



### Concentrate Questions and Answers Equity and Trusts: Law Q&A Revision and Study Guide (3rd edn)

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## p. 62 5. Trusts, Powers, and Discretionary Trusts

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<https://doi.org/10.1093/he/9780198853213.003.0005>

**Published in print:** 06 August 2020

**Published online:** September 2020

### Abstract

The Concentrate Questions and Answers series offer the best preparation for tackling exam questions. Each book includes typical questions, bullet-pointed answer plans, suggested answers, and author commentary. This book offers advice on what to expect in exams and how best to prepare. This chapter covers questions on trusts, powers, and discretionary trusts.

**Keywords:** trusts, powers, discretionary trusts, protective trusts, certainty of objects, Trustee Act 1925, McPhail v Doulton

### Are You Ready?

In order to attempt the questions in this chapter you will need to have covered the following topics:

- The difference between a power and a trust
- The definition of mere powers and fiduciary powers
- The definition of a discretionary trust

### Key Debates

**Debate:** what is the difference between a discretionary trust and a power?

Discretionary trusts and powers may look similar and they may be created for a similar purpose. A testator wishing to provide for the members of his family after his death may prefer to give the trustees a discretion in the allocation of the beneficial interests, so that account can be taken of the changing needs and circumstances of the objects after the testator's death. The appropriate machinery for this is the discretionary trust. Mere powers (whether fiduciary or non-fiduciary) result in different rights. An individual object of a power (whether fiduciary or non-fiduciary) has a right (a mere equity) to prevent any appointment being made outside the defined class of objects. Only an object of a fiduciary power, however, has equitable rights (mere equities) in relation to the exercise of the power. These rights are broadly similar to those enjoyed by an object of a discretionary trust; but the crucial distinction, which was emphasised by Lord Wilberforce in *McPhail v Doulton* [1971] AC 424, is that trustees of a discretionary trust are under a greater duty to survey the class than donees of a fiduciary power. That case repays careful study on a variety of grounds!

### Question 1

- Adam, who has just died, made the following dispositions in his will:
- a £50,000 to my trustees on trust to apply the net income of the fund in making, at their absolute discretion, grants to or for the benefit of any of the employees or former employees of Abel & Sons, their spouses or dependants, or any others having a moral claim on me.
  - b £5,000 to my trustees upon trust to be divided equally amongst my friends at the 'Paradise' public house, Edenton.
  - c £100,000 to be applied by my trustees as they see fit for the benefit of the middle classes of my home town, Edenton.
  - d The residue of my estate to my wife, Eve, absolutely, but I direct my trustees to allow such old friends of mine who wish to do so, to acquire any of my collection of stuffed reptiles at 50 per cent of market price.

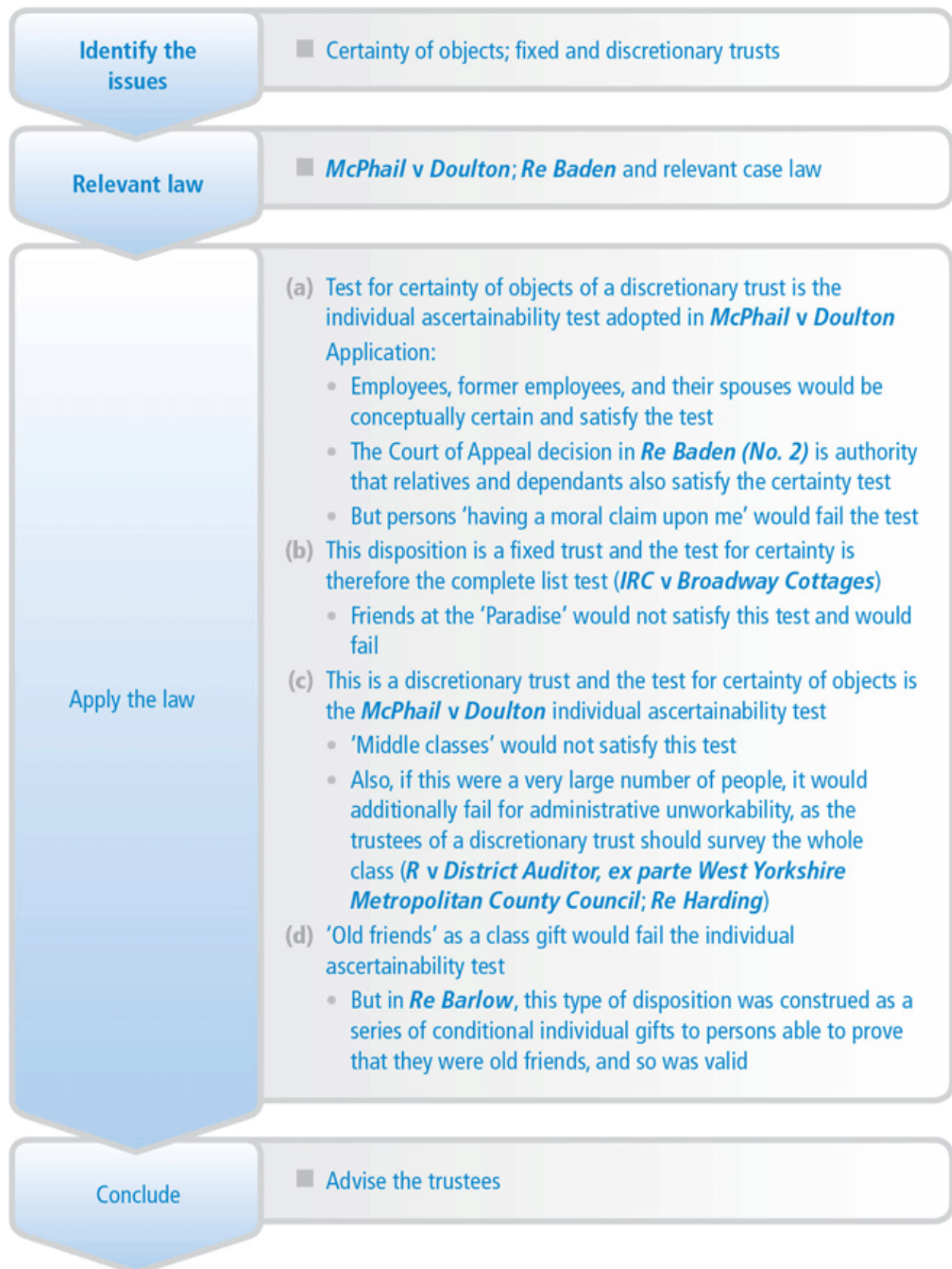
**Advise the trustees of the will as to the validity of these dispositions.**

### Caution!

There usually appears in examination papers a question on certainty of objects dealing with the ramifications of the House of Lords' decision in *McPhail v Doulton* [1971] AC 424 and its application by the Court of Appeal in *Re Baden's Deed Trusts (No. 2)* [1973] Ch 9. So a careful preparation of the case law will repay the effort.

- This question mixes fixed and discretionary trusts—watch out for that and make sure you are clear about which type you are dealing with. The rules for certainty of objects are very different.

### Diagram Answer Plan



## Suggested Answer

### (a) Abel & Sons<sup>1</sup>

<sup>1</sup> In a problem question go straight into the answers matching the numbering in the question. Never, never, never write it as an unnumbered continuous answer.

A trust must be for ascertained or ascertainable beneficiaries:<sup>2</sup> *Re Endacott* [1960] Ch 232, CA. The test to determine certainty of objects in a discretionary trust was decided by the House of Lords in *McPhail v Doulton* [1971] AC 424 ('can it be said with certainty that any given individual is or is not a member of the class?').

<sup>2</sup> This states the law and identifies the issue at the same time. This is the only way to answer a problem question with numbered points.

Since this decision, therefore, it is no longer necessary to prepare a complete list of objects of a discretionary trust as is still required in a fixed trust (*IRC v Broadway Cottages Trust* [1955] Ch 20, CA). In *McPhail v Doulton* the House of Lords adopted the test for certainty of objects of powers established in *Re Gulbenkian's Settlement Trust* [1970] AC 508, and the two tests are now the same.

It is necessary, therefore, to apply<sup>3</sup> the test to the terms of Adam's will and ask: can it be said with certainty whether any individual is or is not an employee or former employee of Abel & Sons, or their spouse or dependant, or any other having a moral claim on Abel?

<sup>3</sup> Here is the application to this part of the problem.

Employees or former employees would satisfy the test.<sup>4</sup>

In *Re Baden's Deed Trusts (No. 2)* [1973] Ch 9, CA, the terms 'relatives' and 'dependants' were subjected to the test. It was considered that the terms were conceptually certain and, therefore, sufficient to satisfy the test although all three judges gave different reasons for finding 'relatives' certain.

<sup>4</sup> Part (a) has sub-parts to it. Take each in turn (you could use a sub-numbering system if you find that makes it clearer to read).

The term ‘spouses’ is clearly certain as a concept and this part of the gift would be valid.

However, the gift also includes a category of ‘any others having a moral claim on me’. It was said in *McPhail v Doulton* that such an expression is conceptually uncertain.

It is not clear whether<sup>5</sup> this would cause the whole gift to fail for uncertainty or whether the courts could sever the offending part, thereby saving the valid parts (*Re Leek* [1969] 1 Ch 563, CA; *Re Gulbenkian’s Settlements* [1968] Ch 126 at p. 138, CA).

<sup>5</sup> Conclusion—you cannot be definitive so state the choices.

### (b) Paradise Public House

The gift upon trust to be divided equally amongst my friends at the ‘Paradise’ is a fixed trust.<sup>6</sup> The beneficiaries hold equitable interests under the trust in fixed shares. It is necessary to be able to draw up a list of all the beneficiaries in order for the division to be made. The older and stricter rule in *IRC v Broadway Cottages Trust* applies. The expression ‘friends’ is not a term that is sufficiently certain for such a complete list to be drawn up.<sup>7</sup> The expression ‘old friends’ was held to be certain in *Re Gibbard’s Will Trusts* [1967] 1 WLR 42 in relation to a power, but this case used the old test of whether it could be said of any one person that they were within the class (a test favoured by Lord Denning MR in his dissenting judgment in the Court of Appeal in *Re Gulbenkian*). This test was rejected by the House of Lords in *Re Gulbenkian*, however, and so is not now good authority for this point. A gift to ‘friends’ was upheld in *Re Barlow’s Will Trusts* [1979] 1 WLR 278, but this was a series of gifts with a condition precedent. The size of the gift to each recipient did not alter according to the numbers answering the description, therefore it is not authority for certainty of the expression ‘friends’ in a class gift, whether a fixed (or discretionary) trust.

<sup>6</sup> This question mixes fixed and discretionary trusts. State clearly in the opening of each section which you are dealing with.

<sup>7</sup> The conclusion (which is clear) is stated here. The answer then goes on to discuss the case law around this point.

### (c) Middle Classes of Edenton

This gift constitutes a purported discretionary trust.<sup>8</sup> It raises questions about certainty of objects and administrative workability.

<sup>8</sup> Make it clear that this is an example of a discretionary (rather than fixed) trust.

The problem of certainty of objects is raised in respect of the definition of ‘middle classes’ (*McPhail v Doulton*). Again, it is necessary to decide whether such a concept is certain, applying the test in *McPhail v Doulton*. Although it may be possible to say definitely whether some individuals are or are not members of the middle classes, there may be a number of people who cannot be classified in this way. There was a difference of approach amongst the judges in *Re Baden’s Deed Trusts (No. 2)*.

Megaw LJ accepted<sup>9</sup> that there may be a substantial number of persons about whom it could not be proved whether they are in or out. However, this may relate more to the question of evidential uncertainty. Conceptual certainty means that the class must be definable. Evidential certainty is the proof an applicant must supply to establish membership of the class. In the case of a gift to ‘middle classes’ it is difficult to define criteria for such a concept.

<sup>9</sup> It is good to display the fact that you have read the case and know the opinions of the individual judges.

However, even if the gift is conceptually certain, then the question of administrative unworkability arises. In *McPhail v Doulton*, it was said that if the definition of ‘objects is so hopelessly wide as not to form anything like a class’, then the trust would be administratively unworkable. A discretionary trustee has duties to survey the class and this is impossible in a class of great width. This was the position in the case of *R v District Auditor, ex parte West Yorkshire Metropolitan County Council (1986) 26 RVR 24*, where a trust for the inhabitants of the county of West Yorkshire was held to be too wide and therefore void for administrative unworkability. In *Re Harding [2008] Ch 235*, it was considered that a trust for the black people of four London boroughs would have been administratively unworkable. If the trust could be construed as a power<sup>10</sup> this rule would not apply: *Re Manisty’s Settlement [1974] Ch 17*.

<sup>10</sup> An easy point to forget so extra marks if you get it.

p. 67

### (d) Old Friends and Stuffed Reptiles

This gift must be distinguished from discretionary trusts.<sup>11</sup> It is not a trust for a class but a number of individual gifts to any person who is able to prove to the trustees that he or she qualifies as ‘an old friend’. Such a gift does not require conceptual certainty.<sup>12</sup> The gift will be valid if only one person seeking to take can be identified as an ‘old friend’ (*Re Allen [1953] Ch 810, CA*). In *Re Barlow’s Will*

*Trusts*, the direction to sell a painting at a preferential price to ‘any friends of mine who may wish to buy one’ was held to be a valid gift. A friend was a social acquaintance of long standing and anyone who satisfied this condition precedent could take the gift.

<sup>11</sup> Statement of the issue and law.

<sup>12</sup> The concluding view.

On the basis of this authority, this final disposition is therefore valid.<sup>13</sup>

<sup>13</sup> Each section has its own conclusion so no need for final summary.

### Looking For Extra Marks?

■ For a high mark, some discussion of the issues going beyond a simple application of the cases to the problem is desirable. Some further discussion of the issues of conceptual certainty, evidential certainty, ascertainability, and administrative workability would be appropriate. If you can display your knowledge of the individual opinions of their Lordships in *McPhail v Doulton* that would be even better.

### Question 2

But it is difficult in borderline cases to draw a dividing line between discretionary trusts and powers ... The decision turns on the proper construction of the language of the instrument. The matter is made more difficult by reason of the fact that a discretionary trust may be ‘exhaustive’ or ‘non-exhaustive’.

(Hanbury and Martin, *Modern Equity*, 18th edn, Sweet & Maxwell, 2009, at p. 66)

**Discuss.**



### Caution!

■ This essay question requires a discussion of the distinction between discretionary trusts and powers with reference to relevant literature; see, for example, Y. Grbich (1974) 37 MLR 643. In particular, such reference must be made where an essay of this type is set as an assessed essay. A straightforward explanation of the difference and the importance of the distinction between discretionary trusts and powers is required. The essay could be grouped under different headings to clarify the different aspects of the problem; for example, the different position of the trustees/donees, and the potential recipients.

■ Be precise in your use of terminology. Confusion can easily arise because some terms are used by different judges or writers to mean different things; so, unless they define the sense in which they are using the terms, you will have to look to the context in order to determine what the meaning is. The term 'trust-power' is a dangerous one to use without any explanation of its meaning. A trust-power is a combination of a duty (a trust) and a power. For this reason, a discretionary trust is often called a trust-power, since it combines a duty to distribute with a power of selection.

■ Unfortunately, the term trust-power can also be used to mean a fiduciary power, since this too combines a power and a trust obligation, i.e. a power to distribute and a duty to consider exercising it. In this chapter, the term trust-power is used to mean a discretionary trust.

■ Another problem is with the term 'mere power'. This expression is used in contradistinction to a trust-power (in the sense of a discretionary trust). It is, in other words, a power which the donee or fiduciary is not obliged to exercise. In this sense, the term 'mere power' embraces both fiduciary and non-fiduciary powers. By contrast, a 'bare power' (sometimes called a 'personal power') means a non-fiduciary power.

p. 68

### Diagram Answer Plan

Both a discretionary trust and a power give a person the right to benefit members of a class whom they choose, and are the same in this respect

A discretionary trust imposes an obligation to select beneficiaries, whereas a power is merely an enabling provision

It follows that trustees must exercise their discretion under a trust, and the court will intervene if they do not, whereas the court will not generally intervene to exercise a power

The donee of a power is not obliged to exercise it, although he should consider its exercise if it is a fiduciary power

The test for certainty of objects of powers established in *Re Gulbenkian* was adopted in *McPhail v Doulton* for discretionary trusts—can it be said of any given postulant that they are, or are not, within the class of objects?

Although no individual potential beneficiary under a discretionary trust has any interest in the property, collectively they own the property and the rule in *Saunders v Vautier* applies

Although the objects of a power generally have no rights, the courts have taken the view in some pension fund cases that, as the objects have given consideration, the courts should have a right to intervene to protect them

A disposition which contains a gift over if there is no selection will be a power, as selection is clearly not intended to be obligatory

In the absence of a gift over, the court must decide if the settlor's intention was to benefit the objects in any event (a discretionary trust) or merely to enable someone to benefit them if he so wished (a power)

### Suggested Answer

At first sight a discretionary trust and a power may achieve the same purpose.<sup>1</sup> A disposition is made which is available for a group of people but the selection of the recipients and the size of their shares is left to the decision of a third party. The purpose of such a disposition is not to benefit each member of the group equally regardless of their need, but instead, a power of selection is given to a trusted third party. That person is to make the selection according to criteria fixed by the settlor or at their absolute discretion. If the settlor wished each member of the group to benefit in any event, then this would have been achieved by creating a fixed trust in equal or other shares.

<sup>1</sup> These introductory paragraphs set out the basic aspects of the issue.

The person making the selection may be obliged to use up all the property or income in making a selection, as in an exhaustive trust, or there may be power to accumulate income and make no selection as in a non-exhaustive trust.

However, the basic difference that a trust imposes an obligation to distribute, whereas a power is merely an enabling provision, results in important differences in the duties of trustees of a discretionary trust and the donees of a power, and the position of the beneficiaries under each.

### Duty of Trustees under Discretionary Trusts<sup>2</sup>

<sup>2</sup> In order to keep a structure to the essay set out the points to be made under headings as here.

A trustee is under a duty to perform the trust. If the trust is discretionary, the trustees are obliged to consider and exercise their discretion. If they fail to exercise their discretion, the court can order them to do so. If the trust is exhaustive, they must make an appointment even though the decision as to the recipient and the size of the distribution is at the trustees' discretion. The court will intervene and make an appointment if the trustees fail to act, or if the trustees predecease the testator—the trust will not fail for want of a trustee. If no appointment is made the property will normally be divided equally between the beneficiaries on the basis that equality is equity, as in the case of *Burrough v Philcox (1840) 5 My & Cr 72*.

## Duty of Donee of a Power<sup>3</sup>

<sup>3</sup> The structure proposed is straightforward. First explain the point in relation to a trust and then to a power.

There is an initial distinction to be drawn between fiduciary powers and bare powers. A fiduciary power is a power of appointment granted to a trustee or to a person in a fiduciary position (*Re Mills [1930] 1 Ch 654*). Because such persons are in a fiduciary position, they cannot simply ignore the power. In *Re Hay's Settlement Trusts [1982] 1 WLR 202*, it was held that the donee of a fiduciary power must consider the exercise of the power and survey the potential beneficiaries from time to time. The court may intervene if the trustee exercises the power improperly.

However, even where there is a fiduciary power the donee is not required to exercise it. In *Re Gestetner's Settlement [1953] Ch 672*, a power given to trustees to distribute amongst a huge and fluctuating class consisting of employees of a number of companies, was considered valid, even though it was impossible to consider all the potential objects. The test for certainty of powers, as established in *Re Gulbenkian's Settlement [1970] AC 508*, is, in fact, the same for certainty of objects in a discretionary trust. This was held to be the appropriate test for discretionary trusts in *McPhail v Doulton [1971] AC 424*. The test is that it must be possible to say with certainty whether any given individual is or is not a member of the class.

A bare power does not impose on the donee any fiduciary duties. A donee of a bare power may exercise the power at will. If the power is not exercised, the court cannot compel the donee to exercise it or even to consider its exercise. If the donee predeceases the testator, then the power lapses. If no appointment is made under any power (whether fiduciary or not), the property will pass to the person entitled in default of its exercise, so that, if the donor of the power has not specified who is to take over in this event, the property may go back to the settlor or to the testator's estate under a resulting trust.

## Position of Beneficiaries under a Discretionary Trust

The beneficiaries under a fixed trust own the property in equity, and, if of full age and sound mind, can call for the trust to be extinguished and the property distributed (*Saunders v Vautier (1841) 10 LJ Ch 354*). Under a discretionary trust, no individual beneficiary owns a particular part of the trust property until an appointment has been made (*Gartside v IRC [1968] AC 553*). However, as a group, all the potential beneficiaries own the trust property and, as in a fixed trust, if adult and of sound mind, they can collectively call for the trust to be brought to an end.

### Position of Objects of a Power

The objects of a power have no interest in the property. They cannot call for a distribution to be made. They only acquire an interest once a distribution is made in their favour. They have no right to seek the intervention of the court if no appointment is made. If no appointment is made, therefore, unless there is a gift over, the property will revert on resulting trust to the settlor or the settlor's estate. The only occasion on which the objects of a bare power can apply to court is to restrain the exercise of a power which is outside the terms of the instrument granting it, as this would be tantamount to a fraud on the power. Objects of a fiduciary power may additionally prevent or have set aside an appointment which is made capriciously, or where improper considerations are taken into account (*Klug v Klug* [1918] 2 Ch 67).

In some cases concerning pension funds, however, the courts have taken the view that, as the beneficiaries are not volunteers, a fiduciary obligation attaches to the power and the courts do have a *locus standi* to act, even in the case of a fiduciary power, where there is nobody else to act because, for example, the company with the power has gone into liquidation (*Mettoy Pension Trustees Ltd v Evans* [1990] 1 WLR 1587). Moreover, it was said in *Imperial Group Pension Trust v Imperial Tobacco* [1991] 1 WLR 589 that if the company with a power to appoint under a pension fund does so, then it must do so bona fide and not in breach of its fiduciary duties to its employees.

### Construction of Document to Distinguish between Power and Discretionary Trust

As indicated in the question, it may be extremely difficult to decide whether a power or a discretionary trust has been created. The language of the gift in a well-drafted document should make it clear. Failing this, the court must decide whether the intention of the instrument is to impose an obligation to benefit the objects, or merely to enable them to be benefited.

An obligation cannot be deduced where the settlor provides a gift over in default of appointment. This implicitly acknowledges that no selection might be made and there is no power to force a selection. A power, therefore, has been created and not a discretionary trust (*Re Gestetner*). The reverse does not, unfortunately, always hold true. In *Re Weekes' Settlement* [1897] 1 Ch 289, it was held that there was no intention to create a trust for the objects of the power, even though there was no gift over, as the disposition did not impose any obligation.

In *Burrough v Philcox*,<sup>4</sup> property was left by the testator to his two children for their lives. The survivor was given a power to leave the property in her will 'amongst my nephews and nieces or their children, either all to one of them, or to as many of them as my surviving child should think proper'. The court decided that this was effective to create a trust. As no selection was made, the court would intervene and make the gift in equal shares amongst the beneficiaries. Had the conclusion been that the gift was a mere power, then the court would have been powerless to intervene and the property would have resulted back to the settlor's estate. Lord Cottenham in *Burrough v Philcox* said

that where there is a general intention in favour of a class with a particular intention to select particular individuals from that class then, if the selection fails, the class will benefit as a whole. The significant factor is an intention to benefit the objects of the gift if no selection is made.

<sup>4</sup> It is worth setting out the facts here as they help to illustrate the point clearly.

So, the distinction is often hard to deduce in cases where the instrument is not clear. The distinction, nevertheless, is important in terms of the differing rights and duties of the trustees and donees and the potential objects of the trust or power.<sup>5</sup>

<sup>5</sup> Usually an essay merits a concluding paragraph—as here.

### Looking For Extra Marks?

■ Discussing what the judge said in the case (e.g. Lord Cottenham in *Burrough v Philcox*) will gain some extra marks. Reference to the arguments in the academic literature such as Gardner (1991) (see ‘Taking Things Further’) would also earn more marks.

### Taking Things Further

■ Emery, C., ‘The most hallowed principle—certainty of beneficiaries of trusts and powers of appointment’ (1982) 98 LQR 551.

*This article breaks down the certainty of objects requirement into four different constituent parts.*

■ Gardner, S., ‘Fiduciary powers in toytown’ (1991) 107 LQR 214.

*This article considers the distinction between discretionary trusts and powers.*

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## 5. Trusts, Powers, and Discretionary Trusts

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