that the *Quistclose* trust (mentioned in Sections 2.3.3 and 5.1) is a species of resulting trust.

1. The voluntary conveyance resulting trust

This is the first type of presumed resulting trust. The usual fact pattern involves gratuitous transfers (i.e. apparent gifts) in which the transferor (A) is attempting to argue that the recipient (B) holds the property on trust for A.

The legal mechanism for this sort of PRT is as follows. If at a trial where A is alleging that he transferred property to B, which B now holds for him on trust, A proves by evidence that he made the transfer, *inter vivos*, a presumption will arise in his favour that, unless rebutted, will oblige the judge to find that B holds the property on trust for A. One thing that should be noted now (and is dealt with in Section 12.1.2) is that this presumption is rebuttable and, in fact, can be rebutted by the slightest evidence of A's actual intention. That is, if the evidence (even weak) is that a gift was intended, there will be no resulting trust. In addition, it is often said that such transfer must also be proved by evidence to have been gratuitous or 'voluntary' before the presumption will arise, although there is an argument that this confuses the facts needed to be proved by evidence to raise the presumption with those capable of rebutting it, and that proof by evidence of the provision of value in exchange is merely one example of facts which will rebut (Penner, para.10.19). The presumption does not apply to testamentary transfers. Nor will it arise in the following three situations:

- If A is B's father or husband, or standing *in loco parentis* (in the place of a parent) to B, then a 'presumption of advancement' is said to instead apply (i.e. that the transfer was by way of gift).
- If the property transferred is an interest in the family home of A and B, then it is presumed that 'equity follows the law': *Stack* v *Dowden* [2007] UKHL 17, [2007] 2 AC 432; *Jones* v *Kernott* [2011] UKSC 53, [2012] 1 AC 776. Normally, a resulting trust will not arise, but a 'common intention constructive trust' is possible.
- If the property in question is an interest in land, then s.60(3) of the LPA 1925 may preclude the presumption arising.

It was noted *obiter* by the Court of Appeal in *Lohia* v *Lohia* [2001] EWCA Civ 1691 and *Ali* v *Khan* [2002] EWCA Civ 974 that the presumption was abolished in the case of a gratuitous transfer of land by s.60(3) of the LPA 1925, which states:

> In a voluntary conveyance a resulting trust for the grantor shall not be implied merely by reason that the property is not expressed to be conveyed for the use or benefit of the grantee.

However, in *National Crime Agency* v *Dong* [2017] EWHC 3116 (Ch), Chief Master Marsh decided that s.60(3) of the Law of Property Act 1925 did not affect the presumption of resulting trust but was merely enacted to deal with technicalities in conveyancing that were no longer needed after the Statute of Uses 1535 was repealed in 1925. This is a sensible reading of s.60(3), which avoids the inconsistency of treating gratuitous transfers of land differently from gifts of personal property or from gifts of land made by paying or contributing to the purchase price. However, like other judgments on this issue, the decision of Chief Master Marsh is an *obiter dictum* since it was unnecessary for the outcome of the case. This was because there was sufficient evidence that the transferor intended the transferee to hold for him on trust and so this was not a case of a presumption 'merely' by voluntary conveyance.

2. The purchase money resulting trust

This second type of presumed resulting trust differs from the first by A's act being to contribute to the purchase price of property rather than a direct transfer from A to B. This, in turn, can involve two situations. The first is where A proves by evidence that *inter vivos* he paid C to transfer property to B. A presumption will arise that this property is held by B on trust for A, unless the presumption of advancement applies, the property is the family home of A and B, or the presumption is rebutted by evidence. This is no different from the operation of the presumption, discussed above, except that s.60(3) of the LPA 1925 is not relevant.

The second permutation is where A proves by evidence that he and B *inter vivos* paid C to convey property to B alone. In such a case, the operation of the presumption will, unless rebutted, compel the judge to hold that B holds that property on trust for A and B as tenants in common in shares proportionate to their contribution. For example, in *The Venture* [1908] P 218 (CA), it was proved by evidence that two brothers contributed funds towards the purchase of a title to a ship. Title was conveyed to one brother alone, and after he died, his widow claimed to be entitled to the ship outright under his will. She alleged that her brother-in-law had merely loaned his brother the contribution to the purchase price. The contributing brother alleged that he had put the money up on the basis of a partnership. Neither party, however, adduced any evidence in support of their respective allegations. The Court of Appeal held that on proof by evidence of the contribution to the purchase price, a presumption arose in favour of the contributing brother which, unless rebutted, compelled the trial judge to find a trust in favour of the contributing brother. It was for the widow to adduce evidence to the contrary, which she had not done. The widow was therefore held to be a trustee for herself and the contributing brother in shares proportionate to the contributions of the two brothers.

3. Resulting trusts consequent upon a failed trust

A resulting trust can also arise when an express trust fails. This failure can happen because the express trust is invalid at the outset (e.g. for lack of certainty of objects) or becomes invalid later, or fails to distribute all the trust assets. If the failed express trust was self-declared (i.e. with the settlor acting as trustee), nothing further happens: the settlor/trustee merely retains the property free of any trust. If the settlor transferred the property to different trustees to hold on an express trust that fails, then normally they will hold rights on resulting trust for the settlor.

Thus, in *Morice* v *Bishop of Durham* (1804) 9 Ves 399, 32 ER 656; affirmed (1805) 10 Ves 522, 32 ER 947 (discussed in Chapter 10), a testatrix left her residuary estate to the Bishop 'on trust for such objects of benevolence and liberality as the bishop in his absolute discretion might choose'. The trust failed for want of objects and the court held that 'the property that is the subject of the trust is undisposed of, and the benefit of such trust must result to whom the law gives the ownership in default of disposition by the former owner.'

This type of resulting trust does not depend on the operation of a presumption. The evidence shows the words which accompanied the transfer and there is consequently no room for any presumption to supply different ones. It arises equally in cases of testamentary or *inter vivos* transfers for the purpose of creating express trusts.

It should not be assumed that a resulting trust is the 'automatic' consequence of every failure of an express trust. A resulting trust always arises when the intended express trust is void (e.g. for lack of beneficiaries, as in *Vandervell* v *IRC* [1966] UKHL 3, [1967] 2 AC 2 91, discussed below). However, when the express trust is fully performed leaving a surplus in the trustee's hands, it may be that the settlor intended the trustee to keep the surplus as a gift. This occurred in several cases in which there had been a close relationship between the settlor and trustee. Their relationship was one of the facts that led the courts to conclude that a gift of the surplus was intended: see *Cook* v *Hutchinson* (1836) 1 Keen 42, 48 ER 222 (father and son), *Croome* v *Croome* (1888) 59 LT 582 (CA) (brothers) and *Re Foord* [1922] 2 Ch 519 (brother and sister).

12.1.2 Rebuttal

As we have seen, the presumption generating a resulting trust is defeated by contrary evidence. Thus, if evidence is adduced in the case of a voluntary conveyance which convinces the court that A intended B to take the property outright (e.g. as a gift or loan), the claim for a trust will fail. The presumption that triggers the trust is there said to have been rebutted. Thus, in *Fowkes* v *Pascoe* (1875) LR 10 Ch App 343 a woman paid for some shares to be transferred into the names of herself and the son of her daughter-in-law's second marriage, whom she treated as a grandchild and who lived in her house. It was claimed after the woman's death that the son held the shares for her on trust. At first instance, Sir George Jessel MR applied the presumption and found a trust for the woman's estate. The Court of Appeal reversed his decision. James LJ asked whether it was possible to reconcile with mental sanity the notion that she put the shares into the names of herself and the surrogate grandson as trustee upon trust for herself. What object could there conceivably be in doing this? Mellish LJ said that the circumstances showed that it was utterly impossible to come to any other conclusion than that this was an outright transfer.

More recently, in *Westdeutchse Landesbank Girozentrale* v *Islington LBC* [1996] UKHL 12, [1996] AC 699, a bank paid £2.5 million to a local authority under an *ultra vires* loan contract. The invalidity of the contract meant that the courts treated the payment as both mistaken and gratuitous. The bank argued for a resulting trust, but the House of Lords held that any presumption of trust in favour of the bank was rebutted by proof by evidence that the money was paid under a supposed obligation to make the local authority outright owner. This showed that the bank intended the local authority (albeit mistakenly) to take outright, rather than as trustee for the bank.

The 'presumption' of advancement

We have seen that the presumption triggering a resulting trust does not arise when B receives the property in question (by transfer or purchase) from B's husband or father or from someone standing *in loco parentis* to B, in which case a 'presumption' of advancement (gift) is said to apply. The presumption of advancement was so called because fathers used to be under a moral duty to advance their children in life, and when a child received rights gratuitously from their father, it was assumed that the father had acted to fulfil his moral duty. It is still called the presumption of advancement even though that moral duty no longer applies to fathers (and never applied between husbands and wives).

The 'presumption' may someday be abolished by s.199(1) of the Equality Act 2010:

> The presumption of advancement (by which, for example, a husband is presumed to be making a gift to his wife if he transfers property to her, or purchases property in her name) is abolished.

That section is not yet in force. You should ask whether the only effect of this provision, if it ever comes into force, will be to widen the situations in which the presumption which triggers the resulting trust will arise. Read the analysis by J. Glister in 'Section 199 of the Equality Act 2010' (2010) 73 *MLR* 807.

Whether in modern times the presumption of advancement should apply equally to all parents regardless of gender is a subject of controversy, although it is applied

equally in Australia and Canada. In England and Wales, the orthodox position is that proof by evidence at trial of a mother's transfer to a child generates a presumption of resulting trust.

Furthermore, the orthodox position in England and Wales is that the presumption of advancement is a true presumption. As a consequence, it is seen as capable of rebuttal by evidence showing that the transferor did not intend the transferee to take as a gift. An example is *Warren* v *Gurney* [1944] 2 All ER 472 (CA), where a father paid for a title to land to be conveyed to his daughter, but retained the title deeds in his possession. On his death, the question arose whether the daughter held the title absolutely or on trust for her father's estate. The fact that this was a purchase by a father in the name of his daughter was said to raise a presumption of advancement. The Court of Appeal, however, held that the father's retention of the title deeds showed that he did not intend the daughter to take the title as a gift. In consequence, the presumption of advancement was rebutted and a resulting trust arose.

A presumption is an inference from facts proved by evidence that a further fact happened. Upon proof by evidence of the happening of relevant facts (e.g. that A transferred shares to B and is not B's father or husband), the court finds proved by presumption a further fact that has legal significance. It is important to understand that this further fact is found to have happened just as much as the primary facts which have been proved by evidence. Unless evidence is adduced and believed, the tribunal of fact must find that further fact proved.

There is an ongoing debate about what exactly is this further fact which is proved by presumption. William Swadling has argued ('Explaining resulting trusts' (2008) 124 *LQR* 72) that the fact proved by presumption is that the transferor or purchaser declared a trust for themselves. The presumed resulting trust for Swadling, therefore, is a species of express trust. In contrast, Robert Chambers has argued that the presumption of advancement is a true presumption that the transferor or purchaser intended to make a gift: 'Is there a presumption of resulting trust?' in Mitchell (ed.) *Constructive and resulting trusts* (2010) p.267. He says that the presumption triggering the **resulting trust** is not a true presumption, but simply a situation in which the presumption of advancement does not apply, in which case, a resulting trust arises because there is no explanation for the transaction. (Note that this is a different view to that put forward in his 1997 book, *Resulting trusts*.) On this view, presumed resulting trusts are actually constructive.

When one recalls that what is needed to rebut the presumption triggering the resulting trust is evidence that the transferor intended the transferee to take the property outright and not as trustee, it becomes obvious that the failed trust resulting trust is not normally capable of rebuttal. The reason is that the settlor's declaration of trust, even though invalid, is evidence that the settlor did not declare a trust for himself. The leading case on this type of resulting trust is *Vandervell* v *IRC* [1966] UKHL 3, [1967] 2 AC 291. The facts are complex, but essentially mirror *Morice* v *Bishop of Durham* (1804) in that there was a transfer of property 'on trust' but with no beneficiaries identified as objects of that trust. Vandervell, the effective grantor of the property concerned (an option to purchase) argued that there could be no resulting trust in his favour because he had shown that for tax purposes he did not want to be the beneficiary of a trust of that property. However, Lord Wilberforce held that this was irrelevant, for the resulting trust here was not triggered by the operation of a presumption (at 329):

> The transaction has been investigated on the evidence of the settlor and his agent and the facts have been found. There is no need, or room, as I see it, to invoke a presumption. The conclusion, on the facts as found, is simply that the option was vested in the trustee company as a trustee on trusts, not defined at the time, possibly to be defined later.

It is noteworthy that both Lord Reid and Lord Donovan dissented over the issue of what Mr Vandervell actually intended. They both held that he had intended to grant the property outright and not on trust.

Because the presumption which triggers the resulting trust has no role to play in the 'failed trust' cases, Megarry J, in the subsequent case of *Re Vandervell's Trusts* (*No.2*) [1974]

Ch 269, christened this type of resulting trust 'automatic', which in truth is nothing more than saying that it arose for a reason other than a declaration of trust. It does not mean that a resulting trust always arises in this situation. As discussed above, if an express trust is fully performed leaving a surplus, the trustee may be entitled to keep the surplus as a gift if that is what the settlor intended – this will depend on the facts.

Self-assessment questions

1. **Define 'resulting trust'.**
2. **What is the 'presumption of advancement'? Is it a presumption at all? Does it matter?**
3. **When does a presumption become necessary? Is this even a sensible question?**

Summary

There are three types of resulting trust:

1. The 'voluntary conveyance' resulting trust.
2. The 'purchase money' resulting trust.
3. The resulting trust consequent on a failed trust.

The presumption which triggers the resulting trust can arise when A gratuitously transfers property to B or pays C for property to be transferred to B. If A is B's father or husband or stands *in loco parentis* to B, then the so-called presumption of advancement applies instead of the presumption of resulting trust, though this is contentious. Either presumption can be rebutted by evidence showing what A intended. There is an ongoing debate about what fact is being proved by presumption.

The presumptions triggering the resulting trust does not apply to the 'failed trust' cases, since the circumstances of the transfer to the trustees to hold in trust provide evidence of the settlor's intention. Exceptionally, in cases where the express trust was fully performed and the settlor and trustee were in a close relationship, the trustee may be permitted to keep the surplus as a gift if that was what the settlor intended.

Activity 12.1

Read *McGrath* v *Wallis* [1995] 2 FLR 114 (available in Lexis+ via the Online Library), and explain the decision.

12.2 Why do resulting trusts arise?

Now that we know when resulting trusts arise, we can begin to address the most contentious issue in this area of law: why do they arise? A lot of scholarly debate focuses on doctrinal aspects of classification and, in particular, the role of presumptions and intention. But we might also view the cases through other lenses. So, for instance, in the case of PRTs, what policy reasons might we have to be suspicious of gifts, especially those of large financial value? Might there be a system that starts from the premise that recipients hold gifts on resulting trust and we need to see evidence that a gift was intended? Might this help protect those who are vulnerable to exploitation by others, for example?

For ARTs, on the other hand, we might view the issue as one of allocation. In these cases, a trust has been created that has failed at the outset or later. What should happen to the trust property? There are a number of possibilities: the trustee could keep it absolutely (possibly a windfall); it could be transferred to the state (similar to the *bona vacantia* doctrine); it could be distributed to members of the public by lottery; etc. Can you think of why return to the settlor (or, for testators, their estate) might be desirable? For instance, think about a world where, if you set up a trust that fails, the trustee always gets to keep the trust assets absolutely. Would you be inclined to set up a trust in this legal environment? What additional expenditure would you incur on legal advice? Thus, there may be reasons of economic efficiency for an ART to arise (unless the settlor intended that any surplus be kept by the trustee).

At times, these questions can become obscured in the academic literature, given its focus on some quite technical matters. With that in mind, the remainder of this analysis summarises some of the prominent views. Each is supported by judges and academics, and it is up to you to determine which view to support – or indeed, whether you prefer a different approach.

There are two framing questions to this debate: (a) what are the facts (proved by evidence or presumption) that will give rise to a resulting trust in each of the three different traditional categories; and (b) are these facts the same or different in each of those categories?

We noted above that the House of Lords in *Vandervell* v *IRC* (1966) (rightly) rejected the notion that failed trust resulting trust cases arose because of the operation of a presumption. However, if it was not the operation of a presumption which caused B to hold on trust for A, what was it? According to Lords Upjohn and Wilberforce, it was because A 'retained' his equitable interest in the rights he transferred to B. The difficulty with this thesis, however, is that, immediately prior to the transfer, A had no equitable interest to retain. As Lord Browne-Wilkinson in *Westdeutsche* [1996] AC 699 pointed out, albeit in a criticism of *Chase Manhattan* (1981), it is only when a trust arises that A acquires an equitable interest. The equitable interest, in other words, is not the cause of the trust but its consequence.

According to Lord Browne-Wilkinson in *Westdeutsche*, all resulting trusts arise because of a presumption that the transferor intended to create a trust for himself. In saying this, he and the rest of his colleagues in the House of Lords rejected an argument put forward initially by Birks and adopted by Chambers (his 1997 thesis) that the presumed resulting trust arises because of a presumption that the transferor did not intend to benefit the transferee. As noted above, *Westdeutsche* was seen as involving a mistaken payment and it was argued for the payor that the fact of their mistake proved that they did not intend to benefit the transferee and that a trust should therefore arise in their favour. If the court will find a trust where no intention to benefit was presumed, then, it was argued, it must logically do so where such 'fact' was proved. The argument was unanimously dismissed by the House of Lords, their lordships holding that the presumption in the presumed resulting trust did not comprise one of no intention to benefit the transferee but instead to make the transferee a trustee for the transferor. Where it was proved that money was paid because the payor mistakenly thought it was owed, this demonstrated no intention on his part to constitute the transferee a trustee for himself. So far, so good. However, in the course of his speech, Lord Browne-Wilkinson made some *obiter* comments about the 'automatic' resulting trust. He said (at 708):

> Under existing law a resulting trust arises in two sets of circumstances: (A) where A makes a voluntary payment to B or pays (wholly or in part) for the purchase of property which is vested either in B alone or in the joint names of A and B, there is a presumption that A did not intend to make a gift to B: the money or property is held on trust for A (if he is the sole provider of the money) or in the case of a joint purchase by A and B in shares proportionate to their contributions. It is important to stress that this is only a presumption, which presumption is easily rebutted either by the counter-presumption of advancement or by direct evidence of A's intention to make an outright transfer… (B) Where A transfers property to B on express trusts, but the trusts declared do not exhaust the whole beneficial interest… Both types of resulting trust are traditionally regarded as examples of trusts giving effect to the common intention of the parties. A resulting trust is not imposed by law against the intentions of the trustee (as is a constructive trust) but gives effect to his presumed intention. Megarry J. in *Re Vandervell's Trusts (No.2)* suggests that a resulting trust of type (B) does not depend on intention but operates automatically. I am not convinced that this is right. If the settlor has expressly, or by necessary implication, abandoned any beneficial interest in the trust property, there is in my view no resulting trust: the undisposed-of equitable interest vests in the Crown as *bona vacantia*…

This analysis has attracted a great deal of commentary. It has been said that:

- So far as the first type of resulting trust is concerned (the PRT), his lordship's view makes some sense if there is no evidence before the court of the transferor's intent. It does, however, require one qualification. As we have seen, a mere

intention to create a trust normally has no effect. The intention must be manifested (expressed). Since presumptions are merely creatures of the law of procedure, facts proved by presumption can logically have no greater force than facts proved by evidence. As a consequence, Lord Browne-Wilkinson might have spoken of a presumption of 'manifested intention' or presumption of 'declaration of trust', so making the 'presumed resulting trust' a species of express trust.

- In contrast, there are difficulties in thinking that a presumption can operate with regard to the 'failed trust' resulting trust (the ART). Such an explanation cannot explain a case like *Vandervell*, where the evidence showed that Mr Vandervell did not wish to create a trust for himself. It also fails to explain numerous cases in the other categories where the evidence is clear that the transferor or purchaser did not make a declaration of trust for himself, nor intend to create such a trust.

Assuming this analysis has merit, it is useful to think about whether and how it might be a problem. Is it necessary for ARTs and PRTs to be justified by reference to the same principle? Is the resulting trust in fact a redundant category, instead covering constructive trusts (for ARTs) and express trusts (for PRTs)? As noted above, how do these doctrinal considerations relate to the broader policy or economic reasons that might support the existence of a trust in resulting trust fact patterns?

An alternate explanation was presented by Lord Millett, namely that all resulting trusts respond to the absence of intention to benefit the recipient. He has expressed this view writing extra-judicially in 'Restitution and constructive trusts' (1998) 114 *LQR* 399. It also provided the basis for the Privy Council's advice in *Air Jamaica Ltd* v *Charlton* [1999] UKPC 20, [1999] 1 WLR 1399 and for the decision in *von Westenholtz* v *Gregson* [2022] EWHC 2947. In *Air Jamaica*, a pension fund trust failed because it violated the common law rule against perpetuities. Clause 4 of the trust deed stated: 'No moneys which at any time have been contributed by the Company under the terms hereof shall in any circumstances be repayable to the Company.' It was argued that this prevented a resulting trust (i.e. an ART) in favour of the company, but this was rejected by the Privy Council. Lord Millett said (at [45]):

> In *Re ABC Television Ltd Pension Scheme*, unreported, 22nd May 1973, Foster J. held that a clause similar to clause 4 of the present Trust Deed 'negatives the possibility of implying a resulting trust'. This is wrong in principle. Like a constructive trust, a resulting trust arises by operation of law, although unlike a constructive trust it gives effect to intention. But it arises whether or not the transferor intended to retain a beneficial interest – he almost always does not – since it responds to the absence of any intention on his part to pass a beneficial interest to the recipient. It may arise even where the transferor positively wished to part with the beneficial interest, as in *Vandervell* v *Inland Revenue Commissioners* [1967] 2 AC 291.

According to Swadling, the fact proved by presumption is a declaration of trust by the transferor for himself: 'Explaining resulting trusts' (2008) 124 *LQR* 72. Swadling argues that this can be supported both by legal history and logic in the case of the 'voluntary conveyance' and 'purchase money' resulting trusts. As with Lord Browne-Wilkinson's view, the difficulty it encounters is trying to explain the numerous cases in which resulting trusts have arisen even though it was clear that the transferor or purchaser never declared a trust.

According to the more recent analysis of Chambers, the presumptions are no longer important except in cases where relevant evidence is inadmissible because it would reveal an illegal purpose (Mitchell (ed.) (2010) p.267), though in light of *Patel* v *Mirza* [2017] AC 467 (discussed below), such situations will now be exceedingly rare. In almost every case, there is sufficient circumstantial evidence to allow a court to decide what the parties intended. For example, in *Lohia* v *Lohia* [2001] EWCA Civ 1691, a title to land was transferred from a father and son into the father's name alone. Many years later, after the father was dead, the son claimed that the title was held on resulting trust for the father's estate and the son in equal shares, and testified that the transfer was a forgery. The trial judge rejected the son's evidence of forgery and decided that the transfer must have been part of some family arrangement in which the father was intended to receive the title for his own benefit. In other words, very

slender circumstantial evidence was sufficient to rebut the presumption triggering the resulting trust (and it was unnecessary to decide whether the presumption was displaced by s.60(3) of the LPA 1925). The outcome would have been the same regardless of which presumption (if any) applied at the start.

As just noted, the real worry used to be the cases involving illegal purposes: if evidence of intention was inadmissible, the presumptions could lead to arbitrary (and therefore unjust) outcomes. In *Tinsley* v *Milligan* [1993] UKHL 3, [1994] 1 AC 340, a same-sex couple purchased a title to a home together in Tinsley's name. They then pretended to the Department of Social Services that Milligan was only a lodger and fraudulently obtained housing benefits to pay her rent. The House of Lords held that evidence of Milligan's contribution to the purchase price gave rise to the presumption triggering a resulting trust in her favour. This was arguably the just result in the particular case, since this is what the parties intended; both were complicit in the fraud, and there is no reason why one fraudster should obtain a windfall at the other's expense. However, the result would have been different if the so-called presumption of advancement had applied (if Milligan had been Tinsley's husband or father). There is no reason why this additional fact, which has nothing to do with the illegality at the heart of the case, should reverse the outcome. As Peter Birks wrote in 'Recovering value transferred under an illegal contract' (2000) 1 *Theoretical Inquiries in Law* 155 at 166:

> Where the litigation concerns the assertion of proprietary rights the courts thus seem prepared to watch the parties play an amoral game of cards, in which the party who turns over the illegality card loses…

Tinsley v *Milligan* was overruled by the Supreme Court in *Patel* v *Mirza* [2016] UKSC 42, [2017] AC 467, in which the claimant paid £620,000 to the defendant under an agreement to use insider information to bet on the price of shares in Royal Bank of Scotland. The betting did not happen and the claimant sued to recover the money. Their agreement was illegal under s.52 of the Criminal Justice Act 1993, since it amounted to a conspiracy to commit the offence of insider dealing. The Supreme Court held that there had been a failure of consideration and so the claimant was entitled to recover the money as restitution of unjust enrichment, despite having to rely on his own illegality. While *Patel* v *Mirza* did not involve a trust, it applies with equal force to trusts, with *Tinsley* v *Milligan* being overruled, albeit in reasoning, not result.

Patel v *Mirza* is a controversial decision, but it does sort out the difficulty created by the inability to lead the evidence needed to rebut the presumption triggering the resulting trust. This presumption, and that of advancement, should no longer lead to unfair results, and they should rarely be needed since courts are now able to decide what the parties intended based on evidence.

The more recent work of Chambers qualifies some views in his 1997 thesis. In that monograph he argued that all resulting trusts arise for the same reason, namely, that the recipient has obtained property that was not intended to be retained for her or his own benefit. In most cases, this is established by evidence, but the presumptions triggering the resulting trust or advancement may have a role to play when there is no evidence of what was intended. In many cases, the transferor or purchaser will intend to create a trust for themselves, and if there is evidence in the proper form, this will give rise to an express trust. However, evidence of an absence of intention to give is sufficient to give rise to a resulting trust: *Hodgson* v *Marks* [1971] EWCA Civ 8, [1971] Ch 892; *Vandervell* v *IRC* [1966] UKHL 3, [1967] 2 AC 291; *Air Jamaica Ltd* v *Charlton* [1999] UKPC 20, [1999] 1 WLR 1399; *von Westenholtz* v *Gregson* [2022] EWHC 2947. This is similar to Lord Millett's view. Where they differ is that Chambers believes that resulting trusts should have a wider role and apply in cases of mistake (like *Chase Manhattan Bank NA* v *Israel-British Bank (London) Ltd* [1981] Ch 105), while Lord Millett believes that resulting trusts should be limited to cases where there was a complete absence of intention to benefit the recipient. A mistaken intention to confer a benefit is in Lord Millett's view sufficient to preclude a resulting trust. It is important to notice, however, that Chambers' views are inconsistent with the *ratio* of the House of Lords decision in *Westdeutsche*.

Activities 12.2–12.4

12.2 Read *Hodgson* v *Marks* (1971). What does this case tell you about the reason why resulting trusts arise?

12.3 Read *Vandervell* v *IRC* (1966). What is the difference between the approach of the Court of Appeal and the House of Lords to the resulting trust of the option to purchase?

12.4 How might Lord Browne-Wilkinson argue that the failed trust resulting trust can be explained as arising to reflect the presumed intention of the transferor? How might Lord Millett respond to that argument?

Essential reading

- *Re Foord* [1922] 2 Ch 519; *Vandervell* v *IRC* [1966] UKHL 3, [1967] 2 AC 291; *Hodgson* v *Marks* [1971] EWCA Civ 8, [1971] Ch 892; *Re Vandervell's Trusts (No.2)* [1974] EWCA Civ 7, [1974] Ch 269; *Lohia* v *Lohia* [2001] 2 WTLR 101; affirmed [2001] EWCA Civ 1691.

Further reading

- *Dyer* v *Dyer* [1788] EWHC Exch J8, 2 Cox 92, 30 ER 42; *Fowkes* v *Pascoe* (1875) LR 10 Ch App 343; *Bennet* v *Bennet* (1879) 10 Ch D 474; *The Venture* [1908] P 218; *Re Vinogradoff* [1935] WN 68; *Wood* v *Watkin* [2019] EWHC 1311 (Ch); *Warren* v *Gurney* [1944] 2 All ER 472 (CA); *Shephard* v *Cartwright* [1955] AC 431; *Re Gillingham Bus Disaster Fund* [1958] Ch 300; *Re Sharpe* [1980] 1 WLR 219; *Goodman* v *Gallant* [1985] EWCA Civ 15, [1986] 1 All ER 311; *Westdeutsche Landesbank Girozentrale* v *Islington LBC* [1996] UKHL 12, [1996] AC 669; *Air Jamaica Ltd* v *Charlton* [1999] UKPC 20, [1999] 1 WLR 1399; *Twinsectra Ltd* v *Yardley* [2002] UKHL 12, [2002] 2 AC 164.
- Birks, P. 'Restitution and resulting trusts' in Goldstein, S. (ed.) *Equity and contemporary legal developments*. (Jerusalem: The Hebrew University of Jerusalem, 1992) p.335.
- Birks, P. 'Trusts raised to reverse unjust enrichment' (1996) 4 *Restitution Law Review* 3.
- Chambers, R. *Resulting trusts*. (Oxford: Clarendon Press, 1997) [ISBN 9780198764441].
- Chambers, R. 'Resulting trusts in Canada' (2000) 38 *Alberta Law Review* 378; reprinted (2002) 16(2) *Trust Law International* 104, 138.
- Chambers, R. 'Is there a presumption of resulting trust?' in Mitchell, C. (ed.) *Constructive and resulting trusts*. (Oxford: Hart Publishing, 2010) [ISBN 9781841139272] p.267.
- Glister, J. 'The presumption of advancement' in Mitchell, C. (ed.) *Constructive and resulting trusts*. (Oxford: Hart Publishing, 2010) [ISBN 9781841139272] p.289.
- Mee, J. 'The past, present, and future of resulting trusts' (2017) 70 *CLP* 189.
- Penner, J.E. 'Resulting trusts and unjust enrichment: three controversies' in Mitchell, C. (ed.) *Constructive and resulting trusts*. (Oxford: Hart Publishing, 2010) [ISBN 9781841139272] p.237.
- Swadling, W. 'Explaining resulting trusts' (2008) 124 *LQR* 72.

SAMPLE EXAMINATION QUESTIONS

Question 1 'Both types of resulting trust are traditionally regarded as examples of trusts giving effect to the common intention of the parties. A resulting trust is not imposed by law against the intentions of the trustee (as is a constructive trust) but gives effect to his presumed intention' (Lord Browne-Wilkinson in *Westdeutsche Landesbank Girozentrale* v *Islington LBC* (1996)).

Discuss.

Question 2 In 2015, Jessica purchased a small country cottage, paying half the purchase price as a deposit. Title was conveyed to Jessica and her friend, Helen, in fee simple as joint tenants, subject to a joint mortgage to secure a loan for the other half of the purchase price. No trusts were declared. Jessica paid all the mortgage payments and expenses for the cottage. No one lived there. Jessica and Helen used it for holidays and sometimes let other friends use it.

Jessica died recently. In her will, she left all her real property to her brother, Dan. Dan claims that Helen holds the cottage on trust for Jessica's estate.

Advise Helen.

Advice on answering the questions

Question 1 This essay is directed to the question of why resulting trusts arise. A good answer might begin by explaining what resulting trusts are and describing when they arise. It might then outline the views of the major players in the debate, taking careful account of the precise state of the law here, noting that some of Lord Browne-Wilkinson's comments in *Westdeutsche* were *obiter*, while those of the House of Lords in *Vandervell* were *ratio*. Of course, the essay might take a different route and instead address the role and importance of the debate itself. Is it necessary or desirable that all resulting trusts are susceptible to some overarching explanation? Why is classification important?

Question 2 This short question is a resulting trusts question. Legal title is initially held by Jessica and Helen as joint tenants. However, there will be a presumption of resulting trust for Helen and Jessica in proportion to their contributions to the purchase price. Helen is the sole legal owner (as the surviving joint tenant) holding the cottage on resulting trust for herself (1/4) and Jessica's estate (3/4), unless it can be proved that Jessica intended to make a gift of a joint interest.

Why this division? Jessica paid the deposit (which was half of the purchase price) and the remainder was paid under a joint mortgage (i.e. they contribute a quarter of the price each, as they are jointly and severally liable). This reflects the idea that the resulting trust arises immediately, and that later conduct (in this case, who actually makes the repayments) is not relevant (e.g. *Curley* v *Parkes* [2004] EWCA Civ 1515, esp. [14]). But note criticism of this outcome (e.g. *Stack* v *Dowden* [2007] 2 AC 432, [118]–[120], Lord Neuberger questioning whether it is always proper for a mortgage liability to be treated like a cash contribution). See also *Wood* v *Watkin* [2019] EWHC 1311 (Ch), [127]–[152] (discussing authority that liability under a mortgage is not always a contribution to the purchase price).

Reflect and review

Look through the points listed below.

Are you ready to move on to the next chapter?

Ready to move on = I am satisfied that I have sufficient understanding of the principles outlined in this chapter to enable me to go on to the next chapter.

Need to revise first = There are one or two areas I am unsure about and need to revise before I go on to the next chapter.

Need to study again = I found many or all of the principles outlined in this chapter very difficult and need to go over them again before I move on.

Tick a box for each topic.

	Ready to move on	Need to revise first	Need to study again
I can state the circumstances in which resulting trusts arise.	☐	☐	☐
I can outline the competing theories of resulting trusts.	☐	☐	☐
I can judge which theory best fits the incidence of resulting trusts.	☐	☐	☐

If you ticked 'need to revise first', which sections of the chapter are you going to revise?

		Must revise	Revision done
12.1	When do resulting trusts arise?	☐	☐
12.2	Why do resulting trusts arise?	☐	☐

13 Constructive trusts

Contents

Introduction

This chapter focuses on constructive trusts, although you should bear in mind that constructive trusts are also dealt with in other chapters of this guide. This has to do with the breadth of the category 'constructive trust'. As already noted, constructive trusts arise by **operation of law**, by which is meant a trust that arises for a reason other than a declaration of trust. This is in contrast to an express trust, which arises because a settlor has manifested an intention that a trust come into existence.

As we shall see, many trusts that are labelled 'constructive' are not really constructive trusts at all. Part of this chapter involves weeding out such trusts, so you may wish to review the chapters of the module guide listed in the Essential reading now.

CORE TEXT

- **Penner, Chapter 17 'Constructive trusts'.**

ESSENTIAL READING

Quick review of:

- **Chapter 3 'Types of trust', Chapter 6 'Formalities' and Chapter 7 'Constitution' of the module guide.**

LEARNING OUTCOMES

By the end of this chapter and the relevant readings, you should be able to:

- **discuss whether certain trusts are constructive trusts or express trusts**
- **discuss whether 'constructive trustee' is a confusing term**
- **explain the controversy over whether the receipt of unauthorised profits by a fiduciary should be held on constructive trust**
- **explain how some trusts can be seen as responses to a defendant's unjust enrichment**
- **define the circumstances in which constructive trusts will arise in circumstances which involve neither wrongdoing nor unjust enrichment.**

13.1 Genuine constructive trusts

The first aim of this chapter is to distinguish genuine cases of constructive trusts from disputed ones. We begin by describing a few genuine cases, so as to give you a flavour of the subject. In the next section, we address cases that are mistakenly thought to be examples of constructive trusts.

Where the holders of a title to land enter into a contract to sell it, equity will usually enforce that contract specifically. It will also apply the maxim 'equity looks upon that as done which ought to be done' and treat the vendor as holding their title on trust for the purchasers from the moment the contract is formed: *Lysaght* v *Edwards* (1876) 2 Ch D 499; *Jerome* v *Kelly* [2004] UKHL 25, [2004] 1 WLR 1409. There is no declaration of trust by anyone, so this is a genuine example of a constructive trust.

Recall from Chapter 7 that there are a number of circumstances in which equity will perfect imperfect gifts. It generally does so through the imposition of a trust on the donor. So, for example, in *Re Rose* [1952] EWCA Civ 4, [1952] Ch 499, a trust was imposed on Mr Rose when he had done what he needed to do to make a gift of shares to his wife, and she had the power to complete the transfer by registration, even though the shares were not yet vested in her. There was no declaration of trust on his part, so this too is a genuine example of a constructive trust.

In *FHR European Ventures LLP* v *Cedar Capital Partners LLC* [2014] UKSC 45, [2015] AC 250, a secret commission received by a fiduciary was held on constructive trust for his principal from the moment of receipt. A trust of a mistaken payment was imposed in *Chase Manhattan Bank NA* v *Israel-British Bank (London) Ltd* [1981] Ch 105. These are both controversial decisions, but there is no doubt that the trusts imposed were true constructive and not express trusts. The imposition of a constructive trust in such situations has been confirmed by the Supreme Court recently in *Crown Prosecution Service* v *Aquila Advisory Service Ltd* [2021] UKSC 49.

13.2 Disputed constructive trusts

As will be discussed in Chapter 17, there are a number of circumstances in which third parties involved in a breach of trust are held to be 'liable to account as constructive trustees', that is, they are **personally** liable to restore the trust with money from their own pockets 'as if they were a trustee'. This is only a personal liability, and does not indicate that rights are being held on trust for the claimant. The label 'constructive trustee' is potentially confusing because it can mean either someone who is (a) not a trustee, but being treated as one, or (b) an actual trustee of a constructive trust. Consequently, this usage is frowned upon, and in *Dubai Aluminium Co Ltd* v *Salaam* [2002] UKHL 48, [2003] 2 AC 366, Lord Millett suggested that the language of constructive trusteeship be jettisoned and the defendant described simply as 'liable to account in equity'. One might ask, in the light of the fact that the duty to give an 'account' is regarded by some as fictitious in such circumstances, whether the courts should simply describe the liability as one to pay money, for that is all that is involved.

In *Williams* v *Central Bank of Nigeria* [2014] UKSC 10, [2014] AC 1189, a majority of the Supreme Court decided that dishonest assistants (i.e. those who dishonestly assist trustees to commit a breach of trust) and knowing recipients (i.e. those who knowingly receive property transferred in breach of trust) are not constructive trustees for the purposes of the Limitation Act 1980. We are not concerned with the limitation issue, but with what the judgments tell us about the nature of the liability for assisting a breach of trust or receiving property in breach of trust. At [9], Lord Sumption distinguished between those constructive trustees who 'are true trustees' and those who are not:

> In its second [possibly inaccurate] meaning, the phrase 'constructive trustee' refers to something else. It comprises persons who never assumed and never intended to assume the status of a trustee, whether formally or informally, but have exposed themselves to equitable remedies by virtue of their participation in the unlawful misapplication of trust assets. Either they have dishonestly assisted in a misapplication of the funds by the trustee, or they have received trust assets knowing that the transfer to them was a breach of trust. In either case, they may be required by equity to account as if they were trustees or fiduciaries, although they are not.

It is notable that he did not distinguish between assistants and recipients in this context, even though the latter will be holding trust property when the liability arises and this has led some commentators to suggest that perhaps, after all, recipients of trust property transferred in breach of trust (but not assistors) really are constructive trustees. They would argue that the decision in *Williams* is that such recipients are not constructive trustees only for the purpose of the Limitation Act 1980.

As we saw in Chapter 3, an express trust is synonymous with a declared trust, for what is expressed in an express trust is a declaration of trust. We also saw that, in certain cases, the legislature has restricted the type of evidence which courts are allowed to admit to prove that such a declaration was made, specifically in cases of alleged declarations of trust of land (LPA 1925, s.53(1)(b)) and testamentary trusts (Wills Act 1837, s.9). As we also saw in Chapter 6, courts will sometimes admit such evidence regardless, thereby allowing the allegation of a declaration of trust to be made good. In *Rochefoucauld* v *Boustead* [1897] 1 Ch 196 (CA), the trust imposed and then enforced was clearly identified as express but has subsequently been treated as constructive by courts and some (not all) commentators. As discussed in the next chapter, there is the same debate over whether secret trusts should be classified as express or constructive.

SELF-ASSESSMENT QUESTIONS

1. **Why is evidence of declarations of trust sometimes admitted despite the prohibition in s.53(1)(b) of the Law of Property Act 1925?**
2. **Why is it potentially misleading to say that a dishonest assistant is 'liable to account as a constructive trustee'?**

13.3 Types of constructive trust

So far, we have identified some examples of the constructive trust and identified certain disputed examples (i.e. *Rochefoucauld* v *Boustead* trusts and situations in which third parties are liable to pay money for interfering in some way with the due administration of a trust). The remainder of this chapter explores why constructive trusts arise. To say that they arise by operation of law gives us only negative information: that they do **not** arise because of a declaration of trust. Can we do any better, in terms of finding any common or recurring themes?

In presenting this analysis, we start by discussing the difference between the 'institutional' constructive trust and the 'remedial' constructive trust. As we will see, it is said that under English law, all constructive trusts are institutional – although one may ask whether the difference between the institutional and remedial trust is as stark as some analysis might suggest.

13.3.1 Institutional constructive trusts

The vendor-purchaser constructive trust, the *Re Rose* constructive trust, and those arising in *FHR* and *Chase Manhattan*, are all regarded as 'institutional' constructive trusts. This is often said to reflect two things. First, they arise because of the application of rules. The trust arises by operation of law in response to relevant facts, and the only role for the court is to declare that this is indeed the case. Second, like express trusts, the trust arises when the relevant facts happen. The raising of the trust is not, in other words, dependent on any order of the court. This can be compared with, for example, an award of damages in tort, as the latter is a remedy granted by the court in respect of a wrong.

13.3.2 Remedial constructive trusts

A remedial constructive trust, on the other hand, is said to arise from the exercise of judicial discretion, where its imposition will achieve fairness in the individual circumstances. This means that it does not arise when the facts happen but is dependent on an order of the court.

The first feature – the discretionary and fact-dependent nature of the remedial constructive trust – has been criticised as suffering from a rule of law problem (i.e. that it risks leading to arbitrary, unprincipled and unpredictable results – so-called 'palm-tree justice', in which the judge makes decisions based on fairness and common sense rather than legal rules). Given widespread acceptance of this concern (at least among English judges and academics), it is not surprising to see that English courts have rejected the remedial constructive trust on a number of occasions, most notably by the House of Lords in *Pettitt* v *Pettitt* [1969] UKHL 5, [1970] AC 777 and *Gissing* v *Gissing* [1970] UKHL 3, [1971] AC 886, by the Privy Council in *Re Goldcorp Exchange Ltd* [1994] UKPC 3, [1995] 1 AC 74, by the Court of Appeal in *Polly Peck International plc* v *Nadir (No.2)* [1992] EWCA Civ 3, [1992] 4 All ER 769 and *Sinclair Investments (UK) Ltd* v *Versailles Trade Finance Ltd* [2011] EWCA Civ 347, [2012] Ch 453, and by the Supreme Court in *Angove's Pty Ltd* v *Bailey* [2016] UKSC 47. Indeed, in *Polly Peck*, Mummery LJ said that the idea that English law could have a remedial constructive trust was 'inconceivable'; while in *Angove's* v *Bailey* at [27], Lord Sumption said:

> English law is generally averse to the discretionary adjustment of property rights, and has not recognised the remedial constructive trust favoured in some other jurisdictions, notably the United States and Canada. It has recognised only the institutional constructive trust…

However, we also need to think critically about the degree to which judges apply strict rules when determining whether an (institutional) constructive trust has arisen. That is, one argument in support of the institutional constructive trust is that we can predict with some certainty when such a trust will arise and, moreover, engage in meaningful debate over the reasoning of the judges who lay down the rules that trigger such trusts. But although some constructive trusts arise where a fairly clear and stable set of facts occur, others arise following a far more open-textured analysis, which asks whether certain conduct or outcomes are, or might be, 'unconscionable' (e.g. *Pennington* v *Waine* [2002] EWCA Civ 227, [2002] 1 WLR 2075) (Chapter 7). For those cases, it may be that the difference between the 'institutional' and 'remedial' constructive trust is less pronounced. Indeed, this may help to explain why there is a robust body of scholarship that has criticised 'unconscionabilty' for being conclusory, inconsistent and unhelpful.

13.4 Making sense of constructive trusts

As we have seen, to say that a trust is constructive (i.e. that it arises by operation of law) gives us only negative information, that it arises for a reason other than a declaration of trust. Is it then possible to identify the reasons why such trusts arise?

Professor Birks famously suggested that rights (including trusts) arise in response to events which happen in the world. So, for example, if I make a contract with you that you will paint my house in return for me paying you £1,000 (event), the law gives you a right to be paid and me a right that you do the painting (response). Birks also took the view that this applied, *inter alia*, to the commission of a tort, that the victim immediately acquired a right to damages from the tortfeasor. Though this is a common view, there is an argument (alluded to above) that there is no right to damages until a court order to that effect is made.

According to Birks, the events giving rise to rights can be subdivided into four main categories: (1) manifestations of consent, (2) wrongs, (3) unjust enrichments, and (4) other miscellaneous events. A punch on the nose, for example, is a wrong. The most common event generating rights is a manifestation of consent, and there is no doubt that most trusts arise because of such manifestations of consent. We call these express trusts. Events 2, 3, and 4 might then be described as events that give rise to rights by operation of law. The question we will ask is which constructive trusts belong in which category. This will help us develop a critical approach to this topic.

13.5 Wrongs

The usual response to wrongdoing, both at law and equity, is an award to its victim of a monetary remedy. At common law, we call this damages. In equity, it goes, as we have seen, by the confusing name of a 'liability to account as a constructive trustee' or sometimes (as, for example, in *FHR*) 'equitable compensation'. For most legal or equitable wrongs, there is no possibility of a trust. So, for example, where a defendant is liable for dishonestly assisting a trustee to commit a breach of trust, the defendant will have no particular property that the beneficiary can claim is held for them on trust. But in some cases, property will have been received as a consequence of the wrong, and the question is whether the court will say that it is held by the wrongdoer on trust for the victim.

A constructive trust can arise when one joint tenant murders the other and thereby acquires sole legal ownership by way of survivorship. The murderer will hold the property on constructive trust for him or herself and the victim's estate in equal shares. This rule also applies in cases of manslaughter. It also applies when there are more than two joint tenants, although it does not affect the rights to survivorship of the innocent joint tenants: see *Troja* v *Troja* (1994) 33 NSWLR 269 (CA). Under the Forfeiture Act 1982, the court has the power to modify the rule: see *Dunbar* v *Plant* [1997] EWCA Civ 2167, [1998] Ch 412.

A constructive trust can also arise in response to the equitable wrong of breach of fiduciary duty. As discussed in Chapter 17, a fiduciary is someone who manages the affairs of others or manages rights on their behalf. Express trustees are fiduciaries and so are company directors and officers, partners, agents, and solicitors. The list is not closed. As fiduciaries, they are required to exercise their discretions and powers properly and only for the purposes for which they were given. They must avoid conflicting interests and duties and must not profit from their fiduciary offices, unless they have the consent of their principals. If fiduciaries make unauthorised profits or accept bribes in breach of fiduciary duty to their principals, they will hold the property in question on constructive trust for them: *FHR European Ventures LLP* v *Cedar Capital Partners LLC* [2014] UKSC 45, [2015] AC 250; *Crown Prosecution Service* v *Aquila Advisory Service Ltd* [2021] UKSC 49.

ESSENTIAL READING

- ***FHR European Ventures LLP* v *Cedar Capital Partners LLC* [2014] UKSC 45, [2015] AC 250.**

FURTHER READING

- ***Keech* v *Sandford* (1726) Sel Cas T King 61, 25 ER 223; *Lister & Co* v *Stubbs* (1890) 45 Ch D 1 (CA); *A-G Hong Kong* v *Reid* [1993] UKPC 2, [1994] 1 AC 324.**
- **Birks, P. 'Rights, wrongs, and remedies' (2000) 20 *Oxford J Legal Studies* 1.**
- **Millett, P. 'Bribes and secret commissions again' (2012) 71 *CLJ* 583.**
- **Smith, L. 'Constructive trusts and the no-profit rule' (2013) 72 *CLJ* 260.**
- **Swadling, W. 'Constructive trusts and breach of fiduciary duty' (2012) 18 *Trusts and Trustees* 985.**
- **Virgo, G. 'Profits obtained in breach of fiduciary duty: personal or proprietary claim?' (2011) 70 *CLJ* 502.**

13.6 Unjust enrichment

Like wrongdoing, the most common response to unjust enrichment is to order the defendant to pay money to the claimant. As already noted, some, like Birks, think that there is a right to be paid this money even before any court order is made. Thus, if I pay you £100 by mistake, Birks takes the view that the common law says that, provided certain conditions are met, you owe me £100. The same view, he thinks, is taken by equity. Thus, if by the exercise of undue influence, I make a gift to you of £100,

you will be 'liable to account' for that money to me. You will, according to Birks, be a debtor in equity to me in the sum of £100. On the assumption that that view is correct, the question then is whether in either case I can claim that you hold the £100 or its traceable proceeds for me on constructive trust.

13.6.1 Mistaken payments

In *Chase Manhattan Bank* v *Israel-British Bank London Ltd* [1981] Ch 105, a case we first encountered in Chapter 3, Goulding J held that a mistaken payment is held in trust for the payer. Why did such a trust arise? According to Goulding J, it was because the mistaken payer retained 'equitable property' in the money paid, and since the legal property was held by the recipient, the consequence was a trust which arose by operation of law.

The problem with this reasoning is that it is premised on the existence of equitable property separate from legal property prior to the mistaken transfer. As we saw in the discussion of the resulting trust (in Chapter 12), this is not correct. There is no pre-existing equitable interest. If a trust arises, an equitable interest arises for the first time. For this reason, the analysis of Goulding J was rightly disapproved by Lord Browne-Wilkinson in *Westdeutsche Landesbank Girozentrale* v *Islington LBC* [1996] UKHL 12, [1996] AC 669. However, his lordship justified the decision in *Chase* on the ground that a trust would arise at the point when the recipient became aware of the mistake, which, crucially, was before the defendant entered insolvency. The question, which Lord Browne-Wilkinson does not answer, is why knowledge on the part of the transferee that a mistake was made should turn him into a trustee.

It has been suggested that a mistaken payment should give rise, not immediately to a trust, but to an equitable interest in the nature of power to recover the money, which would only become a trust when the claimant exercises that power: see Birke Häcker, 'Proprietary restitution after impaired consent transfers: a generalised power model' (2009) 68 *CLJ* 324. Cases of rescission operate in a similar way. A claimant who can rescind a transaction and thereby recover rights from the defendant has an equitable interest in the recoverable rights. However, there is no trust unless the claimant elects to rescind the transaction: see Sir Peter Millett, 'Restitution and constructive trusts' (1998) 114 *LQR* 399 at 416. Until that time, the defendant is bound by the transaction. One significant difference between rescindable transactions and mistaken payments is that in the case of mistaken payments, there is normally no transaction to rescind. Should that make a difference?

13.6.2 Resulting trusts

As we also saw in Chapter 12, automatic resulting trusts arise by operation of law and some commentators suggest that they might be regarded as a subspecies of the constructive trust. The question is why they arise. We saw that the explanation proffered by Lords Upjohn and Wilberforce in *Vandervell* v *IRC* (1966) was that it was triggered by the retention by the transferor of his equitable interest in the rights transferred to the transferee. This explanation, however, does not work for precisely the same reason as Goulding J's reasoning in *Chase Manhattan*. Birks and Chambers have since argued that all resulting trusts, presumed and automatic, arise to reverse the unjust enrichment of the recipient. Although it may be correct to say that the recipient is thereby unjustly enriched, there remains the question of why the law gives the transferor the benefit of a trust in addition to a personal claim to recover the value of the right transferred. Why is one creditor being treated more favourably than the rest? (Indeed, this question can be asked in relation to all constructive trusts.)

13.6.3 Other instances of unjust enrichment

There would seem to be other instances of constructive trusts that can be explained as responses to unjust enrichment. Thus, in *Allcard* v *Skinner* (1887) 36 Ch D 145, Cotton LJ said that property transferred because of the undue influence of the transferee were held on trust for the transferor. You should, however, note that this was a minority opinion. The majority said that the claimant had only a right to rescind the transfer and thereby create a trust in her favour, a weaker species of right.

In *Blacklocks* v *JB Developments (Godalming) Ltd* [1982] Ch 183, the claimant transferred a title to land by mistake. He had intended to keep part of the farm he was selling, but the plan that he attached to the deed of transfer indicated that his title to the whole farm was being transferred. Years later, after the farm was sold on to a new purchaser, the mistake was discovered and the claimant was held entitled to recover the land he had transferred by mistake. The judge held that the title to the mistakenly transferred parcel had been held on constructive trust for the claimant all along. Is there some reason why a mistaken transfer of a title to land should give rise to a constructive trust, but not a mistaken payment of money? Should a mistaken transfer of a title to land give rise to a power to recover it rather than a trust?

FURTHER READING

- ***Chase Manhattan Bank* v *Israel-British Bank London Ltd* [1981] Ch 105; *Blacklocks* v *JB Developments (Godalming) Ltd* [1982] Ch 183; *Westdeutsche Landesbank Girozentrale* v *Islington LBC* [1996] UKHL 12, [1996] AC 669; *Angove's Pty Ltd* v *Bailey* [2016] UKSC 47, [2016] 1 WLR 3179.**
- **Chambers, R. 'Distrust: our fear of trusts in the commercial world' (2010) 63 *Current Legal Problems* 631.**
- **Häcker, B. 'Proprietary restitution after impaired consent transfers: a generalised power model' (2009) 68 *CLJ* 324.**
- **Millett, P. 'Restitution and constructive trusts' (1998) 114 *LQR* 399.**

13.7 Other events

Those constructive trusts which do not respond to either wrongdoing or unjust enrichment must by definition fall within this last category, and there is no doubt that it has content. Indeed, the vast majority of constructive trusts are to be found here.

These include:

- specifically enforceable contracts to transfer rights in land (*Lysaght* v *Edwards* (1876) 2 Ch D 499; *Jerome* v *Kelly* [2004] UKHL 25, [2004] 2 All ER 835)
- rights acquired by the operation of the rule in *Re Rose* [1952] EWCA Civ 4 ([1952] Ch 499; *Mascall* v *Mascall* [1984] EWCA Civ 10, 50 P & CR 119)
- *donatio mortis causa* (*Sen* v *Headley* [1991] EWCA Civ 13, [1991] Ch 425)
- mutual wills (*Walters* v *Olins* [2008] EWCA Civ 782, [2009] Ch 212) (not on syllabus)
- shared ownership of the family home (*Stack* v *Dowden* [2007] UKHL 17, [2007] 2 AC 432; *Jones* v *Kernott* [2011] UKSC 53, [2012] 1 AC 776).

If secret trusts are constructive, they belong here as well. Some of the trusts in this list belong to this subject and others, most notably proprietary estoppel and shared ownership of the family home, are encountered in property law.

You will need to consider why incomplete gifts are sometimes held on constructive trust. You will also need to consider the reasons why secret trusts arise (if they are constructive) or why inadmissible evidence is admitted despite the Wills Act 1837 (if they are express).

FURTHER READING

- **Chambers, R. 'Constructive trusts in Canada' (1999) 37 *Alberta L Rev* 173; reprinted in (2001) 15 *Trust L Int* 214, (2002) 16 *Trust L Int* 2.**
- **Swadling, W.J. 'The vendor-purchaser constructive trust' in Degeling, S. and J. Edelman (eds) *Equity in commercial law*. (Sydney: Law Book Co of Australasia, 2006) [ISBN 9780455222080] (available on the VLE).**

Activity 13.1

Applied comprehension – bribes, policy and remedies

Using the Online Library resources, research the following judgment:

- ***Attorney-General for Hong Kong* v *Reid*** **[1994] 1 AC 324.**

You can complete this learning activity by reading Lord Templeman's advice.

a. **What was Mr Reid by profession, which public offices had he held, and how did he breach his fiduciary duty?**

b. **Identify the underlying policy concerns which explain the justice system's response to fiduciaries in public office who accept bribes in the course of their duties.**

c. **Which approach is applied when the property representing the bribe decreases in value?**

d. **Which approach is applied when the property representing the bribe increases in value?**

No feedback provided.

Sample examination question

What is a constructive trust?

Advice on answering the question

At first glance, this might seem like a simple question, requiring nothing more than a definition such as 'a constructive trust is a trust which arises by operation of law'. While correct, it is clearly insufficient, for properly understood the question requires you to consider when and why constructive trusts arise. This requires a survey of those circumstances in which they arise (and for this you will also need to make reference to the next chapter), and those circumstances where they are mistakenly thought to arise.

The best way to approach such a question is to remember the cases and texts you have read, and try to produce some ideas about why constructive trusts arise in the wide disparity of circumstances in which they do. It is perfectly sensible to claim that constructive trusts arise in response to different fact situations to advance different policies of the law, or to respond to different aspects of justice. Compare, for example, the rationale that might lie behind the constructive trust that converts a contractual obligation to convey land into a constructive trust for the parties, with the constructive trust that arises when a fiduciary receives a bribe or otherwise obtains an unauthorised profit.

Reflect and review

Look through the points listed below.

Are you ready to move on to the next chapter?

Ready to move on = I am satisfied that I have sufficient understanding of the principles outlined in this chapter to enable me to go on to the next chapter.

Need to revise first = There are one or two areas I am unsure about and need to revise before I go on to the next chapter.

Need to study again = I found many or all of the principles outlined in this chapter very difficult and need to go over them again before I move on.

Tick a box for each topic.

	Ready to move on	Need to revise first	Need to study again
I can discuss whether certain trusts are constructive trusts or express trusts.	☐	☐	☐
I can discuss why 'constructive trusteeship' is a confusing term.	☐	☐	☐
I can explain the controversy over whether the receipt of unauthorised profits by a fiduciary should be held on constructive trust.	☐	☐	☐
I can explain how some trusts can be seen as responses to a defendant's unjust enrichment.	☐	☐	☐
I can define the circumstances in which constructive trusts will arise in circumstances which involve neither wrongdoing nor unjust enrichment.	☐	☐	☐

If you ticked 'need to revise first', which sections of the chapter are you going to revise?

		Must revise	Revision done
13.1	Genuine constructive trusts	☐	☐
13.2	Disputed constructive trusts	☐	☐
13.3	Types of constructive trust	☐	☐
13.4	Making sense of constructive trusts	☐	☐
13.5	Wrongs	☐	☐
13.6	Unjust enrichment	☐	☐
13.7	Other events	☐	☐

14 Secret trusts

Contents

Introduction

This chapter is concerned with secret trusts, which are testamentary trusts that arise without 'compliance' with the 'formalities' required by the Wills Act 1837. It is uncertain how secret trusts should be classified. Some people believe that they are express trusts where evidence is admitted despite the Wills Act 1837, while others believe that they are constructive trusts: *Marguiles* v *Marguiles* [2022] EWHC 2843 (Ch). A study of them can help you understand the essential difference between express and constructive trusts and the reasons why trusts arise.

Begin by reviewing the so-called formalities required to declare a testamentary trust, which are discussed in Chapter 6, remembering also the mistakes courts and commentators commonly make about s.53(1)(b) LPA 1925. Recall too that the Wills Act 1837 defines 'the word "will"' to include 'any … testamentary disposition' (s.1) and states that 'No will shall be valid unless' it is in writing and signed by the testator in the presence of two witnesses (s.9). Finally, recall that codicils (i.e. amendments to wills) must satisfy the same formalities (s.20). If a will contains a 'beneficial devise' (gift) to a witness or a witness's spouse, that will not affect the validity of the will, but the gift itself is void (s.15).

Core text

- **Penner, Chapter 9 'Formalities and secret trusts', Sections 'Testamentary trusts: Wills Act 1837, s 9' and 'Informal testamentary trusts: secret and half-secret trusts'.**

Learning outcomes

By the end of this chapter and the relevant readings, you should be able to:

- **state the formal requirements for a valid will**
- **describe the problems raised by secret trusts**
- **analyse the different responses of the courts to secret trusts**
- **state when evidence of a declaration of trust which does not take the form of signed, witnessed writing will be admitted in the case of a secret trust.**

14.1 What are secret trusts?

There are two types of secret trust, fully secret and half secret. In a fully secret trust, the will makes no mention whatever of a trust. The testator has declared that a legatee under the will takes absolutely, but the legatee is in fact secretly a trustee who is to hold on trust for a third party. The same occurs in a half-secret trust, except that the will contains a declaration of trust, but fails to disclose the objects of that trust (e.g. '£10,000 to John on trust for the persons or purposes I have communicated to him').

It is not always easy to tell whether a trust is fully or half secret. The essential question is whether the gift in the will appears to be intended for the recipient's own benefit or to be held in trust. In *Rawstron* v *Freud* [2014] EWHC 2577 (Ch), a famous and wealthy artist, Lucien Freud, left the residue of his estate to his solicitor and daughter, who were the executrices of his estate. They admitted that they were secret trustees of the residue, but argued that it was a fully secret trust. The artist's son argued that a proper construction of the entire will showed that the residue was to be held in trust and therefore it was a half-secret trust which might be invalid (see **14.3.1**, below). The judge, Richard Spearman QC, held at [64] that 'in the light of (a) the natural and ordinary meaning of the words used…, (b) the overall purpose of the Will, (c) the other provisions of the Will, (d) the material factual matrix when the Will was made and (e) common sense', the residue was given to the executrices for their own benefit, and therefore the trust they admitted was fully secret.

Furthermore, whether the secret trust is 'full' or 'half', the other requirements for the creation of a trust must be met. In *Titcombe* v *Ison* [2021] 1 WLUK 624 the court reiterates that, apart from the testamentary formality rules, a secret trust must comply with the other essential conditions for the creation of a trust. Thus, in this case, there was an alleged fully secret trust but a key question was whether the deceased had an intention to create a trust at all or rather to impose a mere moral or family obligation on the recipient of the property (applying the test in *Kasperbauer* v *Griffiths*). On the evidence, this was merely a moral or family obligation and hence no secret trust existed.

Two questions arise. First, why are secret trusts problematic, and second, why do testators create them? As to the first, secret trusts are problematic because if they are going to be given effect by the courts, then evidence in a form not sanctioned by the Wills Act 1837 will need to be admitted, for the declaration of trust will not be in writing, signed by the settlor, and properly witnessed as required by s.9. If the evidence is not admitted in the case of a fully secret trust, the legatee will take outright. In the case of a half-secret trust, non-admission of the non-conforming evidence will mean that the trust fails for want of objects, generating a resulting trust in favour of the testator's estate. As to why testators create secret trusts, the two most common reasons are to avoid publicity and to be able to change their minds without the need for a codicil. The desire to avoid publicity comes from the fact that wills are public documents which anyone can inspect on payment of a nominal fee. If the testator wants, for example, to make provision for an illegitimate child, it might be something they do not want placed in the public domain.

Essential reading

- **Review Chapter 6 'Formalities' of the module guide.**
- **Wills Act 1837, ss.9, 15, 25.**

Summary

In the case of a fully secret trust, the will makes no mention of the trust, and in the case of a half-secret trust, although there is a declaration of trust on the face of the will, it is void for want of objects. Problems are raised by secret trusts because the evidence required to prove the making of the declaration of trust is not in the form authorised by s.9 of the Wills Act 1837.

14.2 Justifications for the admission of evidence of secret trusts

Why should the courts admit evidence of the declaration of a trust which is not in the form prescribed by the statute? Given that evidence not in such form has been adjudged unreliable by the legislature, it might be thought that the court should simply refuse to admit it and:

- in the case of a fully secret trust, allow the legatee to take absolutely, or
- in the case of a half-secret trust hold that the testamentary trust fails for want of objects and that there is consequently a resulting trust (see Chapter 12) in favour of the testator's estate.

14.2.1 The fraud theory

The earliest justification for admitting non-conforming evidence in the case of secret trusts was based on the idea that the statutory provisions, which were originally contained in the Statute of Frauds 1677, were designed to prevent fraud, and a legatee who took on the basis that they were a trustee but who later relied on the statute to take absolutely, would be using the statute as an engine of fraud: compare *Thynn* v *Thynn* (1684) and *Rochefoucauld* v *Boustead* (discussed in Chapter 6). There are, however, a number of problems with the fraud theory. Apart from the fact that it fails to address the point that such evidence is inherently unreliable, it is circular (for the same reason that the thinking in *Rochefoucauld* v *Boustead* is circular). Moreover, it struggles to explain the admission of such evidence in half-secret trusts, for if the non-conforming evidence is refused admission in those cases, there will be a resulting trust for the testator's estate and no possibility of the secret trustee taking for him or herself. Also, in most cases, the secret trustee is not trying to deny what happened, but honestly gives evidence of the communication and seeks the court's advice concerning the validity of the secret trust and disposition of the estate.

Thus, in the leading case of *Blackwell* v *Blackwell* [1929] AC 318, a testator left £12,000 to certain named persons 'upon trust for the purposes indicated by me to them'. He had written to the trustees before his death, telling them to hold the money they would receive under his will on trust for his mistress and their child. On his death, his widow, who was entitled on his intestacy, argued that the half-secret trust on the face of the will was void for want of beneficiaries. The trustees admitted the trust and sought to admit the letter into evidence to save the trust from failing. The widow argued it was inadmissible as unwitnessed, but the House of Lords held that the letter could be admitted in evidence.

In *Blackwell*, Lord Buckmaster and Lord Hailsham redefined the 'fraud' that the courts were trying to prevent as not just the secret trustee taking outright but also as defeating the expectations of the secret beneficiaries or the disappointment of the wishes of the testator. If the secret beneficiary has indeed detrimentally relied on the expectation of receiving a gift from the estate, then it might be possible to provide some relief by way of proprietary estoppel, as in *Thorner* v *Major* [2009] UKHL 18, [2009] 1 WLR 776 (discussed in Chapter 7). However, this is seldom the case. It is true that in every case the testator has relied on the secret trustee's promise to carry out the testator's wishes, and having died, it is too late to make alternate arrangements. This form of detrimental reliance might explain the admission of non-conforming evidence of the declaration of trust, but we should ask whether, and to what extent, it is reasonable for a testator to rely on this instead of setting out the terms of the trust in the will, which the testator has taken the trouble to execute.

14.2.2 The outside (*dehors*) the will theory

An alternative theory was put forward in *Cullen* v *A-G for Ireland* (1866) LR 1 HL 190 and possibly adopted by Viscount Sumner and Lord Warrington in *Blackwell* v *Blackwell* [1929] AC 318. As we have seen, in *Blackwell*, the testator had made a will by which he left £12,000 to five people on trust 'for the purposes indicated by me to them'. The court admitted the oral testimony of the trustees to identify the objects of the

otherwise failing trust. In answer to the objection that in so doing the courts were ignoring the statutory provisions (in the words of the judges, 'giving them the go-by') Lord Warrington said (at 342) that it must be remembered that:

> what is enforced is not a trust imposed by the will, but one arising from the acceptance by the legatee of a trust, communicated to him by the settlor, on the faith of which acceptance the will was made or left unrevoked, as the case might be. If the evidence had merely established who were the persons and what were the purposes indicated it would in my opinion have been inadmissible, as to admit it would be to allow the making of a will by parol. It is the fact of the acceptance of the personal obligation which is the essential feature, and the rest of the evidence is merely for the purpose of ascertaining the nature of that obligation.

Viscount Sumner expressed himself in similar terms (at 339):

> It is communication of the purpose to the legatee, coupled with acquiescence or promise on his part, that removes the matter from the provision of the Wills Act and brings it within the law of trusts…

Although arguably doing nothing more than explaining the operation of the fraud theory, Lord Warrington and Viscount Sumner are often seen to have articulated a rival theory, the 'outside' or, in French, '*dehors*' the will theory. According to this theory, s.9 Wills Act 1837 only tells testators how to make wills. Provided this is done correctly (i.e. it is made by signed, witnessed writing), the relevant property will be transferred to the trustee(s). What makes them trustees is not what is written in the will (there may be no words of trust or inadequate words), but the trustees' prior agreement to hold for the secret beneficiaries. Since this is 'outside' the will, it is not caught by s.9.

If this was indeed what Lord Warrington and Viscount Sumner were saying, then there are several problems with this theory. First, it still fails to address the fundamental objection that the evidence the court admits is inherently unreliable. Second, it assumes a dichotomy between the law of trusts and the law of wills in spite of considerable overlap, since many trusts are created by wills. Third, it does not explain why the acceptance of the trust by the trustee should be important, since that is not normally a requirement in English law for the creation of a valid trust (though, interestingly, it is a requirement of the *Rochefoucauld* doctrine). Finally, it is founded on an unduly narrow interpretation of what constitutes a 'will'. It assumes that the 'will' is the formal document executed by the testator, but this cannot be what the statute means. Prior to the Statute of Frauds 1677, wills could be made orally. By 'will' we normally mean the totality of the testator's valid wishes concerning the distribution of their property on their death. The intention that certain property be held on trust for others can be regarded as part of the will. The Wills Act 1837, s.1 states that 'the word "will" shall extend to a testament, and to a codicil, … and to any other testamentary disposition'.

Note that both the fraud theory and the outside the will theory are still in play, although some judges talk of the outside the will theory as representing the 'modern view' justifying the admission of otherwise inadmissible evidence.

A third theoretical justification, that the doctrine of secret trusts is part of the law on incorporation by reference, is not widely accepted for a number of reasons, the most obvious of which is that the doctrine only applies to documents, whereas in secret trusts the courts routinely admit oral testimony.

Core text

- **Penner, Chapter 9 'Formalities and secret trusts', Section 'Informal testamentary trusts: secret and half-secret trusts'.**

Essential reading

- ***Blackwell* v *Blackwell* [1929] UKHL 1, [1929] AC 318.**

Further reading

- ***Thynn* v *Thynn* (1684) 1 Vern 296; *Cullen* v *A-G for Northern Ireland* (1866) LR 1 HL 190; *McCormick* v *Grogan* (1869) LR 4 HL 82; *In Bonis Smart* [1902] P 238.**

REFLECTION POINT

Why are secret trusts considered so important that judges are willing to accept evidence 'which is not in the form prescribed by the statute'?

Summary

There are two main theories that attempt to justify the admission of the otherwise inadmissible evidence in the case of secret trusts.

1 The fraud theory. This is based on the concept that the statutory provisions were designed to prevent fraud, and that a legatee who had agreed to be a trustee and who was only given the rights on that basis but later relies on the statute to take absolutely, would be using the statute as an engine of fraud. This theory creates some problems, however. It fails to deal with the point that the courts are admitting unreliable evidence; it is circular; it struggles to explain the admission of evidence in the case of half-secret trusts; and it does not explain the many cases in which secret trustees honestly give evidence of the secret trust. In both *Blackwell* v *Blackwell* and *Cullen* v *A-G for Northern Ireland* an alternative theory is evident.

2 The outside (*dehors*) the will theory. This theory also raises a number of problems. It too fails to address the fundamental objection that the evidence the court admits is inherently unreliable, it falsely assumes a dichotomy between the law of trusts and the law of wills, it fails to explain why the acceptance of the trust by the trustee should be important and it is founded on an unduly narrow interpretation of what constitutes a will.

Courts make reference to both theories, although some regard the *dehors* the will theory as the modern justification.

14.3 Some specific issues

We have seen that, in general, courts will in cases of secret trusts admit evidence not in the form sanctioned by the statute to prove the declaration of trust. We have also seen that the various explanations for doing so do not stand up. There are, however, a number of situations in which courts still refuse to admit the non-conforming evidence.

Problem questions on secret trusts generally revolve around the question whether, in the case of the particular secret trusts described, the non-conforming evidence will be admitted. Some of the main factors which stand in the way of admission of the evidence are set out below. You should note, however, that the list is not exhaustive.

14.3.1 Timing of acceptance

As we have seen, both the fraud theory and the outside the will theory require the secret trustee to have accepted, or at least acquiesced in, the office of trusteeship. Both acceptance and acquiescence require at the very least that the declaration of trust be communicated to the secret trustee. The crucial question is **when** that communication must take place.

For fully secret trusts, the rule is that the communication to the secret trustee be made before the testator's death. The reason, laid down in a case where the fraud theory was being used, is that if the trustee did not know they were intended to be a trustee, they could hardly be said to have accepted or acquiesced in their appointment: *Re Boyes* [1884] 26 Ch D 531. However, the rule is more restrictive for half-secret trusts, where, at least according to the Court of Appeal in *Re Keen* [1937] Ch 236, the communication must take place before or at the time of the execution of the will. The reason for this was that otherwise the testator would be free to change their will without the execution of a codicil.

The difficulty with this reasoning is that, if the trust really does arise outside the will, then a change of mind over the terms of the trust is not a change in the will at all. Moreover, it seems strange that a communication post execution of the will is acceptable for a fully secret but not for a half-secret trust. Several other jurisdictions have refused to follow this rule and you should ask whether it can be supported. It should also be noted that the

finding in *Re Keen* is arguably *obiter* as the secret trust was struck down on the separate and logically prior ground of inconsistency between the time at which the terms of the trust were communicated to the trustees and the will's account of this event.

Further problems arise where there are intended to be two or more trustees but communication is not made to all of them. Are the trustees who have not been told bound by the trust or can they take the property in question outright? The rules are contained in *Re Stead* [1900] 1 Ch 237, a fully secret trust case. They provide that where the trustees take as tenants in common, then only those who know of the trust are bound, but where they take as joint tenants, then it has to be asked whether the communication was made before or after the execution of the will. If the former, then all will be bound, but if the latter, only those who were told. There is no case law on this point with regard to half-secret trusts, although in such a case they will almost certainly take as joint tenants and if *Re Keen* is correctly decided, the communication will anyway have to precede the execution of the will.

14.3.2 Predecease of the secret beneficiary

What happens if the secret beneficiary predeceases the testator? The starting point, it is suggested, is to ask what would have been the result had this trust been expressed in the form required by s.9 of the Wills Act 1837. The answer is that the doctrine of lapse applies and the gift will fall into residue. There is no good reason why the same result should not obtain where the declaration of trust is not proved by signed, witnessed writing. However, in *Re Gardner (No.2)* [1923] 2 Ch 230, Romer J held that the secret trust was an *inter vivos* trust which was in existence before the death of the beneficiary, and therefore passed to her estate. The problem with this reasoning is that there could be no *inter vivos* trust because there was no self-declaration of trust and therefore the intended trust had not been constituted before the death of the testator.

14.3.3 Predecease of the secret trustee

If the trust had been fully spelt out on the face of the will, it is clear that it would not fail if the trustee predeceased the testator. Applying the rule that 'equity will not allow a trust to fail for want of a trustee', a substitute trustee would be appointed. The difficulty here, however, is that, as we have seen, secret trusts seem to be based on acceptance or acquiescence by a particular trustee and it is that agreement that takes them outside the statutory rules on admissibility. If that is right, then the doctrine of lapse should apply and the gift should fall into residue. The textbooks, however, generally distinguish between fully secret and half-secret trusts in this regard, arguing for failure only in the case of the former.

14.3.4 Witnessing by secret beneficiary

As we have seen, s.15 of the Wills Act 1837 makes void any 'beneficial devise' to an attesting witness or their spouse. If a trust in favour of a witness or their spouse had been included on the face of the will, then it is clear that the witnessing beneficiary could not take the benefit of that trust, which would then be void for want of objects and give rise to a resulting trust for the residuary legatees. It might be thought that the position should be no different in the case of a secret trust. However, in *Re Young* [1951] Ch 344, Dankwerts J upheld a half-secret trust in favour of a witness. Since the trust took effect outside the will, he said, the Wills Act rules did not apply.

14.3.5 Witnessing by secret trustee

There is normally no problem with a trustee witnessing the will, for the trustee can take no benefit from their office as trustee, and so the devise is not 'beneficial'. The question is, however, difficult in the case of secret trusts. If the trust is fully secret, then the operation of s.15 will mean that the property will not reach the trustee and so the trust will never be constituted. In the case of a half-secret trust, admissible evidence will show the court that the legatee is a trustee and so arguably s.15 would not apply.

SELF-ASSESSMENT QUESTIONS

1. **What is the difference between a fully secret trust and a half-secret trust?**
2. **What are the justifications for the admission of non-conforming evidence in the case of secret trusts?**
3. **What does it mean to say that a gift 'falls into residue'?**
4. **Can a trustee witness a will, and if so, in what circumstances?**

Summary

Timing of communication of the trust: In the case of both fully and half-secret trusts the trustee must have accepted or acquiesced in the office of trusteeship. However, the crucial question is when that communication has to be made. In fully secret trusts, it must be before the death of the testator. In half-secret trusts, it must precede the execution of the will, although the reasons justifying the difference are doubtful.

Where the property is given to two or more trustees but communication is not made to all of them, *Re Stead* provides a rule for determining which of them is bound in the case of fully secret trusts. Only the trustee to whom communication is made is bound unless the trustees take as joint tenants and communication is made before the making of the will, in which case all are bound. However, the justification for this rule is doubtful.

If the secret beneficiary predeceases the testator, the doctrine of lapse should apply and the gift should fall into the residue. Romer J's decision to the contrary in *Re Gardner (No.2)* is doubtful but it is the only authority and should be followed until overruled.

If a half-secret trustee dies before the testator, it is said that the trust will not fail because 'equity will not allow a trust to fail for want of a trustee'. The case is less certain for a fully secret trust, in particular following the fraud theory, where the decease of the secret trustee would ensure that no fraud could occur. But query whether the first proposition is correct.

In *Re Young*, Dankwerts J upheld a secret trust in favour of a beneficiary who witnessed the will on the basis of the *dehors* the will theory.

If a fully secret trustee witnesses the will, the operation of s.15 will mean that the property will not reach the trustee and so the trust will never be constituted, unless some extension of the *dehors* the will theory is brought into play. In the case of a half-secret trust, s.15 should not apply as the will itself shows that the legatee is intended to be a trustee, but if this is correct, then *Re Young* must be wrong, for the *dehors* the will theory cannot save a gift in both the case of a witnessing beneficiary and the case of a witnessing trustee.

14.4 What type of trust is ultimately enforced?

What type of trust is a secret trust? More specifically, is it express or constructive? We saw in Chapter 6 how the trust in *Rochefoucauld* v *Boustead* was express, despite the fact that some later cases and commentators call it constructive. Perhaps the same is true of secret trusts, with the fraud and outside-the-will theories providing justifications (albeit, perhaps not very strong ones) for the admission of evidence of a declaration of trust not in a form sanctioned by statute. Indeed, many of the leading cases talk in terms of the admission of evidence of the declaration, just as in *Rochefoucauld*, and the fraud theory is common to both. If that is right, the trust arises directly from a declaration of trust (i.e. it is an express trust). Alternatively, secret trusts might be regarded as constructive, with the express trust being void for non-compliance with s.9, and the testator's detrimental reliance on the secret trustee's undertaking providing a sufficient reason to impose a trust. This might possibly explain why timely communication to and acceptance by the secret trustee are required, for they are not requirements to create a valid express trust, which can be created even

though the intended trustee is wholly unaware of its existence: *Smith* v *Wheeler* (1668) 1 Lev 279, 83 ER 406; *Siggers* v *Evans* (1855) 5 E&B 367, 119 ER 518.

Does it matter whether we class secret trusts as express or constructive? It would certainly help us to better understand why they arise. It might also matter in the case of a secret trust of an interest in land where there is no written evidence of a declaration of trust. Having surmounted the hurdle of s.9 of the Wills Act 1837, would the claimant be defeated by s.53(1)(b) of the LPA 1925? Such a result would be strange, for the requirements of s.9 are more onerous than those of s.53(1)(b). Nourse LJ's comments in *Sen* v *Headley* [1991] EWCA Civ 13, [1991] Ch 425 regarding a *donatio mortis causa* of land should apply with equal force to a secret trust:

> A *donatio mortis causa* of land is neither more nor less anomalous than any other. Every such gift is a circumvention of the Wills Act 1837. Why should the additional statutory formalities for the creation and transmission of interests in land be regarded as some larger obstacle?

The trust in *Sen* v *Headley* was clearly and properly identified as constructive and so exempted from the operation of s.53(1)(b) by s.53(2). If secret trusts are also constructive, then they too are exempt, but even if they are express, the reasons for ignoring the Wills Act 1837 should also apply to s.53(1)(b).

Essential reading

- ***Re Boyes* (1884) 26 Ch D 531; *Re Gardner (No.2)* [1923] 2 Ch 230; *Re Keen* [1937] Ch 236; *Re Young* [1951] Ch 344; *Ottaway* v *Norman* [1972] Ch 698.**

Further reading

- ***Re Fleetwood* (1880) 15 Ch D 594; *Re Baillee* (1886) 2 TLR 660; *Re Colin Cooper* [1939] Ch 811; *Re Browne* [1944] IR 90; *Re Edwards* [1948] Ch 440; *Re Bateman's WT* [1970] 3 All ER 817; *Re Snowden* [1979] Ch 528; *Ledgerwood* v *Perpetual Trustee* (1997) 41 NSWLR 532.**
- **Holdsworth, W.S. 'Secret trusts' (1937) 53 *LQR* 501.**
- **Perrins, B. 'Can you keep half a secret?' (1972) 88 *LQR* 225.**
- **Mee, J. 'Half-secret trusts in England and Ireland' (1992) *Conv* 202.**
- **Critchley, P. 'Instruments of fraud, testamentary dispositions and the doctrine of secret trusts' (1999) 115 *LQR* 631.**

Activities 14.1–14.4

14.1 **Compare the rules of s.53(1)(b) of the Law of Property Act 1925 and s.9 of the Wills Act 1837. Which is the more stringent? And why? In particular, why was s.15 of the Wills Act 1837 enacted?**

14.2 **In what way are secret trusts in conflict with these rules?**

14.3 **Read carefully the speeches in *Blackwell* v *Blackwell*. How do the different judges formulate their justifications for not insisting on the strict requirements of the Wills Act? Are they convincing?**

14.4 **Go through the specific factors which might disqualify non-conforming evidence in the case of a secret trust from being admitted, asking yourself whether it makes any difference to the result which justification, fraud or *dehors*, is used.**

SAMPLE EXAMINATION QUESTIONS

Question 1 Is there yet any coherent justification for the admission of non-conforming evidence in the case of secret trusts?

Question 2 Peter has recently died. By his will, he left his vast shareholding to his close friend, Denis. Prior to his death, he told Denis to hold the shares on trust for Mary, Peter's illegitimate daughter. He also left his title to his house to Robert, 'who has already been informed in writing that it is to be held in trust'. In fact, Robert had been told by Peter before the will was made that the house was to be held for Mary, although orally and not in writing. The two witnesses to the will are Denis's wife, Jane, and Mary.

Advise Laura, Peter's residuary legatee.

Advice on answering the questions

Question 1 A good answer to this question would start by outlining what a secret trust is and why people create them. It would then go on to explain why secret trusts are problematic and how the courts have managed to admit the non-conforming evidence, first through the fraud theory and later through the *dehors* the will theory. Having outlined the various justifications for admission, a critique of those justifications should be given. Some indications of what might be said are outlined above and need not be repeated here.

Question 2 In any problem question, you should start by outlining the issues raised. The first is obviously the general question whether evidence not in the form required by the statute will be admitted to prove the declaration of trust. The more specific points raised by the question are the inconsistency over the method of communication, the fact that the subject matter of the trust is an interest in land and there does not seem to be any written evidence of that declaration to satisfy s.53(1)(b), the fact that the secret beneficiary is a witness to the will, and, finally, that the secret trustee's spouse is the other witness.

As to the general question of the admission of evidence to prove the declaration of trust, a brief outline of the fraud theory and the outside the will theory needs to be given. As this is a problem question rather than an essay, it is not so vital that a critique of these two theories be provided. Once these two theories have been outlined, the question then is how they apply to the specific problems raised.

The first is the inconsistency between the terms of the will ('notified in writing') and the evidence sought to be admitted ('communicated orally'). This point forms the narrow ratio of *Re Keen*. You should outline the rule laid down by *Re Keen* and then apply it to the facts of this case. They might then raise the question whether an inconsistency such as that in *Re Keen* should be fatal, for in a fully secret trust the fundamental inconsistency between what the will says (that the legatee takes absolutely) and the evidence admitted (that the legatee takes as trustee) seems never to have been an issue.

The second issue concerns the fact that the subject matter of the trust is a title to land but the declaration of trust cannot be proved by written evidence as required by s.53(1)(b) LPA 1925. There are two issues here, both of which are discussed above. First, is a secret trust an express or a constructive trust? Second, if it is an express trust, will such a finding be necessarily fatal?

The third issue is the witnessing of the will by the secret beneficiary. You should explain the usual consequences of beneficiaries of trusts witnessing wills (the avoidance of their gift) and note the different conclusion reached in the case of secret trusts by Danckwerts J in *Re Young*.

The fourth and final issue is the witnessing of the will by the spouse of the secret trustee. You should explain what would normally happen in such a case (i.e. if the trust was not secret). You should then explain that although the act of witnessing might have been problematic had the trust been fully secret, in the case of a half-secret trust this should not cause problems.

Reflect and review

Look through the points listed below.

Are you ready to move on to the next chapter?

Ready to move on = I am satisfied that I have sufficient understanding of the principles outlined in this chapter to enable me to go on to the next chapter.

Need to revise first = There are one or two areas I am unsure about and need to revise before I go on to the next chapter.

Need to study again = I found many or all of the principles outlined in this chapter very difficult and need to go over them again before I move on.

Tick a box for each topic.

	Ready to move on	Need to revise first	Need to study again
I can state the formal requirements for a valid will.	☐	☐	☐
I can describe the problems raised by secret trusts.	☐	☐	☐
I can analyse the different responses of the courts to secret trusts.	☐	☐	☐
I can state when evidence of a declaration of trust which does not take the form of signed, witnessed writing will be admitted in the case of a secret trust.	☐	☐	☐

If you ticked 'need to revise first', which sections of the chapter are you going to revise?

		Must revise	Revision done
14.1	What are secret trusts?	☐	☐
14.2	Justifications for the admission of evidence of secret trusts	☐	☐
14.3	Some specific issues	☐	☐
14.4	What type of trust is ultimately enforced?	☐	☐

15 Appointment, retirement and removal of trustees

Contents

Introduction

It is essential both that there are trustees to carry out the trust, and that the current trustees are capable of doing so.

The trustees of a trust may change over the life of the trust. A trustee may become incapable of carrying out the trust because of illness or may become unfit to carry out the trust because they are revealed to be dishonest, or because their own interests are in conflict with their duties under the trust. It is therefore essential that there are powers to appoint new trustees, to allow trustees to retire and to remove trustees. Such powers can be conferred by the settlor when the trust is created, by statute, or may lie within the jurisdiction of the court in its general supervisory role over trusts. Although these powers are simple to understand in principle, their exercise can be somewhat technical and generally involve taking a number of considerations into account. This is especially true in respect of the operation of powers conferred by statute. Different sorts of considerations apply to the appointment, retirement and removal of trustees, and we will examine each in turn.

CORE TEXT

- **Penner, Chapter 8 'The trust up and running', Section 'Appointment, retirement, and removal of trustees'.**

LEARNING OUTCOMES

By the end of this chapter and the relevant readings, you should be able to:

- **give examples of circumstances in which the appointment, retirement or removal of a trustee is desirable or necessary**
- **explain why the statutory powers of appointment, retirement and removal of trustees are generally relied upon in preference to powers in the trust instrument or the jurisdiction of the court**
- **explain how the statutory powers found in ss.36 and 39 of the Trustee Act 1925 and s.19 of the Trusts of Land and Appointment of Trustees Act 1996 work, and explain the extent to which they are fiduciary powers**
- **explain the court's powers in relation to the appointment and removal of trustees**
- **explain when, why and how property held on trust is dealt with upon a change of trustees.**

15.1 The appointment, retirement and removal of trustees in outline

15.1.1 The appointment of first trustees

In the case of an *inter vivos* trust, the appointment of the first trustees is generally straightforward. In the case of a self-declaration of trust, the settlor is of course the first trustee. In the case of a trust constituted by transfer of the subject matter to trustees, such persons become trustees when it is received. Trusts are generally created by using a written document (the trust instrument) which recites the terms of the trusts and is often the instrument that constitutes the trust (e.g. it operates as a deed of transfer of title to chattels). This document will name the first trustees of the trust. Problems are more likely to arise in the case of testamentary trusts (i.e. trusts that come into effect as part of the testator-settlor's will). In many cases, the first trustees of the trust will be the same persons appointed as the executors of the will. However, a person nominated under a will to be executor or trustee can refuse the appointment or may have died by the time the will comes into operation upon the testator's death. Thus, a power to appoint trustees held by someone other than the settlor may be needed even to appoint the first trustees.

15.1.2 Appointment of new trustees and the discharge of trustees

There are three basic occasions when it may be necessary to appoint new trustees:

1. Upon the death of a human trustee, or more rarely, upon the effective incapacitation of a trust company (due to insolvency or loss of the right to carry on a trust business).
2. On the occasion of the retirement or removal of a trustee.
3. Where it is desirable to increase the number of trustees.

Generally speaking, it is desirable for a trust to have at least two trustees (as joint owners of the relevant property) for two main reasons. First, it is felt that the opportunities for fraud or incompetent dealing are much reduced when decisions are taken by two persons rather than one. Second, where the trust property includes interests in land it is essential that there are two trustees for the trustee to be able to provide a proper receipt for purchase monies and facilitate overreaching if that land is later sold: Trustee Act 1925, s.14; LPA 1925, s.27. Note that these sections provide an exception for a 'trust corporation' to act as sole trustee. This is not the same thing as an ordinary trust company, but has a special meaning: Trustee Act 1925, s.68(18); LPA 1925, s.205(1)(xxviii). Also note that the Trustee Act 1925, s.34(2) limits the number of trustees to four in the case of a trust of a title to land (in keeping with the LPA 1925, s.34(2), which limits the number of co-owners of a title to land to a maximum of four joint tenants).

Upon the death of a trustee or the incapacitation of a trust company, new trustees must be appointed. Trustees may retire, but as we will see, the power to retire is typically conditional upon the appointment of a new replacement trustee. The basic reasons that govern a trustee's power to retire from the trust are obvious. People should not be obliged to serve as trustees against their will, but on the other hand, retirement may cause expense and inconvenience to the trust (and thus to the rights of beneficiaries) and indeed could endanger the trust if one of two trustees were retired without replacement.

Trustees are therefore typically required to ensure they have a replacement before exercising their power to retire. The difference between retirement and removal is that a trustee chooses to retire voluntarily, whereas a trustee is removed at the order of another (either by the other trustees, someone else with the power to do so, or by order of the court) when the trustee is unfit to serve as trustee or incapable of doing so. Finally, there may be cases where it is desirable to add a new trustee. This will most obviously be so where the trust was originally constituted with only one

human trustee, for the reasons stated above, but may also be desirable in the case where the new trustee will provide a benefit in terms of judgment. Thus, it may be desirable to appoint a human trustee related to the beneficiaries to act as co-trustee with a trust company in order to assist in the exercise of dispositive discretions, or to add a professional trustee in the case where a family trust is conducted by two family member trustees, to take advantage of the professional's expertise.

15.2 Powers in the trust instrument

Powers to appoint or remove trustees or to retire from the trust may be given by the terms of the trust. However, there may be difficulties in framing such powers so that they operate effectively over the lifetime of the trust. It is not uncommon for the settlor of a trust to reserve such powers. But if the settlor should become incapacitated or die, there will be no one with those powers. The same problem would attend the grant of those powers to any named individual. The problem is obvious: the trust may endure for longer than the life of any particular individual, and for that reason, those powers are normally granted to the current trustees, whoever they are (i.e. to office holders rather than to named individuals). The statutory provisions in place essentially provide the same thing (i.e. trustees or their personal representatives if they die in office), so it is common to rely upon them. A further problem can arise if the powers are poorly drafted or conditional (see, for example, *Re Wheeler and De Rochow* [1896] 1 Ch 315), since they may fail to operate properly when the discharge or appointment of trustees is necessary. In practice, the statutory powers of appointment must once again be relied upon.

SELF-ASSESSMENT QUESTIONS

1. **What are the circumstances in which a new trustee might need to be appointed?**
2. **Why does the trust instrument usually give the trustees the power to appoint new trustees?**

15.3 Powers under ss.36 and 39 of the Trustee Act 1925

The general scheme of statutory powers of appointment is provided by ss.36 and 39 of the Trustee Act 1925.

Only by dying is a trustee automatically discharged from the trust, and since trustees normally hold the trust property as joint tenants rather than as tenants in common, none will pass to the deceased trustee's estate. If there is no one able or willing to exercise a power conferred by the trust instrument to appoint a replacement trustee, then the surviving or continuing trustees have that power, and if all the trustees are dead, the personal representatives of the last surviving or continuing trustee have that power: s.36(1). By virtue of s.36(8), a refusing or retiring trustee may appoint their replacement or successor if willing to do so. This can give rise to problems: an appointment is void if a refusing or retiring trustee is willing to participate in the appointment and does not: *Re Coates to Parsons* (1886) 34 Ch D 370. However, a trustee who is liable to be removed because they fall within one of the grounds for replacement in s.36(1) (i.e. a trustee who is unfit, incapable, or abroad for more than 12 months) may be replaced by the other trustees without the trustee's participation, even though the trustee may be willing to so participate in their own removal (i.e. otherwise would count as a 'retiring' trustee under s.36(8)): *Re Stoneham ST* [1953] Ch 59.

ACTIVITY 15.1

On what statutory provisions would you rely to:

a. **replace one trustee with another?**
b. **add an additional trustee?**
c. **retire as trustee?**

15.4 Powers under s.19 of the Trusts of Land and Appointment of Trustees Act 1996

Recall the principle in *Saunders* v *Vautier* (Chapter 4) by which beneficiaries who are of full age and of sound mind and absolutely entitled may collapse the trust and end it. In *Re Brockbank* [1948] Ch 206, the court held that this principle did not entitle the beneficiaries to direct the trustees to retire in favour of new trustees they desired. Section 19 of the Trusts of Land and Appointment of Trustees Act 1996 reverses *Re Brockbank* in part.

This power can be excluded by the settlor of a trust under s.21 of the Act.

There is a problem created by s.22(1) of the Act, which reads:

> In this Act 'beneficiary', in relation to any trust, means any person who under the trust has an interest in property subject to the trust (including a person who has such an interest as a trustee or a personal representative).

Recall from the discussion of the principle of *Saunders* v *Vautier* in Chapter 4 that, although discretionary beneficiaries may together take advantage of the rule (*Stephenson* v *Barclays Bank Trust Co* [1975] 1 WLR 882), they are not regarded as individually having any subsisting beneficial interest (*Gartside* v *IRC* [1968] AC 553). It is arguable that s.22 excludes beneficiaries under discretionary trusts from the benefit of s.19.

Activity 15.2

Read *Re Brockbank* and explain the reasons given for the decision.

15.4.1 Fiduciary nature of the powers

Review Section 4.2 on the nature of fiduciary duties and powers. The fiduciary nature of the powers to appoint or remove trustees, or retire from the trust, is straightforward: in exercising these powers, the power-holders are exercising a discretion, one which concerns the operation of the trust, and so will affect the interests of the beneficiaries. Such powers must, therefore, be exercised with the interests of the beneficiaries as paramount.

Activities 15.3 and 15.4

15.3 Taking into account the fiduciary nature of the powers concerned, explain whether the following exercises of powers of appointment, retirement and removal are valid:

- **a. Fred and Joe are trustees. They appoint Fred's sister Stella to replace Joe because Stella is 'down on her luck' and could use the trustee's fees.**
- **b. Simon retires from a discretionary trust because he has grown to hate the beneficiaries and can no longer bear to decide how to distribute funds to them.**
- **c. Sam, the settlor of a trust of shares in his private company, replaces X Co as trustee with Y Co under a power in the instrument because X Co refuses to vote in the way he thinks best for the operation of the company.**
- **d. Arthur retires from the trust in favour of Madge because the majority of beneficiaries ask him to. His co-trustee, Paul, consents to this.**

15.4 Review s.19 of the Trusts of Land and Appointment of Trustees Act 1996. Is the power given therein to the beneficiaries a fiduciary power?

15.5 The statutory and inherent jurisdiction of the court

It is a maxim of equity that 'a trust will not fail for want of a trustee'. At the same time, no one can be compelled to accept the office of trustee (although people can become resulting or constructive trustees by operation of law without their knowledge or consent). Situations may therefore arise in which there is no one willing or able to

exercise a power in the trust instrument or a statutory power to appoint trustees. In such cases, the court must step in. The court, in its inherent jurisdiction to ensure that trusts are carried out, may appoint trustees, but s.41 of the Trustee Act 1925 provides that the court may appoint new trustees where it is 'expedient' to do so and it is 'inexpedient, difficult, or impracticable so to do without the assistance of the court'. Resort to this power of the court should not be made where a person can appoint trustees under a power in the instrument or a statutory power (*Re Gibbon's Trusts* (1882) 30 WR 287), although if the existence of a valid power is uncertain resort to the court may properly be made (*Re May's Will Trusts* [1941] Ch 109).

Similarly, there may be cases where it is desirable to remove or replace trustees, but there is no one with a power under the trust instrument or a statutory power who is willing or able to do so. Again, the court serves as a last resort. Here, there is no specific statutory provision, and the inherent jurisdiction of the court must be relied upon.

ACTIVITIES 15.5 AND 15.6

15.5 Read *Re Tempest* (1866) LR 1 Ch 485 and describe the principles which guide the court in appointing trustees.

15.6 Read *Letterstedt* v *Broers* (1884) 9 App Cas 371 and describe the scope of the court's inherent jurisdiction to remove trustees and the considerations which guide it when so doing.

15.6 The vesting of the trust property upon a change of trustee(s)

When trustees are appointed, they must acquire the subject matter of the trust. Similarly, when they are discharged from the trust, they must give up that property. Typically, there will be more than one person holding the property on trust. So the newly appointed trustee must become a joint owner of the property with the continuing trustees, and a retiring trustee must cease to be a joint owner of the property. So, if A and B are trustees and A retires and is replaced by C, then A and B as joint owners must together transfer the subject matter to B and C as joint owners. If a trustee is removed (i.e. 'ordered to retire') the trustee must act so as to transfer or release the property to the new and continuing trustees. If the trustee refuses to do so, they will be in breach of trust, or if they fail to respond to such an order of the court, will be in contempt.

Section 40 of the Trustee Act 1925 provides that where an appointment is made, the deed by which a trustee is appointed will serve to vest the trust property in the trustee in so far as a deed can do so. Title to chattels can be transferred by deed. However, rights that cannot be transferred by deed, such as shares in a private company and titles to land, must be conveyed in the appropriate way.

Partly because of the inconvenience and cost of re-vesting the property upon a change of trusteeship, large trusts with boards of trustees (such as large charities or pension funds) which may change the composition of the set of trustees on a regular basis, often have managing trustees and a custodian trustee. The custodian trustee (always a company) is a bare trustee that simply holds the trust property and follows the direction of its beneficiaries, but in this case those beneficiaries are the managing trustees who in turn hold their equitable interests in trust for the real beneficiaries. The managing trustees are the real trustees because they operate the trust via their directions to the custodian trustee. When a managing trustee is discharged or a new one appointed, this can be done by deed and no re-vesting of the underlying trust property is required, for they remain with the custodian.

Self-assessment questions

1. Why is the presence of managing and custodian trustees in a trust relevant to the issue of the appointment and discharge of trustees?
2. How did the Trusts of Land and Appointment of Trustees Act 1996 change the law concerning the appointment and discharge of trustees?

Sample examination questions

Question 1 By his will, a testator, who died last year, appointed Tick and Tock to be his executors and trustees and left his residuary estate, consisting of freehold and leasehold estates, company shares and bearer securities, upon trust for his three sisters in equal shares absolutely. The three sisters are all of full age and desire the trust to continue. Tock has been living in Spain for the last six weeks, and although he intends to remain ordinarily resident in England, he has indicated that he will spend much of his time in Spain in the future. Tick wishes to appoint Little in place of Tock, but the three sisters either want Tock to remain or Large to be appointed in his place. Advise Tick.

Question 2 Discuss the reasons for the various statutory provisions which concern powers to appoint and discharge trustees and explain the considerations governing their operation.

ADVICE ON ANSWERING THE QUESTIONS

Question 1 This question raises four main issues:

1. **Who has the power to decide on the person to be appointed?**

   Who, in the circumstances, has a discretion to decide upon appointments, and if more than one, who has priority? If there was a power in the trust instrument, that would have priority (s.36(1)(a) Trustee Act 1925), but there appears to be none. Therefore, Tick and Tock will have a power under s.36(1)(b). But the three sisters also have a power by virtue of s.19 Trusts of Land and Appointment of Trustees Act 1996 (as they are fixed interest beneficiaries there is no s.22(1) problem) to direct the trustees to retire and/or appoint new trustees according to their written direction.

2. **By whom must the appointment be made?**

   Whether in response to a written direction from the sisters or acting under s.36(1), the appointment or discharge must be made by Tick and Tock. If one is unwilling to act, his replacement under s.36(1) can be made by the other. Tock has not been out of the country for 12 months so cannot be removed unilaterally by Tick.

3. **By what method must the appointment be made?**

   Any appointment or discharge must be made by deed.

4. **How will the trust property be vested in the trustees?**

   The vesting of trust property in new trustees must occur by way of the appropriate modes of transfer of the property in question, except where it is provided that the deed of appointment or discharge serves to divest the discharged trustee and vest the new trustee with the trust property (s.40). In this case, the transfer of freehold and leasehold estates, a transfer is required to be completed by registered disposition in the Land Registry (for existing registered titles) or by first registration (unregistered titles): ss.27(2)(a) and 4 LRA 2002. The shares must be transferred separately, either by transfer form and registration by the company, or via the CREST system. Bearer securities are transferred by delivery.

Question 2 This question involves two parts:

1. An explanation of ss.36, 39 and 41 of the Trustee Act 1925, and of s.19 of the Trusts of Land and Appointment of Trustees Act 1996; with regard to ss.36 and 39, it should be explained how they relate to powers provided in the trust instrument (if any) and to the powers of the court. With respect to s.41, the background of the inherent jurisdiction of the court should be explained. With s.19, the background of the previous law under *Re Brockbank* [1948] Ch 206 and the possible uncertainty of its application to discretionary and similar trusts should be described.

2. Regarding the considerations which go into the exercise of powers of appointment, it should be noted that they are fiduciary powers when exercised by trustees, and the best interests of the beneficiaries should be the only considerations. With respect to the court, similar considerations apply (*Re Tempest*; *Letterstedt* v *Broers*); with respect to the beneficiaries' exercise of their rights under s.19, there would appear to be no scope for any fiduciary obligation, but beneficiaries should be wary of using the threat of removal to 'micro-manage' the trust, making the trustee act to their order. In such circumstances, they might be regarded as having established an agency relationship, with the trustee simply doing their bidding.

Reflect and review

Look through the points listed below.

Are you ready to move on to the next chapter?

Ready to move on = I am satisfied that I have sufficient understanding of the principles outlined in this chapter to enable me to go on to the next chapter.

Need to revise first = There are one or two areas I am unsure about and need to revise before I go on to the next chapter.

Need to study again = I found many or all of the principles outlined in this chapter very difficult and need to go over them again before I move on.

Tick a box for each topic.

	Ready to move on	Need to revise first	Need to study again
I can give examples of circumstances in which the appointment, retirement or removal of a trustee is desirable or necessary.	☐	☐	☐
I can explain why the statutory powers of appointment, retirement and removal of trustees are generally relied upon in preference to powers in the trust instrument or the jurisdiction of the court.	☐	☐	☐
I can explain how the statutory powers found in ss.36 and 39 of the Trustee Act 1925 and s.19 of the Trusts of Land and Appointment of Trustees Act 1996 work, and explain the extent to which they are fiduciary powers.	☐	☐	☐
I can explain the court's powers in relation to the appointment and removal of trustees.	☐	☐	☐
I can explain when, why and how property held on trust is dealt with upon a change of trustees.	☐	☐	☐

If you ticked 'need to revise first', which sections of the chapter are you going to revise?

		Must revise	Revision done
15.1	The appointment, retirement and removal of trustees in outline	☐	☐
15.2	Powers in the trust instrument	☐	☐
15.3	Powers under ss.36 and 39 of the Trustee Act 1925	☐	☐
15.4	Powers under s.19 of the Trusts of Land and Appointment of Trustees Act 1996	☐	☐
15.5	The statutory and inherent jurisdiction of the court	☐	☐
15.6	The vesting of the trust property upon a change of trustee(s)	☐	☐

NOTES

16 Breach of trust

Contents

Introduction

A trust can be breached in different ways. For example, a trustee:

- might fail to carry out the terms of the trust and fail to pay the beneficiaries what they are due
- might enter into transactions with the trust property that are prohibited by the terms of the trust or by the general law.

The general rule is that trustees are strictly liable for any loss caused by their breach of trust (although there are some duties whose breach requires negligence or lack of care) and that they will be liable to pay money out of their own pockets to make up any loss to the trust funds caused by their breach of duty. It is vital to realise that this liability is only personal. As a consequence, if a trustee is insolvent, the beneficiaries' claim that the trustee make good the loss will generally be not worth pursuing.

Trustees are not necessarily liable for the breaches of their co-trustees. Further, trustees may be relieved of liability by an exemption clause in the trust instrument or by the court in certain circumstances.

Third parties (i.e. non-trustees) may also incur personal liabilities when a trust has been breached. They may be liable if they were accessories to the breach of trust or received trust property or their traceable proceeds (see Chapter 18 'Claims based on tracing') dissipated in breach of trust. In addition, they will be liable to be ordered to reconvey any trust property received in breach of trust, unless they are protected by the defence of *bona fide* purchaser for value without notice or similar immunity provided by land registration statutes.

Core text

- **Penner, Chapter 13 'Breach of trust'.**

Essential reading

- **Section 4.1 of the module guide.**

Learning outcomes

By the end of this chapter and the relevant readings, you should be able to:

- **describe the various ways in which a trust can be breached**
- **explain the various personal and proprietary rights that the beneficiaries may have against trustees and third parties when a trust is breached**
- **explain the process of 'surcharging' or 'falsifying' the trust accounts**
- **explain the liability of trustees for breach of trust among themselves, and the consequences of a beneficiary's consent to a breach of trust**
- **explain and apply s.61 of the Trustee Act 1925 and the law governing trustee exemption clauses**
- **explain and apply the tests which govern third-party liability for assisting in a breach of trust and receiving trust property.**

16.1 Liability of trustees for breach of trust

16.1.1 Personal and proprietary rights

Perhaps the most straightforward breach of trust is the case where the trustee fails to carry out a term of the trust, for example, to invest the trust property, or to dispose of them according to the terms of the trust. In such cases, the beneficiaries can apply to the court, which will order the trustee to carry out their duties. Perhaps more effectively, the beneficiaries may have the power or may seek the court's assistance to replace a defaulting trustee with one who will carry out the trust (see Chapter 15). The remedy here is essentially an order for performance of the trust. The court will either order the trustees to carry out their duties on pain of being in contempt of court or replace them with trustees who are willing to do so. The liability of the trustee to such an order is clearly personal, to deal with their trustee's nonfeasance (i.e. failure to act).

Personal liability indicates the case where trustees are liable to pay money out of their own pockets to restore the value of the trust property. It is a personal right to require a payment of a sum of money enforceable against specific persons (i.e. trustees). This is different from the beneficiaries' right with respect to the specific property that is held in trust for them. The same distinction applies to the liability of third parties who assist a breach of trust or receive property dissipated in breach of trust. They may be personally liable to pay out money from their own pockets to restore the value of the trust fund or may be required to give up specific property that is held in trust.

16.1.2 Falsifying and surcharging the trust account

As discussed in Chapter 4, one of the trustees' primary duties is to keep trust accounts (i.e. proper records of the trustees' dealings with the trust) and, when required, to provide them to the beneficiaries, to the court, or to others who are entitled to receive them (e.g. the Charity Commission). Because the trust property often constitutes a fund that changes over time (e.g. as the trust property is invested in various ways, income is added to the trust, and payments are made to beneficiaries), the trustees must keep track of the property coming into and going out of the trust fund. They must maintain records of these transactions, such records being the trust account.

The main way in which trustees are made personally liable to restore the value of the trust is through the accounting process. The trust account is adjusted to remove unauthorised disbursements and to add amounts that the trustees would have received if they had acted properly, and the trustees are then required to make up the difference from their own pockets. When an item is removed from the account, we say that the account is 'falsified' and when an item is added, the account is 'surcharged'. A basic division can be made between breaches of trust where the trust account can be falsified and those where it can be surcharged. This is an odd use of the word falsify, not to mean 'to make false' as it usually does, but 'declare to be false'. The terminology of falsifying and surcharging the account follows from the trustee's primary duty to keep trust accounts.

Falsifying

When the beneficiaries sue the trustees for breach of trust, this is traditionally framed as calling for an account. The beneficiaries apply to court asking the trustees to account for what they have done with the trust property. Where the trustees have made an unauthorised transfer of trust property (e.g. by making an unauthorised investment or paying someone who is not a proper beneficiary of the trust) the beneficiaries are entitled to ask the court to falsify the account in respect of that particular transaction. Where possible, the trustees can remedy the breach by reversing the transaction to restore the trust. For example, they can remedy an unauthorised sale of a title to land previously held on trust by re-purchasing it, making up any difference in price from their own pockets. If they cannot reverse the transaction (e.g. where money was paid away to a non-beneficiary who became insolvent), the trustees will be personally liable to pay an equivalent sum (plus interest) from their own pockets into the trust.

Surcharging

The beneficiaries ask the court to surcharge the account where the trust fund has less value than it should, but not because the trustee entered into a transaction which can be falsified. Two examples of this kind of breach are:

1. Where trustees fail to take sufficient care when investing the trust fund causing it to be worth less than it would have been if they had acted properly;
2. Where trustees fail to insure trust property, which is then damaged, destroyed or stolen.

In both these examples, there is no particular unauthorised transfer that can be falsified. The real problem is the failure to enter into a transaction that should have taken place (to make a better investment or purchase insurance). The trustees are personally liable to make good the loss from their own pockets. The trust account is surcharged by the court to add the value that should have been received either from better investments or from insurance proceeds. Note that in cases where the trust is surcharged, there is no way to restore the trust by reversing any particular transaction, and so the liability of the trustee can only be personal.

Strict liability

In most of the above cases, the liability of the trustees is strict. The law does not ask whether the trustees breached the trust honestly, negligently or intentionally, except in cases where they are liable for failing to take sufficient care when investing or preserving the trust property. The trustees are liable for the breach regardless. However, there are certain circumstances in which trustees may escape liability for breaches they have committed. Principally, these are where (a) the beneficiaries consent to the breach, (b) the trust instrument contains a clause exempting the trustees from liability or (c) the court relieves the trustees of liability under s.61 of the Trustee Act 1925 (discussed below).

In all the above cases, one identifies a breach of trust by showing that a term of the trust or a general duty imposed on trustees has been breached. An entirely different circumstance in which trustees may be liable for breach is where they are in breach of a fiduciary obligation owed to the beneficiaries. This is different from a breach of trust because fiduciary duties apply not only to trustees but to other legal actors, such as agents, company directors and solicitors. Fiduciary duties, in short, are not the same thing as trust duties, although trustees typically have both. For this reason, fiduciary duties will be dealt with separately, in the next chapter.

16.1.3 Liability to account and equitable compensation

Trustees (or third parties, for that matter) may be liable to pay money out of their own pockets to restore a loss to the value of the trust fund, either by an unauthorised transaction which can be falsified or by a failure to acquire rights or value for which the account can be surcharged. This liability is by and large the counterpart in equity to the liability at common law to pay money damages to compensate for a loss caused by a tort or breach of contract. In all these cases, there was a breach of duty, that breach gave rise to a loss quantifiable in money, and the duty holder was liable to pay money compensation for the loss that resulted. Unfortunately, the peculiar terminology of equity has obscured the basic simplicity of what is going on.

The trustees' primary duty is to keep the trust property separate from their own and to keep the trust accounts. Therefore, the liability of trustees to pay money to restore the value of any losses the trust fund suffered due to their breach is generally referred to as a liability to account. Even in the case of third parties who are personally liable to restore the trust – for example because they dishonestly assisted the trustee in carrying out a breach which caused a loss – their liability is often framed as a liability to account 'as if they were trustees'. In both cases, the liability is in reality a liability to pay money to restore loss. Therefore, it may be perfectly sensible to say that these are cases of equitable compensation.

Historically, however, the term 'equitable compensation' has not been given this broad reading, but refers to cases where a claimant is compensated **directly** by a money payment (i.e. the payment is not made to restore the value of a trust fund). This can happen in the case of a breach of trust (e.g. where an account is not available because the trust has come to an end). For instance, in *Target Holdings Ltd* v *Redferns* [1995] UKHL 10, [1996] AC 422, a solicitor held funds obtained from a lender on trust to complete a purchase of a title to land. The solicitor was also instructed by the lender to obtain a mortgage on the land in the lender's favour and to release the funds to the vendor only when that security was in place. In breach of trust, the funds were released before the securities were obtained, though they were put in place 11 days later. As it turned out, the lender was a victim of fraud on the part of its borrower, with the land being worth far less than it was led to believe. It sued the solicitor for equitable compensation in respect of its loss, which it said was caused by the breach of trust. In the House of Lords, the relevant question related to how principles of causation were relevant to the assessment of causation, which we shall return to shortly.

Equitable compensation, then, appears to refer to cases where the defendant is liable in equity to pay an individual directly in order to compensate that person for a loss caused by the defendant's breach of an equitable duty. This can occur in cases where there is no trust, for example, where a fiduciary obligation is breached. Those cases will be dealt with in Chapter 17.

16.1.4 Personal liability and causation of loss

Trustees will only be liable for a loss to the trust fund or to a beneficiary if the loss has been caused by their breach of duty. For example, trustees will not be liable if the trust fund loses value just because there is a general decline in the market value of the trust property (*Re Chapman* [1896] 2 Ch 763). The beneficiaries must show that the loss was caused by the breach.

There are two sorts of situation in which causation for loss must be considered: (1) where the account is falsified; and (2) where the account is surcharged. (Losses caused by a trustee breaching a fiduciary obligation to the beneficiaries will be discussed in the next chapter.)

Account falsified

When an account is falsified, the beneficiaries claim that a transfer out of trust property was in breach of trust. The loss caused by the breach in such a case is often straightforward. The trust no longer has a right it once did, and the trustee is bound either to reverse the transaction, or to pay money to put the trust in the position it would have been in had the right been retained. So, for example, say the trustees in breach of trust sold shares for £50,000. At the date of trial, which is when the loss will be valued (see *Nocton* v *Lord Ashburton* [1914] AC 932 and *Target Holdings*), the shares are worth £80,000. The trustees must either purchase shares to replace those that were sold, or if that is not possible, pay £30,000 into the trust (plus the value of any dividends that would have been received if the shares had been kept, but minus any interest earned on the £50,000 actually received from their sale). The loss caused is clearly the decline in value of the trust property caused by the falsifiable transaction. The amount of loss is simply a calculation concerning the value of property. In certain respects, the valuation of the loss departs from the principles that would be applicable at common law, in the sense that the trustees may be required to pay money to the trust even if that would put the trust in a better position than if the breach had never occurred.

But what happens if there is some other event, unrelated to the breach, that means that the loss (or some loss) would have been incurred anyway? Many of the relevant cases were decided in the 19th century, and a court today might be more willing to apply by analogy the common law tests of remoteness of damage and causation: see *Bristol and West Building Society* v *Mothew* [1996] EWCA Civ 533, [1998] Ch 1. In *Target Holdings* (discussed above), Lord Browne-Wilkinson saw parallels between the principles informing equitable compensation and common law damages, in particular the relevance of a 'but for' test of causation. This approach was approved and followed

by the Supreme Court in *AIB Group (UK) plc* v *Mark Redler & Co* [2014] UKSC 58, [2015] AC 1503, in which Lord Toulson said at [64] that:

> the basic right of a beneficiary is to have the trust duly administered in accordance with the provisions of the trust instrument, if any, and the general law. Where there has been a breach of that duty, the basic purpose of any remedy will be either to put the beneficiary in the same position as if the breach had not occurred or to vest in the beneficiary any profit which the trustee may have made by reason of the breach (and which ought therefore properly to be held on behalf of the beneficiary). Placing the beneficiary in the same position as he would have been in but for the breach may involve restoring the value of something lost by the breach or making good financial damage caused by the breach. But a monetary award which reflected neither loss caused nor profit gained by the wrongdoer would be penal...

In *AIB* v *Redler* it was held that the loss claimed by AIB was not caused by Redler's breach, because that loss (being a product of the collapse of the property market) would have occurred even if Redler had followed AIB's instructions to the letter and obtained a first-ranking charge. One reason to support the Supreme Court's approach is the difficulty in drawing a clear line between cases involving an unauthorised transaction and those involving a failure to take due care, bearing in mind that the breach in *AIB* v *Redler* could conceivably be understood in either category. In addition, in many instances, a breach of trust will occur in the backdrop of contractual obligations, meaning that it may be proper to have regard to common law measures of damages when calculating equitable compensation. Lord Toulson therefore also said at [71] of *AIB* v *Redler* that:

> I agree with the view of Professor David Hayton, in his chapter 'Unique rules for the unique institution, the trust' in Degeling and Edelman (eds) *Equity in commercial law* (2005), pp.279–308, that in circumstances such as those in *Target Holdings* the extent of equitable compensation should be the same as if damages for breach of contract were sought at common law. That is not because there should be a departure in such a case from the basic equitable principles applicable to a breach of trust, whether by a solicitor or anyone else. (If there were a conflict between the rules of equity and the rules of the common law, the rules of equity would prevail by reason of section 49(1) of the Senior Courts Act 1981 …) Rather, the fact that the trust was part of the machinery for the performance of a contract is relevant as a fact in looking at what loss the bank suffered by reason of the breach of trust, because it would be artificial and unreal to look at the trust in isolation from the obligations for which it was brought into being. I do not believe that this requires any departure from proper principles.

In *Main* v *Giambrone* [2017] EWCA Civ 1193 the Court of Appeal discussed *Target Holdings* and *AIB* v *Redler*, and held that the 'but for' test of causation was satisfied in a falsification claim. In that case, the solicitors – a firm of Italian lawyers – had released deposits put down by purchasers of off-the-plan apartments despite not having received compliant guarantees from the developers. Later issues meant that the apartments were never built and the purchasers lost their deposits. It was held that the purchasers could recover against the solicitors equitable compensation to the value of their deposits. This may seem odd, given what was said in *Target Holdings* and *AIB* v *Redler*.

The ground of distinction was that the trustees in those cases had active duties to perform (to get in the relevant securities), whereas the trustee here – the firm of solicitors – had no active duties, merely the negative one of not paying the money out until certain certificates were produced. It was concluded that, as the trustee had breached a custodial duty, it was liable to make full compensation, even though obtaining the relevant certificates would not have prevented its clients from losing their money. Aspects of *Main* v *Giambrone* were applied in *LIV Bridging Finance Ltd* v *EAD Solicitors LLP* [2020] EWHC 1590 (Ch), where the quantum of equitable compensation was assessed by reference to the specific duties of the solicitors.

The reasoning and effect of *Target Holdings* and *AIB* v *Redler* were also discussed by the Court of Appeal in *Auden McKenzie (Pharma Division) Ltd* v *Patel* [2019] EWCA Civ 2291. The defendant appealed against a summary judgment awarding equitable

compensation. Although doubting whether those cases would assist this particular defendant, David Richards LJ recognised that the quantification of equitable compensation is a 'developing area of law' and 'best decided on the facts as found at trial' [64]. He also stated [60] that although *Target Holdings* and *AIB:*

> do not directly assist [the defendant] they do demonstrate a willingness on the part of the courts to develop the equitable remedies for breach of trust and breach of fiduciary duty and, where required to do what is practically just, to entertain some departure from the strict obligation of trustees and fiduciaries to restore the fund under their control.

Account surcharged

Where the account is surcharged, issues of causation are somewhat different. Recall the case of *Nestle* v *National Westminster Bank* (Chapter 4, Activity 4.6), where the plaintiff claimed that the trustees (who were clearly in breach of trust for failing to seek advice about the scope of the trust's investment clause and therefore made investments in breach of trust) caused a loss in the capital value of the trust fund. The claimant sought to surcharge the account, claiming that the trustees would have produced much greater capital growth in the trust fund if they had made their investment decisions properly. She lost. While it was clear that the trustees acted in breach, the claimant had not shown that the low capital growth was due to the trustee's breach, because even if they had known the true scope of their investment powers, it was not shown that they would have obtained greater capital growth given the standards of professional investment prevailing at the time.

Thus, when the account is sought to be surcharged, showing whether a breach caused a loss is not a simple matter of property valuation. It involves a genuine requirement to show that the loss flowed from the breach of trust and not from some other factor, such as in *Nestle*, the standard investment practices at the time. In such cases, it has been said that the common law principles of causation, remoteness of damages, and measure of damages, should be applied by analogy (*Bristol & West Building Society* v *Mothew* [1998] Ch 1, per Millett LJ).

Activities 16.1–16.4

16.1 Explain the difference between cases in which (a) the trust is specifically enforced and (b) the trustee is personally liable for breach of trust.

16.2 What is the difference between falsifying and surcharging the trust account?

16.3 Give examples of breaches of trust and identify whether this would entitle the beneficiaries to:

- **a. falsify the account**
- **b. surcharge the account.**

16.4 Read *AIB Group (UK) plc* v *Mark Redler & Co* [2014] UKSC 58, [2015] AC 1503 and explain the decision, in particular the way in which the court applied the rules of causation which govern the award of equitable compensation.

Summary

A trustee or third party may be liable to restore a loss caused to the value of the trust fund. This liability is the counterpart in equity of the liability at common law to pay damages for a tort or breach of contract. Liability to account is the liability of the trustee or a third party to compensate the beneficiaries to restore any loss to the trust by making a money payment into the account. Equitable compensation refers to cases where the defendant has a liability in equity to pay an individual directly in order to compensate that person for a loss caused by the defendant's breach of an equitable duty. This occurs in more than just breach of trust cases; for example, where the defendant breaches a fiduciary duty causing loss.

A trustee is only liable for a loss to the trust fund or to a beneficiary if the loss has been caused by the trustee's breach of trust. Consequently, this raises the issue of causation.

Two situations must be considered:

1. Where the account is falsified, the trust no longer had a particular asset and the trustee is bound either to reverse the transaction, or to pay money into the trust to restore the value of the trust had the asset been retained. Traditionally, the issue of causation only concerned fluctuations in the value of specific property. Whether that approach is in the process of change depends on how one characterises cases such as *Target Holdings* and *AIB* v *Redler*.
2. Where the account is surcharged, the claimant must show that the loss flowed from the breach and not from some other factor. As a consequence, the common law principles of causation, remoteness of damages and measure of damages should be applied by analogy.

16.2 Liability of trustees *inter se*

16.2.1 Joint and several liability

Where there is more than one trustee, the question of liability among trustees (*inter se*) arises. The background principle is that trustees must carry out the trust together, and, because they will normally hold those rights as joint tenants, must all participate where a transaction involves dealing with the trust property. The law does not recognise the principle of a 'sleeping trustee', who does nothing in the administration of the trust (*Bahin* v *Hughes* (1886) 31 Ch D 390). Trustees are jointly and severally liable when they act together, or ought to have acted together, in doing anything which they should not have done, or failing to do what they should have done. Nevertheless, where a breach is committed by a trustee clearly acting alone, where for example one trustee misappropriates some of the trust property, their co-trustees will not be liable.

Where trustees are together liable, the court may, under the Civil Liability (Contribution) Act 1978, apportion liability among them according to their individual degree of fault. One trustee may also seek an indemnity from another trustee (i.e. may require the other trustee to pay their share of equitable compensation) when the latter alone misappropriated trust property, or when the latter is a solicitor who exercised a controlling influence over the trust, and thus is essentially responsible for the breach (*Bahin* v *Hughes*).

16.2.2 Consent of beneficiaries

A beneficiary who is *sui juris* (i.e. of full age and of sound mind) may consent to a trustee acting in a way that departs from the terms of the trust. If all the beneficiaries are *sui juris*, and they all consent to an action which departs from the trust terms, there is no breach of trust. For genuine consent, the beneficiaries must be fully informed of the relevant facts, although they need not know the exact nature of their legal rights. The test, as applied in *Re Pauling's ST* [1964] Ch 303 at 339 (CA), is whether it would be just to allow the beneficiary to 'turn round and sue the trustees' over actions in which the beneficiary participated or to which the beneficiary consented.

Of course, a beneficiary who is not *sui juris* cannot consent, and a beneficiary who is *sui juris* must consent for themselves. If an individual beneficiary consents to the trustees departing from the trust, they are not able to sue for breach, but the other beneficiaries are. Where a beneficiary consents to a breach causing loss to the trust fund, her or his interest under the trust may be 'impounded', in particular circumstances (*Chillingworth* v *Chambers* [1896] 1 Ch 685; Trustee Act 1925, s.62); that is to say, as much of the value of their interest as is needed will go to making up the loss to the trust fund.

16.2.3 Trustee exemption clauses

A trust instrument may contain a clause that exempts trustees from personal liability for breach of trust. The exemption will not affect the beneficiaries' rights with respect to the trust property or their traceable proceeds, which the trustees will continue to hold in

trust regardless of any personal liability. The clauses, if effective, will exempt the trustees from personal liability to restore a trust with money taken from their own pockets.

The principles defining the valid scope of trustee exemption clauses were discussed by Millett LJ in *Armitage* v *Nurse* [1997] EWCA Civ 1279, [1998] Ch 241. He said that the trustee's duties to act loyally, honestly, and in good faith were an 'irreducible core' set of trust obligations, breach of which could not be relieved by any exemption clause. A trustee exemption clause could, however, relieve trustees of liability for a breach evincing any other kind or degree of fault. No matter how grossly negligent a breach may be, a properly drawn clause could relieve the trustees of liability for the consequent loss. According to Millett LJ, trustees may even be relieved of liability for an intentional breach of trust if it was done with the best interests of the beneficiaries in mind. This last point was doubted in *Walker* v *Stones* [2001] QB 902 (CA). Perhaps a clause should relieve trustees of a 'one-off' breach of this kind, but a consistent intentional disregard of the trust terms should not be relieved, even if the trustees do so honestly, for this would allow them to rewrite the trust. If that is desirable, the proper procedures for varying the trust should be followed. Reckless breaches (i.e. where the trustees knowingly take risks with the beneficiaries' interests) count as dishonest or disloyal breaches, and cannot be relieved, and this includes the case where the trustees undertake a breach advertently relying on the exemption clause to get themselves off the hook if things go wrong.

Armitage v *Nurse* is a controversial decision. In response, the Law Commission published a consultation paper (No. 171, 2003) proposing that any exemption clause purporting to relieve trustees of liability for negligence or worse (i.e. recklessness, dishonesty, and so on) would be invalid at law. However, after consultation, they decided to recommend no legislative change, and leave the various professional regulatory bodies to ensure that settlors were informed of the effects of trustee exemption clauses by those offering the services of trustees (Law Com 301, 2006).

16.2.4 Section 61 Trustee Act 1925

Section 61 empowers the court to relieve trustees of all or part of their liability for breach of trust if they have 'acted honestly and reasonably, and ought fairly to be excused for the breach of trust'. Each limb of the test (honesty, reasonableness, and fairness) must be met. There is little case law on the application of the section. Relief was denied where the trustee's breach manifested a conflict of interest (*Re Pauling's ST*) and also in *Bartlett* v *Barclay's Bank Trust Co Ltd* [1980] 1 Ch 515, where a professional trustee made a risky unauthorised investment, on the ground that the breach was unreasonable and that the trustee ought not fairly to be excused at the beneficiaries' expense.

In *Santander UK plc* v *RA Legal Solicitors* [2014] EWCA Civ 183, [2014] PNLR 20, relief was denied to solicitors who had breached a trust during a conveyancing transaction even though their breach did not cause their client's loss. They had not acted reasonably because they had failed to follow the normal conveyancing procedures set out in the Law Society's 'Completion Code' and thereby created a greater risk of loss. Because their breach created this risk, they failed to satisfy the onus on them to show that they had acted reasonably, and the court refused to exercise its discretion to relieve them from liability even though the client would have suffered the same loss if they had followed the Code.

Section 61 was successfully pleaded in *Evans* v *Westcombe* [1999] 2 All ER 777 to partly relieve a lay administrator of an estate who distributed rights in the reasonable belief that one beneficiary of the estate, who later turned up, had died.

Self-assessment questions

1. **In what circumstances will trustees all be liable together?**
2. **In what circumstances will a trustee not be liable for a breach of trust?**
3. **When can a trustee claim an indemnity from co-trustees?**

4. **What is necessary for a beneficiary's consent to a departure from the trust terms to be valid?**
5. **What does it mean for a beneficiary's interest to be impounded?**
6. **To what limits may a trustee exemption clause go to relieve a trustee of liability for breach of trust?**
7. **In what circumstances will the court relieve a trustee under s.61 of the Trustee Act 1925?**

Summary

Trustees may all be liable where they acted (or should have acted) together in circumstances where a breach has occurred, but are solely liable for their own individual breaches committed without the participation of other trustees.

Sui juris beneficiaries can consent to departures from the trust terms, but the trustees breach the trust in respect of any departures relating to those beneficiaries who cannot or do not consent. Beneficiaries who consent to a breach may have their interests impounded to make up the loss to the trust occasioned by the breach. Trustees may be relieved of liability under the trust instrument by an exemption clause, which is valid even if very widely drawn, but dishonest or reckless breaches may not be relieved. Section 61(1) of the Trustee Act 1925 empowers the court to relieve a trustee of all or part of the liability for an honest and reasonable breach.

ESSENTIAL READING

- **Trustee Act 1925, ss.61, 62.**
- ***AIB Group (UK) plc* v *Mark Redler & Co* [2014] UKSC 58, [2014] 3 WLR 1367; *Re Pauling's ST* [1964] Ch 303 (CA); *Armitage* v *Nurse* [1997] EWCA Civ 1279, [1998] Ch 241; *Main* v *Giambrone* [2017] EWCA Civ 1193.**

FURTHER READING

- ***Target Holdings Ltd* v *Redferns* [1995] UKHL 10, [1996] AC 421; *Libertarian Investments Ltd* v *Hall* [2013] HKCFA 93, 16 HKCFAR 681 at [167]–[172]; *Santander UK plc* v *RA Legal Solicitors* [2014] EWCA Civ 183, [2014] PNLR 20; *Auden McKenzie (Pharma Division) Ltd* v *Patel* [2019] EWCA Civ 2291 (especially from [30] onwards).**
- **Mitchell, C. 'Stewardship of property and liability to account' [2014] *Conv* 215.**

16.3 Liability of third parties

So far, we have outlined the liability of trustees for breach of trust. However, beneficiaries may also have very important remedies against third parties (i.e. not the trustees) who are somehow involved in a breach of trust.

Trustees de son tort

The most straightforward case of third party liability for breach of trust arises when people, although not formally appointed, take it upon themselves to act as trustees. They are called *trustees de son tort* (trustees by their own wrong) and are liable for any breach of trust they commit just as they would be if they had been properly appointed as trustees (see *Mara* v *Browne* [1896] 1 Ch 199). The term 'constructive trusteeship' properly applies in this context because they are, by operation of law, held to be trustees.

Property rights to the trust property

If the trustees transfer trust property in breach of trust to someone who is not a *bona fide* purchaser for value of a legal right (recall 4.1), the beneficiaries may simply call on that person to return the rights, or their traceable proceeds. Although, as we will see in Chapter 18, the rules governing tracing are complicated, this liability is essentially straightforward. Where the beneficiaries can identify a right that was previously held

on trust, or its traceable substitute, in the hands of a third party, they can obtain an order that the right be reconveyed. The court will require the third party to transfer the right to the beneficiaries in certain cases, but more usually to their trustees (who may be new trustees appointed to replace the old ones who committed the breach in the first place).

Personal liability of third parties

Third parties will sometimes be personally liable (i.e. liable to pay money from their own pockets) to make up the loss to the trust fund caused by a breach of trust. They may be required to do so in a number of cases, two of which are:

1. where they have dishonestly assisted the trustees to breach the trust (discussed in Section 16.4) and
2. where they have received trust property dissipated in breach of trust (discussed in Section 16.5).

16.4 Dishonest assistance

A third party (i.e. someone who is neither a trustee nor a beneficiary) may participate or assist in a breach of trust. For example, this might be a solicitor who works with the trustees to carry out the terms of the trust, but who becomes involved in assisting them in a transaction which breaches the terms of the trust. Traditionally, such a person could be held liable for 'knowing assistance' in a breach of trust. The term 'knowing' indicated that actual knowledge of involvement in a breach of trust or a deliberate closing of eyes was required before the third party could be held liable. Because assistants are liable to restore the trust out of their own pockets, it was sometimes said that they are liable as 'constructive trustees', meaning that they are personally liable for the same amount 'as if they were trustees'. This terminology of 'constructive trusteeship' is now generally avoided because of its potential for confusion.

The leading cases on accessory liability are the decisions of the Privy Council in *Royal Brunei Airlines Sdn Bhd* v *Tan* [1995] UKPC 4, [1995] 2 AC 378 and *Barlow Clowes International Ltd* v *Eurotrust International Ltd* [2005] UKPC 37, [2006] 1 WLR 1476, and the decision of the House of Lords in *Twinsectra Ltd* v *Yardley* [2002] UKHL 12, [2002] 2 AC 164. They established that an accessory must dishonestly assist a breach of trust in order to be liable. Mere negligence is not sufficient to found liability. It does not matter whether the trustee himself was fraudulent or dishonest in committing the breach. A solicitor who dishonestly advised an innocent trustee to commit a breach would be liable all the same. All turns on the accessory's dishonesty.

What then counts as dishonesty? In *Royal Brunei* (1995), the Privy Council advised that dishonesty requires that the accessory knows the facts that would indicate to a reasonable person that they are participating in a breach of trust. This test has subjective elements in the sense that it depends on what the assistant actually knows. However, the test is ultimately objective, in that the standard of honesty is determined by the views of honest and reasonable people. Accessories are not allowed to set their own standards of honesty, such that if they personally see nothing wrong with breaching a trust they could claim to be honest. In *Twinsectra* (2002), the House of Lords either refined or confused the *Royal Brunei* test for dishonesty (depending on your point of view) holding that, although the test of morality was an objective one, it had to be shown that the defendant subjectively knew that his conduct fell below that objective standard. That third requirement was removed by the Privy Council in *Barlow Clowes* v *Eurotrust Ltd* (2005). The question then is what an English court, bound by *Twinsectra* but not *Barlow Clowes*, is to do. The Court of Appeal decided that they should follow the latter in *Abou-Rahmah* v *Abacha* [2006] EWCA Civ 1492, [2007] Bus LR 220.

More recently, the Court of Appeal has confirmed that the test is purely objective: *Group Seven Ltd* v *Notable Services LLP* [2019] EWCA Civ 614, [2019] 3 WLR 1011. The Court relied heavily on the Supreme Court decision in *Ivey* v *Genting Casinos (UK) Ltd* [2017] UKSC 67, [2018] AC 391. That case related to a professional gambler who was alleged

by a casino to have cheated at a card game. Using a particular technique known as 'edge sorting', he won just over £7.7m. The question before the Supreme Court was the meaning of 'cheating' and whether it was necessary that the gambler was subjectively aware that he was acting wrongly. The Supreme Court answered this in the negative. In the course of its discussion, the Court discussed the meaning of 'dishonesty' in the context of criminal law, noting reasons why the standard should be objective (albeit that the actual state of mind of the defendant may be relevant). The Supreme Court also referred to dishonesty in civil law cases, and indeed stated at para [62] that:

> Civil actions may also frequently raise the question whether an action was honest or dishonest. The liability of an accessory to a breach of trust is, for example, not strict, as the liability of the trustee is, but (absent an exoneration clause) is fault-based. Negligence is not sufficient. Nothing less than dishonest assistance will suffice. Successive cases at the highest level have decided that the test of dishonesty is objective. After some hesitation in *Twinsectra Ltd* v *Yardley* [2002] UKHL 12; [2002] 2 AC 164, the law is settled on the objective test set out by Lord Nicholls in *Royal Brunei Airlines Sdn Bhd* v *Tan* [1995] 2 AC 378: see *Barlow Clowes International Ltd* v *Eurotrust International Ltd* [2005] UKPC 37; [2006] 1 WLR 1476, *Abou-Rahmah* v *Abacha* [2006] EWCA Civ 1492; [2007] Bus LR 220; [2007] 1 Lloyd's Rep 115 and *Starglade Properties Ltd* v *Nash* [2010] EWCA Civ 1314; [2011] Lloyd's Rep FC 102.

Drawing from these statements, the Court of Appeal in Group Seven concluded at [58] that:

> In the light of *Ivey*, it must in our view now be treated as settled law that the touchstone of accessory liability for breach of trust or fiduciary duty is indeed dishonesty, as Lord Nicholls so clearly explained in *Tan*, and that there is no room in the application of that test for the now discredited subjective second limb of the *Ghosh* test. That is not to say, of course, that the subjective knowledge and state of mind of the defendant are unimportant. On the contrary, the defendant's actual state of knowledge and belief as to relevant facts forms a crucial part of the first stage of the test of dishonesty set out in *Tan*. But once the relevant facts have been ascertained, including the defendant's state of knowledge or belief as to the facts, the standard of appraisal which must then be applied to those facts is a purely objective one. The court has to ask itself what is essentially a jury question, namely whether the defendant's conduct was honest or dishonest according to the standards of ordinary decent people.

ACTIVITY 16.5

Read *Group Seven Ltd* v *Notable Services LLP* [2019] EWCA Civ 614, [2019] 3 WLR 1011. Why was the *Twinsectra* decision said to have introduced uncertainty in relation to the standard for dishonesty in dishonest assistance cases? Why did the Court of Appeal not consider itself bound by that decision? What arguments can be made in favour of an objective standard for dishonesty? In answering the latter question, you may wish to read some of the discussion in *Ivey* v *Genting Casinos (UK) Ltd* [2017] UKSC 67, [2018] AC 391.

16.5 Knowing receipt

An action in knowing receipt can be brought against a third party who has received or dealt with trust property (or their traceable proceeds) transferred in breach of trust – see *Davies* v *Ford* [2023] EWCA Civ 167. Liability for knowing receipt is personal and does not depend on the third party retaining those rights or proceeds. This can be contrasted with the proprietary claim against a third-party recipient, where it is essential for the recipient to still have the relevant rights or proceeds for the action to arise: see further Chapter 18 in relation to tracing, following and claiming.

To illustrate these ideas, consider the following breaches of trust. Tom, the trustee, in breach of trust withdraws money from the trust's bank account to give £1,000 to each of his children, Martha and Graham, as birthday presents. Martha spends her £1,000 on a holiday; Graham spends his on a title to a scooter. The beneficiaries have a right to Graham's scooter, which is the traceable proceeds of the £1,000 trust money he received. This is the proprietary claim referred to above: the beneficiaries can point to the scooter and say, 'you hold your title to it on trust for us'. A court will require

Graham to transfer the title to them or to the new trustees (supposing, as is likely, that Tom has been replaced).

What can the beneficiaries say to Martha? She has nothing left of what she received, for she spent it in a way that gave rise to no traceable substitute. Can the beneficiaries require her to dig into her own pocket and pay £1,000 to restore the value of the trust fund? In other words, is she personally liable for the value received? The orthodox position is that Martha would only be liable if she had some degree of knowledge when she received the £1,000 in breach of trust (which is why this species of liability is usually called 'knowing receipt') or she later acquired some degree of knowledge of the breach and then dealt with the money as her own anyway instead of returning it to the trust (hence the term, 'knowing dealing'). As in the case of 'knowing assistance', she was called a 'constructive trustee' because her personal liability to restore the trust was the same 'as if' she were a trustee. As we shall see, there is now case law that says that the relevant question is whether it would be unconscionable for Martha to retain the trust property or proceeds.

16.5.1 The standard of knowledge required

This first section explores the question of what standard of knowledge is required. This follows the orthodox position found in the cases that some 'fault' on the part of the recipient should be required for liability to arise.

Determining a standard of knowledge required for the personal liability of a recipient of trust property has generated a great deal of judicial comment. The issues were complicated by the fact that, because knowing assistants and knowing recipients were traditionally both treated as 'constructive' trustees (i.e. as if they were trustees), it was often felt that the standard of knowledge for liability in both cases was the same. However, in *Royal Brunei* the Privy Council firmly distinguished the two heads of liability, saying that there was no reason why the standards should be the same, and this principle was accepted (albeit *obiter*) by the House of Lords in *Twinsectra*. Determining the standard was also complicated by the distinction between knowledge and notice. You will recall (from Section 4.1) that a standard of 'notice' is used to assess whether a recipient of trust property is a *bona fide* purchaser. Notice generally applies when the purchaser should protect themselves by investigating in a reasonably diligent fashion the title they intend to buy in order to be free of any competing claims to it. In many cases of breach of trust, however, the recipients have no reason to investigate the source of the rights they receive. In our examples, Graham and Martha do not ask their father, Tom, to prove that the money they receive is his to give, nor would they be expected to do so.

Note that, in the example above, both Martha and Graham were volunteers (i.e. donees who gave no consideration for the transfers), as the payment of money was a gift. Imagine that instead of giving £1,000 to each of his children, Tom spent £2,000 on a weekend at a fancy hotel. Could the hotelier be liable for knowing receipt, as it received £2,000 of trust funds? The cases suggest that if the transfer destroys the equitable interest of the beneficiaries (notably because the hotelier was a *bona fide* purchaser for value without notice), then an action for knowing receipt will not be available: see discussion in *Byers* v *Samba Financial Group* [2021] EWHC 60 (Ch), esp. [107]–[117]. (You do not need to worry about the choice of laws aspects of this case.)

Re Montagu's Settlement Trusts

Prior to the Court of Appeal decision in *Bank of Credit and Commerce International (Overseas) Ltd* v *Akindele* [2000] EWCA Civ 502, [2001] Ch 437, the leading case was *Re Montagu's ST* [1987] Ch 264. In *Montagu* the trustees gave the defendant title to a number of paintings held under a family settlement. This was a breach of trust. The defendant at one time knew that the paintings were part of the family settlement, but had forgotten that fact and treated them as his own. He sold the paintings, and after his death many years later (when there was no longer any possibility of tracing the proceeds of sale), his son, as the principal beneficiary of the family settlement, claimed that the defendant's estate was liable to restore the value that had been lost. Megarry J

denied the claim. He held that in order to found a claim for knowing receipt or dealing, the defendant had to have actual knowledge that his receipt was in breach of trust, was 'wilfully blind' to that fact (i.e. had shut his eyes to the obvious) or had wilfully and recklessly failed to make the inquiries that an honest and reasonable person would make. Furthermore, a person was not liable for knowledge they might have once had, but had honestly and genuinely forgotten when the breach occurred.

BCCI v *Akindele*

In *Akindele*, the defendant entered into an arrangement with the claimant bank to buy shares. The contract was an unusual one, in that the 'share purchase' was basically a sham. The real contract was to provide a loan to the bank for a certain time period in return for which the bank guaranteed a repayment of the loan at a high rate of interest. The actual transaction was entered into on behalf of the bank by several of its employees as part of a fraud on the bank. The bank sued the defendant for the large amount of interest he received under the transaction, claiming that the sham nature of the transaction and the high rate of interest would have indicated to a reasonable and honest person that the transaction was fraudulent, or at least have caused a reasonable or honest person to make further inquiries before entering into the transaction. The bank's claim failed. In essence, the court accepted the defendant's explanation that he believed the transaction and the high rate of interest under it were legitimate investments offered to him as one of the bank's 'high net worth' clients. He did not concern himself with the details of the contract, and so did not regard the odd aspects of the transaction to be a matter of concern.

While the outcome in *Akindele* was consistent with *Re Montagu*, it was not decided in accordance with the law as stated in *Re Montagu*. Nourse LJ decided that just as *Royal Brunei* had cleared away the tangled case law of the past to establish from first principles the basis upon which a person could be liable for assisting a breach of trust, the court should do the same for the law on recipient liability. He said that the central thread underpinning the case law on knowing receipt was that a defendant would be personally liable only if it would be 'unconscionable' for him to retain the benefit of the receipt of trust property: [2001] Ch 437 at 455. Nourse LJ did not provide any detailed guidance about the factors that would go to make the retention of benefit unconscionable but he saw unconscionability as avoiding the perils of a granular test of knowledge (which can be very difficult to apply), and allowing courts to make 'commonsense decisions in the commercial context in which claims in knowing receipt are now frequently made': at 455.

A number of questions arise in relation to *Akindele*. One question concerns the factors that should be relevant to unconscionability. Consider, for example, the status of the recipient. In *Re Montagu* the recipient was a volunteer and so could not claim to be a *bona fide* purchaser. If the paintings had still been in his possession (or in his estate), they would have still been subject to the trust interest of the beneficiaries, but the paintings had been sold long ago and the proceeds dissipated so as to be untraceable. In *Akindele*, by contrast, the defendant had given consideration under a valid contract for the rights he received (he had given the bank the use of his money for two years under a contract). In *Re Montagu*, the recipient got to keep the value of the right he received and had not paid for in any way, whereas in *Akindele*, if he had been liable, he would have lost value for which he had paid. Given the differences in these two situations, should the standard of knowledge be lower in the case of a donee recipient being one who paid nothing for what they received in breach of trust?

A second question is whether unconscionability is a desirable standard for liability in knowing receipt cases. One concern in the scholarly literature is that unconscionability is an amorphous, shifting concept that provides inadequate *ex ante* guidance for future cases. In thinking about this question, read closely the statements of Nourse LJ (who was alert to this concern) – do you find his analysis compelling?

A third question relates to whether *Akindele* really concerns knowing receipt. The directors, acting in breach of their fiduciary duties, acted as agents for the company to make a contract with the defendant. Clearly, they did not have actual authority to

commit a fraud on the company, so the essential question was whether the defendant relied on their apparent authority to make the contract. He did and so the contract was binding. If not, the contract would have been void and the money recoverable at common law in a claim for unjust enrichment. *Akindele* has been described as '[falling] into error' in conflating issues in relation to authority and knowing receipt: *Criterion Properties plc* v S*tratford UK Properties LLC* [2004] UKHL 28 at [4] (Lord Nicholls); and see Stevens, R. 'The proper scope of knowing receipt' (2004) 4 *LMCLQ* 421. Perhaps the main difficulty in this area of law is that most of the modern cases of knowing receipt are company law cases. *Re Montagu* stands out because it is a case dealing with breach of trust.

Finally, there is academic scholarship in relation to the nature of knowing receipt. Charles Mitchell and Stephen Watterson have argued that liability of knowing receipt is actually the liability which arises when the recipient dissipates the trust property with knowledge of the existence of the bare trust (to restore the trust property to the proper trustees) which arose when the rights were received, that knowledge turning the recipient into a genuine trustee of the right and therefore accountable for his stewardship of it: 'Remedies for knowing receipt' in Mitchell (ed.) (2010) p.115. A contrary argument put by Swadling is that the liability we call knowing receipt is in fact an instance of the equitable wrong known as 'inconsistent dealing': Swadling, W. 'The nature of "knowing receipt"' in Davies, P. and J. Penner (eds) *Equity, trusts and commerce*. (Oxford: Hart Publishing, 2017), p.303.

16.5.2 An unjust enrichment approach

The Court of Appeal in *Akindele* briefly referred to a different approach to the personal liability of a recipient, an unjust enrichment approach. The court felt itself bound to work within the constraints of previous case law and unable to consider this approach, but as it has been mooted extra-judicially by some of the most senior members of the bench (Lord Nicholls, whose views are quoted in *Akindele* on this issue, and Lord Millett), and since this area of law is ripe for review by the Supreme Court, it should be considered. You should be aware, however, that this approach has not been adopted by the courts at present. The law, as it currently stands, is as discussed above where liability in knowing receipt depends on 'fault', which currently is described as 'unconscionability'.

Go to the VLE and read 'Knowing receipt: the need for a new landmark' by Lord Nicholls of Birkenhead.

From an unjust enrichment perspective, the recipient of rights transferred in breach of trust should be strictly liable to repay its value to the trust, for otherwise they would be unjustly enriched at the expense of the beneficiaries. Their liability should not turn on their knowledge, but purely on the fact that they were enriched, at the beneficiaries' expense, in circumstances where they ought never to have received that enrichment. In these terms, the case is said to be similar to if you paid your gas bill a second time by mistake, forgetting that you had already sent a cheque. The gas company is strictly liable to return the second payment because they would otherwise be unjustly enriched at your expense. Your mistake means that your intention to enrich the company was vitiated and so should not count against you. The same goes, on this reasoning, for the recipient of trust property dissipated in breach of trust. The beneficiaries give no consent to the transfer, so the case is even stronger than mistake.

The 'change of position' defence

This is not to say, however, that the recipient would have no defence. The strict liability of the unjust enrichment defendant is modulated by the defences of *bona fide* purchase and change of position. Innocent recipients of legal rights who give value in return will normally be fully protected as *bona fide* purchasers. By contrast, the change of position defence can protect innocent donees who rely upon the apparent security of the receipt without knowledge of the breach of trust. It can apply if they use the value received in a way which they would not have done but for having received it. By doing so, they change their position so that it would be unjust to make them pay it all back, and to that extent, they can be relieved of liability.

The defence is best explained by an example. Consider Martha, above, who spent her birthday gift on a holiday. Assume she was innocent of the fact that Tom gave her the money in breach of trust. If she can show that she would not have gone on holiday but for the £1,000 gift, and that she went only because the £1,000 gift made her rich enough to afford it, then she can claim that her position has changed. She innocently spent money in a way she would not have done out of her own pocket given her previous finances, and it would be unjust now to make her pay it back because that would put her in a worse position than if she had never received the money at all.

Unlike *bona fide* purchase, which is an 'all or nothing' defence, change of position can be a partial defence, reducing liability only to the extent that the defendant has changed their position. So, for example, if Martha had spent only £600 on the holiday in reliance on her receipt of the £1,000, she might have her liability in unjust enrichment reduced to £400.

As noted above, it is important to note that while the unjust enrichment approach has both academic and practitioner supporters, there is no English case that adopts this approach to recipient liability.

Activity 16.6

Ted is the trustee of the Davis family trust. He takes home two paintings which are held on the family trust, puts one on his wall and sells his title to the other for £2,000. Ted then makes an unauthorised investment which causes a loss to the trust of £20,000. Alex, his solicitor, who advised him on the investment, read the trust terms incorrectly and concluded the investment was authorised. Ted then decided to transfer £50,000 to Barbara, a non-beneficiary; Alex carried out the transaction. Ted gives title to the trust painting on his wall to Fred, another non-beneficiary, who sells it for £10,000 and spends the money on a lavish birthday party for his wife.

List the possible proprietary and personal claims the beneficiaries have against (a) Ted, (b) Alex, (c) Barbara, and (d) Fred in the following situation, and state what the appropriate test for liability is in each case.

Essential reading

- ***Royal Brunei Airlines Sdn Bhd* v *Tan*** [1995] UKPC 4, [1995] 2 AC 378; ***Barlow Clowes Int Ltd* v *Eurotrust Int Ltd*** [2005] UKPC 37, [2006] 1 WLR 1476; ***Group Seven Ltd* v *Notable Services*** [2019] EWCA Civ 614, [2019] 3 WLR 1011; ***Re Montagu's ST*** [1987] Ch 264; ***Bank of Credit and Commerce Int (Overseas) Ltd* v *Akindele*** [2000] EWCA Civ 502, [2001] Ch 437.

Further reading

- ***Twinsectra Ltd* v *Yardley*** [2002] UKHL 12, [2002] 2 AC 164; ***Abou-Rahmah* v *Abacha*** [2006] EWCA Civ 1492; ***El Ajou* v *Dollar Land Holdings plc*** [1993] EWCA Civ 4, [1994] 2 All ER 685; ***Arthur* v *A-G Turks & Caicos Islands*** [2012] UKPC 30; ***Byers* v *Samba Financial Group*** [2021] EWHC 60 (Ch), esp. [107]–[117].
- **Birks, P. 'Receipt' in Birks, P. and A. Pretto (eds) *Breach of trust*. (Oxford: Hart Publishing, 2002) [ISBN 9781841131740] p.213.**
- **Chambers, R. 'The end of knowing receipt' (2016) 2 *Canadian J Comparative Contemporary L* 1.**
- **Gardner, S. 'Knowing assistance and knowing receipt: taking stock' (1996) 112 *LQR* 56.**
- **Gardner, S. 'Moment of truth for knowing receipt?' (2009) 125 *LQR* 20.**
- **Mitchell, C. and S. Watterson 'Remedies for knowing receipt' in Mitchell, M. (ed.) *Constructive and resulting trusts*. (Oxford: Hart Publishing, 2010) [ISBN 9781841139272] p.115.**
- **Nicholls, Lord 'Knowing receipt: the need for a new landmark' in Cornish, W.R. et al. (eds) *Restitution past, present and future: essays in honour of Gareth Jones*. (Oxford: Hart Publishing, 1998) [ISBN 9781901362428] p.231.**

- **Smith, L.D. 'Unjust enrichment, property, and the structure of trusts' (2000) 116 *LQR* 412.**
- **Stevens, R. 'The proper scope of knowing receipt' (2004) 4 *LMCLQ* 421.**
- **Swadling, W. 'The nature of "knowing receipt"' in Davies, P. and J. Penner (eds) *Equity, trusts and commerce*. (Oxford: Hart Publishing, 2017) [ISBN 9781509907298].**

Activity 16.7

Read *Re Montagu's ST* and *BCCI* v *Akindele*.

Which approach to personal recipient liability is more persuasive? Does the unjust enrichment approach seem preferable to both?

Self-assessment questions

1. **Who or what is a *trustee de son tort*?**
2. **What is 'knowing dealing'?**
3. **What is 'accessory liability'?**
4. **What are the essential duties of trustees, according to Millett LJ in *Armitage* v *Nurse*?**
5. **Why is the decision in *Armitage* v *Nurse* considered controversial?**
6. **What is 'falsifying the trust account'?**
7. **What is liability for 'equitable compensation'? How does it differ from a trustee's 'liability to account'?**

Summary

Third parties may participate in a breach of trust, by assisting the trustees to commit the breach. They may also receive trust property transferred in breach. Traditionally, they would be personally liable as 'constructive trustees' (i.e. as if they were trustees) to restore the value of the trust from their own pockets. To be liable for assistance, the third party must 'dishonestly assist' the trustees. Mere negligence is not enough. The test for dishonesty is objective, although it incorporates the subjective knowledge of the defendant.

If a third party receives rights dissipated in breach of trust and they are retained or substituted for other rights, the beneficiaries can force the third party to hand them back to the trust. However, if the rights are dissipated and there is no exchange product, the extent of the third party's degree of knowledge determines whether they will be personally liable to restore their value. The standard of knowledge required has been debated over the years in many judicial decisions.

According to *Re Montagu*, recipient liability requires actual knowledge that the receipt was in breach of trust or wilful blindness to the obvious. On the other hand, according to *Akindele*, liability arises where it would be 'unconscionable' for the defendant to retain the benefit of the receipt of the trust property.

An unjust enrichment approach to recipient liability has been proposed, although no English case has actually adopted it. On this approach, a recipient of rights dissipated in breach of trust would be strictly liable to repay its value to the trust, for otherwise they would be unjustly enriched at the expense of the beneficiaries. However, this liability would be subject to the defences of *bona fide* purchase and change of position. If innocent recipients rely upon the legitimacy of their receipt and thereby change their position, making it unfair for them to pay all or some of it back, their liability will be reduced accordingly.

Activity 16.8

Core comprehension – dishonest assistance and knowing receipt

Using the Online Library resources, research the following journal article:

- **Watterson, S. 'Limitation of actions, dishonest assistance and knowing receipt' (2014) 73 *CLJ* 253–56.**

a. **In *Williams* how did the claimant's arguments attempt to extend the definition of trustees?**

b. **Why did the Supreme Court reject this argument?**

c. **How did the claimant's arguments attempt to extend the definition of 'constructive trustees'?**

d. **Why did the Supreme Court reject this argument?**

e. **Which premise of the Supreme Court is questioned by Watterson?**

f. **Which similarities does Watterson highlight between constructive trustees and expressed trustees?**

g. **How does the *Arthur* v *A-G Turks & Caicos Islands* [2012] UKPC 30 support Watterson's analysis?**

Activity 16.9

Applied comprehension – professional duties and breach of trust

Using the Online Library resources, research the following case:

- ***AIB Group (UK) Plc* v *Mark Redler & Co Solicitors* [2014] UKSC 58.**

a. **Outline the breach and the relief which the Bank alleged against the solicitors.**

b. **How did the solicitors breach the terms of the Council of Mortgage Lenders' Handbook?**

c. **Identify (i) the numerical difference between the Bank's calculation of liability and the solicitor's calculation and (ii) the important fact which explains the source of the gap.**

d. **Which broad principle of equitable compensation was identified by Lord Browne-Wilkinson in the *Target Holdings* case?**

e. **Identify the two principles fundamental to an award of damages at common law.**

f. **Identify the basic rule to an award for breach of trust in equity.**

Sample examination questions

Question 1 To what extent is a third-party defendant's state of knowledge relevant in claims for personal liability to restore the trust?

Question 2 Stanley was a solicitor who often advised Tom, the chief trust officer of a large trust company. In 2014, he advised him to invest a large portion of the value of the Adams family trusts in investments prohibited by the trust instrument to enhance the returns on the trust fund. Tom agreed with the idea, and did so. The strategy was unsuccessful and the trust fund is now worth only half of what it was. In 2015, Stanley negligently prepared a tax-saving scheme for the Bryson family trust, which Tom implemented, and which resulted in an unnecessary £30,000 tax liability. In 2016, Tom asked Stanley to prepare the documentation for the transfer of a house from the Carling family trust to the widow of the family. Stanley was sceptical about whether the transfer was permitted by the terms of the trust, but in response to his query on this point, Tom said, 'I think it's okay, and the widow needs the house, and in any event I'm covered by the exemption clause. Get to it.' Stanley carried out the transfer as instructed. All three trust instruments contain exemption clauses relieving trustees of liability for any loss to the trust except when caused 'by his own actual fraud'. Advise the beneficiaries of each of the trusts.

Question 3 Tamara, a trustee, breaches the trust she manages by (a) failing to invest the trust property with due care so that the fund is worth much less than it should be; (b) by selling a title to a parcel of land held by the trust, a transaction prohibited by the trust terms; (c) by making an unauthorised payment to Barney, one of the beneficiaries who realises it is a breach of trust but consents to it.

Advise Tamara.

ADVICE ON ANSWERING THE QUESTIONS

Question 1 The question concerns personal liability both for 'intermeddling with' the trust property so as to become a *trustee de son tort*, assistance in a breach of trust, and for receipt of trust property dissipated in breach of trust. Regarding the first, knowledge is in a certain sense irrelevant, for the *trustee de son tort* by their actions makes plain that they are acting as if they were a trustee of the trust. One cannot do that unknowingly, although whether the intermeddler realises their potential liability is irrelevant. As to assistance, the question requires an analysis of the test of dishonesty, addressed most recently by the Court of Appeal in *Group Seven Ltd* v *Notable Services* and also considered in detail in *Barlow Clowes*, *Twinsectra* and *Royal Brunei Airlines*. Finally, recipient liability must be discussed, first examining the law defining the standard of knowledge for knowing receipt prior to *Akindele*, and then considering how knowledge might figure in the *Akindele* 'unconscionability' test. The unjust enrichment approach should be considered briefly as a possible way forward regarding recipient liability, and it should be pointed out that on this approach the issue of the defendant's knowledge comes into play only when the change of position defence is invoked.

Question 2 The investment is clearly in breach of trust. The account can be falsified against Tom in respect of this transaction. The issues are whether Tom can be relieved by the exemption clause, and whether Stanley may be liable as an accessory. As to the former, Millett LJ in *Armitage* stated that an intentional breach carried out honestly for the benefit of the beneficiaries would not count as wilful fraud. As for Stanley, he is not protected by the exemption clause and, having intentionally breached the trust, he may be regarded as dishonest, although Millett LJ's reasoning regarding the trustee might, by analogy, be applied to Stanley, so that he could not be treated as dishonest. The test for dishonesty should be discussed in detail and applied as well as it can be to Stanley. Tom is not liable for the loss caused by the negligently prepared tax-saving scheme unless he was negligent in his appointment or monitoring of Stanley, and there is no evidence of this. Stanley is liable for his professional negligence. Tom, on behalf of the trust, should pursue a claim for damages for professional negligence against Stanley. The trust account can clearly be falsified in respect of the final transaction. Tom will be personally liable unless relieved by the exemption clause, but this is doubtful, for as Millett LJ said in *Armitage*, a trustee who intentionally relies on an exemption clause to carry out a possible breach of trust is wilfully reckless and thus dishonest, so the exemption clause will not operate in their favour. Stanley may be liable here for assistance, depending upon whether you would characterise his conduct as dishonest under the test in *Royal Brunei*, *Barlow Clowes* and *Group Seven*; that is, did he act in a wilfully blind fashion, failing to make enquiries? The widow will be subject to a proprietary claim for the title to the house. As a donee, she is not a *bona fide* purchaser. If she has managed to dispose of the title, the beneficiaries can trace into the proceeds. If those have been dissipated, the widow may be subject to a personal claim, in respect of which a discussion of *Montagu*, *Akindele* and unjust enrichment is required.

Question 3 Tamara must be advised that she will be personally liable for each of the three breaches of trust. Regarding (a), the beneficiaries can surcharge the account, and the amount of compensation she will have to pay to restore the trust will be such as to place the trust in the position it would have been in had she invested with care. The rules of causation in this respect are likely to be analogous to those of the common law (Millett LJ in *Mothew*), although the rule from *Target Holdings* is the 'common sense causation with the full benefit of hindsight' test. In *Nestle* v *National Westminster Bank* (recall Chapter 4, Activity 4.6), the court held that if the trustee had been liable, compensation would have been awarded to bring the fund up to the level it would have had, had a proper investment policy been followed, not merely the minimum level the trustee might have achieved without being subject to a legal challenge. Regarding (b), the sale can be falsified on the trust account. Tamara should, if she can, restore the trust by re-purchasing the title to land for it. If she cannot, the compensation she will pay will be determined as the value of the title at the time of trial (*Nocton* v *Lord Ashburton*; *Target Holdings*) minus, of course, the amount received

by the trustees in payment for it. Regarding (c), Tamara will again be liable to restore the trust for the loss caused by this falsifiable appointment. She may, however, be relieved in whole or in part as Barney's interest may be impounded (*Chillingworth* v *Chambers*; Trustee Act 1925, s.62). Tamara should also be advised that the beneficiaries may well apply to the court to have her replaced.

Reflect and review

Look through the points listed below.

Are you ready to move on to the next chapter?

Ready to move on = I am satisfied that I have sufficient understanding of the principles outlined in this chapter to enable me to go on to the next chapter.

Need to revise first = There are one or two areas I am unsure about and need to revise before I go on to the next chapter.

Need to study again = I found many or all of the principles outlined in this chapter very difficult and need to go over them again before I move on.

Tick a box for each topic.

	Ready to move on	Need to revise first	Need to study again
I can describe the various ways in which a trust can be breached.	☐	☐	☐
I can explain the various personal and proprietary rights that the beneficiaries may have against trustees and third parties when a trust is breached.	☐	☐	☐
I can explain the process of 'surcharging' or 'falsifying' the trust accounts.	☐	☐	☐
I can explain the liability of trustees for breach of trust among themselves, and the consequences of a beneficiary's consent to a breach of trust.	☐	☐	☐
I can explain and apply s.61 of the Trustee Act 1925 and the law governing trustee exemption clauses.	☐	☐	☐
I can explain and apply the tests which govern third party liability for assisting in a breach of trust and receiving trust property.	☐	☐	☐

If you ticked 'need to revise first', which sections of the chapter are you going to revise?

		Must revise	Revision done
16.1	Liability of a trustees for breach of trust	☐	☐
16.2	Liability of trustees *inter se*	☐	☐
16.3	Liability of third parties	☐	☐
16.4	Dishonest assistance	☐	☐
16.5	Knowing receipt	☐	☐

17 Breach of fiduciary duty

Contents

Introduction

As discussed in Chapter 4, the trustees' primary duties are to keep accurate trust accounts, obey the terms of the trust and take care of the trust property. A breach of any of those duties is a breach of trust which is discussed in Chapter 16. Express trustees also owe fiduciary duties to exercise their powers only for the purposes for which they were granted and not to benefit themselves or for any other improper purpose. Trustees are not the only fiduciaries. There are many others, like company directors and officers, who also have discretionary powers to manage rights on behalf of others and are subject to fiduciary duties with respect to the exercise of their powers.

The law provides rules that are designed to make it more likely that fiduciaries will exercise their powers properly. Fiduciaries are not allowed to have personal interests or duties that conflict with their duties as fiduciaries, unless that conflict is authorised. They are also not allowed to make unauthorised profits from their positions as fiduciaries. These rules are often called the 'no conflict' and 'no profit' rules, respectively, and they function to reduce the temptations that fiduciaries might have to use their powers improperly. There are also rules, called the 'self dealing' and 'fair dealing' rules that regulate the powers of fiduciaries to acquire the rights they manage for their own personal use.

Core text

- **Penner, Chapter 7 'The beneficiary principle' and Chapter 14 'Fiduciary relationships'.**

Essential reading

- **Section 4.2 of the module guide.**

Learning outcomes

By the end of this chapter and the relevant readings, you should be able to:

- **explain what fiduciary duties are, and distinguish them from the other duties that a trustee might have**
- **describe the consequences that attach to the receipt by a fiduciary of an unauthorised profit**
- **explain what happens when a trustee purchases trust property for their own use or sells property to the trust**
- **describe the circumstances in which a trustee may safely purchase the interests of their beneficiaries**
- **explain and apply the law governing equitable compensation for breach of fiduciary duty**
- **explain the uncertainty regarding the application of trustee exemption clauses to a breach of a trustee's fiduciary duty.**

17.1 Fiduciary relationships

A fiduciary is someone who manages rights or activities on behalf of others. An express trustee is often regarded as the paradigm fiduciary. Trustees are required to use the trust property only according to the terms of the trust for the benefit of the beneficiaries, or for the public benefit in the case of charitable purpose trusts. There are many other fiduciaries, including agents, business partners, company directors and officers, senior employees, guardians, personal representatives (i.e. executors and administrators) and solicitors. The list is not closed.

The essence of a fiduciary relationship is that the fiduciary is in a position to exercise discretion in carrying out the duties for their principal. So, for example:

- trustees exercise discretion when investing the trust property
- agents exercise discretion when making contracts for their principals
- company directors exercise discretion in the way they run the company.

It is commonly said that fiduciaries must act in the best interests of their principals. Care must be taken not to be misled by the use of the term 'principal' in this context. It does not indicate that there is an agency relationship, but is used in the literature on fiduciaries as a convenient term to describe any person to whom fiduciary duties are owed, including trust or estate beneficiaries, clients, companies, employers, partners, or actual principals.

Also, it can be misleading to say that fiduciaries must act in the best interests of their principals. Charitable purpose trusts do not have beneficiaries and, although they are enforced by the Charity Commission, there is no-one who could be regarded as a principal whose interests must be served. Express trustees owe the same fiduciary duties whether the trust has beneficiaries or not, and it does not make sense to say that trustees must act in the best interests of a purpose.

17.2 Breach of trust versus breach of fiduciary duty

It has been argued that every breach of trust is also a breach of fiduciary duty: P. Birks 'The content of fiduciary obligations' (2002) 16 *Trust Law International* 34. However, the Court of Appeal has held that a breach of a duty of care by trustees is not a breach of their fiduciary duties: *Bristol & West Building Society* v *Mothew* [1988] Ch 1. The typical case of breach of trust, where trustees make an unauthorised investment or pay a non-beneficiary, is not a breach of fiduciary duty unless the trustees did so because of a conflict of interest or duty. In the same way, agents who breach their contracts of agency are not at the same time always in breach of their fiduciary duties. A breach of fiduciary duty generally occurs when fiduciaries do something they are entitled to do, but in a way that shows that they are not acting for proper purposes.

Suppose, for example, that trustees decide to invest trust property by purchasing shares in a mining company. If that investment is unauthorised by the terms of the trust, it would be a breach of trust, but not necessarily a breach of fiduciary duty. If instead the investment is authorised, then normally the trustees would be perfectly entitled to make it. However, if they or their loved ones had an interest in the company or sold their own shares to the trust, this otherwise valid investment would reveal a clear conflict of interest. By investing in this way, the trustees do not breach the terms of the trust, but they will be in breach of fiduciary duty unless they have the beneficiaries' fully informed consent to the transaction.

Activity 17.1

Why specifically is there a conflict of interest in the above example?

17.3 The 'no conflict' rule

The general rule governing the behaviour of fiduciaries is that they must not place themselves in a position where their own interests (or their duties to others) may come into conflict with their duties to carry out their functions as trustees, agents, directors, etc. In other words, fiduciaries must avoid conflicts between their duties to their principals and their own interests or other duties. The leading case is *Boardman* v *Phipps* [1966] UKHL 2, [1967] 2 AC 46.

ACTIVITY 17.2

Read *Boardman* v *Phipps* and:

a. explain the views of the majority and the minority in the case;

b. state which view(s) you prefer, giving your reasons.

You should take care to note that fiduciaries can breach their fiduciary duties entirely honestly, as in *Boardman*. Although traditionally a breach of fiduciary duty was sometimes called equitable or constructive fraud (see *Nocton* v *Lord Ashburton* [1914] AC 932; *Armitage* v *Nurse* [1997] EWCA Civ 1279, [1998] Ch 241), no fraudulent intentions are required. The breach does not depend on whether or not the fiduciaries realise that they are acting in a situation of conflict but on whether there is in fact a conflict of interest.

Boardman was a case that involved a trust, but most of the situations in which the 'no conflict' rule has been applied concern company directors and agents (*Regal (Hastings) Ltd* v *Gulliver* [1942] UKHL 1, [1967] 2 AC 134; *Industrial Development Consultants Ltd* v *Cooley* [1972] 1 WLR 443). Because these fiduciary duties often arise in commercial circumstances, it has been argued that the 'no conflict' rule must be applied realistically and contextually. For conflicts of interest in such situations are endemic, and typically the subject of contractual negotiation between fiduciaries and their principals. For example, contractual provisions may allow company directors to determine their own levels of pay or also hold directorships in competing companies.

Unless the principal consents, a fiduciary may not operate a competing business (*Re Thomson* [1930] 1 Ch 203), but the scope of that prohibition is not entirely clear. It has been said that a stringent application of the rule to business opportunities may be economically inefficient, reducing incentives to generate wealth, and anti-competitive in certain circumstances. (See *Peso Silver Mines Ltd* v *Cropper* [1966] SCR 673, 58 DLR (2d) 1 (Canada); *Canadian Aero Services Ltd* v *O'Malley* [1974] SCR 592, 40 DLR (3d) 371 (Canada); *Guth* v *Loft Inc* (1939) 5 A 2d 503 (Delaware); *Broz* v *Cellular Information Systems Inc* (1996) 673 A 2d 148 (Delaware); *Queensland Mines Ltd* v *Hudson* (1978) 18 ALR 1 (PC); *Island Export Finance* v *Umunna* [1986] BCLC 460; *Balston Ltd* v *Headline Filters Ltd* [1987] FSR 330.)

17.4 The 'no profit' rule

The 'no profit' rule is a sub-rule of the no conflict rule. Principals may remunerate their fiduciaries or expressly allow them to retain any incidental profits acquired in the course of carrying out their fiduciary duties. However, if fiduciaries were allowed to retain unauthorised or 'secret' profits, their own interests would be to seek out and obtain those profits and this would be in conflict with their interests to perform their duties to their principals properly: *Bray* v *Ford* [1896] 2 AC 46. Most fiduciaries are, of course, authorised to receive some payments in connection with their work. Directors and agents are typically paid for their services. Most trust instruments contain charging clauses entitling the trustees to be paid for their services on an ongoing basis out of the trust funds. See *Duke of Norfolk's Settlement Trusts* [1982] Ch 61 for a discussion of the circumstances in which a trustee can apply for increased remuneration beyond that provided for in the trust instrument.

A fiduciary will be stripped of any unauthorised profit made in breach of fiduciary duty and required to surrender it to the principal, either as a personal liability to account for its value or as a constructive trust of the right obtained as a profit (or its traceable proceeds). As discussed in Chapter 13, there had been a long-running debate

about which of these responses is appropriate, which was resolved (not entirely satisfactorily) in *FHR European Ventures LLP* v *Cedar Capital Partners LLC* [2014] UKSC 45, [2015] AC 250.

The sorts of cases in which incidental profits may arise are numerous. Where a trust has a majority shareholding in a company, and the trustees use their voting power to become appointed as directors, they may not keep for themselves any fees earned as directors, unless they are authorised to do so: *Re Macadam* [1946] Ch 73. In *Williams* v *Barton* [1927] 2 Ch 9, the trustee received a commission from a brokerage firm for introducing new clients to them, and he was liable to the trust for the commission he received for bringing in the trust business. A trustee will be stripped of any profits earned by engaging in business in competition with that of the trust: *Re Thomson's Settlement* [1986] Ch 99. For obvious reasons, a fiduciary will be stripped of any bribe accepted to exercise their fiduciary powers for the advantage of the persons paying the bribes: *A-G for Hong Kong* v *Reid* [1993] UKPC 2, [1994] 1 AC 324, [1994] 1 NZLR 1.

Self-assessment question

1. **To which of the following profits does the 'no profits' rule apply?**
   a. **Director's fees earned by a trustee elected to represent the trust's share-holding.**
   b. **A company agent's year-end performance bonus.**
   c. **A bribe paid to a solicitor to settle a case on favourable terms.**
   d. **A secret commission paid by a vendor to a purchaser's agent.**

17.5 The 'self dealing' rule

Self dealing occurs when a fiduciary transacts with the principal and the fiduciary is involved in both sides of the transaction. For example, suppose that a trustee buys company shares from 'the trust'. Since the trust is not a legal person and the trustee is already the owner of the shares, this transaction is really just entries in the trust account and a transfer of money from the trustee's personal bank account to the trust bank account. Clearly, the trustee's personal interests are in conflict with her or his duties as trustee. Unless the beneficiaries have been fully informed and had properly consented to the transaction, they will be entitled to set it aside regardless of whether or not it was fair. The 'self dealing' rule applies not only where fiduciaries enter into transactions in their own name, but also where they are involved in the other side of the transaction through a nominee, partnership, or company of which the trustee is a director.

The remedies available to the beneficiaries depend on whether the contract of sale is still executory (i.e. not yet performed) or performed, and if performed, whether the right has been sold on to a *bona fide* purchaser. If the contract has not yet been performed, the fiduciary is not allowed to perform it. Where the contract has been performed and the fiduciary still has the right, or it is in the hands of a third party who is not a *bona fide* purchaser of a legal right for value, the fiduciary or third party must reverse the transaction and restore the prior situation. If the transaction cannot be reversed, perhaps because the fiduciary has sold the rights (assuming legal) on to a *bona fide* purchaser, the fiduciary will be liable for any profits made from the sale. If it can be shown that the right was sold on at an undervalue, the fiduciary will be liable for the profit that should have been earned. In short, where a transaction cannot be reversed, the trustee will be required to pay to the principal an amount calculated to ensure that the principal receives the full market value of the right in question.

Activity 17.3

Read *Holder* v *Holder* [1968] Ch 353, and explain why the self-dealing rule was not applied in that case.

17.6 The 'fair dealing' rule

The fair-dealing rule applies to transactions in which the fiduciary purchases from the principal property over which the fiduciary has some control. The classic example is a trustee who purchases the interest under the trust of one of the beneficiaries. A non-trustee example is where a manager of a block of flats offers to buy the freehold title from the landlord. Notice that in these cases, unlike the cases to which the self-dealing rule applies, there really are two parties to the transaction: the fiduciary cannot act as both vendor and purchaser, but must deal with the principal to complete the transaction. Thus the danger is less.

The rationale behind the rule is that having dealt with the property in question in the past, the fiduciary is probably in a better position to negotiate, knowing more about their value, and so on. Of course, in entering into such a transaction, the fiduciary's own interests are in conflict with those of the principal. Notice that the rule applies only to transactions concerning rights that are the subject matter of a trust or business in which the fiduciary acts for the principal.

Under the fair-dealing rule the fiduciary has the burden of proof (*Re Thompson's Settlement* [1986] Ch 99) to show that:

- the fiduciary did not take advantage of their position
- the fiduciary disclosed all relevant information to the principal
- the beneficiary did not rely solely on the fiduciary's advice to enter into the transaction, and
- the price was fair.

Where the fair-dealing rule applies to impeach a transaction, the remedies are the same as in the self-dealing case. The transaction can be set aside if possible, and if not (typically because the right has been sold on to a *bona fide* purchaser of a legal right for value), then the fiduciary will be liable to pay an amount to ensure that the principal receives its full market value.

ACTIVITY 17.4

State whether the self-dealing rule, the fair-dealing rule, or neither, applies to the following transactions:

a. **A trustee sells her shares in XYZ plc to the trust.**

b. **An agent for an antiques dealer offers to buy the latter's antiques business.**

c. **A trustee pays an income beneficiary £10,000 to purchase the beneficiary's right to income under the trust for the next 10 years.**

d. **A solicitor buys a painting from Jonah, for whom he acted in divorce proceedings.**

e. **A director of ABC Ltd enters into a contract on its behalf for the purchase of raw materials from XYZ Ltd, a private company she owns.**

17.7 Equitable compensation

As we have seen, the normal responses to a breach of fiduciary obligation are rescission of the breaching transaction, an account of profits, or a constructive trust. In certain circumstances, that is not possible. If, for example, in breach of fiduciary duty, a solicitor advised a client to enter into a transaction that turned out to be financially disastrous, the transaction is not reversible by the solicitor, because the solicitor did not enter into it. All the client can do is seek compensation for the loss caused by following the solicitor's tainted advice. This is a claim for equitable compensation (i.e. the equivalent to damages at common law for a tort or breach of contract, as discussed in Chapter16).

The leading case is *Nocton* v *Ashburton* [1914] AC 932. A solicitor advised his client to release a security interest, which he did. The transaction was in furtherance of a land development scheme, and the solicitor's advice was given in conflict of interest: the release of the security would increase the possibility of the solicitor realising his own investment in the scheme, whereas in doing so the risk that the claimant's personal liability if the scheme went awry (which it did) was increased. The House of Lords held that the solicitor must compensate the client for his loss.

As we have seen (Section 16.1.4), the principles regarding causation of loss in equity are different from common law principles. The equitable principles are designed 'to make good a loss in fact suffered by the beneficiaries, which using hindsight and common sense, can be seen to have been caused by the breach' (*Target Holdings Lt*d v *Redferns* [1995] UKHL 10, [1996] AC 421, per Lord Browne-Wilkinson). Two cases where these principles were applied to a breach of fiduciary obligation are *Canson Enterprises Ltd* v *Boughton & Co* [1991] 3 SCR 534, 85 DLR (4th) 129, a Canadian case discussed in *Target Holdings*, and *Swindle* v *Harrison* [1997] 4 All ER 705 (CA).

In *Canson*, a solicitor breached his fiduciary duty to his client, whom he advised in a land title purchase, by failing to inform it that the vendors had made an improper profit. It was established that, had the client known about this, it would have withdrawn from the purchase. The client went on to build a warehouse on the land, and because of the negligence of its builders and engineers, the warehouse was defective, leading to a large financial loss. The client sued the solicitor for the loss, arguing that, if the solicitor had complied with his duty, the client would not have purchased the land and then gone on to develop it with such disastrous results. The Supreme Court of Canada held that the solicitor's breach of duty did not cause the client's loss.

In *Swindle* v *Harrison*, a solicitor (the unfortunately named Mr Swindle) arranged bridging finance for a client to purchase land, but breached his fiduciary duty to her by failing to tell her that he received a commission for so doing. The bridging finance permitted her to purchase the land, on which she briefly ran a hotel and restaurant business that failed because of her disastrous management skills, causing her loss. She sued the solicitor, claiming that his breach of duty had caused the loss on the basis that had he not arranged the bridging finance (in the course of doing which he breached his fiduciary duty to her), she would not have been able to purchase the property, start the business and suffer the loss. Not surprisingly, this claim also failed. Although the loss for which compensation was sought might not have happened 'but for' the defendant's breach, it did not flow from the breach in the sense of being caused by it.

In *Canson*, the cause of the loss was the negligence of the claimant's builders and engineers, and in *Swindle*, it was caused by the claimant's decision to run the business and failure to run it properly.

It would appear that the reason why these claimants thought it possible to claim for these losses was that the principles of causation that apply to the award of equitable compensation were thought to be more flexible and generous to claimants than common law principles.

Summary

The fair-dealing rule applies to transactions in which the fiduciary has some control over the principal's rights in their fiduciary capacity and purchases them from the principal. Since there are two parties to the transactions, the danger here is less than in the self-dealing rule. The rule only arises concerning rights that are the subject of a trust or a business in which the fiduciary acts for the principal. The transaction will be a breach of the 'fair dealing' rule unless the fiduciary can prove that:

- the fiduciary did not take advantage of her or his position
- the fiduciary has disclosed all the relevant information to the principal
- the principal did not solely rely on the fiduciary's advice to enter into the transaction, and
- the price was fair.

In certain circumstances the breaching transaction cannot be reversed and so a different remedy is required. If the fiduciary made a profit from the transaction, the fiduciary will claim an account of profits or constructive trust. If the principal suffered a loss, the principal will make a claim for equitable compensation. Although the rules for causation of loss are thought to be more generous than the common law rules, *Canson Enterprises Ltd* v *Boughton & Co* and *Swindle* v *Harrison* appear to show otherwise. In both cases, the principal's claims failed even though the losses for which compensation was claimed would not have happened 'but for' the defendant's breach, but they still did not flow from the breach in the sense of being caused by it.

17.8 Trustee exemption clauses

Recall *Armitage* v *Nurse* [1997] EWCA Civ 1279, [1998] Ch 241 (**17.2.3**), which sets out the scope of trustee exemption clauses. Unfortunately, the case is unclear about the application of such clauses to breaches of fiduciary duties. Millett LJ regarded the core duties of trustees as including a duty of loyalty, which suggests that fiduciary obligations are core duties that cannot be covered by an exemption clause. However, the judgment does not actually say that. In particular, it focuses on the trustee's state of mind, holding that a clause cannot exempt liability for intentionally fraudulent or reckless acts. As we have seen in Section 17.3, breaches of fiduciary obligation do not necessarily involve dishonesty or recklessness. The defendant in *Boardman* was liable even though his intentions were wholly honest. Millett LJ specifically declined to discuss the application of such clauses to different sorts of breach of fiduciary obligation in detail, as no such conduct was pleaded by the claimant. As a consequence, the limits of trustee exemption clauses remain uncertain.

The issue was, however, raised in the decision of the Court of Appeal in *Barnsley* v *Noble* [2016] EWCA Civ 799, [2017] Ch 191. The case concerned trustees and executors of a will, who had been accused of self-dealing. They sought to escape liability by reliance on an exemption clause in the will, which provided:

> In the professed execution of the trusts and powers hereof no trustee shall be liable for any loss to the trust premises arising by reason of any improper investment made in good faith … or by reason of any other matter or thing except wilful and individual fraud or wrongdoing on the part of the trustee.

The Court of Appeal held they could so rely, though the case is only concerned with the interpretation of the clause. The argument above that an obligation not to self-deal forms part of the core duties of a fiduciary and so is non-excludable was unfortunately not put to the court.

SELF-ASSESSMENT QUESTIONS

1. **In a trust, who is the fiduciary?**
2. **State the 'no conflict' rule as simply as you can.**
3. **What is the 'no profit' rule?**
4. **What was the breach of fiduciary duty in *Swindle* v *Harrison*?**
5. **What duties, if any, are breached if (a) a trustee buys a second-hand car from the trust, or (b) a trustee buys a second-hand car from one of the beneficiaries of the trust?**

ESSENTIAL READING

- ***Keech* v *Sandford* (1726) Sel Cas T King 61, 25 ER 223; *Boardman* v *Phipps* [1966] UKHL 2, [1967] 2 AC 46; *Holder* v *Holder* [1968] Ch 353; *Re Thompson's Settlement* [1986] Ch 99.**

Further reading

- Birks, P. 'The content of fiduciary obligations' (2002) 16 *Trust Law Int* 34.
- Conaglen, M. 'A re-appraisal of the fiduciary self-dealing and fair-dealing rules' (2006) 65 *CLJ* 366.
- Lee, R. 'Rethinking the content of the fiduciary obligation' [2009] 73 *Conv* 236.
- Penner, J. 'Distinguishing fiduciary, trust, and accounting relationships' (2014) 8 *J Equity* 202.
- Smith, L. 'Fiduciary relationships: ensuring the loyal exercise of judgement on behalf of another' (2014) 130 *LQR* 608.
- Worthington, S. 'Four questions on fiduciaries' (2016) 2 *Canadian J Comparative and Contemporary L* 723.
- *Regal (Hastings) Ltd* v *Gulliver* [1942] UKHL 1, [1967] 2 AC 134.

Sample examination questions

Question 1 Richard managed Paul's pub. In January, he fired the regular Friday night DJ in order to hire his brother, Quentin, for the job. Even though Quentin is inexperienced, Richard paid him twice what he had paid the old DJ. In February, Richard changed the beer supplier, accepting a £2,000 'signing bonus' from the new supplier, which he invested in shares now worth £3,000. In March, Richard persuaded Paul to sell the pub to him. Richard's accounts for the pub business were in disarray, so it was difficult to value the business, but Paul accepted Richard's estimate as to the pub's profitability and on that basis sold the pub to him for £150,000. In April, Richard sold the pub to a large brewer for £300,000. Advise Paul.

Question 2 'A fiduciary duty is difficult to define, but a breach of fiduciary duty is easy to spot, which is why the content of fiduciary duties is best understood by looking at the various cases in which they are breached.' Discuss.

Question 3 Fred was recruited by Massive Music Ltd (MML) to scout for new talent. He was told by his friend, Susan, an employee of Rage Records plc (RRP), that a new band in Scotland, Pot of Gold (POG), was worth investigating. Paying for his flight on his MML expense account, Fred listened to and interviewed the band with a view to signing them with MML. The band members adamantly refused to sign with MML because of its English origins, but indicated they would sign with RRP, a global American company. Fred arranged to sign them with RRP instead, collecting a £50,000 fee from RRP, which he used to pay off his mortgage. POG has since made £2.5 million in profits for RRP. Fred did, however, sign his brother, Liam, to a lucrative contract with MML, which was unaware that Liam was Fred's brother. MML lost £500,000 recording and promoting Liam, whose contract was terminated. Advise MML.

ADVICE ON ANSWERING THE QUESTIONS

Question 1 This is a straightforward question involving several breaches of fiduciary duties. In making the decision to fire the former DJ and hire his brother at twice the salary, Richard favoured the interests of a third party (his brother) over those of Paul. The transaction cannot be 'reversed' in the typical sense, since the transaction did not involve a transfer of property. Paul can claim that Richard compensate him for any losses caused by the decision, in particular the cost of Quentin's salary in excess of what an inexperienced DJ's services are worth. If Quentin's hiring can be shown to have led to a decline in business, that loss can also be claimed. Quentin will only be personally liable as a third-party accessory to a breach of Richard's fiduciary duty or as a recipient of payments made in breach of fiduciary duty if it can be established that he accepted the job dishonestly in the knowledge that Richard ought not to have hired him. The 'signing bonus' is clearly an unauthorised profit. If the money is held under a constructive trust (see Chapter 13) its value can be traced into the shares. The purchase of the pub clearly breaches the fair-dealing rule, and Richard will be liable to compensate Paul in the amount of £150,000 so that Paul receives the full market value of the pub. The transaction is unlikely to be reversible because it is very unlikely that the large brewer is not a *bona fide* purchaser.

Question 2 A good answer to this question will explore the different rules indicating the way in which fiduciary duties can be breached (i.e. 'no-conflict', 'no profit', 'self dealing' and 'fair dealing' rules). These should be discussed with the aim of explaining how they shape a fiduciary's duties to their principal. A very good answer will tackle the quotation more directly by proposing a more general explanation or theory of fiduciary duties which tries to show the common basis for the various rules.

Question 3 The question concerns the no-conflict rule in the context of a business opportunity. It is clear that the opportunity to recruit POG came Fred's way when he was acting in the capacity of fiduciary to MML. As the decisions in *Keech* v *Sandford* (1726) and *Industrial Development Consultants Ltd* v *Cooley* (1972) make clear, the fact that POG will not sign with MML under any circumstances does not allow Fred to pursue the opportunity in another way to his own advantage. In such a circumstance, Fred could only proceed by fully informing MML of the situation and gaining their consent to act on his own behalf. As he did not do so, he may be stripped of any profits he acquires from realising the opportunity. Thus he will be required to account for the £50,000 signing fee from RRP, which can be traced into the mortgage payment if held by him on constructive trust (see Chapter 13). It is unlikely that RRP will be liable to MML, as it is difficult to see how they could be shown to have acted dishonestly. The signing of Liam was in breach of the no-conflict rule, as with Quentin in Question 1, and Fred will be liable for all of the losses to his principal flowing from this breach, which in this case appears to be £500,000.

Reflect and review

Look through the points listed below.

Are you ready to move on to the next chapter?

Ready to move on = I am satisfied that I have sufficient understanding of the principles outlined in this chapter to enable me to go on to the next chapter.

Need to revise first = There are one or two areas I am unsure about and need to revise before I go on to the next chapter.

Need to study again = I found many or all of the principles outlined in this chapter very difficult and need to go over them again before I move on.

Tick a box for each topic.

	Ready to move on	Need to revise first	Need to study again
I can explain what fiduciary duties are, and distinguish them from other duties a trustee might have.	☐	☐	☐
I can describe the consequences which attach to the receipt by a fiduciary of an unauthorised profit.	☐	☐	☐
I can explain what happens when a trustee purchases trust property or sells property to the trust.	☐	☐	☐
I can describe the circumstances in which a trustee may safely purchase the interests of their beneficiaries.	☐	☐	☐
I can explain and apply the law governing equitable compensation for breach of fiduciary duty.	☐	☐	☐
I can explain the uncertainty regarding the application of trustee exemption clauses to a breach of a trustee's fiduciary duty.	☐	☐	☐

If you ticked 'need to revise first', which sections of the chapter are you going to revise?

		Must revise	Revision done
17.1	Fiduciary relationships	☐	☐
17.2	Breach of trust v breach of fiduciary duty	☐	☐
17.3	The 'no conflict' rule	☐	☐
17.4	The 'no profit' rule	☐	☐
17.5	The 'self dealing' rule	☐	☐
17.6	The 'fair dealing' rule	☐	☐
17.7	Equitable compensation	☐	☐
17.8	Trustee exemption clauses	☐	☐

NOTES

18 Claims based on tracing

Contents

Introduction

This chapter is concerned primarily with the recovery of property that has been misappropriated from a trust. In many cases, that property may have been sold on to a *bona fide* purchaser and so it is no longer possible to recover it. However, the beneficiaries may have a claim to the proceeds of sale. This raises two main questions. First, how do the beneficiaries identify the relevant proceeds of sale? That is a supposedly 'evidential' process called 'tracing'. Second, what sort of claims can the beneficiaries make to those proceeds? Both issues are discussed in this chapter.

This chapter is concerned not only with proprietary claims but also with personal claims that may depend on tracing. As discussed in Chapter 16, if property is transferred in breach of trust, someone may be personally liable for dishonest assistance if they help transfer that property, while the person who receives it may be personally liable for knowing receipt. It may be necessary to use tracing to show that the property handled by the assistant and received by the recipient were the traceable proceeds of the property misappropriated from a trust.

CORE TEXT

- **Penner, Chapter 15 'Third party liability for breach of trust and fiduciary obligations'.**

LEARNING OUTCOMES

By the end of this chapter and the relevant readings, you should be able to:

- **define the difference between following, tracing and claiming**
- **explain why the law of tracing often falls into the law of trusts**
- **explain when the common law does not allow a title holder to trace**
- **understand and apply the rules governing tracing through mixtures**
- **explain what backwards tracing is and why the law regarding it is unsettled**
- **outline the proprietary and personal claims that can arise following the tracing process**
- **show how rights to subrogation can arise following the tracing process.**

18.1 Tracing

Tracing is a process by which a claim to property held by a defendant can be transferred to another type of property that the defendant acquired in exchange for the original property. An example will help. If your trustee, in breach of trust, gives £10,000 of the trust money to Sally, you can, of course, claim against Sally for the return of that money. Having received the money as a gift, Sally is a donee (i.e. volunteer) and thus not a *bona fide* purchaser for value (see **4.1**). If Sally spends the money on a title to a car, then you can 'trace' from the original £10,000 to that car. Having traced in this way, you can then claim that the car is held on trust for you. Although the rules of tracing are fairly well settled, controversy still surrounds its juridical basis. Since virtually all cases involve torts or breaches of trust, some see it as a response to wrongdoing. Others, especially Birks, Burrows, Chambers and Lionel Smith, see it instead as a response to unjust enrichment. L.D. Smith (*The law of tracing* (Oxford: Clarendon Press, 1997) p.357) observed that trust claims based on tracing are 'functionally identical to purchase-money resulting trusts'. Others still regard it as a standalone process, peculiar to the law of trusts.

18.1.1 Following, tracing and claiming

It is helpful to distinguish between following, tracing and claiming. We follow property, trace through exchanges and claim property. This terminology was used by Smith in *The law of tracing* (1997) and adopted by Millett LJ in *Boscawen* v *Bajwa* [1995] EWCA Civ 15, [1996] 1 WLR 328. One **follows** property when it is transferred from one person to another. One **traces** from one type of property to another when the former is exchanged for the latter. One **claims** property that is identified by following or tracing. For example, if, in breach of trust, the trustee gave a title to a painting held on trust to John, the beneficiaries could follow it into John's hands and make a proprietary claim to it. If John sold the title to the painting for £1,000, they could trace through the exchange from the title to that money, and claim that the money is held for them on trust. If John paid the money into a bank account, they could trace from the money to the bank account (i.e. the bank's debt to John) and say that it is held on trust for them.

Go to the VLE and read 'Property, unjust enrichment, and tracing' by P. Birks.

It has been argued by Smith and others that when tracing through an exchange, one is tracing the value of the original property into the new right. However, if one type of property is exchanged for another, enabling the beneficiaries to claim a trust of the substitute, the value of that property is not relevant to the claim. For example, if £1,000 of trust money is used to buy a title to a painting, the beneficiaries can claim the title regardless of its value, even if it turns out to be worth millions: *Foskett* v *McKeown* [2000] UKHL 29, [2001] 1 AC 102.

Self-assessment question

In breach of trust, Tom paid £1,000 to Eric which he used to buy a title to a television. Eric then gave the title to the television to his girlfriend, Padma, who then traded it for a title to a sofa. The beneficiaries sued Padma for the title to the sofa.

Describe the basis of the beneficiaries' action, using the terms 'following', 'tracing' and 'claiming'.

18.1.2 Tracing at common law

Taylor v *Plumer* (1815) 3 M&S 562, 105 ER 721 is said to provide the foundational authority for the common law right to trace (i.e. for the legal owner of property to trace to property acquired in exchange and assert legal title to the new property) but that is questionable. It is now generally recognised that the case was decided upon equitable principles: see L. Smith 'Tracing in *Taylor* v *Plumer*: equity in the King's Court' [1995] 2 *LMCLQ* 240. Nevertheless, it appears that the common law can provide the legal owner with a power to assert title in the traceable proceeds (*Lipkin Gorman* v *Karpnale Ltd* [1988] UKHL 12, [1991] 2 AC 548). This requires an act on the part of the legal owner, who does not automatically, by operation of law, acquire ownership of traceable proceeds in the way the beneficiary does in equity in respect of the traceable proceeds of trust

property. To this extent, the power to assert title counts as tracing at common law. It also appears that the rules governing tracing through mixtures (discussed below) are less developed at common law than they are in equity.

In *FC Jones & Sons* v *Jones* [1996] EWCA Civ 1324, [1997] Ch 159, a trustee in bankruptcy was allowed to trace at common law from cheques drawn on the account of the bankrupt firm and paid into a brokerage account in the name of the wife of one of the partners. Millett LJ said (at [28]) that equitable tracing rules should be available in support of the common law claim:

> There is no merit in having distinct and differing tracing rules at law and in equity, given that tracing is neither a right nor a remedy but merely the process by which the plaintiff establishes what has happened to his property and makes good his claim that the rights which he claims can properly be regarded as representing his property. The fact that there are different tracing rules at law and in equity is unfortunate although probably inevitable, but unnecessary differences should not be created where they are not required by the different nature of legal and equitable doctrines and remedies. There is, in my view, even less merit in the present rule which precludes the invocation of the equitable tracing rules to support a common law claim; until that rule is swept away unnecessary obstacles to the development of a rational and coherent law of restitution will remain.

Summary

Where property has been transferred in breach of trust, equity allows beneficiaries not only to follow that property into the hands of third parties (not being *bona fide* purchasers for value without notice) but to trace to property received through an unauthorised exchange. After the exercise of tracing, beneficiaries may claim against the persons who hold or held the traceable proceeds of trust property. The common law has no exact equivalent to tracing, although it does allow title holders to assert a title in the traceable proceeds of property held at common law in certain circumstances. It is orthodoxy that the common law power to assert title cannot be exercised following the mixing of the property in question with other property.

18.1.3 The rules of tracing

The requirement of a fiduciary relationship

In order for an individual to have the advantage of the equitable rules of tracing, they must normally have a beneficial interest under a trust, for it is that property which is traced into proceeds. However, equity is also willing to allow claimants to trace where other fiduciaries breach their duty (*Re Diplock* [1948] Ch 465 (CA), affirmed [1951] AC 251). So, for example, if company directors use their power to transfer the company's property in breach of their fiduciary duties, say by transferring company money to their own bank accounts, the company will have the advantage of the equitable rules of tracing to trace into any proceeds acquired with that money. Courts have shown themselves willing to find the existence of a fiduciary relationship in order for plaintiffs to apply the tracing rules (*El Ajou* v *Dollar Land Holdings* [1993] 3 All ER 717), even where none really existed (*Chase Manhattan* v *Israel-British Bank* [1981] Ch 105).

Whole and part ownership

These rules are straightforward. If the trustee takes £500 of trust money and spends it all to buy a title to a rare book, the beneficiaries can claim that the book is held for them absolutely. If the trustee uses £250 of trust money and £250 of their own money to buy the book, it will be held by the trustee for the trustee and beneficiaries in equal shares: see *Foskett* v *McKeown* [2000] UKHL 29, [2001] 1 AC 102.

Tracing through mixtures

What happens when the trustee or a third-party recipient of trust property mixes them with their own so that the original property cannot be identified? The rules have largely developed in the case of a trustee or recipient mixing trust money or its traceable proceeds with their own by depositing it at a bank so as to add to the balance of their

bank account; for example, depositing £500 of trust money in their bank account, which has a balance of £250, raising the balance to £750. The first thing to note is that equity does not regard this mixing as giving rise to co-ownership of the chose in action against the bank, as it does in the example of the last section where trust money and the trustee's money went to purchase a rare book. The trust does not have a 2/3 share in the chose in action, the trustee a 1/3 share. Equity seems to hold that the trust money and the trustee's money remain separately held, although which money belongs to whom is not distinguishable. Because of this, if £300 is withdrawn from the bank account by the trustee and spent on an armchair, it is not regarded as co-owned by them in 2/3 and 1/3 shares. Rather, equity employs rules to determine whose money was withdrawn and spent to acquire the title. The rules are different when the person who mixes the trust money is a wrongdoer, for example, a trustee in breach or a third-party recipient who takes trust property in the knowledge that they receive it in breach of trust, from those that apply to an innocent mixer, such as a third-party recipient who does not know that the money was wrongfully taken from a trust.

The rules governing wrongdoers

Go to the VLE and read 'Tracing, "swollen assets" and the lowest intermediate balance rule' by L.D. Smith.

The rules are wrongly seen as a set of evidentiary presumptions. The first presumption is that wrongdoers who mix trust money or its traceable proceeds with their own, and then take money out of the mixture and spend it, are 'presumed' to spend their own money first, so that anything which remains can be claimed by the beneficiaries: *Re Hallett's Estate* (1880) 13 Ch D 696 (CA). However, equity very soon afterward admitted the opposite 'presumption' in *Re Oatway* [1903] 2 Ch 356 where a beneficiary was able to make a claim to shares bought with money first taken from the mixture and where the rest was then dissipated with no traceable product. The explanation traditionally given is that there is a presumption that the trustee always acts in the best interests of the trust beneficiaries. However, that presumption is constrained by another rule, the lowest intermediate balance rule. Say, for example, following the purchase of a worthless armchair, the trustee spends the rest of the money in the account on worthless shares, reducing the balance to zero. The trustee then adds £500 of their own money. The courts have held that the beneficiary cannot claim that the new balance of £500 is theirs. If the trustee spends all the trust money and later replenishes the account, as in this example, it will not be presumed that they were paying back the trust money they took, despite the fact that that is exactly what a trustee who was acting in the best interests of their beneficiaries would do: *James Roscoe (Bolton) Ltd* v *Winder* [1915] 1 Ch 62 (affirmed in *Bishopsgate Investment Management Ltd* v *Homan Ltd* [1994] EWCA Civ 33, [1995] Ch 211).

A presumption of honesty does not therefore work. In any case, it is difficult to see why we should be presuming someone to be honest when all the evidence shows the exact opposite. In truth, the only way to reconcile these three cases is not to think of presumptions at all, but in terms of the resolution of evidential difficulties. In both *Hallett* and *Oatway* such difficulties existed. Somebody's money was left in the account in *Hallett*, while somebody's money bought the shares in *Oatway*. The difficulty was that the trustee's wrongful act of mixing made it impossible to tell whose it was. It might have been the trustee's own money, it might have been the trust money, or it might have been a combination of both. That evidential difficulty having been caused by the trustee's wrongful act, the benefit of the doubt was given to the innocent party, the beneficiaries. Thus, if it suited the beneficiaries to say that trust money had been spent first, as in *Oatway*, then they could do so. On the other hand, if it suited them to say that the trustee's own money had been spent first, as in *Hallett*, they could do that as well. But when we get to a case like *Roscoe* v *Winder* [1915] 1 Ch 62, there is no doubt to resolve beyond the lowest intermediate balance, for we know where the money came from which later increased the balance: from the trustee's own funds.

The rules governing innocent persons

The beneficiary does not get the benefit of any doubt against an innocent person who mixes trust money with their own. The rules attempt to be neutral as between them. However, the traditional rule tended to lead to haphazard results. That rule, drawn from *Clayton's case* (1816) 8 LJ Ch 256, is the 'first in first out' (FIFO) rule, which works

exactly as it sounds. Thus, if an innocent recipient added £500 of trust money to their bank account already containing £250, then their money will be spent first. So the innocent recipient will acquire a 5/6 share of a title to an armchair bought for £300, since all of their £250 was used up in the purchase, and the beneficiary gets a 1/6 share, since to make up the £300 purchase price the innocent had to draw upon £50 of the trust money. The remaining £450 in the account is all the beneficiary's, and so if it is spent on worthless shares, they are the beneficiary's alone. The Court of Appeal in *Barlow Clowes International Ltd* v *Vaughan* [1991] EWCA Civ 11, [1992] 4 All ER 22 affirmed the general applicability of the FIFO rule, but it also acknowledged that it can work unfairly, and indeed in that case the claimants were treated as having shares in the entire fund proportionate to their contributions, so that they shared *pro rata* in the traceable proceeds available.

Activities 18.1 and 18.2

18.1 In breach of trust, Thomas transferred £10,000 to Victor, telling him that the money was a birthday present. Victor paid the money into his bank account, raising the balance to £13,000. He then withdrew £5,000 and used it to buy a title to a painting, now worth £7,000. He next withdrew £4,000, which he spent on a round-the-world cruise. He was then informed of the fact that the £10,000 he received was transferred in breach of trust. He then spent a further £3,000 from the account to buy a title to a car, which has since decreased in value, leaving a balance of £1,000. Advise the beneficiaries of the trust.

18.2 Tara, a trustee of the Adams family trust and also the Khan family trust, improperly withdrew £20,000 from the Adams trust and deposited it in her bank account, raising the balance to £30,000. She then withdrew £15,000 from the account to buy shares which have since doubled in value. She then, in breach of trust, added to the same account £40,000 from the Khan family trust, raising the balance to £55,000. She then spent £10,000 on shares which have also doubled in value, then £25,000 on a title to a car now worth half that amount, and later £15,000 on her general living expenses. She then added £20,000 of her own money, raising the balance to £25,000. Advise the beneficiaries of the two trusts.

Backwards tracing

Backwards tracing is the notion that beneficiaries can trace into a right that was purchased on credit when the provider of that credit is paid off with trust money. Thus, if a trustee or recipient of trust funds buys a title to a car for £10,000 with money borrowed from a bank or with their credit card and then pays off the loan or credit card bill with trust money, can the beneficiaries trace backwards and claim the car as the traceable proceeds of the trust money? Without saying so, English law seems to have allowed backwards tracing in a few exceptional cases: *Agip (Africa) Ltd* v *Jackson* [1990] Ch 265; affirmed [1990] EWCA Civ 2, [1991] Ch 547 (backwards tracing through the bank clearing system); *El Ajou* v *Dollar Land Holdings plc* [1993] 3 All ER 717 (Ch D); reversed [1993] EWCA Civ 4, [1994] 2 All ER 685 (tracing through credit facilities); *Foskett* v *McKeown* [2000] UKHL 29, [2001] 1 AC 102 (tracing into payments made on a right, a life insurance policy that had already been acquired). In *Bishopsgate Investment Management Ltd* v *Homan* [1994] EWCA Civ 33, [1995] Ch 211, the Court of Appeal denied that backwards tracing was recognised in English law and in *The Serious Fraud Office* v *Hotel Portfolio II UK Ltd* [2021] EWHC 1273 (Comm) the High Court held that assets acquired through a loan could not be traced when the loan was repaid using money acquired in breach of trust because those assets had been acquired before the breach of trust. That would be pure 'backwards tracing', which was not permissible and the facts did not fall within any of the permissible exceptions to that rule.

Note, however, by way of contrast that the Privy Council, on appeal from the Court of Appeal of Jersey, expressly allowed backwards tracing in *Federal Republic of Brazil* v *Durant International Corp* [2015] UKPC 35, [2016] AC 297. A total of US$10.5 million in bribes had been paid into a bank account and, at roughly the same time, a total of

US$13.5 million had been paid out of that account to the defendants. However, only US$7.7 million in bribes had been paid into the account before the money had been paid out to the defendants. The remaining US$2.8 million in bribes had been paid into the account after the defendants had been paid. The Privy Council held that all the bribes could be traced to the defendants. Lord Toulson said:

> 33. … the plaintiffs submit, as Professor Smith argues, that money used to pay a debt can in principle be traced into whatever was acquired in return for the debt. That is a very broad proposition and it would take the doctrine of tracing far beyond its limits in the case law to date. As a statement of general application, the Board would reject it. The courts should be very cautious before expanding equitable proprietary remedies in a way which may have an adverse effect on other innocent parties. If a trustee on the verge of bankruptcy uses trust funds to pay off an unsecured creditor to whom he is personally indebted, in the absence of special circumstances it is hard to see why the beneficiaries' claim should take precedence over those of the general body of unsecured creditors.
>
> 34. However there may be cases where there is a close causal and transactional link between the incurring of a debt and the use of trust funds to discharge it…
>
> 38. The development of increasingly sophisticated and elaborate methods of money laundering, often involving a web of credits and debits between intermediaries, makes it particularly important that a court should not allow a camouflage of interconnected transactions to obscure its vision of their true overall purpose and effect. If the court is satisfied that the various steps are part of a co-ordinated scheme, it should not matter that, either as a deliberate part of the choreography or possibly because of the incidents of the banking system, a debit appears in the bank account of an intermediary before a reciprocal credit entry…
>
> 39. … An account may be used as a conduit for the transfer of funds, whether the account holder is operating the account in credit or within an overdraft facility.
>
> 40. The Board therefore rejects the argument that there can never be backward tracing, or that the court can never trace the value of a right whose proceeds are paid into an overdrawn account. But the claimant has to establish a co-ordination between the depletion of the trust fund and the acquisition of the right which is the subject of the tracing claim, looking at the whole transaction, such as to warrant the court attributing the value of the interest acquired to the misuse of the trust fund.

The crucial point to note here is his lordship's endorsement of the doctrine of backwards tracing in situations where there is a 'close causal and transactional link' between the transactions in question. It may well be that this is an exception to the general impermissibility of backwards tracing, which would apply in English law (even though *Durant* was decided under the law of Jersey). This approach – to allow backwards tracing when there is a 'close causal and transactional link' – is supported, *obiter*, in *Shovlin* v *Site Civils and Surfacing Ltd* [2022] EWHC 3198 (Ch).

Activity 18.3

Read *Federal Republic of Brazil v Durant International Corp* and explain what it decides, assessing whether the reasoning is persuasive.

18.2 Claiming

18.2.1 Personal claims

Recall the description throughout Chapter 16 of the various claims that can be made against trustees and third parties in cases of breach of trust. In many cases, such claims will depend upon tracing, because it is only after the process of tracing has been undertaken that it will be known whether certain claims arise. So, for example, if the trustee transfers money in breach of trust to a third party, Sam, who adds it to his bank account, any 'proprietary' claim against Sam will involve tracing through exchanges from the trust money to the bank account or to property purchased from withdrawals from that account. Similarly, a personal claim can be reliant upon the tracing process. Let

us say that Sam now draws a cheque for £1,000 on the account in favour of his cousin, Madeleine, telling her that it is a birthday present, and let us further assume that one can trace some of the trust money into that payment. Now assume that Madeleine finds out that the money was wrongly taken from the trust, but decides to spend the money on a holiday to Italy regardless. Madeleine may be personally liable for 'knowing receipt', as she dishonestly dealt with trust property, or rather the traceable proceeds of trust property. That is, although no proprietary claim can arise against Madeleine, for she has spent the trust money, she may be personally liable to restore its value to the trust. Unless we had followed and traced the trust property from the trustee to Sam, and then traced through his bank account into the property that we followed into Madeleine's hands, this personal claim could not arise. So remember that although tracing is a process of dealing with property, it can be an essential feature in establishing personal, not just proprietary, claims.

18.2.2 'Proprietary' claims

There are two standard 'proprietary' claims that can be made in respect of traceable property. Where the traceable proceeds are now property that has risen in value, the beneficiary will claim that it is held for them in trust, because they will then have the advantage of the rise in value. Where the property has declined in value, the beneficiary can decline ownership of the property and instead demand repayment of the trust money, with that debt secured by an equitable lien over the property. An equitable lien is an entitlement to have property sold to pay off a debt, if the debt in question is not paid off by the debtor.

A lien will be most convenient for the beneficiary in the case where property is purchased with money from both the beneficiary and the wrongdoer and it later declines in value. For example, suppose £5,000 of the trustee's own money were used to purchase a title to a car for £10,000 which is now worth only £7,000. If the beneficiaries claim an ownership share, they will have a half-interest in the title to the car worth only £3,500. They would be better to forgo that claim and demand that the trustee repay them £5,000 from their own pocket (a personal claim against the trustee to restore the trust) and claim a lien on the car to secure that obligation. Thus if the trustee does not pay back the £5,000, the beneficiaries can have the title to the car sold, for £7,000, of which they have the right to £5,000. Thus by forgoing the ownership share they get all their money back.

18.2.3 Subrogation

Subrogation occurs when A acquires B's rights against C by operation of law. The insurance context provides an illustration: assume that an insurer, A, insures B against negligent injuries by a third party. If C, a third party, negligently injures B, B will have a right to sue C for damages to compensate B for B's injury. However, when A the insurer pays B an insurance award to cover B's loss, A acquires by subrogation B's right of action against C. A is said to be subrogated to B's claim against C. Similarly, in certain circumstances, if A pays off a debt that B owes to C, A will be subrogated to C's claim against B, which A paid off. In other words, A can now bring an action against B for the amount that B previously owed to C.

The right to be subrogated in such a circumstance can be acquired by a beneficiary if trust money is used to discharge a debt. The trust will be subrogated to the creditor's right of action against the debtor whose debt was discharged with trust money. This will be particularly useful if trust money was used to discharge a secured debt, such as a mortgage, for there will be subrogation both to the debt and the security for that debt. If, for example, trust money is used to pay off the trustee's mortgage, the trust will be subrogated to the rights of the mortgage lender, including the right to sell the property and use the proceeds of sale to satisfy the debt if it is not repaid. See *Boscawen* v *Bajwa* [1995] EWCA Civ 15, [1996] 1 WLR 328. This may be especially valuable if the trustee is bankrupt, since the charge on the trustee's house will ensure that the proceeds from the sale of the trustee's house will go first to paying off the debt owed to the trust.

Activities 18.4 and 18.5

18.4 Go back to the fact situations in Activities 18.1 and 18.2 and state the claims that might be made following the tracing process.

18.5 Read *Boscawen* v *Bajwa* and explain the decision.

Summary

Equity has developed various rules which allow beneficiaries to trace through mixtures of trust property with others. Where wrongdoers mix trust property with their own, the beneficiaries are essentially entitled to control the book-keeping. As between mixtures in bank accounts of money belonging to innocent people, the 'first in, first out' (FIFO) rule is the authoritative starting point, although a proportionate share rule may be applied if the FIFO rule would generate unfair results.

Backward tracing is the concept of tracing into property purchased on credit where the trust money is later used to pay off that debt.

Tracing can be a basis for both 'proprietary' and personal claims. In certain circumstances it may be to the advantage of beneficiaries to claim a charge over the traceable proceeds rather than an ownership share.

Rights to subrogation can arise at the end of a tracing process, and are advantageous where trust property is used to discharge a secured debt.

Essential reading

- ***Re Hallett's Estate*** **(1880) 13 Ch D 696 (CA); *Re Oatway* [1903] 2 Ch 356; *Boscawen* v *Bajwa* [1995] EWCA Civ 15, [1996] 1 WLR 328; *Armstrong DLW GmbH* v *Winnington Networks Ltd* [2012] EWHC 10 (Ch), [2012] 3 WLR 835.**

Further reading

- ***Lipkin Gorman*** **v *Karpnale Ltd* [1988] UKHL 12, [1991] 2 AC 548; *Barlow Clowes International Ltd* v *Vaughan* [1991] EWCA Civ 11, [1992] 4 All ER 22; *Bishopsgate Investment Management Ltd* v *Homan* [1994] EWCA Civ 33, [1995] Ch 211; *FC Jones & Sons* v *Jones* [1996] EWCA Civ 1324, [1997] Ch 159; *Foskett* v *McKeown* [2000] UKHL 29, [2001] 1 AC 102; *Armstrong DLW GmbH* v *Winnington Networks Ltd* [2012] EWHC 10 (Ch), [2012] 3 WLR 835, [2012] 3 All ER 425.**
- **Birks, P. 'Property, unjust enrichment, and tracing' (2001) 54 *Current Legal Problems* 231.**
- **Burrows, A. *The law of restitution*. (Oxford: Oxford University Press, 2010) third edition [ISBN 9780199296521], Chapter 6 ('Tracing'), Chapter 7 ('Subrogation') and Chapter 8 ('Proprietary restitution').**
- **Chambers, R. 'Tracing and unjust enrichment' in Neyers, J., M. McInnes and S. Pitel *Understanding unjust enrichment*. (Oxford: Hart Publishing, 2004) [ISBN 9781841134239] p.263.**
- **Conaglen, M. 'Difficulties with tracing backwards' (2011) 127 *LQR* 432.**
- **Matthews, P. 'The legal and moral limits of common law tracing' in Birks, P. (ed) *Laundering and tracing*. (Oxford: Clarendon Press, 1995) [ISBN 9780198261018] p.23.**
- **Penner, J.E. 'Value, property, and unjust enrichment: trusts of traceable proceeds' in Chambers, R., C. Mitchell and J. Penner (eds) *Philosophical foundations of the law of unjust enrichment*. (Oxford: Oxford University Press, 2009) [ISBN 9780199567751] p.306.**
- **Smith, L.D. 'Tracing, "swollen rights" and the lowest intermediate balance rule' (1994) 8 *Trust Law International* 102.**
- **Smith, L.D. 'Tracing into the payment of a debt' (1995) 54 *CLJ* 290.**
- **Smith, L.D. *The law of tracing*. (Oxford: Clarendon Press, 1997) [ISBN 9780198260707].**

Activity 18.6

Core comprehension – tracing swollen assets and the lowest intermediate balance

Read the following article, which is available on the VLE:

- **Smith, L. 'Tracing, "swollen assets" and the lowest intermediate balance: *Bishopsgate Investment Management Ltd* v *Homan*' (1994) 8 *TLI* 102.**

The business activities of Robert Maxwell can be briefly researched online, if you wish to understand the context to the case.

a. **Which impropriety occurred in the management of the funds belonging to the Bishopsgate Investment Management Ltd (BIM)?**

b. **Following the death of Maxwell, which further situation complicated the impropriety?**

c. **Why did the liquidators of BIM seek to prevent the administrators of MCC from distributing rights to creditors?**

d. **On which grounds did the Companies Court refuse BIM application?**

e. **Outline the main points of the 'swollen rights theory'.**

f. **Outline the main points of the 'lowest intermediate balance rule'.**

g. **What are the implications of the lowest intermediate balance approach on tracing funds to an account which at some point has less funds than the improperly transferred amount but at a later point has more funds than the improper transfer amount?**

h. **What are the implications of the lowest intermediate balance approach on tracing funds in an account which at a later point has become overdrawn?**

i. **Why is intention irrelevant to the tracing rules?**

j. **How do the tracing rules assist the victim if an intention to reimburse can be proven?**

Activity 18.7

Applied comprehension – tracing and subrogation

Using your online resources research the following judgment:

- ***Boscawen* v *Bajwa* [1996] 1 WLR 328.**

a. **Explain what is meant by 'subrogation'.**

b. **What do the expressions 'the tracing claim' and 'the tracing remedy' describe?**

c. **Why is it more accurate to describe tracing as a process rather than a claim or remedy?**

d. **Why does the success of the claimant's case depend on the process of tracing?**

e. **Identify how subrogation can function as a proprietary remedy when the claimant's money is used to discharge a mortgage on the defendant's land.**

Sample examination questions

Because questions raising tracing issues usually concern breach of trust or breach of fiduciary duty, the questions will usually require you to deal with the law governing liability for those breaches, as the following questions do. Concentrate on the tracing issues for now, but realise that a full exploration of all the relevant issues raised by the question will be required in the examination:

Question 1 **Flick is a trustee of two settlements, Settlement No.1 and Settlement No.2. In January of this year, he received a cheque for £10,000, representing dividends from investments in Settlement No.1. He deposited this cheque in his personal bank account, which at the time had a credit balance of £5,000. In February, he sold investments forming part of the trust fund of Settlement No.2 for £12,000 and paid this into the same account. In March, he withdrew £15,000 from the account and bought shares in his own name in X Co Ltd. In April, he won £10,000 on the football pools and paid this into the same account. In May, he withdrew £12,000 from the account and gambled it away. He has now been adjudicated a bankrupt. The shares in X Co Ltd are currently worth £30,000.**

Advise the beneficiaries under each settlement as to their respective claims.

Question 2 **Tammy, a trustee, made the following payments in breach of trust:**

a. **£5,000 to her niece, Ethel, as a graduation present. Ethel used the whole of the £5,000 to buy a second-hand car which she could otherwise not have afforded. She then crashed the car. She received £4,500 under her insurance policy, the premiums for which she had paid out of her own savings.**

b. **£10,000 to her accountant Richard to buy shares. Knowing Tammy's financial circumstances, Richard wondered where the money came from, but did not ask, and bought the shares which have since fallen in value to £4,000.**

c. **£20,000 to pay off the mortgage on Tammy's house.**

d. **£5,000 to pay off a credit card bill which Tammy had incurred by buying an antique wardrobe. She still has the wardrobe.**

Tammy is now bankrupt. Advise the beneficiaries concerning the liability of Tammy, Ethel and Richard.

ADVICE ON ANSWERING THE QUESTIONS

Question 1 Flick has mixed money of two different trusts with his own, so that both the rules governing wrongdoers and the rules governing innocent people apply. Before the withdrawal in March, the account contained £5,000 of his own money, £10,000 of No.1 money and £12,000 of No.2 money. The shares in X Co Ltd have doubled in value, so as against Flick, No.1 and No.2 will claim their money made up all of the purchase price. As between No.1 and No.2, they will have shares in the shares either 2/3 for No.1, 1/3 for No.2 on the FIFO basis and 5/11 No.1 and 6/11 No.2 on the proportionate share basis. The £10,000 in pool winnings is Flick's money, raising his money in the account to £15,000. The beneficiaries will insist that the entire £12,000 dissipated gambling represents Flick's money, reducing the amount he has in the account to £3,000, out of a total balance of £10,000. The £7,000 will represent money entirely of No.2 if the FIFO rule applies, or a sum shared by them proportionately in 5/11 and 6/11 shares, respectively, if the proportionate share approach is taken.

Question 2

a. On orthodox tracing principles, the beneficiaries can trace into the crashed car, which is worthless, but not into the insurance proceeds. True, she would not have purchased the insurance or received the insurance award but for the purchase of the title to the car with trust money, but no trust money was actually used to purchase the insurance policy.

b. The beneficiaries should be advised to claim a charge over the shares for the re-payment of the trust's £10,000, which will provide a better result than claiming a half-interest in shares now worth only £14,000.

c. Following *Boscawen* v *Bajwa*, the beneficiaries should be advised to claim to be subrogated to the rights of Tammy's mortgagee to secure repayment of the £20,000.

d. This part requires a discussion of the possibility of backwards tracing in English law. If it is available, the beneficiaries can claim that the wardrobe is held for them by Tammy on constructive trust.

Reflect and review

Look through the points listed below.

Are you ready to move on to the next chapter?

Ready to move on = I am satisfied that I have sufficient understanding of the principles outlined in this chapter to enable me to go on to the next chapter.

Need to revise first = There are one or two areas I am unsure about and need to revise before I go on to the next chapter.

Need to study again = I found many or all of the principles outlined in this chapter very difficult and need to go over them again before I move on.

Tick a box for each topic.

	Ready to move on	Need to revise first	Need to study again
I can define the difference between following, tracing and claiming.	☐	☐	☐
I can explain why the law of tracing often falls into the law of trusts.	☐	☐	☐
I can explain when the common law does not allow a title holder to trace.	☐	☐	☐
I understand and can apply the rules governing tracing through mixtures.	☐	☐	☐
I can explain what backwards tracing is and why the law regarding it is unsettled.	☐	☐	☐
I can outline the proprietary and personal claims that can arise following the tracing process.	☐	☐	☐
I can show how rights to subrogation can arise following the tracing process.	☐	☐	☐

If you ticked 'need to revise first', which sections of the chapter are you going to revise?

		Must revise	Revision done
18.1	Tracing	☐	☐
18.2	Claiming	☐	☐

NOTES

Feedback to activities

Contents

NOTES

Chapter 1

Activity 1.1

a. '… the "common law" encompasses all the laws of a common law jurisdiction, whether created by the judges or by legislation. Thus, we can speak of common law systems…' (p.263)

b. '… A lesser meaning is that the 'common law' is the law created only by the judges rather than by legislation.' (p.263)

c. 'In its narrowest meaning the "common law" is used to distinguish between "Common Law" and "Equity", two judge-made bodies of law…' (p.263)

d. '… Equity is merely a gloss upon, or a **supplement** to, the common law. If Equity were suddenly to be abolished by statute there would still be the common law to enable society to be regulated, although only in a rather rudimentary fashion. If the common law were to be abolished there would be anarchy.'

'…The common law laid down general rules but occasionally Equity intervened to provide a liberal and **just modification of the law in exceptional cases**.' (p.264) (emphasis added)

e. The King's Court.

f. '…The Chancellor was a senior ecclesiastic having some knowledge of canon law and civil law, and, perhaps, some common law. He dealt with the petitions as reason and good conscience demanded. He was ready, in what developed into his Court of Chancery, to provide relief where the Common Law was unsatisfactory, as where relief could not be obtained because the petitioner's circumstances were not covered by the restricted number of writs available at common law.'

g. (i) '…Because land was the major source of wealth, Equity primarily intervened so as to develop land law to meet the needs of society.'

(ii) '…Equity follows the law in recognising T as the owner at law but insists that T must use that ownership for the benefit of the beneficiaries.' (p.265)

Activity 1.2

a. 'The expression "common law" is used to describe judge-made law in contrast to statute law, and not in the narrower sense.' (p.601)

b. '…That body of rules administered by our English courts of justice which, were it not for the operation of the Judicature Acts, would be administered only by those courts which would be known as Courts of Equity.' (p.601)

c. '…"equity" refers to the doctrines and remedies that originated in the English Court of Chancery in contrast to the "common law" which is the body of rules developed by the King's courts.' (p.601)

d. Contract, property and restitution law.

e. '…equity is "doctrinally distinct from the law"'.

'…is "motivated by different policies.'

'…it relies on broadly based standards whereas the common law is rule based and relatively unyielding to cases of individual hardship.'

'…equity is flexible whereas the common law favours certainty'.

'…Equity's concern is with individual justice, whereas the common law delivers universal justice'.

f. '…Direct reform of the common law is difficult, because much of it is too well settled. However, reform can be achieved indirectly by using equity doctrines to modify or prevent the application of common law rules in cases where the concern is to give effect to values other than efficiency.' (p.602)

g. '…an important function of equity is to impose fairness standards on commercial and other behaviour.' (p.603)

Chapter 2

ACTIVITY 2.1

a. The parties were husband and wife, who both contributed to the purchase of a fee simple title to a family home. The issue was whether there was any basis for altering the co-ownership shares each spouse would normally receive based upon the proportions each contributed to its purchase. The court held that there was not.

b. Briefly, Bagnall J insisted that justice must be determined according to law, which can be attained by mortals who apply rules and principles acquired over time, not on the basis of general considerations of fairness, in particular in respect of property rights, otherwise no lawyer could safely advise their client. It might be unfair, all things considered, for Mrs Cowcher to receive a smaller share than her husband given all she had done for him, but there was no basis in the law of trusts to grant her a larger share for that reason alone.

ACTIVITY 2.2

The main point to grasp here is that a trust is not the same thing as an agency, contract, or debt, but that the trust can be used in combination with many of these other legal devices (in particular trust and contract, trust and agency, and trust and debt), to generate different legal arrangements.

Chapter 3

ACTIVITY 3.1

No feedback provided.

ACTIVITY 3.2

A typical family trust contains successive and discretionary elements. A successive interest is one taking effect after a prior interest ends. If you are married, then you might typically provide for your spouse for the rest of their life after your death, and leave the remaining funds for your children on your death. So you might put funds on trust for 'your spouse for life, remainder to your children in equal shares'. Under those terms your spouse will get the income from the trust investments as long as they live, and upon their death, your children, who have the 'capital' interest, will be entitled to the transfer of equal shares in the trust property. So far, we have a fixed trust. You might, however, give your trustees a discretion over the income while your spouse is alive to give the income to your spouse and/or your brothers and sisters in such shares as your trustee 'shall in his absolute discretion see fit'. That way, your trustee can give money to any of these people according to their current needs. Or you might make the shares of capital discretionary too, allowing the trustee to appoint the capital on the death of your spouse in whatever shares the trustee decides. Drafting trusts so as to properly take into account all future possibilities is a difficult business, and centuries of effort have gone into refining the structure of trusts to do so. Nowadays, trust instruments tend to avoid the use of contingent interests, but instead give the trustees very expansive discretions to add or delete beneficiaries, to vary shares, and so on, so that the trust can be adapted to changing circumstances.

ACTIVITY 3.3

a. Obviously a discretionary, testamentary trust with a defeating provision (establishing a residence outside the UK); clearly a special trust. The gift of capital is a public purpose, or charitable, trust.

b. An express, *inter vivos*, trust, which is also invalid for being a private purpose trust.

c. An express trust, which fails for uncertainty of objects – an automatic resulting trust of the £10,000 to his estate on death.

d. The question is whether there is a resulting trust here.

e. The express trust formed by Fred and Bill with the solicitor is breached by the latter. The nephew, who is not a *bona fide* purchaser, holds the £10,000 on trust for Fred and Bill, under a constructive trust arising by operation of law.

Chapter 4

Activity 4.1

The main points of difference are:

a. The relations between the agent and principal here are personal and contractual, not proprietary. Thus when the agent collects the rent for P, the agent generally receives the money outright – he merely owes P a sum of like amount. If the rent money is stolen from the agent, it is the agent's loss. He still owes P the same amount. If the agent held the rent he collected on trust for P, then if the rent money was stolen then it would be P's loss: *Morley* v *Morley* (1678) 2 Cas Ch 2.

   On the other hand, if the agent became bankrupt before paying P what he owed, P would be an ordinary creditor of the agent, whereas if the agent held collected rents on trust for P, P would be able to claim the rent money as held on trust for him, so avoiding the effects A's bankruptcy has on mere creditors.

b. The relationship between trustee and beneficiaries is not one of debtor and creditor. The benefit of a debt can, however, form the subject matter of a trust.

Activity 4.2

No feedback provided.

Activity 4.3

A fraud on a power occurs whenever a power, usually a power of appointment, is used to achieve a purpose outside the intended use of that power, typically to benefit some person by a power of appointment who is not a proper object of the power. For example, if a trustee makes a deal with a proper object of a power to exercise the power in that object's favour, granting him £10,000, if the object agrees to then give £5,000 to the trustee, this is clearly a fraud on a power. *Vatcher* v *Paull* establishes that making the exercise of a power conditional or defeasible on what the proper objects may do does not automatically make the exercise a fraudulent one.

Activity 4.4

How does the standard apply in dealing with agents in the general course of business, and what phrases does the court use to describe the standard? (*Speight* v *Gaunt*; *Re Whiteley*) Does it require the trustee to outperform the market (*Re Chapman*)?

Activity 4.5

Having the power to elect the board of directors, must the trustee elect himself to the board? Insist on minutes of board meetings? Actively direct the company's affairs?

Activity 4.6

The trustees were in breach of trust for failing to understand the investment clause of the trust instrument, and therefore they invested in a smaller range of securities than they might have done, and yet Miss Nestle's claim that the 80 per cent fall in the real value of the trust capital failed – was it because the breach did not lead to the loss? Or because the trustees properly favoured the interests of the life tenants (income beneficiaries) or both?

Activity 4.7

Against social investing, one should emphasise that Scargill's claim was that a trustee should be able to advance the trustee's ethical commitments via their investment of the trust property, even against the beneficiaries' wishes or best interests. In favour, one might say that given the vast amounts held in trust, especially by pension funds, this would provide a means for ethical and moral views to improve business practices in the world of investment banking and finance; second, it is not clear that all ethical investment strategies result in reduced returns.

Activity 4.8

Clearly the decision to delegate investment powers turns most importantly on the trustee's own expertise. To the extent the trustee is not an expert, they must seek expert advice, and for reasons of efficiency in both time and the expenditure of fees, which will depend in part on the size of the trust and the sort of duties the trust imposes (for example, to pay regular income, or rather to accumulate income for a long period) it may be sensible to delegate the power of investment. Of course, before doing so, the qualifications of any proposed agent must be investigated.

Activity 4.9

a. '…The new duty will bring certainty and consistency to the standard of competence and behaviour expected of trustees. It will be a safeguard for beneficiaries and thereby balance the wider powers given to trustees elsewhere in the Act. The duty will take effect in addition to the existing fundamental duties of trustees (for example, to act in the best interests of the beneficiaries and to comply with the terms of the trust) but will exclude any common law duty of care which might otherwise have applied.' [Part 1. The Duty of Care at 11]

b. '…To comply with the new duty a trustee must show such skill and care as is reasonable in the circumstances of the case making allowance for his or her special knowledge, experience or professional status (section 1(1)(a) and (b)). Thus, in relation to the purchase of stocks and shares, a higher standard may be expected of a trustee who is an investment banker, specialising in equities, than of a trustee who is a beekeeper, particularly if the investment banker is acting as a trustee in the course of his or her investment banking business.' [Part 1, Section 1 at 13]

c. '…In determining what constitutes reasonable care consideration would also be given to the nature, composition and purposes of the trust being administered.' [Part 1, Section 1 at 13]

d. '…Section 2 introduces Schedule 1 to the Act, which defines when the new duty will apply. In general terms the new duty will apply to any exercise by a trustee of a power to invest trust property or to acquire land; to appoint agents, nominees and custodians; or to insure trust property.'

Activity 4.10

a. Trustees must select investments strictly on financial grounds.

b. '…The beneficiaries might well consider that it was far better to receive less than to receive more money from what they consider to be evil and tainted sources. "Benefit" is a word with a very wide meaning, and there are circumstances in which arrangements which work to the financial disadvantage of a beneficiary may yet be for his benefit.'

c. Example: *Evans* concerned a limited form of 'social' or community investment and was particular to the structure of the cooperative society whereby a certain interdependency existed between investment and employment. The loan arrangement was made not on any broad social or ethical ground but in the interests of the beneficiaries' economic wellbeing. (53 words)

d. '…when the objects of the charity are such that investments of a particular type would conflict with the aims of the charity.'

Examples:

'...cancer charities refusing to invest in tobacco shares, trustees of temperance societies ruling out investment in breweries or distilleries and Quaker charities deciding not to invest in the arms trade.'

e. '...if the investment in fact made is equally beneficial to the beneficiaries, then criticism would be difficult to sustain in practice, whatever the position in theory'.

f. Example: Thornton emphasises the impracticalities of measuring what is 'equally beneficial', given the unpredictable variances in the investment markets. She suggests that the occurrence of the choice suggested is a practical impossibility. (31 words)

g. '...declarations to the effect that the Commissioners were obliged to have regard to Christian principles when making investment decisions, and that a policy which still attached overriding importance to financial considerations was erroneous in law.'

h. '...The contention of the Church Commissioners, with which the Vice-Chancellor implicitly concurred, was that their existing policy, although it narrowed the range of potential investments they might make, did not unduly restrict their ability to pursue a financially viable investment strategy. Most crucially, it did not do so "because there...remained open to the Commissioners an adequate width of alternative investments."'

i. '...The concept of excluding any sector of the market and yet retaining a "sufficient" range of investment selection is flawed, flying as it does in the face both of portfolio theory and of the guiding principle of the beneficiaries' best (as opposed to "good enough") financial interests.'

Activity 4.11

a. '...ethical investment industry'.

'SRI' or socially responsible investment.

b. Market statistics collected and analysed by Moody's ESG Solutions Group.

c. The total fund value of ethical retail funds is £6.1 billion. The total fund value of SRI rights is £221 billion.

d. '...they are no doubt affected by the same personal moral, social and political promptings...'

e. '...The starting point is the duty of trustees to exercise their powers in the best interests of the present and future beneficiaries of the trust...When the purpose of the trust is to provide financial benefits for the beneficiaries, as is usually the case, the best interests of the beneficiaries are normally their best financial interests. In the case of a power of investment...the power must be exercised so as to yield the best return for the beneficiaries, judged in relation to the risks of the investments in question...'

f. '...he must "none the less do his best to exercise fair and impartial judgment" in the best interests of the beneficiaries.'

g. Example: Trustees can select a range of investment products to spread the risk of investment and thus achieve good financial returns for the particular trust. (24 words)

Chapter 5

ACTIVITY 5.1

a. The plaintiff, Mrs Paul, who had lived with Mr Constance in the last years of his life, claimed against Mr Constance's widow, who was administering Mr Constance's estate on his death, that Mr Constance had declared that he held a bank account in his name on trust for himself and Mrs Paul in equal shares, the declaration taking the form of his telling Mrs Paul on several occasions that the money in the bank 'was as much yours as mine'.

b. The defendant argued that the proper interpretation of the facts indicated that although Mr Constance might have attempted to make a gift of a share of the money to Mrs Paul, he had failed to do so properly, as in *Jones* v *Lock*; the court had no power to treat this failed intention to make a gift as a declaration of trust; further, from this principle, the defendant argued that there needed to be a clear intent by the purported settlor to confer rights on a purported beneficiary to count as a declaration of express trust, and here there was none.

c. The Court of Appeal held (1), that there was no question of a direct gift in this case which had failed, as in *Jones* v *Lock*, and that, given the unsophisticated nature of the parties, Mr Constance's expression that the money was as much the plaintiff's as his own on numerous occasions was sufficient as a declaration of trust. An express trust was therefore found to have been created.

ACTIVITY 5.2

No feedback provided.

ACTIVITY 5.3

After reading and noting the Court of Appeal's decision, the difference in approach taken by Megaw LJ and Sachs LJ towards certainty of objects should become clear. Sachs LJ makes a distinction between conceptual uncertainty and evidential uncertainty; the 'is or is not' test applies only to the former, and 'the court is never defeated by evidential uncertainty'. Therefore it is a question of fact whether 'any individual postulant has on inquiry been proved to be within (the class); if he is not so proved then he is not in it'. However, Megaw LJ introduces a factor of substantial numbers into the 'is or is not test'. If it could be said with certainty that a substantial number of beneficiaries fell within a class, the class is certain and therefore the trust is valid. However, it gives no guidance to the trustee as to the extent of any survey they must make of the class before distributing (i.e. the extent of the consideration they must give to distributing to those not within the 'substantial numbers' yet who may fall within the class intended by the settlor). What is not clear, given that there was conceptual certainty on the facts, is whether Megaw LJ would require this too.

A trust to distribute monies to adherents of the Anglican church might serve as an example of a trust which would fail Sachs LJ's test but possibly pass Megaw LJ's – it is not clear that it could be said with certainty of every person whether or not they were within the class (e.g. those who only attend services sporadically) and this is a matter of conceptual, not evidential, uncertainty. However, it is clear that on any definition of 'adherent', substantial numbers would fall within the class (e.g. all those who are members of the clergy, regular attenders, etc.) and so this trust may pass Megaw LJ's test. We should note again, however, that Megaw LJ's comments were made in the context of a conceptually certain trust.

ACTIVITY 5.4

'Conceptual uncertainty' arises from the settlor's use of imprecise or vague language in expressing their intentions. Vagueness can be understood as the problem of the uncertain boundaries which arise when we try to apply words to things in the world. For example, the word 'tall' appears to have very uncertain boundaries; 'tall' is not a synonym for '5'10" and over'; it is not that precise. As a consequence, the use of the word 'tall' in a trust would result in the declaration of the trust being void for

conceptual uncertainty. 'Evidential uncertainty' arises when there is insufficient evidence to conclude that an object is within the specified class of objects. The terms of a trust may be conceptually clear, but actually providing evidence to meet them may be impossible.

Activity 5.5

Evidential uncertainty defeats a fixed trust entirely. The reason is straightforward: if the settlor expresses their gift in such a way that evidence must be adduced to identify the rights or person and that evidence is not available, the trust cannot be executed according to its terms.

Evidential uncertainty as regards any particular object will not invalidate a discretionary trust, nor a power of appointment. As long as there are objects who can provide sufficient evidence to prove that they are within the class, there will be valid objects under the trust, and it will not fail. If, however, there is no possibility of adducing evidence to prove that anyone falls within the class, then the trust will fail just as in the case of a fixed trust, even if perfectly conceptually certain. Examples of this sort of trust are likely to be fanciful (e.g. a trust for all those persons who had male ancestors in the 16th century with an extra Y chromosome).

Activity 5.6

a. When a power is held by a fiduciary, typically the trustee(s) of the trust, the fiduciary cannot release it. Moreover, they will have duties in relationship to it, to consider exercising it from time to time, and so to survey the class and determine whether an appointment should be made, and to respond to requests by particular objects that they be considered; they must exercise the power in a responsible manner for the purposes for which it was given, and in particular must not act capriciously in determining whether and how to exercise it.

b. While Megarry J held that intermediate powers are valid when held by fiduciaries, not being subject to the administrative workability test, which he held applied only to discretionary trusts, nor being capricious, he said that he would probably hold an intermediate trust invalid, on the basis that the duties of a discretionary trustee are more stringent than a fiduciary powerholder and that the beneficiaries of a discretionary trust have more rights of enforcement than objects of fiduciary powers. It is not clear how these differences lead to the invalidity of intermediate trusts, for the enhanced duties of the discretionary trustee are clearly a matter of degree, following *McPhail* v *Doulton*, and the object's rights of enforcement do not seem to have anything to do with whether a trustee or donee of a power can carry out a sensible survey of objects and distribute rights responsibly.

Activity 5.7

a. '…This is wrong. The House of Lords, on the contrary, merely returned the state of the law to what it had always been before the wayward decision of the Court of Appeal in *I.R.C.* v *Broadway Cottages Trust*.' (p.22)

b. '…if trust property is to be divided among a class of beneficiaries in equal (or any other fixed), shares, the trust cannot, in the nature of things, be administered unless the number and identity of beneficiaries are known.' (p.22–23)

c. 'The problem was simply, did the court know what the settlor meant by his use of such words as "family" or "relations"?' (p.24)

d. '…The beneficiaries conceded "that it would be impossible at any given time to achieve a complete and exhaustive enumeration of all persons then qualified for inclusion in the class of 'beneficiaries' under the terms of the schedule." In other words, the class was evidentially uncertain.'

   'On the other hand, it is conceded on the part of the Crown that the qualifications for inclusion in the class of "beneficiaries" prescribed by the schedule are sufficiently precise to make it possible to determine with certainty whether any particular individual is or is not a member of the class.' (p.24)

e. Example: As the beneficiaries conceded the aspect of conceptual uncertainty, the Crown successfully advanced the argument that evidential uncertainty also existed (i.e. there was not **sufficient evidence of identities of all the beneficiaries**).

f. '…There can be no division in equal shares among a class of persons unless all the members of the class are known.' (p.27)

g. '… A class including as yet unborn or unascertained beneficiaries is perfectly valid ***ab initio***… What matters is not that the whole class **must** be ascertained, but that if and when members came into existence they **can** be ascertained.' (p.27)

ACTIVITY 5.8

a. Banking and Investment – trading of securities.

Bankruptcy

'…application by the Administrators of Lehman Brothers International (Europe) ("LBIE") seeks the court's directions as to the principles governing the beneficial ownership, as between LBIE and a number of its affiliates within the Lehman group, of securities which LBIE had, prior to the onset of its administration, acquired from third parties ("the street") for the account of those affiliates and which, vis-à-vis the rest of the world, still remain vested in LBIE.' [1]

b. '…a study of the legal question whether the recognition in English law in *Hunter* v *Moss* [1994] 1 WLR 452 that there can be a trust of part of an un-segregated mass of fungibles is sufficiently flexible to be capable of being applied to the constantly fluctuating mass of security interests appearing in LBIE's un-segregated house depot accounts with its depositories.'

c. '…(iii) A trust of part of a fungible mass without the appropriation of any specific part of it for the beneficiary does not fail for uncertainty of subject matter, provided that the mass itself is sufficiently identified and provided also that the beneficiary's proportionate share of it is not itself uncertain.' [225]

Relevant extract: [227]

d. Example: Because the shares were fungible (i.e. they were identical and interchangeable).

e. '…because the dealer had never appropriated specific quantities of matching wine to each of its customers from stocks held in bulk in its warehouses.' [229]

f. '…a developer's failure to carve from its general assets a retention fund for its builder pursuant to an obligation in the building contract, before becoming insolvent, was held to preclude the identification of the necessary subject matter of an enforceable trust of the retention monies.' [230]

g. '…The difficulty with applying the Court of Appeal's judgment in *Hunter* v *Moss* to any case not on almost identical facts lies in the absence of any clearly expressed rationale as to how such a trust works in practice.' [232]

h. '… such a trust works by creating a beneficial co-ownership share in the identified fund, rather than in the conceptually much more difficult notion of seeking to identify a particular part of that fund which the beneficiary owns outright.' [232]

i. '…The law does not lightly allow contracting parties' purposes and intentions to be defeated by supposed uncertainty, and there is in my judgment no reason why the law should do so any more readily than normal merely because the issue is as to the validity of an intended trust. On the contrary, the law commonly recognises the creation of a trust as a necessary consequence of an intention that parties should share property beneficially, in circumstances where the parties themselves have given no thought at all to the terms of the consequential trust, if indeed they even recognised its existence. In all such cases the law fills the consequential gaps by implication, and by importation of generally applicable principles.' [245]

j. '…By parity of reasoning, and on the assumption that LBIE and its affiliates intended that the affiliates should enjoy proprietary interests in securities acquired by LBIE for their account, the fact that the mode of LBIE's operation of its house depot accounts to which they all consented may throw up difficulties of analysis as to their proportionate shares in the securities which remain after the collapse is not a basis for concluding that the trust which the law necessarily recognises so as to give effect to their intended proprietary interests should fail for want of certainty, whether as to terms, or as to the amount of those beneficial interests.' [247]

Chapter 6

Activity 6.1

No feedback provided.

Activity 6.2

No feedback provided.

Activity 6.3

No feedback provided.

Chapter 7

Activity 7.1

The first point to note is that *Milroy* v *Lord* establishes the general rule that 'equity will not assist a volunteer to perfect an imperfect trust'. Consequently the limit placed on the settlor is that, if the settlor attempts to create a trust with a third party as trustee but that trust is imperfectly constituted, the settlor will not by that fact alone become the trustee. The general principle is that the court will not construe a failed attempt to make a gift in one way as an effective attempt in another way, and typically this will mean that the court will not treat a failed gift or a failed attempt to constitute a trust as a self-declaration of trust.

Regarding the limits on the court, you should remember that if the court intervened and imposed a trust on the settlor, it would result in a trust coming into existence which was not one intended by the settlor; it would, in other words, be a constructive trust. However, as you read on you will see that the court has departed from the rule in *Milroy* v *Lord* in six specific situations.

Activity 7.2

a. There are three principal methods by which a gift of the shares and the title to the painting can be made:

   1. A transfer of the shares (as choses in action) must be made in the proper manner and the title to the painting by delivery or deed.

   2. By you declaring yourself a trustee of the shares and your title to the painting in favour of your friend.

   3. Finally, you can transfer the shares and the title to the painting to a third person to hold on trust for your friend. It is these three modes of transfer which the court in *Milroy* v *Lord* held were mutually exclusive, and, in particular, would not treat failed attempts to transfer the right by modes (1) and (3) above as cases of (2) (i.e. as self-declarations of trust, regarding which you will notice that no transfer of any right is necessary, and is therefore the simplest to effect).

b. Turner LJ in *Milroy* v *Lord* said that 'equity will not assist a volunteer to perfect an imperfect trust'. *Re Rose* presents one of six departures from this general rule. But does this departure represent a conflict with the Court of Appeal's decision in

the earlier case? In his leading judgment, Evershed MR certainly did not think it did. He said that Turner LJ's judgment was only meant to apply where the transfer in question had not been carried out in the appropriate way. This, however, is nowhere stated in *Milroy* v *Lord* itself. Nor is there any logical reason why it should make a difference. Indeed, it could be said that *Milroy* v *Lord* tells us that any intervention by the court would result in a trust being created that was not intended by the settlor/donor. Furthermore in both cases the donor had told the donee that the gift was perfect, so this cannot be a distinguishing factor. Thus, despite Lord Evershed MR's words, there does appear to be a conflict with the previous case.

c. The term 'unconscionable', like 'unfair' or 'unjust' gives little guidance to a court trying properly to characterise the sorts of facts which should cause it to perfect an imperfect gift, for it is a conclusion only. What it fails to tell us is what particular facts lead to this conclusion. Perhaps the most obvious cases occur when the parties have acted on the basis that a gift was valid, and so have detrimentally relied upon it. But it is not clear that the only way to deal with such an occurrence is to perfect the gift, rather than compensating the relying party for their loss, or stripping the donor of any extra advantage they would receive if the gift were now treated as invalid, for example, strip the donor of the value of a house the intending donee built on land which was not properly transferred. Cases such as *Re Rose* and *Pennington* do not, however, present compelling cases of 'unconscionability', whatever that word might mean.

Chapter 8

Activity 8.1

Some commentators say that the judges blindly followed Eve J's decision, although it arguably went beyond the bounds of the rule that equity will not assist a volunteer. The opposing view is that trustees cannot have any option whether or not to sue to enforce a covenant: either they have the duty to sue to constitute the trust, or no right to do so because equity will not assist volunteers to enforce promises without consideration (whether oral or within a deed) to constitute a trust, and equity will not make a distinction between volunteer trustees and volunteer beneficiaries: a promise to a volunteer is equally unenforceable whether made to a donee directly or to a trustee in a beneficiary's favour. The fact that the promise is contained in a deed which the law would enforce is immaterial from this perspective: to allow the enforcement of covenants to settle by the trustee would allow the law to determine the constitution of trusts, which is the province of equity.

Activity 8.2

In *Re Basham*, the plaintiff who, with her husband, had helped her mother and stepfather for a considerable period of her life in expectation of receiving the survivor's property, was able to claim that this detrimental reliance entitled her to the property. Notice that the expectation was of a future gift of property, not the expectation that a past gift was valid and acted upon.

In *Eves*, the detrimental reliance consisted in exceptional work in contributing to extensive improvements to the land in question – the plaintiff had been (untruthfully) told by her partner that her name would have been put on the title to the land but for her age, and therefore her reliance contributed to the Court's holding that there had been a common intention or understanding that her partner held the property for them both, and this entitled her to a share.

Chapter 9

Activity 9.1

No feedback provided.

Activity 9.2

a. Tax relief to charities is generally based upon the idea that charities provide public benefits; since they are not for the private benefit of individuals or corporations, they should not be subject to the rules of taxation which are meant to raise revenue from private individuals for the running of the state. It is also sometimes claimed that charitable works would have to be provided by the state if charities did not carry them out, so they save the state money. As you will see, however, not all charities provide the same kind of public benefits, and it is arguable that blanket tax relief for them all is not warranted. Finally, countries like the UK have a large charitable sector, which forms a substantial part of the economy, and it is sometimes argued that this economic activity should be taxed in some way, even if not in the same way as the 'for profit' sector.

b. The point here is that the forum for determining charitable status should be more democratic; judges might appropriately determine rights under the law, but they have no expertise in drawing fine distinctions between activities that are truly for the public benefit and those which might only appear to be so. Should there be some public body other than the courts which should do so?

c. The point here is that in view of the fiscal privileges, courts tend to be conservative about what counts as charitable, in order to prevent giving charitable tax status to activities which are not clearly for the public benefit – if tax consequences did not follow, then the courts might allow many more 'not for profit' purposes to count as charitable.

Activity 9.3

The trust was for a working men's hostel in Cyprus where there was a severe housing shortage. But working men are not all poor, and so it was not clear the trust genuinely relieved poverty. But given the housing shortage, the trust was allowed as charitable under the category of trusts to relieve poverty.

Activity 9.4

It is very difficult to distinguish these research cases, since it is not clear that Shaw's purpose was less beneficial to the public than research to show that Bacon was the author of Shakespeare's plays.

Activity 9.5

No feedback provided.

Activity 9.6

No feedback provided.

Activity 9.7

No feedback provided.

Activity 9.8

No feedback provided.

Activity 9.9

a. The question here is whether a general charitable intent is disclosed – *Re Harwood* suggests that it is easier to find a general charitable intent when the named charity never existed than when it once did but is now defunct, on the basis that in the former case the testator's intention is more general, the specific location not

mattering so much to him (otherwise he would have taken more care in naming an actual charitable institution). Do you find this reasoning persuasive?

b. This is not a case of *cy-près*. If one charitable institution's work is continued by another, the gift goes to the continuing institution as a fulfilment of the testator's intention, unless there is some indication that the testator would not have favoured this.

c. This might not be a case of *cy-près*. According to *Re Vernon WT*, a gift to a charitable company ought normally to be construed as a gift to the company directly, to carry out whatever charitable activities it does. This reasoning does not seem entirely persuasive, and in appropriate cases one might construe the gift as being for the named charitable purpose, treating it as having failed, and then assessing whether there was a general charitable intent to allow the gift to be applied *cy-près*.

ACTIVITY 9.10

a. Not charitable – clearly political.

b. Probably not charitable, for failing the public benefit test because of the restrictions to children of the corporation – the preference may possibly save it – see *IRC* v *Educational Grants Association Ltd*.

c. Almost certainly not charitable as actually being against religion, and perhaps political as well, despite the fact that the research, if it could be carried out, would be enormously significant.

d. The actual educational purpose is charitable, but is almost certainly tainted by the association with a political party; the court would probably rightly fear that this amounted to propaganda masquerading as education.

e. If restricted to students, this would almost certainly be charitable, but see *IRC* v *City of Glasgow Police Athletic Association*.

f. This is charitable.

g. May perhaps be charitable – the restriction to relatives does not violate the public benefit test (*Re Scarisbrick*); the question is whether 'lacking ordinary comforts' amounts to poverty.

h. Not charitable, for being a political purpose; see *A-G* v *McGovern*.

ACTIVITY 9.11

a. The Statute of Charitable Uses 1601 (in particular the Preamble).

The Charities Act 2006.

The Charities Act 2011.

b. '… trusts for the relief of poverty; trusts for the advancement of education; trusts for the advancement of religion; and trusts for other purposes beneficial to the community, not falling under any of the preceding heads.' [6]

c. Example: The provision of housing benefits the community in general, however, it is necessary to demonstrate that it is specifically for the relief of charitable need to meet the requirement of a charitable trust. (33 words)

d. 'the term "charity" is defined by section 1 of the Charities Act 2011 as: "an institution which (a) is established for charitable purposes only, and (b) falls to be subject to the control of the High Court in the exercise of its jurisdiction with respect to charities".' [13]

'The term "charitable purpose" is defined by section 2 (1) as: "a purpose which (a) falls within section 3 (1), and (b) is for the public benefit".' [14]

'Section 3 (3) … and section 4 (3) … make clear that decisions of the courts on the law of charity prior to the coming into force of Part 1 of the Charities Act 2006 continue to be relevant to the interpretation of the statutory definition of charity.' [23] and [24]

e. (1) A purpose falls within this subsection if it falls within any of the following descriptions of purposes—

(a) the prevention or relief of poverty;

(b) the advancement of education;

(c) the advancement of religion;

(d) the advancement of health or the saving of lives;

(e) the advancement of citizenship or community development;

(f) the advancement of the arts, culture, heritage or science;

(g) the advancement of amateur sport;

(h) the advancement of human rights, conflict resolution or reconciliation or the promotion of religious or racial harmony or equality and diversity;

(i) the advancement of environmental protection or improvement;

(j) the relief of those in need because of youth, age, ill-health, disability, financial hardship or other disadvantage;

(k) the advancement of animal welfare;

(l) the promotion of the efficiency of the armed forces of the Crown or of the efficiency of the police, fire and rescue services or ambulance services;

(m) any other purposes—

(i) that are not within paragraphs (a) to (l) but are recognised as charitable purposes by virtue of section 5 (recreational and similar trusts, etc.) or under the old law,

(ii) that may reasonably be regarded as analogous to, or within the spirit of, any purposes falling within any of paragraphs (a) to (l) or sub-paragraph (i), or

(iii) that may reasonably be regarded as analogous to, or within the spirit of, any purposes which have been recognised, under the law relating to charities in England and Wales, as falling within sub-paragraph (ii) or this sub-paragraph.

f. Example: The non-presumption of public benefit places the burden on the charity to demonstrate how it meets the public benefit requirement and objective. (22 words)

Relevant extracts:

'… it is not to be presumed that a purpose of a particular description is for the public benefit.' [25]

'… what the law now requires by way of the provision of benefit and to whom it must be provided.' [26]

g. The benefit aspect.

The public aspect.

h. 'In the modern law, the concept of public benefit as integral to a charitable purpose is regarded as having two principal aspects, namely that, for a purpose to be charitable:

a. it must be beneficial, and any detriment or harm that results from the purpose must not outweigh the benefit ('the benefit aspect'); and

b. it must benefit the public in general, or a sufficient section of the public ('the public aspect').' [39]

ACTIVITY 9.12

a. 'In order to be a charity, an institution must be established exclusively for certain purposes which are "for the public benefit". "Public benefit" has the meaning attributed to it in case law and is not to be presumed.' [1]

b. '…within the spirit of the preamble to the Statute of Elizabeth or, post-2006, within the list of charitable purposes in section 2(2) of the Act.' (p.626)

c. '…the class must be neither numerically negligible nor defined by a common attribute which is based on a personal relationship or common employment.' (p.627)

d. '…The Tribunal, however, uses the term "sufficiently wide" in this context. To the extent that this suggests a width in terms of the beneficiaries' wealth or class, it appears to differ from case law, where the term's infrequent use has indicated sufficiency of numbers.' (p.626)

e. '…For example, with regard to the University College of North Wales case, the Tribunal suggests that the Court of Appeal rejected only the proposition that all beneficiaries should be poor, whereas, it is submitted, the court rejected the broader proposition that the means of the beneficiary should be taken into account in education cases.' (p.627)

f. '…The Tribunal defines the "rich" as those who can afford the fees charged, including people who make "considerable sacrifices" in order to do so. The "poor" are defined as those who cannot reasonably do so, but there is no indication of how reasonableness is to be measured in this context'. (p.628)

   '…Elsewhere, however, the Tribunal engages in a different, and more complex, formulation of "rich" and "poor", which is based on descriptions of wealth rather than the affordability of the fees charged'. (p.629)

g. Example: The Tribunal considered the ability to pay the fees of £12,000 – therefore a sub-group of people who may not be poor in the ordinary meaning of the word may be considered poor if the level of the fees proves unaffordable. (39 words).

h. Example: As poverty is relative to affordability, it is easier to identify the degree of public benefit by considering the accessibility of the institution to the public. An explicit exclusion of the poor is easy to identify (no public benefit), an explicit inclusion of the poor likewise (public benefit). An implicit inclusion is more ambiguous and the individual circumstances would require further scrutiny (62 words).

i. 'In the same way that allowing only Methodists to cross a bridge in a public place restricts eligibility according to a criterion with no rational link to the purpose and might be regarded as capricious: *IRC* v *Baddeley* [1955] AC 572, 592.' [FN37]

ACTIVITY 9.13

a. '… 2. The objects of the company are for the public benefit:

   2.1 to promote and protect human rights (as set out in the Universal Declaration of Human Rights and subsequent United Nations conventions and declarations) throughout the world, and in particular (but without limitation):

   2.1.1 the rights to human dignity and to be free from cruel, inhuman or degrading treatment or punishment;

   2.1.2 the right to privacy and to personal and social development; and

   2.1.3 to promote the sound administration of the law.' [6]

b. 'The Charity Commission's reasons for refusing to register HDT were, in summary, that its objects were too vague and uncertain for the Commission to be certain that it was established for charitable purposes only and further that it has a political purpose, namely that of seeking to change the law of foreign states, which precludes charitable status.' [3]

c. '…HDT's grounds of appeal, in summary, were that its objects were not vague and uncertain and further that the Charity Commission's decision demonstrated a fundamental misunderstanding of the nature of a constitutional human rights challenge, because litigation aimed at upholding a citizen's constitutional rights does not seek to change the law of the relevant jurisdiction but rather enforces and upholds the superior rights guaranteed by that country's constitution.' [3]

d. Example: HDT worked collaboratively with reputable human rights law firms to conduct litigation in support of people whose human rights had been breached by the criminalisation of private, adult, consensual homosexual conduct. (31 words)

Relevant extracts: [8]–[9]

e. '…We accept HDT's submission that the term "human rights" is to be given its ordinary natural meaning and that there is no authority for the Charity Commission's view that it is to be understood only as referring to those human rights accepted by the law of England and Wales.' [43]

'…We accept Professor Van Bueren's evidence (see paragraph 39 above) that "human rights" is a broad and rapidly evolving concept, and necessarily so in order to take account of developments in law, society and science. We conclude that Parliament must have had the "living instrument" approach in mind in leaving the term "human rights" undefined in the Act. It follows that the scope of the rights falling within the description of charitable purposes in the Act may evolve and change from time to time.' [44]

'…We are satisfied on the basis of the evidence of Professor Chinkin (see paragraph 41 above) that the term "human rights" used in the description of charitable purposes in the Act extends to the rights set out in the UDHR, the ICCPR and the ECHR.' [45]

f. '…that a political purpose is one which (i) furthers the interests of a political party; (ii) seeks to procure changes in the laws of this country; (iii) seeks to procure changes in the law of a foreign country; (iv) seeks to procure a reversal of government policy or of particular decisions of governmental authorities in this country; or (v) seeks to procure a reversal of government policy or of particular decisions of governmental authorities in a foreign country.' [80]

g. '…that its work involved upholding human rights law and that it does not seek to change the law. It submitted that the activity of upholding human rights law had been recognised by the Privy Council as one which respected the different roles of the legislature and the courts'. [84]

'…if the main objects of an institution were exclusively charitable, the fact that the trustees had the power to employ political means for their furtherance would not deprive the institution of its charitable status.' [85]

h. '…Slade J was concerned with an association which (as he found) sought to change valid, but arguably unjust, domestic laws. We find on the evidence before us that HDT is concerned with the promotion of human rights by establishing whether particular laws are valid, through a process of constitutional interpretation. We find that this process falls entirely outside the categories of activity considered by Slade J in *McGovern*.' [95]

'… In conclusion, for the reasons above we are satisfied that the promotion and protection of human rights (a) by means which include the support or conduct of litigation which is (b) aimed at securing the interpretation and/or enforcement of superior constitutional rights (c) in a foreign country which has given effect to the relevant treaty obligation so as to enable that process – is not a political purpose, and neither is it in our view a political activity.' [101]

i. '…were all concerned with different descriptions of charitable purposes than those for which HDT is established.' [107]

j. '…whether HDT's litigation activities in furtherance of its purposes may be found to be beneficial and, secondly, whether any benefit accrues to the public as a whole or to a sufficient section of it.'

k. '…there is a public benefit in seeking to interpret, clarify and protect superior constitutional rights.'

'…a particular benefit to those individuals whose human rights are promoted and protected by this means and also a wider benefit to the community at large from having such rights interpreted, clarified and enforced in a process to which their country has assented.' [109]

'…It was not in dispute before us that the benefit accrues to the whole community or a sufficiently appreciable section of it and we find that this is the case.' [110]

Chapter 10

Activity 10.1

No feedback provided.

Activity 10.2

As possible non-charitable purpose trusts, you might consider certain political activities, such as campaigning against the building of a motorway through a woodland; or activities such as providing buildings and continuing maintenance thereof for a private association such as a cricket club. Parts (a), (b) and (c) all concern how you ought to regard the factual beneficiaries of your trust purpose: would they necessarily have the time or interest in enforcing the trust against the trustee, and should they have any equivalent to *Saunders* v *Vautier* rights (Section 4.6.4) to vary the trust, or collapse it, distributing the property among themselves?

Activity 10.3

No feedback provided.

Activity 10.4

a. Traditional purposes were the education, maintenance (providing for the housing and feeding) or advancement (providing for a position in life, a church living or an army commission) of the settlor's children.

b. The difficulty is distinguishing a true *Sanderson*-type limitation on the amount the beneficiary is to receive from the case where the settlor merely expresses a motive for the gift of an entire fund. The practical difference is important, for if all of the funds are not required to meet the cost of the named expense, then in a *Re Sanderson* trust these funds will not belong to the beneficiary, but to a person who receives a gift of the remaining funds, or on resulting trust.

Activity 10.5

This requires an overview of the various reasons in favour of and against the law's upholding private purpose trusts. As we have seen, the main difficulty is in ensuring that there are persons who can enforce the trust against the trustee. Does it matter, in your opinion, that those who can enforce the trust need not do so if they do not want to? For example, would it have mattered if the employees in *Re Denley* had not wanted a recreation ground, and left the trustees to use the title to land in other ways? Does legislation creating enforcers with a duty to enforce the trust which is itself enforced by the criminal law (as in the Cayman Islands) appeal to you? Should the state be concerned to enforce purposes which are not 'public' (i.e. charitable) purposes?

Chapter 11

Activity 11.1

Given the fact that the gift was expressed to be 'in memory of his late wife' and to be used 'solely in the work of constructing new buildings for the Association and/or improvements to the said buildings', it is difficult not to conclude that the testator's intentions, as expressed, indicated that he wished his money to be devoted to a particular purpose and no other, a purpose (especially considering the 'improvements' provision) that might clearly extend beyond any valid perpetuity period.

Activity 11.2

Oliver J reasoned that (a) as a valid gift may be made to an unincorporated body as a simple accretion to the funds, so (b) why should a gift specifying a purpose be invalid?

The members could, exercising their contractual rights, either enforce the purpose or not as they chose. In this respect, he appeared to adopt the bare trust/contractual mandate construction. However, Oliver J also considered that the expressed purpose could be treated merely as a motive for the gift, not as a trust obligation. Finally, he felt that *Re Denley* was 'directly in point', and that the gift could be held valid on the authority of that case.

Activity 11.3

Goff J in *Re West Sussex* clearly followed the earlier line of cases and not the contract-holding theory. He regarded the purpose trust as at an end when the association was dissolved, and so the members had no rights to the funds. This approach was somewhat contradicted by his apparent admission that had the members chosen to distribute the funds to themselves, defeating the purposes for which the money was held, before the association was dissolved, they might have done so. But this makes little sense, for if the funds were beneficially theirs to deal with prior to the dissolution, then they remained theirs afterwards, for the dissolution of their contractual relations forming the association could do nothing to alter their rights to the fund. In *Re Bucks Constabulary Fund*, a case with almost identical facts, Walton J found himself 'wholly unable to square' the decision of Goff J in *West Sussex* 'with the relevant principles of law applicable'. He applied the modern contract-holding analysis. There being no contrary provision in the contract of membership, the members of the Bucks fund were entitled to it in equal shares.

Chapter 12

Activity 12.1

The case concerned the presumption of advancement and the evidence required to rebut it. It was proved by evidence that a father and son had both contributed to the purchase price of a title to land which was taken in the son's name. The presumption of advancement was rebutted and a trust in favour of the father was established because, in the court's view, putting the house in the son's name alone could be explained because it made mortgage financing easier, and in addition, at one point the father's solicitor drew up a declaration of trust which formally declared that each held a share in proportion to their contributions, although it was never executed. Furthermore, as the father was only 63 and in good health, there was no obvious reason to make a gift to his son of a large share in the house in which the father intended to live.

Activity 12.2

The Court of Appeal addressed the argument that, if a resulting trust arises because the transferor intended to create a trust for herself, then s.53(1)(b) of the LPA 1925 should apply and the trust should be unenforceable if that intention was not evidenced in writing. The court said that the transferor's intention to create a trust for herself meant that she did not intend to make a gift to the transferee, and the resulting trust responded to that lack of intention to give rather than the intention to create a trust.

ACTIVITY 12.3

The Court of Appeal approached the case as one of a gratuitous transfer resulting trust (the first situation as described in Section 12.1.1), and held that Mr Vandervell had not adduced sufficient evidence to rebut the presumption of resulting trust. This approach was disapproved in the House of Lords, where their Lordships treated it as a case of Situation 3, an automatic resulting trust arising on failure to specify any objects. The House saw no need or room to invoke any presumption, for there was no gap in the evidence.

ACTIVITY 12.4

In *Westdeutsche Landesbank*, Lord Browne-Wilkinson said that automatic resulting trusts arise on the basis that the settlor is presumed to intend that the trust property will come back to them if their intended gifts for some reason fail (e.g. uncertainty of objects) and that in certain cases a settlor might wish instead for the rights to go to the Crown as *bona vacantia* (goods without an owner) if their intended gift fails. The obvious problem with this view is that it is not true that settlors regularly entertain any such intentions, and the automatic resulting trust is applied regardless. Lord Millett might say in reply that we can 'presume' that this is what settlors would have wanted had they addressed their minds to the issue, but the courts on a number of occasions, most especially in *Gissing* v *Gissing*, have said that it is not legitimate for the courts to create trusts in this way.

Chapter 13

ACTIVITY 13.1

No feedback provided.

Chapter 14

ACTIVITY 14.1

The admissibility hurdle in s.9 Wills Act is far higher than that of s.53(1)(b), requiring in addition to the testator's signature, the witnessing of the signature by two witnesses before the evidence is admissible. The reasons are not far to seek. When the will comes into operation, the testator is dead and can no longer give evidence that the signature was genuinely made in the full knowledge of what they were doing, etc. and so a higher standard of formality to prevent fraud is imposed. Section 15, by avoiding 'beneficial devises' to attesting witnesses, ensures that the testimony of witnesses to a will in court, if the will is challenged, is not tainted in favour of the document's admissibility.

ACTIVITY 14.2

Secret trusts are in direct conflict with s.9 because by them, evidence which the legislature has said is not admissible to prove a testator's will is regularly admitted.

ACTIVITY 14.3

This case reveals a clear disparity in the reasoning of their Lordships, some relying on the *dehors* the will theory, some relying upon a modified fraud theory by which the operative fraud, if evidence of the declaration of trust was not admitted, would be a fraud on the intended beneficiaries. It is obviously a matter of judgment whether the rationales are convincing.

ACTIVITY 14.4

As regards the original fraud theory, the disqualifying factors should be judged on the basis of whether deciding the case one way or the other would give rise to a fraud by the trustee. For example, where the secret trustee predeceases the testator, there can

be no fraud, so there is no reason to admit the non-conforming evidence. Of course, under the broader fraud theory given voice to in Blackwell, by which the operative fraud is denying the secret beneficiaries the gift the testator intended, any time the evidence is not admitted there is a fraud. Then the court should admit the evidence in any circumstance it can, but of course this theory is circular. On the *dehors* the will theory, problems can arise with the consistent application of the rules. For example, by that theory one might save a half-secret trust from the application of s.15 where either the secret beneficiary witnesses the will or the half-secret trustee does, but one cannot do so in both cases.

Chapter 15

Activity 15.1

a. as regards replacing a trustee, s.36(1)

b. as regards adding an additional trustee, s.36(6)

c. as regards retiring from the trust, s.39(1).

Activity 15.2

The essence of the decision lies in the nature of the rule in *Saunders* v *Vautier*: beneficiaries can collapse the trust, but cannot 'micro-manage' the trust by directing the trustee as to how they should use their powers. If the power to appoint new trustees is given to the trustee, the beneficiaries cannot insist that the trustee make the appointment the beneficiaries favour; that would defeat the point of there being a trust at all. Of course, the beneficiaries can if they wish bring the entire trust to an end, and set up a new trust with a trustee that they prefer, but the beneficiaries cannot make a trustee who is properly exercising trustee's judgment adopt the beneficiaries' views over their own as to the proper administration of the trust.

Activity 15.3

a. This is clearly a breach of fiduciary duty, as the choice of trustee is in Stella's interest, and perhaps indirectly in the trustees' interests, not in the interests of the beneficiaries.

b. Although a difficult situation, if Simon believes that he cannot effectively act in the beneficiaries' best interests, he should retire.

c. Another difficult situation. If Sam is acting in the best interests of the beneficiaries, his use of the power is not an abuse of his fiduciary position; however, if he removes the trustee in order to preserve or enhance his own position in the company, it would amount to a breach.

d. The question here is whether Arthur is properly exercising his discretion; 'because the beneficiaries asked me to' is not a valid reason. If, however, the beneficiaries' request reflects good reasons for his retiring, then his retirement may be acceptable.

Activity 15.4

As the beneficiaries can be expected to look out for their own interests in exercising the power, and there is no one else's interests they ought to consider, this would not appear to be a fiduciary power.

Activity 15.5

The court will look to the wishes of the settlor, if ascertainable, will not make appointments which favour some beneficiaries over others, and will in general make an appointment which will further the proper execution of the trust.

ACTIVITY 15.6

The scope of the court's jurisdiction to intervene is broad – it can remove or replace trustees if the proper execution of the trust is threatened. The main criterion must always be the welfare of the beneficiaries, although mere friction between the trustee and the beneficiaries is not by itself a ground for replacing the trustee.

Chapter 16

ACTIVITY 16.1

a. A trust is specifically enforced when the trustee has failed to administer the trust or pay income or transfer capital to the respective income and capital beneficiaries. Here the beneficiaries will apply to the court and the court will order the trustee to carry out the trustee's duties or replace the trustee with a trustee willing to do so. In doing this, the court has ordered specific performance of the trust.

b. A trustee is personally liable to the beneficiaries when the trustee has to pay money out of their own pocket to compensate for a loss to the trust.

ACTIVITY 16.2

The account is falsified if the trustee has entered into a particular unauthorised and identifiable transaction. Consequently the beneficiaries will apply to the court and call for the trustee to account for this transaction. The beneficiaries will 'falsify' the account in respect of that transaction and the trustee will either have to reverse the particular transaction or be personally liable to pay the equivalent sum, plus interest, from their own pocket to the trust. By contrast, the beneficiaries surcharge the account when the trust has less value than it should, but not because the trustee has entered into a particular identifiable transaction. This generally occurs when the trustee has negligently invested trust funds or when the trustee has failed to insure the trust property and a loss has occurred.

ACTIVITY 16.3

a. The account would be falsified when the trustee has used trust property to purchase some rights for themself, for example, a title to a car. The beneficiaries would apply to the court and the trustee may either reverse the transaction or pay the money back into the trust fund out of their own pocket.

b. The account would be surcharged when a trustee has failed to invest in stocks and shares with sufficient care and consequently a loss has occurred. Another example would be failing to insure the trust property and later a loss of the subject matter of those rights occurs.

ACTIVITY 16.4

The main point to explain is that the breach (wrongly paying away the trust money before the conditions were met for its release) did not cause all the loss suffered by AIB. While certainly a breach, it alone did not generate the loss, most of which was called by AIB's own decision to make a loan of that size to a couple in financial difficulties. If the defendant solicitors had performed the trust properly, AIB would have suffered the same loss except for the £300,000 the solicitors wrongly paid to the couple and for which they already admitted liability.

ACTIVITY 16.5

In *Twinsectra Ltd* v *Yardley* [2002] UKHL 12, [2002] 2 AC 164, Lord Hutton laid out three possible tests for dishonesty which might apply to the case of a third party dishonestly assisting in a breach of trust:

1. a purely subjective test, sometimes called the 'Robin Hood' test, whereby a person will only be dishonest if they transgresses their own personal standard of dishonesty, irrespective of the views of honest and reasonable people; this standard has not been adopted by the courts

2. a purely objective test, whereby a person is dishonest if they fail to act to the standard expected by honest and reasonable people, irrespective of whether they themselves do or do not appreciate they are acting dishonestly; and
3. a combined test, whereby a person is found to be dishonest if they transgressed the standard of honesty as determined by the views of honest and reasonable people, and the person realises that they have breached that standard.

The combined test (which Lord Hutton preferred) clearly sets an additional element to be proved by the claimant, as merely showing that the objective standard of honesty was breached is not sufficient – there must be some basis for showing the defendant appreciated he was acting dishonestly. Furthermore, the defendant may lead evidence to show that he did not fully appreciate that he was acting dishonestly. Lord Millett was harshly critical of applying the combined test in civil cases; while that test might be appropriate for criminal liability, where arguably *mens rea* is of the essence of liability, it is not justified in cases of civil liability in which victims of breaches of trust ought to be able to expect that those people who act dishonestly on an objective standard should compensate their victims. Interestingly, Lord Hutton and Lord Millett interpreted Lord Nicholl's speech in *Royal Brunei Airlines* to very different effect, each arguing that the test they favour truly represented the test outlined by Lord Nicholls. Lord Hutton's approach was not applied by the Privy Council in *Barlow Clowes*, raising the question of whether the law was better reflected in the dissenting opinion of Lord Millett in *Twinsectra*.

In *Group Seven* v *Notable Services* the Court of Appeal held that the test is objective. Although the doctrine of precedent might suggest that the Court of Appeal was bound by *Twinsectra* (as Privy Council decisions are merely persuasive in the Court of Appeal), the judges were able to point to the Supreme Court's decision in *Ivey* v *Genting Casinos (UK) Ltd* to support their approach. In that case, the Supreme Court was critical of the use of subjective tests of dishonesty, including in the context of criminal law. For instance, the Supreme Court stated at [59] that:

> There is no reason why the law should excuse those who make a mistake about what contemporary standards of honesty are, whether in the context of insurance claims, high finance, market manipulation or tax evasion. The law does not, in principle, excuse those whose standards are criminal by the benchmarks set by society, nor ought it to do so. On the contrary, it is an important, even crucial, function of the criminal law to determine what is criminal and what is not; its purpose is to set the standards of behaviour which are acceptable.

Activity 16.6

Although the first painting was placed on Ted's wall, Ted of course continued to hold the title to it in trust. As to the second, Ted is personally liable. By selling the title, he has caused a loss to the trust and so he must pay its value plus interest back into the trust. The facts do not indicate what Ted did with the £2,000 he received for selling the title to the second painting, but if he retains it, the beneficiaries have a proprietary claim to it, and if he purchased any traceable rights with the money, they have a proprietary claim to those. Regarding Ted's unauthorised investment, Ted is strictly personally liable for this breach of trust. He is not relieved of this liability because he sought the advice of a solicitor, unless (recall Section 4.5) he is regarded as having properly delegated the investment of the funds to Alex. If Ted is not regarded as having delegated the decision to Alex, he can bring an action for damages for negligence against Alex (making Alex personally liable to him, that is to say, Ted, for his loss (Ted's own liability to the trust fund)). If he is regarded as having properly delegated the decision to Alex, then Ted will not himself be personally liable to restore the trust, for the loss was not caused by any breach he committed, but he will have a right of action on behalf of the trust against Alex to pay damages for his negligence, and the damages he receives he will hold on trust for the beneficiaries. Ted must pursue this claim against Alex, and if he fails to do so the beneficiaries can apply to the court for an order of specific performance to make Ted bring the action against Alex. Alex was negligent but not dishonest in misconstruing the trust terms, so he is not personally liable to the beneficiaries, although as we have seen he is liable for his negligence as outlined above.

With regard to the transfer of £50,000, Ted is clearly personally liable. There is nothing on the facts to indicate that Alex was either negligent in carrying out this transaction, or did so knowing or suspecting it was in breach of trust, so he is not personally liable for dishonest assistance. Alex would not be liable to the trustees, but instead is liable to Ted for his professional negligence. With regard to Alex's assistance in the transfer of monies to Barbara, much would turn on his level of involvement in the transaction. If Alex dishonestly assisted in the breach of trust he would be personally liable to the beneficiaries to restore the trust to the value it was before this transaction. However, if he was simply negligent, then the beneficiaries will have no claim against him. Barbara is a volunteer recipient of the £50,000. If she retains any of the money or its traceable proceeds, the beneficiaries will have a proprietary claim against her. As to her personal liability, she will only be liable, following *Re Montagu*, if she had some degree of knowledge that the money was given to her in breach of trust, or following *Akindele*, it would be unconscionable not to pay back its value (whatever 'unconscionable' means). Finally, one might consider whether she should be personally liable on an unjust enrichment basis to repay an equivalent sum to the trust in order to reverse her unjust enrichment at the beneficiaries' expense.

With regard to the receipt of title to the first painting, there can be no proprietary claim against Fred, because, having dissipated the proceeds of sale, there are no traceable proceeds. Fred, like Barbara, is another volunteer recipient and so *Re Montagu*, *Akindele*, or the unjust enrichment approach would apply to determine his personal liability. Fred may be able to advance the 'change of position' defence as he relied on the validity of the gift to sell it and spend the money on a 'lavish' birthday party for his wife, which he might well not have done had he not received the title in the first place.

Activity 16.7

This is perhaps the biggest issue in the law of trusts at present. Until the House of Lords establishes in a clear fashion the principles of personal recipient liability, controversy will remain. The unconscionability test set down by Nourse LJ has been criticised on the grounds that it involves too much uncertainty. 'Unconscionable' does not mean anything specifically, as 'dishonest' does, and for that reason was rejected as a touchstone of liability in *Royal Brunei*. The *Montagu* test does give some guidance as to the requirements of knowledge, although one should note Nourse LJ's argument that the central thread in the case law is whether the recipient's conscience was bound. The challenge posed by the unjust enrichment approach lies in the intuition that the recipient should not be enriched at the beneficiaries' expense. Between those two, the obvious result at first glance is that the recipient should pay back the value to the trust. Notice that the unjust enrichment approach does not disregard the defendant's knowledge entirely – rather it restricts the issue of dishonesty to the application of the change of position defence. Only an innocent recipient can claim change of position.

While the unjust enrichment approach clearly has its attractions, not all are convinced. Smith ('Unjust enrichment, property, and the structure of trusts' (2000) 116 *LQR* 412) points out that cases of recipient liability are not really two-party situations where value is transferred from the beneficiaries to the third party, as when you pay your gas company twice by mistake, in which two-party case the unjust enrichment principles developed and are most clear; they are three-party situations – the trustee, who as a conceptual feature of the trust is interposed between the beneficiaries and the recipient, makes this a three-party situation.

Do the unjust enrichment rules straightforwardly apply where the settlor by creating the structure of the trust also creates the possibility that the trustee may breach the trust? In other words, do the beneficiaries deserve the same sympathy as the person who mistakenly makes a payment? Furthermore, the law provides the beneficiaries under a trust with better remedial rights than the mistaken payer in certain respects: they, but not the mistaken payer, can both follow and trace the trust property so as to make proprietary claims against the recipient. Perhaps equity has struck a proper remedial balance, giving the beneficiaries extensive proprietary rights against recipients, but limiting them, when those rights run out, to a more limited personal liability which depends on the recipient's knowledge.

Activity 16.8

a. '…that s. 21(1) might apply, so that no statutory limitation period would govern his claims. First, if a breach of trust was fraudulent, s. 21(1)(a) disapplied the statutory limitation period both (i) to an action against the trustee who was party to the fraud and (ii) to actions against third parties who incurred ancillary liabilities as dishonest assistants or knowing recipients.'

b. '…A majority (Lords Mance and Clarke dissenting) held that s. 21(1)(a) was confined to actions against a trustee who was party to a fraudulent breach of trust. It did not cover third parties, who were implicated in the frauds, as dishonest assistants or otherwise.'

c. '…dishonest assistants or knowing recipients, who were sometimes said to owe personal liabilities to account "as constructive trustees", were "trustees" within the meaning of s. 21(1)(a) (or s. 21(1)(b)).' (p.253)

d. '…Section 38(1) required "trust" and "trustee" to bear the same meanings as in s. 68(1)(17) of the Trustee Act 1925. Although this definition expressly includes "constructive trusts" and "trustees", the majority held (i) that neither dishonest assistants nor knowing recipients, whilst said to be liable to account "as constructive trustees", were "true" trustees – not even constructive trustees; and (ii) they were also not "constructive trustees" within the statutory definition.' (p.254)

e. '…In particular, their decision that a knowing recipient is not a "trustee" for the purposes of the Limitation Act 1980 relied heavily on a wider premise that a knowing recipient is not a "trustee" – and not even a constructive trustee – *under the general law*. With respect, that is questionable.' (p.255)

f. '…The knowing recipient is fixed with custodial duties that are of the same nature as those voluntarily assumed by express trustees.' (p.255)

'…the accounting mechanisms through which the knowing recipient can be made liable for performance of his duties, or their breach, are the same as those through which trust beneficiaries can take action against express trustees.' (p.255)

g. '…Citing Mitchell and Watterson's article, it said: "The recipient's personal liability as a constructive trustee by virtue of knowing receipt means that the recipient is subject to custodial duties which are the same as those voluntarily assumed by express trustees … The recipient's core duty is to restore the misapplied trust property…"' (at [37])

Activity 16.9

a. '…The bank alleged that the solicitors acted in breach of trust, breach of fiduciary duty, breach of contract and negligence. It claimed relief in the forms of (i) reconstitution of the fund paid away in breach of trust and in breach of fiduciary duty, (ii) equitable compensation for breach of trust and breach of fiduciary duty, and (iii) damages for breach of contract and negligence, in each case with interest.' [9]

b. '…Due to a misunderstanding [at 5] the solicitors only partly paid the outstanding amount on the existing Barclay's mortgage [at 5] and released the remainder to the borrowers.[see para. 5]. This is in breach of the CML instruction: "You must hold the loan on trust for us until completion. If completion is delayed, you must return it to us when and how we tell you".' [4]

c. (i) '…The difference, leaving interest aside, is between £2.5m and £275,000 in round figures.' [8]

(ii) The house did not reach its valuation of £4.5 million.

'…Subsequently the borrowers defaulted, and the property was repossessed and sold by Barclays in February 2011 for £1.2m, of which the bank received £867,697.' [8]

d. '…"Equitable compensation for breach of trust is designed to achieve exactly what the word compensation suggests: to make good a loss in fact suffered by the beneficiaries and which, using hindsight and common sense, can be seen to have been caused by the breach."' [19]

e. '…First, the defendant's wrongful act must cause the damage of which complaint is made. Second, the plaintiff is to be put "in the same position as he would have been in if he had not suffered the wrong for which he is now getting his compensation or reparation" (*Livingstone* v *Rawyards Coal Co* (1880) 5 App Cas 25, 39, per Lord Blackburn).' [26]

f. '…the basic rule is that a trustee in breach of trust must either restore to the trust the assets which have been lost by reason of the breach of trust or pay monetary compensation to the trust estate. In so doing, courts of equity did not award "damages" but would make an in personam order for the payment of equitable compensation: *Nocton* v *Lord Ashburton* [1914] AC 932, at paras 952, 958, per Viscount Haldane LC.' [30]

Chapter 17

ACTIVITY 17.1

At a simple level, the fiduciary (the trustees) should not use the trust funds in such a way as to further their own interests. More specifically, there is a conflict because the buyer of the shares, the trust, would like to buy the shares at the lowest possible price, whereas as seller of the shares, the trustee wants the highest price he or she can get for them.

ACTIVITY 17.2

First you should explain as clearly as you can the facts, and in particular the various different ways in which Boardman acted in consultation with the trustees – was it right to say that Boardman was a fiduciary to the beneficiaries in the first place? Then you should turn to the views of the individual judges. Lords Guest and Hodson said that Boardman placed himself in a fiduciary position by his close association with the trustees in respect of their carrying out the trust, and relying on the foundational case for the rule, *Keech* v *Sandford* (1726) Sel Cas 1 King 61, held he was liable to disgorge any profits made in the course of acting as a fiduciary. Lord Cohen's view was more subtle: he said that Boardman was in a position of conflict of interest because, having become interested in purchasing shares of the company himself, could not have disinterestedly advised the trustees about purchasing more shares for the trust. Lord Upjohn's dissent focuses on the harshness of the result, stating that the rule about a fiduciary's placing themself in a position where their interests may conflict with those of their principal must be reasonably applied, and the conflict was really only fanciful on these facts. A stringent application of the rule can be justified on the basis that fiduciaries must be kept to the highest standards of loyalty, and that if the rule is applied more sensitively or 'contextually', it would lose its prophylactic force – it would require judges to make difficult judgments in every case in trying to measure whether the conflict of interests, based upon the parties' expectations and so on, was substantial. The reality of many situations, where minor conflicts of interest are common, weighs in favour of a more sensitive application of the rule – the decision in *Boardman* does seem harsh.

ACTIVITY 17.3

The self-dealing rule is one of the most stringently enforced of all the rules that apply to a fiduciary (see *Re Thompson's Settlement*), and the relaxation of this rule in *Holder* v *Holder* should be seen as exceptional, based on the special facts of the case: the court treated the defendant as if he were not, in substance, a trustee. Furthermore, Harman LJ in particular pointed out that the purpose of the rule, to prevent the fiduciary from acting as both vendor and purchaser, would not be fulfilled by applying the rule in this case, for the sale of the property was entirely arranged by two executors who proved the will, the defendant taking no part on the vendor's side of the transaction.

Activity 17.4

a. The self-dealing rule applies to this transaction as the trustee has sold her own rights, the shares in XYZ plc, to the trust.

b. The fair-dealing rule applies to this transaction because the agent has attempted to purchase his principal's rights, the antiques business.

c. Here the trustee is buying the beneficiary's future trust income, which is an interest, and consequently the fair-dealing rule applies to this transaction.

d. Clearly in this situation neither rule applies as the purchase of the title to the painting is completely separate from the divorce proceedings in which the solicitor was a fiduciary to Jonah.

e. The director is a fiduciary of the company; although the director is selling her own rights to ABC Ltd it is clearly a self-dealing transaction.

Chapter 18

Activity 18.1

This question involves tracing between innocents, the beneficiary and Victor, to begin with, and then, if the proportionate share rule is applied to tracing among innocents, between a wrongdoer and an innocent, after Victor finds out the money was trust money. On the 'first in, first out' rule, Victor spends the £3,000 of his own money that was in the account at the beginning plus £2,000 of trust money to buy the title to the painting. The rest of the money is trust money, going on the cruise, which provides no proceeds, and into the traceable proceeds of the car. The remaining money in the account is the trust's. If a proportionate share rule is adopted between innocents, 10/13ths of the value of the title to the painting is the trust's, as is 10/13ths of the remaining £8,000, and then of the £4,000 that remains after the cruise expenditure. Victor is now no longer innocent, and so the beneficiary has the advantage of the *Re Hallett*'s and *Re Oatway* rules; consequently, the beneficiary can claim that all of Victor's money (3/13 x £4,000 = £923) went to buy the title to the car, which has decreased in value, although the remainder of the £3,000 purchase price must be trust money, but the beneficiary can claim the entire £1,000 balance that remains in the account.

Activity 18.2

This is a question involving tracing between a wrongdoer and two innocents. As between the innocents themselves, the rules governing tracing between innocents apply, and as between the innocents, whether singly or together, and the trustee, the rules dealing with wrongdoers apply. The first transaction following mixing is the purchase of the shares; here only the Adams trust and the trustee are involved, and the trust will choose to say that the entire purchase was funded with trust money, for the shares have doubled in value. The Khan money is now added, so the account stands £10,000 to the trustee, £5,000 to the Adams trust, £40,000 to the Khan trust. First, assume the 'first in, first out' rule for innocents is applied.

The innocents will want to claim the value of the second share purchase, as, like the first, it has risen in value. The £5,000 Adams trust money is spent first under the rule, plus £5,000 of the Khan money to make up the purchase price. The account now stands £10,000 to the trustee, £35,000 to the Khan trust. There is no more mixing of the innocents' monies. The car has declined in value, some money has been expended on traceable proceeds, and £5,000 of money which might represent trust money remains in the account; under the lowest intermediate balance rule the Khan trust cannot benefit from Tara's addition of her own £20,000 at the end, unless there is evidence she did so to restore the trust, and there is no such evidence. The Khan trust will require all of the £5,000 in the balance to represent trust money, £25,000 of the money spent on the car to have been trust money (although it has declined in value, the only other alternative is the money spent on living expenses which generated no traceable proceeds) and £5,000 of the trust money to have been dissipated on general living expenses. All of Tara's £10,000 is treated as having been dissipated. If we apply

the proportionate share rule, the Adams trust will have a 1/9 share, the Khan trust an 8/9 share in the £45,000 of trust money in the account immediately after mixing. They will then apply the rules together against Tara, taking proportionate shares in the entire value of the second share purchase, in the £5,000 balance in the account, in the entire value of the car, and £5,000 of the money dissipated.

Activity 18.3

The Privy Council held that backwards tracing is not available as a general rule, but only 'where there is a close causal and transactional link' between two transactions. That link can exist even if the traceable proceeds are generated before the receipt of the money that generates those proceeds. This is consistent with an example used by Lionel Smith in his book on tracing. If trust money is misappropriated and used to pay for a car, then the car is the traceable proceeds of the trust money and it cannot matter whether the purchase price for the car was paid the day before legal ownership of the car passed to the buyer or the day after. The order of events do not alter the conclusion that money was exchanged for a car. *Brazil* v *Durant International Corp* does not tell us how far backwards tracing can be pushed. For example, if the purchaser obtained a bank loan to buy the car and then used misappropriated trust money to repay the loan one year later, could that money be traced to the car. Smith suggested that this should be possible, but the Privy Council suggested otherwise.

Activity 18.4

In the first situation involving Victor, the beneficiary will claim a share under a constructive trust of the title to the painting, as it has risen in value. If 'first in, first out' rules are applied, then the beneficiary will claim that the title to the car is held for him on constructive trust absolutely and the balance of £1,000. There is no point in merely charging the car, for the beneficiary has the full interest in it anyway. For the money lost through the decline in value of the car and that dissipated, the beneficiary can bring a personal action against Victor to restore the trust, as he made those expenditures dishonestly. If the proportionate share rules apply, the only difference will be that the beneficiaries will charge the title to the car with the repayment of their money, rather than taking a proportionate constructive trust interest.

In the second situation involving Tara, the Adams trust will claim that the shares are held for them on constructive trust, as they have risen in value. Tracing between innocents under the 'first in, first out' rules, the two trusts will claim interests under constructive trusts of the second lot of shares, as they too have risen in value. The Khan trust will claim an interest under a constructive trust of the title to the car, as although it has declined in value it was purchased entirely with trust money so there is no advantage in foregoing the trust interest and charging the car instead. The value lost on the decline in the value of the car and through dissipation can be claimed against the trustee personally. On the proportionate share analysis, the trusts will claim a shared entitlement under a constructive trust in the second lot of shares, and in the car – there is no advantage in charging the car, for as innocents they must act together, and one cannot have the advantage of a charge as against the other innocent. The advantage of a charge only operates where the wrongdoer contributes to the purchase price, such that a charge will operate to their disadvantage. Again, the beneficiaries can claim personally against Tara for the trust value which has been lost and cannot be recovered by claiming ownership shares in the purchased rights.

Activity 18.5

The defendant Bajwa intended to sell his mortgaged title to land, and immediately following the sale Bajwa would normally have been required to use the sale money to discharge the outstanding amount of the mortgage debt. The purchase money was raised by the intending purchasers from a different, second, lender who, of course, required that a mortgage on the land was obtained in its favour when the purchase went through. The purchase money was transferred into a solicitor's client account (which is a trust account) in advance of the purchase. By mistake, and in breach of trust, the money was advanced before the title to the house was transferred, Bajwa using the money to pay off the mortgage. As a result, Bajwa ended up with a clear title

to his house, without a mortgage, and the second lender had advanced its funds and received no mortgage in return. The Court of Appeal held that the second mortgage lender was entitled to be subrogated to Bajwa's lender's mortgage on the land which its money had been used to discharge.

Activity 18.6

a. '...Bishopsgate Investment Management Ltd (BIM) was the trustee of certain pension schemes. During Maxwell's lifetime, funds belonging to BIM as trustee were improperly transferred to bank accounts of companies controlled by Maxwell.'

b. The insolvency of both MCC and BIM.

c. '...on the ground that BIM was entitled to make an equitable charge over all the assets of MCC, in priority to all secured creditors.'

d. In that Court, Vinelott J held that the administrators could make the distribution. He said that unless the liquidators of BIM could trace BIM funds into specific assets of MCC, no charge could be established over assets of MCC.

e. '...the claimant need only show the assets of the recipient were swollen by the receipt; nothing further need be shown.'

f. '...Where value is traced into a bank account, the amount of that value which traceably remains in the account at a later time is limited to the lowest balance which has existed in the interim.'

g. '...The plaintiff can only assert the difference between the improperly transferred amount and the lowest intermediate balance. For example, if the lowest intermediate balance is only half the improperly transferred amount, the plaintiff can only assert 50 per cent of the improperly transferred amount, even if the balance increases later.' (See also the arithmetical example in the article.)

h. '...Where, as in Bishopsgate, there is an intervening time at which the account was over drawn, the earlier deposits do not traceably survive in any positive balance which might exist later.'

i. '...Tracing is an inquiry into what was acquired as a matter of fact, with the plaintiff's value.'

j. '...In that case, her inability to trace is totally irrelevant, since rights derived through tracing are distinct from rights derived through intentional transfer.'

Activity 18.7

a. Subrogation is concerned with the assignment by operation of law of a third party's rights (which may or may not be proprietary rights). It is based on intention, actual or inferred.

b. '...the proprietary claim and the proprietary remedy which equity makes available to the beneficial owner who seeks to recover his property *in specie* from those into whose hands it has come.' (p.9)

c. '...It is the process by which the plaintiff traces what has happened to his property, identifies the persons who have handled or received it, and justifies his claim that the money which they handled or received (and, if necessary, which they still retain) can properly be regarded as representing his property.' (p.9)

d. '...He needs to do this because his claim is based on the retention by him of a beneficial interest in the property which the defendant handled or received.' (p.9)

e. '...the court may achieve a similar result by treating the land as subject to a charge by way of subrogation in favour of the plaintiff.' (p.9)