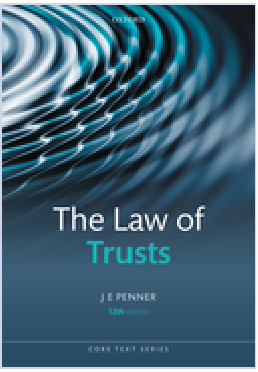

The Law of Trusts (12th edn)

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2. Express trusts: basic principles

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Abstract

Titles in the Core Text series take the reader straight to the heart of the subject, providing focused, concise, and reliable guides for students at all levels. This chapter deals with basic principles relating to the express trust. First, express trusts are distinguished from trusts arising by operation of law. Next, express trusts are considered from the perspective of three stakeholders—the settlor, trustee, and beneficiary. Finally, the significance of the express trust is explored with respect to three concerns: the fusion of law and equity; the law of succession; security interests and the context of insolvency.

Keywords: express trusts, trusts arising by operation of law, settlors, trustees, beneficiaries, bona fide purchase, law of succession, testamentary trusts, security interests, insolvency

Summary

Express trusts and trusts arising by operation of law (TABOLs)

2.1 In **Chapter 1**, we operated with the rather vague notion that a trustee 'holds property on trust' for the beneficiaries. It is now time to make this notion explicit and precise.

Express trusts

2.2 An express trust is one that is intentionally set up. The uses and trusts that we looked at in **Chapter 1** were all express, set up intentionally by the feoffor or the settlor, respectively. The term 'express' is not a particularly helpful one—it correctly reflects the fact that in order to create a trust intentionally the settlor must express his intentions, either orally or in writing. But it is not the expression per se that is the essence of the matter; it is the fact that the settlor exercised his power to set up a trust that is essential, as we shall see in a moment. In the case of trusts, there are two principal ways in which a settlor can create a trust: by 'self-declaration' or by transfer of the intended trust assets to another person to hold on trust. Imagine that you
p. 16 want to create a trust fund to provide for your minor children. To remind you of the terminology set out in **Chapter 1**, you are called the 'settlor', because you 'settle' the property upon your children under the trust. You can settle the property simply by declaring that you now hold the property, say 1,000 shares of XYZ Co Ltd, on trust for your children. That is a 'self-declaration of trust': you make yourself the trustee for your children. Or you can transfer the shares to someone else—your sister, say—to hold on trust for them. In both cases, the trustee, whether you or your sister, must deal with the property according to the terms of the trust. In both cases, your children are the 'cestuis que trust', or 'beneficiaries'. Most express trusts are created in writing, and the document that contains the *terms* of the trust, ie the detailed provisions that structure the way the property is to be held by the trustee for the benefit of the beneficiaries, is normally called the *trust instrument*. Sometimes this document can also work to transfer the legal title of the property from the settlor to the trustee in non-self declaration cases but if not, legal title in the property must be transferred to the trustee according to the correct transfer procedures for that kind of property, whether land or shares or whatever other kind of property is to be held on trust.

2.3 Since, as we have just seen, a settlor can declare himself trustee of property for someone, the settlor and the trustee can be the same person. A settlor can also convey property to a trustee on trust for himself, so the settlor and beneficiary can be the same person. A trustee can also be one of several beneficiaries, as would result from, for example, a transfer of title to Blackacre to B on trust for B and C in equal shares. But what cannot exist is a lone trustee who is also a lone beneficiary. The law does not recognise a division of the individual self so that you would have an obligation to hold property for yourself in a defined way, an obligation that you could enforce against yourself.

Exercising powers to create an express trust

2.4 You should think of the express trust as the creation of the settlor; an express trust is created when a settlor *effectively exercises his powers of ownership* to do so. A 'power' is the capacity to change or create rights, duties, and/or other powers. One has the power to enter into contracts: if you and I agree that I will pay you £5 for washing my car, then we give birth to a new legal relationship—we both have rights and duties that we did not have before. I have the right that you wash my car and the duty to pay you £5 for doing so, and you have, correspondingly, the duty to wash it and the right to be paid £5. Owners of property have, simply by virtue of their ownership, all sorts of associated powers. If I own Blackacre, I can exercise my powers over it to lease it, to give it away, to license you to come onto it to have dinner with me, and so on. One of the other powers I have is to create a trust of Blackacre in your favour, either by self-declaration or by transferring Blackacre to a trustee to hold on trust. In both cases, I have imposed a duty upon the title-holder to Blackacre to hold it for your benefit, and have conferred a right upon you to the benefit of Blackacre. Express trusts can be created by the settlor's exercise of his power gratuitously, or because he is obliged to do so under a contract. For example, occupational pension funds are held on trust and arise in fulfilment of the duties generated by employment contracts.

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Capacity and eligibility

2.5 A trust purportedly declared by a mentally incapacitated person is void. A minor, someone under the age of eighteen, has what might be called a 'provisional' capacity to declare a trust. The trust is valid, but the trust is 'voidable', that is he can recover any property transferred to the trustee at any time prior to reaching the age of 18 or within in a reasonable time thereafter (*Edwards v Carter* (1893)). There are no capacity or age restrictions on being a beneficiary of a trust, and trusts for those who are minors or incapacitated are common. In general, minors may not be appointed as trustees (Lewin (2020), 2-019). Companies have legal personality and capacity, so they can be settlors, trustees, or beneficiaries.

Trusts arising by operation of law (TABOLs)

2.6 New rights, duties, and powers not only are created by individuals exercising their legal powers but also may arise 'by operation of law'. Consider the case of a tortious injury, ie an injury that occurs because someone has committed a civil wrong (a 'tort'). If I negligently run you down with my car, you now have the right to sue me for 'damages', ie money compensation. But it would be a dreadful mistake to think that because I was the one who ran you down, I thereby exercised a *power* of mine to confer upon you a right to sue me for damages. The law only recognises capacities to create new rights, duties, or powers where the law wishes to provide a facility to do things in particular ways: the law recognises a power to enter contracts, or declare trusts, or make a will, because the law is in favour of those things. The law is not in favour of my running people down, so I have no legal powers attached to that capacity. The right to sue someone for damages arises *by operation of law* on the occurrence of your negligently caused injury because the law regards it as just that you should be able to bring an action for compensation (Penner (2021a), [4.1]).

2.7 The distinction between rights, duties, or powers that an individual creates when he exercises a power, and those that arise by operation of law, is of great significance in the law of trusts: while express trusts are created by a settlor through the exercise of his powers of ownership, other trusts, generically called 'constructive trusts' (**Chapter 17**), are **t**rusts **a**rising **b**y **o**peration of **l**aw (TABOLs) on the basis of particular facts. One example is what is called the 'common intention constructive trust'. In certain circumstances, a legal title holder of land may be required to hold the land on trust for himself and, typically, his wife or partner, in equal shares because although the spouse's or partner's name was not put on the title when the property was acquired, their common understanding was that the property should be held for the benefit of them both, and the wife or partner relied upon this understanding to her detriment (eg by paying to repair the property).

Beneficial, equitable, and legal interests

2.8 The trustee must hold the property for the benefit of others; correlatively, the trustee is not entitled to use
p. 18 the property for his own benefit. What the trust does, then, is drive a wedge between the legal title that the trustee has, and the right to use it for his own benefit; in other words, where someone holds his title to property on trust for another, he does not have any *beneficial interest* in the property. Correspondingly, the beneficiaries, though not having the legal title to the property, *are* entitled to the benefit of it; together the beneficiaries do have the beneficial interest in the trust property. Compare this situation to the case where a legal owner of property owns it outright, ie owns it not subject to any trust; in this case the beneficial interest is the legal owner's.

2.9 Now, here is the aspect of this terminology that sometimes causes confusion: the beneficiaries under a trust, as we have just said, have the beneficial interest in the trust property, but not because, like the outright owner, they have the legal title to it, but because *equity* will require their trustee to use the trust property, not for his own benefit, but for theirs. So, *their* beneficial interest is an *equitable* beneficial interest. In the case of the outright legal owner, he has a *legal* beneficial interest. So the word 'beneficial' can describe the position both of a legal owner of property who owns it outright and of a beneficiary of a trust. The typical confusion that the terminology of 'beneficial interest' creates is when people confuse 'beneficial' interest with 'equitable' interest. One mistake that arises from this confusion is to think that the outright legal owner of property holds both the legal *and* the equitable title to it, as if he held it 'on trust for himself'. But we have already seen (**2.3**) that a legal owner cannot hold property on trust for himself as a sole beneficiary. The outright legal owner has the legal interest *simpliciter*, and there is no equitable interest at all (*Westdeutsche Landesbank Girozentrale v Islington London Borough Council* (1996) per Lord Browne-Wilkinson, at 706). Thus, in determining the rights of individuals to property under the law of trusts, the pertinent question is always whether equity recognises a distinct beneficial interest in the property, ie an equitable interest, which displaces the legal owner's beneficial interest. The mistake is to think that because a legal owner has the beneficial interest, he has both a legal and an equitable title to the property. Of course, the ideas of beneficial interests and equitable interests are *related*: only in a legal system which had some sort of doctrine, like the law of trusts, which held that a legal owner's beneficial interest could be extinguished in favour of another, so that he held his legal title for the benefit of that other, would a concept of beneficial interest arise.

The position of the settlor

2.10 A settlor creates the trust, determining its terms; once having created the trust the settlor, however, is not the person who enforces it. It is the beneficiaries alone who are entitled to do that. Equity regards the creation of a trust as a 'disposition' of the trust property. The settlor disposes of his interest in the trust property, so that it is no longer his. In the case of a self-declaration of trust, though he retains the title to the trust property, he disposes of his legal beneficial interest by creating an equitable beneficial interest for the beneficiaries. In the case of a transfer of assets to someone else, the case is even clearer. The settlor not only
p. 19 disposes of his beneficial interest but transfers his title to the trustee, who himself will be bound by the beneficiaries' beneficial equitable interests. In this latter case, the settlor will drop out of the picture completely.

Revocability

2.11 A settlor may be able to revoke the trust, that is bring it to an end and get the trust property back, but it is important to understand the legal basis for revoking a trust where it is possible. Trusts are normally created by the settlor transferring property to a trustee while at the same time declaring the terms of the trust, thereby creating the equitable beneficial interest of the beneficiaries. And just like any other transfer or creation of an interest in property, once the act of transfer or creation is complete, the interest in the property belongs to the recipient, and that is the end of it as far as the transferor is concerned. Thus, the settlor cannot think of the trust property as still 'really his'. He cannot get it back, because he is legally out of the picture (though this is subject to the doctrine of 'resulting trusts' (**2.14**)), unless under a self-declaration he makes himself the trustee, but the lesson is the same; he has no right or power just to extinguish the trust and start using the assets again as if they were beneficially his own. In the same way that a donor of an outright gift has nothing to say about what the 'donee' (ie the recipient) does with the property once the gift is made, neither has the settlor anything to say about the trust, the way it is administered, etc, after the trust is created. The equitable interests under the trust belong to the beneficiaries, and they, and only they, may enforce the terms of the trust against the trustee. *But*, in setting out the terms of the trust, the settlor *may grant himself powers under it*. He can give himself a power to bring the trust to an end, that is to revoke it. He can also give himself lesser powers, such as the power to replace the trustees, or the power to direct the trustee in the making of investments, and so on. But the point to realise is this: *if* the settlor has a power to revoke the trust or to appoint new trustees, *that power must be an express or implied power under the terms of the trust itself*; the power derives from the trust terms, not from the settlor's position as the one who originally owned the property. Indeed, under the terms of the trust the settlor may give such powers to anyone he chooses. If a settlor does grant to herself a power to revoke the trust, she is not, of course, 'out of the picture' in the same way she would be if she does not, but as a powerholder *under the trust*, not in virtue of being the settlor.

2.12 It is also important to note that the settlor's power to revoke the trust is one he holds for his own benefit, and this has the consequence that this power to regain title to the trust property is a valuable asset he holds. In *Tasarruf Mevduati Sigorta Fonu v Merrill Lynch Bank and Trust Co (Cayman) Ltd* (2011) the UKPC held that such a power was an asset of a bankrupt individual which he could be required to exercise (or be required to delegate the exercise of) so that receivers could claim, for the benefit of his creditors, the assets of the revocable trusts he had established.

A trust will not fail for want of a trustee

2.13 The settlor's exercise of the power to declare a trust is conceived of as essentially unilateral, in the same **p. 20** way that exercising the power to make a gift of the property is unilateral, rather than the bilateral act of making an agreement with someone as in a common law contract. This gives rise to the principal that a trust will not fail for want of a trustee. It operates slightly differently depending upon whether the trust is created by will, a 'testamentary trust', or when the settlor is alive, an *inter vivos* ('between living persons') trust. As to the former, if, for example, John in his will gives property to Fred to hold on trust for Anna, and Fred refuses to act as trustee—no one is ever forced to take on a trusteeship—the court will appoint someone else to be trustee. As to the latter, the rule only applies once the trust is actually set up or 'constituted' (**Chapter 6**), that is the trust is self-declared or the settlor transfers assets to a person willing to act as trustee. Whilst you are alive, the law will not compel anyone to be the first trustee of your intended trust. You must find a willing trustee yourself. But once the trust is constituted, if, for whatever reason the original trustee can no longer serve (eg he is killed by lightning) the court will again appoint someone else.

'Automatic' resulting trusts

2.14 Sometimes trust terms intending to benefit beneficiaries 'fail' for one reason or another. As we shall see in **Chapter 5** one reason may be because the terms are 'uncertain'. Consider this: £1m on trust to be distributed to 'those people who have helped me out in the course of my life.' This provision is uncertain because of the various meanings this might have to different people (**5.29** et seq). So, this intended trust fails, which means the £1m is not disposed of. The trustee will have to hold that £1m on trust for the settlor (or his estate if he has died) on what is known as an 'automatic resulting trust' (ART), a trust which arises by operation of law (**2.6**). 'Resulting' here means 'jumping back'—the interest in the money jumps back to the settlor because he provided it. The first important point to note here is that an automatic resulting trust can always arise in principle as we shall see (**10.73**), and so in this sense the settlor is never really out of the picture. The second important point is that this shows that the trustee of the trust is not a 'residual claimant' of the trust assets—if the trust terms do not effectively dispose of the trust assets the trustee is not entitled to keep them for himself, or declare new trusts over the assets—the settlor is entitled to them under the resulting trust. We shall discuss resulting trusts in detail in **Chapter 10**.

The position of the trustee

The powers of the trustee

2.15 Since the trustee has title to the property in question, the trustee has all the rights and powers that go with having title to the kinds of property in the trust. If the trust property is land, in which lots of different interests can be created, then because he has the title it is the trustee who can create them; he has the power to grant easements, to mortgage the land, to grant leases of the land, to license people to enter the land, and so on. If land held on trust is occupied by squatters, then it is the trustee who has the right to evict them. It is the trustee who has the power to buy and sell the trust property, so he is the one who makes the trust investments. The trustee must, however, act upon these rights and exercise those powers in accordance with his obligation to exercise his ownership of the property according to the trust terms, and in this way the trustee's exercise of his legal powers will be governed by the way the trust instrument imposes duties upon him to exercise his powers for the benefit of the beneficiaries. In general, then, the beneficiaries' rights in respect of the trust property vis-à-vis third parties are legally protected by the trustee's enforcement of his rights to the trust property. Third parties owe their duties in respect of tangible property—for example to keep off it—to the legal owner, the trustee, and the trustee enforces those rights in his own name to protect the beneficiaries' equitable beneficial interests. Similarly, if one of the trust assets is a mortgage loan over land, and the mortgagor falls behind in his payments, it is the trustee's duty to use his powers as the mortgagee to take possession of the mortgaged land and sell it so as to recover the outstanding mortgage debt.

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2.16 The beneficiaries do not have any power to enforce any of these legal rights themselves; the trustee must do so, for the simple reason that he is the one who has those legal rights (see *MCC Proceeds Inc v Lehman Bros* (1998)). If the trustee for some reason refused to do so, the beneficiaries could launch a legal action against a third party such as the mortgagor in the last example, *joining the trustee*, ie suing the trustee as well, so as to make him participate and enforce his legal rights to the property for the benefit of the beneficiaries; this is colloquially known as the 'Vandepitte procedure' after *Vandepitte v Preferred Accident Insurance Corporation of New York* (1933) (see also *Parker-Tweedale v Dunbar Bank plc* (1991)).

2.17 One thing to notice here: as these examples illustrate, someone may have a power over property, to transfer it, for example, but be subject to a duty to exercise or not exercise that power in a certain way. A trustee has a duty to exercise his power to transfer the trust moneys representing the income of the trust assets to the income beneficiary, and a duty not to transfer the trust assets to a non-beneficiary. So duties can in this way 'control' a trustee's exercise of his powers; to the extent that a trustee complies with these duties, he will not have committed any breach of trust, any breach of his trustee's obligations. But just because there is a duty to *do x or y* does not mean that when a trustee exercises his power over the trust assets in a way that breaches his duty, this exercise of his power is *not effective*. The effectiveness of his exercise of the power can be shown by an example: if, in breach of trust, the trustee transfers £1,000 of trust money as a birthday present to his nephew, who is not a beneficiary of the trust, that transfer is perfectly effective to transfer the legal title to the money to the nephew even though it is clearly in breach of trust. As we shall see in **Chapters 13 and 15**, there are a host of remedies that the beneficiaries can resort to when this sort of breach of trust occurs, but the point to be taken on board here is that the duties imposed on the trustee in the trust instrument do not 'disable' the trustee in the exercise of his legal powers over the trust assets; he has those powers simply in virtue of the fact that he holds the legal title to those assets.

p. 22 **2.18** It is also vital to understand the basis upon which the trustee holds his powers over the trust property, and the way it is said that the terms of the trust 'grant' a trustee a power to do this or that. As I have rather laboured above, the trustee carries out the trust by exercising his powers over the trust property, and he has those powers simply by virtue of the fact that he has the title to that property. Undertaking to act as a trustee, being bound by the terms of the trust, does not *endow* him with those powers—his having title to the trust assets does that. But lawyers typically say that the trust instrument 'grants' the trustee a power to do this or do that. We can use the 'power of investment' as an example. Until the turn of the twentieth century, under the general law of trusts trustees were generally required to hold the particular assets they received at the creation of the trust as *the* trust assets; they were not entitled to exchange these assets for others, and so under the general law, they had a duty *not* to invest the trust assets, ie exchange the assets from time to time to realise income or capital value returns (see Nolan (2004)). In short, trustees had a duty not to transfer the trust assets in order to make investments.

2.19 But, of course, some settlors did want their trustees to invest the trust assets, and so they created trusts with terms that gave the trustee a 'power' to invest. But what such a provision does is to *remove* the general law duty on the trustee *not* to invest. In general, settlors have 'freedom of trust', that is, by the terms of the trust they can impose duties on the trustee greater than or different from those imposed on trustees by the general law, and can relieve trustees of duties imposed by the general law. So, a settlor can, in practical terms, 'empower' a trustee to do things by relieving him of a duty not to do such things that he would otherwise have under the general law. But the terms of the trust do not 'endow' the trustee with the powers which are or are not subject to those duties. He has those, as we have seen, just by virtue of his title to the assets. So, while in most cases it is innocuous to talk about 'powers granted' to the trustee in a trust instrument or by legislation, always be conscious of the fact that what these 'grants of powers' in fact do is to relieve a trustee of duties not to do this or that which he would otherwise have had under the general law.

2.20 It should also be noted that such provisions often appear in trust instruments even after the law has changed making them unnecessary, or much less necessary. Again, the 'power to invest' is a good example. By virtue of the development of case law and legislation, trustees now have a broad 'power to invest', indeed, normally a duty to exercise their powers of title to invest the trust funds (**8.2** et seq). So the general law now no longer imposes a ban on a trustee exercising his powers of title to invest the trust assets. But all professionally drawn trust instruments have a provision concerning investments, for two reasons: (1) such a provision allows the settlor to create a bespoke, or 'tailor-made', investment provision, so that he can direct the sorts of investments the trustee can make; and (2), as good lawyers know, the law can always change by case law development or legislation; in the absence of an express provision on investments, the trustee's power to invest would be subject to fluctuations in legal doctrine; since trusts can last a very long time, it is much better to have a clear, express provision, rather than making the trustee subject to the general law as it changes from time to time.

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The trustee's liability to account, 'getting in' the trust assets, understanding the trust terms, and keeping the trust property separate

2.21 The principal task of the trustee is to keep the trust property separate from his own and dispose of it according to the terms of the trust. In carrying out this task, he must keep track of what he does with the trust property; this is called 'keeping the trust account(s)', and, as you would imagine, normally involves keeping the documents concerning transactions with the trust property in good order. When a beneficiary suspects that something has gone wrong with the administration of the trust, this is normally because he does not accept the trustee's account, ie his record of what he has done with the trust property, and the beneficiary's primary legal right is to bring the trustee to the Court of Chancery and have 'the account taken', ie reviewed. In a sense then, all the specific 'basic' duties of a trustee can be explained in terms of his liability to account to the beneficiaries, to show them what he has done with the trust assets.

2.22 On accepting a trusteeship, a trustee has a duty to 'get in' the trust assets. That is, he must make sure that title to the trust assets gets into his hands. So, for example, where Bernadette is appointed a trustee under Fred's will, and Bernadette accepts the trusteeship, then Bernadette must make sure that the assets in Fred's estate which are to form the trust assets get into her hands. Typically, this will just mean that she ensures that the executor of Fred's will transfers the trust assets to her in a timely fashion. She cannot just do nothing for years; as someone entitled under Fred's will, she has the right to make sure that the executor administers Fred's estate in a timely fashion. Similarly, if Bernadette is taking over the trust from a trustee who wants to retire from the role, again, she must make sure that title to the trust assets is transferred to her in a timely fashion.

2.23 Bernadette must also familiarise herself with the trust terms and make sure she understands them. This is obvious—how can she properly discharge her obligations under the terms of the trust if she doesn't know what they require of her? The practical force of this duty is, in most cases, to seek legal advice about the terms of the trust if she thinks that something is unclear or awry. Unfortunately, badly drawn trust instruments, cobbled-together efforts based upon precedent trust instruments, and which may not be well suited to the settlor's intentions for the beneficiaries, are not uncommon, so it is likewise not uncommon for incoming trustees to have to seek legal advice to ascertain what particular trust provisions require, or even whether they are legally valid.

2.24 Finally, Bernadette must keep the trust assets separate from her own. If she did not do that, mixing trust assets with her own assets, it would be difficult if not impossible for her to fulfil her duty to account to the beneficiaries—how could she explain what she did with the trust assets if she cannot figure out which assets those are? As we shall see (**5.101**), some cases have started to nibble at the margins of this principle, but in the vast majority of trusts it would be a clear breach of trust if the trustee mixed the trust assets with his own, or did anything else the consequence of which would be that it would be difficult or impossible to identify the assets under the trust. Note, however, that the terms of a trust may allow the mixing of the assets of several
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beneficiaries, so long as their respective interests in the merged fund are clear. A good example of this is a solicitor's client account, which is a bank account that the solicitor holds on trust for those of his clients who deposit money with him, for example to complete the purchase of a house. The solicitor only has one client account with the bank, and deposits any client money he receives into it. But it is easy to keep track of the beneficial interests of his clients as money comes in and goes out of the client account, including allocating

any interest the account earns in proportionate shares. It is essentially a bookkeeping exercise, so there is no difficulty for the solicitor in accounting for what he has done with the funds to his several clients/beneficiaries. Their respective beneficial interests are the proportionate beneficial equitable shares they have in the solicitor/trustee's title to the bank balance. Another example of such pooled beneficial interest occurs under collective investment schemes where the manager of the investments (or, more usually, a holding company) holds title to the investments, shares, bonds, and so on, but on trust for investors in proportion to the amounts they have invested.

The power to apply to the court

2.25 The court of equity has a general supervisory jurisdiction over trusts, and the trustee has a general power to apply to the court for directions. The need to do so may arise, for example, because the terms of the trust are unclear, or because a problem of administering the trust has arisen, or for other reasons.

Administrative and dispositive duties

2.26 The trustee's obligations under the trust are often subcategorised into duties of two kinds: 'administrative' and 'dispositive' duties. Roughly, administrative duties govern the trustee's power to make contracts and his powers of ownership to maintain the value of the trust property. Trustees have the duty to invest the trust property safely and so that it makes a reasonable return. Where appropriate, trustees must also insure the trust property, against fire, for example, if the trust property is a house.

2.27 Dispositive duties are those that require the trustee to apply the trust assets to benefit the beneficiaries according to the terms of the trust. These are the duties the trustee's compliance with which delivers to the beneficiaries the particular benefits the settlor intended.

The principle of no delegation: delegatus non potest delegare

2.28 The general rule is that trustees may not delegate the tasks they're required to perform under the trust because the trustee undertook to perform them themselves. The rule applies to delegation between trustees as well—all trustees must act unanimously (though the trust instrument can provide otherwise). But equity has long recognised an exception to his rule, the 'ministerial' act exception; a ministerial act is one which does not require the exercise of any discretion. An example would be employing an agent to collect rents from trust properties held on lease, or the use of brokers to execute share purchases and sales. The power to delegate has been extended by statute (**8.41** et seq).

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The trustee acts in his own name, and is not an agent of the beneficiaries

2.29 In the same way that the trustee is the trust's 'face to the world' because of his ownership of the property, the same goes for the contractual obligations the trustee enters into in the course of carrying out the trust. When, for example, a trustee sells some company shares he holds on trust and buys others in the course of his investment of the trust fund, he makes these contracts to buy and sell in his own name. The trust itself has no legal personality like a company, on behalf of which agents of the company make contracts that bind the company itself as a legal person. Having no legal personality, one cannot sue the trust itself for breach of contract; one sues the trustee for his own breach of contract, even though the breach was of a contractual obligation he undertook in the course of carrying out the trust. In general, trustees are 'indemnified', have an 'indemnity', for any liabilities they incur in properly carrying out the terms of a trust, which means that they have a claim against the funds of the trust to meet any contractual obligations or expenses they incur in carrying it out.

2.30 In the case of a typical trust where the contracts that the trustee enters into are investments of various kinds, and contracts of service with solicitors and financial advisors, this indemnity is generally a perfectly adequate mechanism for protecting the trustee. However, a group of late nineteenth-century cases reveals the obvious dangers for a trustee who carries on a business for the benefit of the beneficiaries of a trust in his own name. (On a trustee's power to carry on a business, see generally Lewin (2020), 36–106.) You can imagine that a trustee might run such a business so badly or unluckily that it goes bankrupt; in other words, all the funds of the trust may be lost. Because the trustee is liable for the business's debts himself, he will be personally liable to the creditors of the business and, there being no remaining trust funds, his indemnity against the trust funds will be worthless. In that case, he will have to dig into his own pocket to meet the claims of the creditors.

2.31 Only a mad trustee would nowadays run a trust business in his own name—if a business were to be settled on trust, then a trustee would insist that the business be incorporated, the trust owning the shares of the business. Then, if the business were to go bankrupt, the trust might lose all its value (ie the value of the shares would drop to nothing), but the trustee would not himself be personally liable to the business's creditors. (Principally because of tax legislation, certain businesses nowadays, particularly in Australia, are conducted through trusts, and the absence both of limited liability and a proper legislative scheme of insolvency rules causes no end of headaches; for details see D'Angelo (2014).)

2.32 The main point to draw from this discussion is that the trust relationship and the agency relationship are different relationships. A trustee is *not*, simply by virtue of his role as trustee, an agent for his beneficiaries. This is a good thing for beneficiaries. If the trustee was their agent, the beneficiaries would themselves be liable on any contract the trustee entered into, for when an agent makes a contract for his principal, the principal himself is held to be a party to that contract. Furthermore, in general if the trustee was
p. 26 an agent for his beneficiaries, this would upset the normal way in which trusts operate. In the vast majority of trusts, the benefit that the beneficiaries receive from the trust property is entirely determined by the terms of the trust; beneficiaries under most trusts have essentially no right to direct the trustee in his use of the powers he has by virtue of his legal title as if he were their legal agent. They get the benefit of the property as defined by the terms of the trust, such as it is. That is, of course, the main reason settlors benefit people through trusts in the first place, so that *they* can decide what the beneficiaries will get out of the property, in other words to give them a specified benefit from the property *without giving them the powers of an owner*.

2.33 Although the trust relationship and the agency relationship are distinct, nothing stops them from occurring together. It would be rare in a family trust, where property is held by a trustee for a settlor's spouse and children, for the trustee to be the spouse and children's agent as well. Normally, the trustee would not take any directions from the beneficiaries, such as entering into particular contracts concerning the trust property because they said so or running a business held by the trust at their direction. The trustee carries out the settlor's wishes as expressed in the trust terms, and the spouse and children take what they get. But trusts are used outside the family context, including where there is an agency relationship. For example, if you are an airline, in certain cases it may make sense for a ticket agent of yours to hold the money he receives on the sale of your airline tickets on trust for you (see eg *Royal Brunei Airlines v Tan* (1995), **15.7**). But although he is, in this respect, your trustee, he is still acting as your agent, and as his principal you will still be liable for his acts as your agent, for example under any contracts selling your tickets he makes on your behalf. Another example arose in the Canadian case of *Trident Holdings Ltd v Danand Investments Ltd* (1988). Danand was the legal owner of land for six equitable co-owners who wished to develop it. Trident contracted with Danand, the trustee, to install electrics, but claiming a breach of contract, brought an action against Danand and the six equitable owners of the land. The six argued that, as beneficiaries of a trust of the land, they were not directly liable to Trident. The court noted, however, that the only terms of the trust concerning the land were that Danand as 'bare nominee and trustee' (**5.70**, **11.1**-**11.2**) had to follow the directions of the six. The court therefore quite properly found that the six directed Danand—Danand was their agent, and therefore as principals they were each personally liable to Trident under the contract. The fact that Danand held property on trust for the six did not entail that Danand was not also their agent.

2.34 In *Paragon Finance plc v Thakerar* (1999), Lord Millett considered the factors which would determine whether the relationship between an agent and his principal was, in respect of money received by the agent, one of trustee–beneficiary or one of debtor–creditor. He said (at 416, *emphasis added*):

> *It is fundamental to the existence of a trust that the trustee is bound to keep the trust property separate from his own and apply it exclusively for the benefit of his beneficiary. Any right on the part of the defendant to mix the money which he received with his own and use it for his own cash flow would be inconsistent with the existence of a trust.* p. 27 ↵ *So would a liability to account annually, for a trustee is obliged to account to his beneficiary and pay over the trust property on demand*. The fact that the defendant was [an agent and therefore] a fiduciary was irrelevant if he had no fiduciary or trust obligations in regard to the money. If this was the position, then the defendant was a fiduciary and subject to an equitable duty to account, but he was not a … trustee. His liability arose from his failure to account, not from his retention and use of the money for his own benefit, for this was something which he was entitled to do.

The position of the beneficiary

The right to enforce the trust

2.35 The trustee must hold for the benefit of the beneficiaries; the trustee is not entitled to 'use the trust property' for his own benefit. His obligation to deal with the trust assets correlates with the beneficiaries' rights that he does so, and they, and only they are entitled to enforce this obligation.

How beneficiaries receive their entitlements under a trust

2.36 There are two paradigmatic instances of trusts. The first is the trust of land. In the traditional, dynastic family trust, the legal titles in question typically concerned a 'mansion' house where the family resided, and surrounding agricultural land rented out to tenants. What is important to notice here was that the benefit of one title, to the mansion house (typically with accompanying chattels such as the furniture, paintings, and so on in the place), was taken by the beneficiaries in the form of a licence to reside there by way of the trustee's exercising his power to license them to enter into possession, enjoying it 'in specie' (enjoying the thing itself), as lawyers are wont to say. This form of benefit is also typical in the literally millions of trusts of land in England and Wales resulting from the peculiar requirement of English land legislation that any instance of co-ownership of land must take the form of a trust (see eg Burn and Cartwright (2011), ch 14). Now consider the titles to agricultural land. Here the trustee leases the land to tenants and this provides the beneficiaries a money income in the form of rents. Here the benefit of the title is not by way of taking possession in specie, but by 'investing' the land by renting it out to third parties. Remember then, that in the case of a trust of land the settlor can choose one way or the other to benefit his beneficiaries.

2.37 The second is the modern wealth management trust. Typically, these trusts hold intangible assets such as shares, bonds, or bank balances, that is, financial assets. 'Intangible assets' are those whose value does not turn on the value of possessing any tangible things such as land or chattels such as cars or clothes washers. An intangible asset might be *evidenced* by a document, such as a company share certificate, but the value of the share is in the rights it gives you against the company, to receive dividends, for example. So how do the
p. 28 beneficiaries of a wealth management trust receive the benefit of the trust? Let's consider a clear case and then a more complicated one. The clear case is the traditional income/capital trust. For simplicity, consider a trust of 1,200 shares of XYZ Ltd held on trust for Martha for life, and then for her children Tom, Dick, and Mary in equal shares. Because she has an interest for her life, Martha is sometimes said to be the 'life tenant', and the children the 'remaindermen', adopting the terminology of traditional land law, but it is probably better to use the modern terms: Martha is the 'income' beneficiary, and the children the 'capital' beneficiaries, as this is more descriptive of their interests. One of the things that students often fail to appreciate when considering the interests of beneficiaries under this sort of trust is that their beneficial interests 'under the trust' are essentially *future, legal* interests. Martha's right to income under the trust is an interest in receiving the legal title to the money that 'represents' the trust income, in this case the dividends the trustee will receive from time to time because he owns the shares. (The term 'represents' is used because the payment to Martha will typically not be the actual payment received by the trustee. He may receive the income into the trust bank account, and within a reasonable time the trustee must transfer a like amount from the trust bank account to Martha's own.) The lesson is exactly the same for the capital beneficiaries. When they get their benefit under the trust, they get it *legally*, ie they are entitled to the transfer of the legal title to the trust assets upon Martha's death. Upon Martha's death the trustee will have a duty to transfer the legal title to 400 shares each to Tom, Dick, and Mary. At that point the trust comes to an end. So, in the case of a modern wealth management trust, no beneficiary lives on their 'equitable interest' as such; rather, beneficiaries live on the *legal* proceeds of their equitable interests, in the form of the money or other property transferred to them under the trust terms.

2.38 The more complicated case arises because the terms of a trust can be more complicated than a simple income/capital trust. We will look at the basic 'tools' which allow settlors to create more complicated trusts in **Chapter 3**, but for now you should know that trustees often have discretions. They may have a discretion to benefit some beneficiaries more than others, for example a discretion to apply the income of the trust to Albert, Betty, and Claude 'in such shares as the trustee in his absolute discretion decides'. They may also have a discretion as to how they will 'apply the trust assets to the benefit of the beneficiaries'. This can be done in different ways; one way, as we have seen, is just to transfer the legal title to the trust assets to the beneficiaries, as when Martha is paid the money representing the dividends, or when the trustee transfers the legal title to the shares to her children in the right proportions. But there are other ways. Imagine that, under the terms of a trust, a trustee has a discretion in how he will apply trust property to the benefit of one of the beneficiaries—call him Lionel. Suppose that the trustee thinks it would make sense for Lionel to have a new car. There are three ways in which this objective might be achieved. The trustee could just give Lionel money from the trust funds to buy a car. Or the trustee could use trust funds to buy the car for Lionel, that is pay the car seller on Lionel's behalf, so that Lionel acquires title to the car. Or the trustee could use trust funds to buy a car in his own name, ie taking title to the car as a trust asset, and then licensing the car to Lionel to use. This would be the safest way of dealing with those irresponsible or feckless Lionels of this world whose existence
p. 29 or perceived existence preys upon the imaginations of fretful settlors—if Lionel had a bad gambling habit, for instance, keeping the car as trust property and just licensing him to use it would prevent Lionel from selling it and blowing the proceeds playing online poker.

2.39 Thus the application of trust funds can serve the beneficiary in different ways. In the case of minor children, it is obvious that it would rarely be a good idea simply to transfer money to them as a way of applying the trust assets for their benefit. Rather, the trustee would use the funds for their 'maintenance', say giving trust money to their parents to buy clothes for the children, or for their education by transferring trust funds to a school to cover the children's school fees.

The beneficiaries' interests under a trust are derivative, not possessory

2.40 Whilst equity regards the beneficiaries as having the beneficial interest in the trust property, the 'true owners' of it as it were, equity does not *disturb* the trustee's title to or possession of the property. Rather, equity requires the trustee to use his powers of title in the trust assets for the benefit of the beneficiaries. So, the 'equitable ownership' of the trust property is a special kind of ownership: so long as the trust is in existence, the beneficiaries take the benefit of their rights not by dealing with the trust property directly, as if they were legal owners, but indirectly, by enforcing the terms of the trust obligation against the trustee. So, for example, a beneficiary entitled to the income from the trust property is not allowed to claim the dividends on company shares in the trust from the company himself. It is the trustee who alone is entitled to do that. The beneficiary may only demand that the trustee transfer to him trust moneys equivalent to the value of the dividends the trustee receives.

2.41 As Matthews (2005) puts it, the beneficiaries' 'equitable ownership' and the trustee's 'legal ownership' of the trust assets are not *competitive*, as if the system treated both as essentially the same sort of owner who are in constant conflict over which of them will prevail (although facile formulations such as 'in the eyes of the law, the trustee owns the property, although in the eyes of equity, the beneficiary does' can give that misleading impression). Rather, the beneficiary's title is *derivative*. It does not exist independently of the trustee's title; it *depends* upon it, because only through the obligation imposed upon the trustee to make use of *his* title in such and such a way do the beneficiaries acquire any interest in the property at all (as Maitland (1929), 17–19, long ago pointed out). One key point to note here about the beneficiary's interest under the trust is that it does not give ipso facto the beneficiary a right *to possess* the trust property if the trustee has title to assets such as land and chattels. As we saw in **2.36**, this depends upon the terms of the trust, whether they allow or require the trustee to exercise his powers of title to apply the property to the beneficiaries' benefit by licensing the beneficiaries to take possession. In *Shell UK v Total UK* (2010) the CA muddled this, holding that a beneficiary of a trust of land, though not entitled under the trust to possess the land, and not in actual possession of it, had a sufficient interest merely as a beneficiary to found a claim in tort to which, on orthodox principles of tort law, only those persons with an actual right to possession would have been entitled.

p. 30 **2.42** Analogies are dangerous here, but consider the case of companies. Shareholders are said to own the company, which in turn owns its own property. As in the case of beneficiaries vis-à-vis the trust property, shareholders have no right to make use of the company property, to visit the company premises, lounge around on the furniture, and drink the company coffee, simply because they own shares. Their share ownership does not entitle them to so much as touch the company property. Any benefit they receive from the company property, and the profitable use made of it by the company directors and employees, comes to them via the defined rights to dividends and so on which comprise their rights as shareholders. Thus, the 'interest' the shareholders have in the company assets is *derivative of, not competitive with*, the company's ownership of its property. In summary: the beneficiaries' interests lie in the trustee's exercising his powers of title to realise the value of the assets for the beneficiaries, sometimes licensing them to take possession of the assets in specie, but more typically, through sale and reinvestment in the case of a modern wealth management trust, and also of course in the trustee's power to transfer the legal title to the assets so as to apply the assets to the beneficiaries' benefit.

The beneficiary's interest is itself a kind of property right

2.43 A trust beneficiary has the personal right that the trustee complies with his duties as set out under the terms of the trust to apply the trust property to the beneficiary's benefit. Obviously, the net result of the trustee's compliance with his duties is that the beneficiary will receive whatever benefit the terms of the trust dictate. If he is an income beneficiary, for example, he has the right to receive payments when the trust investments generate income. He holds this right against the trustee, who has the correlative duty to pay the beneficiary that income. In this respect, the beneficiary has a right that the trustee pays him an amount of property at a particular time, and therefore he has a right that is very much like the right to be paid a debt, and he can transfer this right by assigning it to a third party.

2.44 Assignable personal rights of this kind, like debts, are a kind of property right in the law. So, for example, if Tom in our previous example (**2.37**) was being pressed by a creditor, he might reduce his debt by assigning his one-third share of the trust capital. The creditor, as his assignee, would be able to go to the trustee and require the trustee to pay him the one-third share of the capital on the death of Tom's mother. More interestingly, the beneficial interest being a property right under English law, which of course includes equity, the beneficiary can, as owner of his interest under the trust, declare a trust of that interest. The trust he creates will be called a 'sub-trust'. So, for example, Tom may decide that he wants his capital interest under the trust to be used for the benefit of his own children. He can, therefore, declare a trust over it. If he wants his sister Mary to be the trustee of this trust, he will execute an assignment of his capital interest to her on trust for the benefit of his children, so that on Martha's death Mary can claim the capital share from the trustee herself and then carry out whatever the terms of the trust for Tom's children require her to do.

2.45 Two things to note about equitable interests and sub-trusts. The first is that we now see that we have, up until this point, spoken of the trustee's *legal* title to the trust property, as if that were the only possibility. p. 31 We now see that the trust property (also called the 'trust assets' or 'trust corpus' or 'trust fund') can contain equitable interests itself. Nowadays, by the way, this is not at all uncommon, because of the way that financial assets like shares are held. Typically, the right to a company share that any private individual or trustee owns is not the legal share itself—that is held by an *intermediary*, who takes legal title to the shares from the issuing company and then sells an equitable interest in the shares, holding its legal title on trust for the buyers. There may be, and often are, several layers of intermediaries, so the right the private individual has in the company shares may be under a sub-sub-sub-trust of the first intermediary's trust of the legal title to the shares.

2.46 The second thing to notice is that, now having the concept of a sub-trust in hand, we can further distinguish the concept of beneficial interests from equitable interests (**2.8**–**2.9**). When Tom creates a sub-trust in favour of his children, assigning his equitable interest to Mary, Mary now holds his equitable interest under the trust—but she does not have the beneficial interest in it, because she holds it on trust for Tom's children. So not every equitable interest in property is a beneficial interest. In the same way that a trustee who holds the legal title of trust property does not have the beneficial interest in it—the beneficiaries of that trust do—a trustee who holds an equitable interest on trust similarly has no beneficial interests in it—the beneficiaries of that sub-trust do.

2.47 This allows us to give something of a definition of a beneficial interest under English law (including again, of course, equity): a person has the beneficial interest in property when equity regards him as having the power to declare a trust over it. An outright owner of a legal title to property can declare a trust over it; in the eyes of equity, this is because he has the beneficial interest in the property. A trustee, on the other hand, who just as much has the legal title to property cannot declare a trust over those assets—the settlor has already done that. In the eyes of equity this is because he has no beneficial interest in it. In this case the beneficiaries have the beneficial interest in the property, so they can declare a trust over those assets by way of sub-trust (Penner (2014a), 489–491).

The beneficiaries' interest in the trust fund

2.48 It is often said that the beneficiary's interest in the trust property is an interest in a 'fund', but it is important to note that the idea of a fund is an ambiguous one in the law, referring to two different cases, which I shall call 'pooled asset funds' and 'substitutional funds'. An example of a pooled asset fund is the collection of assets held by someone's trustee in bankruptcy (**2.87** et seq). Take a simple case where B is bankrupt and owns a group of assets, his house, some shares, and some money, with the total value of £120,000, and has three creditors, X, Y, and Z, to whom he owes £75,000, £50,000, and £25,000 respectively. Having assets of £120,000, and debts of £150,000, B is clearly insolvent, ie has debts significantly exceeding his assets. B's trustee in bankruptcy, T, will use B's house, shares, and money, as a pool of assets to distribute to his creditors. X, Y, and Z do not have any individual rights to any of the specific assets; rather, T must realise the value of all of the assets (selling the house and the shares, for instance) to meet the claims of them all on a *pari passu* basis, ie they will receive a share of the total value of the £120,000 in proportion to the amount they are owed, so X will receive £60,000, Y will receive £40,000, and Z £20,000.

p. 32 **2.49** The substitutional fund concerns a different notion. On this notion of an interest in a fund, there is no requirement that there be more than one asset forming a pool. Rather, the idea is that the fund asset(s) may change over time as one is substituted for another. This is true of trust funds. If a trustee sells a trust asset, say a house, for cash, the cash will now be the trust asset in place of the house. The beneficiary's interest is not just an interest in the house, but in any asset which 'represents' the house (the original trust asset) for the time being (*Re Earl of Strafford* (1979)); so, if the trustee then uses the cash to buy shares, the beneficiary's interest in the trust property will now be in the shares. To distinguish the pooled asset and substitutional notions of the fund is not to say that they cannot occur at the same time. In the typical trust, there will be more than one trust asset, and the trustee has the power to change the individual items of property, typically so that the trustee can manage the trust for the benefit of the beneficiaries, by changing the trust investments from time to time. Although the particular investments that the trust holds change from time to time, the beneficiary's interest in the property of the trust does not. The beneficiary does not have a particular right to any of the particular items in the trust fund. That is why, when a beneficiary assigns his interest (**2.43**) under a typical trust, he does not need to specify that he is assigning his interest in each and every particular item of trust property that happens to be in the trust at the time. He assigns his interest in the fund, which comprises (1) whatever happens to be in it at the time (the pool of assets), and (2) whatever happens to be in it in the future (property arising by any substitutions that take place). (See further Penner (2006a).)

2.50 This substitutional fund aspect of the trust does not depend upon the settlor's intentions or the terms of the trust instrument. As we have seen (**2.18**) in the past most trustees were required to hold the very assets first transferred to them on trust, and not exchange them for others, by way of making an investment, for example. Nevertheless, if they used their powers of title to exchange trust assets for new assets, those assets would now be claimable by the beneficiaries, even if the transaction was in breach of trust. The principle that operates here is one that we have already discussed in detail: the beneficiary's beneficial interest in the trust assets is in the trustee's exercising his powers of title in those assets. Where the exercise of those powers of title results in the trustee's acquiring a new asset, most obviously where the trustee exchanges trust assets for other assets, the beneficiaries' beneficial interest automatically attaches to those assets, for those assets are the fruits of the trustee's exercise of his powers of title over the original trust assets. (As we shall see when we look at breach of trust in detail (**Chapter 13**), where a trustee commits a breach of trust the beneficiaries can disclaim a substitute asset, instead requiring the trustee to dig into his own pocket to restore to the trust the money value of the trust asset wrongfully traded away.)

The beneficiaries' interests 'run' with the trust property

2.51 As we have seen (**2.43**), as an assignable right, and as a right over which the beneficiary can declare a trust, the beneficiary's beneficial interest is a kind of property. But the beneficiaries' beneficial interest can be seen to be a property right in other ways because the beneficiary's interest is entwined with the trust property

p. 33 in other ways. The beneficiary's interest is proprietary in so far as it is an interest in the trust property itself, ie in so far as its fate is tied up with the fate of the trust property. One indication of its proprietary character is that it lasts only so long as the trust property does, that is it will only be effective so long as the trust property continues to exist. If the trust property is stolen or lost and cannot be recovered, or is destroyed, then the trust essentially evaporates, because there is no property to which the beneficiary's rights under a trust can attach (*Morley v Morley* (1678)). As a consequence of this theft or destruction the trustee's personal duty to dispose of the property in accordance with the terms of the trust likewise disappears, because he is no longer an owner of any trust property. Thus, if the property disappears, then so does the trust, and so does the beneficiary's right. There is a sharp difference between the right of the beneficiary in this respect and the right of a creditor. If a debtor is robbed it is no skin off his creditor's nose—a debt does not attach to any specific property of the debtor, and thus not specifically to any property of his that is stolen, and the debtor cannot use the robbery as an excuse for not paying in full. In the case of the beneficiary, however, he is the one who loses if the trust property is lost or stolen, since equity regards his rights as being dependent upon his continuing equitable interest in the trust property, which attaches to the trust property from the outset of the trust.

2.52 Note, however, that the complete loss of the trust property may not leave the beneficiaries absolutely bereft. If the trust property is lost through no fault of the trustee, then that is the end of the matter. But if the trust property was lost because of the trustee's fault, the trustee's liability for this breach of trust continues even if the breach caused the total loss of the trust property. For example, if the trustee commits a breach of trust by investing the trust fund improperly so that all the money is lost, the trustee is liable to reconstitute the trust by restoring property of the same value as what was lost. But this right against the trustee is a purely *personal* right, in essence to make him *recreate* the trust, to make the beneficiaries genuine beneficiaries once again. None of the trustee's own property is to be treated as trust property to which this obligation to reconstitute the trust somehow magically attaches to form a new trust fund. The trustee has a personal obligation to use his own resources to restore the trust fund, but it is up to him to use whichever of his resources he chooses to use to do so. If the trustee is bankrupt by this point (which is not uncommon), the beneficiaries are out of luck.

The beneficiaries' rights in relation to third parties: following, tracing, and claiming

2.53 But in practice the most important way in which the beneficiaries' interest under the trust counts as a beneficial interest in the trust assets themselves comes from the way in which the beneficiaries' interest 'runs' with the trust property in the sense that they can insist that their beneficial interest in the trust assets binds third parties who, in breach of trust, receive title to the trust property from the trustee. The point about these recipients receiving in breach of trust is important. When a trustee transfers trust money in compliance with the terms of the trust—when, for example, he pays money representing trust income to the income
p. 34 beneficiary, or pays trust money to buy shares in the course of investing the trust property in compliance with the trust terms—of course the recipients of that money are not 'bound' by any continuing interest of the beneficiaries. As to the first example, paying money to the income beneficiary, the whole point of the trust after all, as we have seen, is to distribute the trust assets to the beneficiaries, so when that is done they must receive the outright legal title to the assets transferred. As to the person selling shares to the trust, of course he takes the outright, beneficial legal title to the money he receives; this transaction is in fulfilment of the

trust terms, that is, the trustee is entitled under the terms to enter into this contract to transfer the title of the trust money to the seller of shares, extinguishing the trust interest in them, substituting the money as a trust asset with the title to the shares.

2.54 Because a trust is an arrangement in which the title to the trust property, and therefore all the powers to deal with it, is held by someone who is not permitted to act as if he owns it for his own benefit, settling property on trust creates an obvious danger: if the trustee is an incompetent or a rogue, he is in the position drastically to harm the beneficiary's interest by transferring the trust property to a non-beneficiary. In such cases (subject to an exception (**2.56** et seq)), the beneficiary can 'follow' the title to trust property into the hands of the person to whom the trustee wrongly transferred it, and he can get a court of equity to order the recipient to transfer the trust assets he received to a new, honest trustee, who would carry out the terms of the trust from then on. This is the sense, and the *only* sense, in which the beneficiary's interests 'binds' the title of the recipient. In particular, it does *not* mean that the recipient has to carry out the trust as if he were appointed as a replacement trustee for the wrongdoing trustee. The only problem is that the beneficiary cannot claim his beneficial equitable interest against *every* subsequent holder of the legal title, and so the proprietary nature of the beneficiary's right in the trust assets is to that extent diminished.

2.55 Historically, the law concerning which subsequent holders of the title to the trust property would be required by equity to hold the property subject to the beneficiary's equitable title developed piecemeal (Maitland (1929), 117–120). These subsequent takers of the title to the property can be collectively called 'successors in title' to the trustee, for they acquire title to the trust property from the trustee. But the beneficiary's right to claim that the successor's title was bound by his interest stopped at the door of the *bona fide purchaser of a legal interest in the trust property without notice, whether actual, constructive, or imputed, of the trust*, a person sometimes called 'equity's darling'.

The bona fide purchaser

2.56 If the trustee transfers the legal title to the trust property in breach of trust to someone who:

- has given good, ie valuable, 'consideration' for it, ie has given money or money's worth in exchange for it; and
- has no 'actual' notice, ie knowledge, of the beneficiary's rights; and
- p. 35 has no 'constructive' notice of them either, ie knowledge of those interests that he would have acquired if he had made all usual and reasonable investigations when purchasing that kind of property; and
- has no 'imputed notice' either, ie any agents working for him in making the purchase have no actual or constructive notice,

then this purchaser takes the property with good legal title free of the beneficiary's interest: the beneficiary's interest in the property is extinguished; in other words he loses the right to assert that the recipient's title is subject to his equitable interest.

2.57 We can then divide recipients of trust property transferred in breach of trust into two classes. First, we have *volunteers*, the term given to persons who receive property but do not give valuable consideration for it—this class covers donees, those who take the trustee's property on his death or those who take on his bankruptcy. For these recipients, their knowledge of the trust is irrelevant, because they will take the property subject to the beneficiary's interest in any event. Secondly, we have those who have given consideration—these people can acquire beneficial ownership of the property free and clear of the trust, so long as they can establish they had no notice of it.

2.58 There are a few points worth noting. First, the rule applies to the bona fide purchaser of any legal *interest*, not just a *legal title* in the property that someone may acquire. An example is a mortgage. Where a person who bona fide and without notice lends money to the trustee and the trustee, in breach of trust, mortgages land held on trust to secure the repayment of the loan, the lender/mortgagee takes an interest that is not subject to the beneficiary's rights. The practical upshot in this situation would be that if the trustee were to fail to pay back the loan, then the lender/mortgagee could 'realise' his mortgage by taking possession of the trust land and selling it to pay off the debt. As a bona fide purchaser of this mortgage, he would prevail over the beneficiary's equitable interest in the property. In other words, the beneficiaries would only be entitled to any surplus money on the land's sale that was not needed to pay off the mortgage loan, which might be little or nothing.

Bona fide purchasers of equitable interests

2.59 Secondly, notice that the rule only applies to the case where the purchaser acquires a *legal* interest. If, for example, the trustee in breach of trust grants an *equitable* security interest in the trust property, that is, a security interest that equity will enforce but which is not recognised at common law, then the lender will take subject to the rights of the beneficiary even if he is a bona fide purchaser for value of this interest with no actual, constructive, or imputed notice of the beneficiary's rights. The bona fide purchase rule only applies in a contest between a legal interest holder and an equitable interest holder. In a contest between two equitable interest holders, like the beneficiary and the lender in this example, the general rule of equity is that the interest that was created first in time prevails. Why is there this difference? It appears to have arisen as a kind
p. 36 of 'jurisdictional' curiosity. Because the purchaser of an *equitable* interest was already within the jurisdiction of equity, ie his interest was equitable, equity had to deal with their competitive claims, and adopted the 'first in time' rule. On the other hand, equity did not weigh up the competing claims of the beneficiary and the bona fide purchaser of a *legal* interest. Only if that purchaser's conscience was affected could he be subject to the 'conscience-based' jurisdiction of equity; since it was not—he had done nothing unconscionable—equity regarded itself as having no power to intervene against him (see *Pilcher v Rawlins* (1872)), and this is the origin of the expression 'equity's darling'. Thus the bona fide purchaser of a legal interest got his legal title free and clear of the trust because of a sort of 'default' rule about the conscience-based jurisdiction of equity.

Where the trust property includes equitable interests

2.60 In much of the foregoing it was assumed for the sake of simplicity that the trustee always holds the *legal* title to the trust property but, as we have seen (**2.43** et seq), a beneficiary's equitable interest is itself a valuable right that can be assigned; such a right can therefore form part of a trust corpus itself. Thus, a beneficiary can declare a trust of it, a 'sub-trust'. Here the trustee of the legal property holds it on trust for the beneficiary, who in turn holds his right to it under the sub-trust for the sub-beneficiary. If equitable rights, as opposed to legal title to assets, are held on trust, then again we have a case, as in the preceding paragraph, where the bona fide purchaser rule does not operate, because a person cannot acquire a *legal* interest in an *equitable* interest in property; any interest in an equitable interest in property must itself be equitable. Just as in the case of the preceding paragraph, a first in time rule will operate.

2.61 But although the bona fide purchaser rule can be understood as having arisen because of the jurisdictional separation between law and equity, and equity's understanding of its own jurisdiction (ie as conscience-based) in the context of that division, are there good, practical reasons of *justice* for having a bona fide purchaser rule? An equivalent common law rule applies to money: a person who in good faith gives good value for money (eg sells goods taking money in return) gets good title to the money even if it turns out that, for example, the money was stolen. The rule is justified on the basis that given the importance of money transactions, it is better for the law to favour *security of receipt* over *security of title.* The concern is that if the bona fide recipient of money were the loser in this situation, individuals, to be sure they got a good title to money, would have to spend a great deal of time inquiring into the validity of the buyer's title to the money, which in these contexts would be very difficult. In consequence, some transactions might not go ahead at all, and the others would be made more costly. So instead the law allows for ease of transactions, and throws the risk onto the original title holder. Also, it might be more sensible for the risk of theft to lie with the original owner. As the owner, he is in the best position to prevent the theft of his money, not the bona fide purchaser from the thief or someone further down the line in a chain of transactions.

2.62 Of course, the law does not take this attitude with respect to all kinds of property. In the case of chattels, ie things such as chairs and chocolate bars, the law favours security of title over security of receipt. Here the
p. 37 rule *nemo dat quod non habet* applies (as the general rule; some exceptions apply; see eg Sale of Goods Act 1979, ss 21–5). Roughly translated, this means 'one cannot give what one hasn't got', and in the case of chattels, precisely what the thief has not got is good title to the goods, so he cannot pass a good title to anyone who buys them from him, no matter how innocent they are. So if you buy a 'hot' television from a friend of a friend, no matter how innocently, the true owner can bring an action against you for 'conversion', ie for converting *his* goods to *your* use, and you will pay him damages for the full value of the television.

2.63 We are thus faced with this question: on what side of this line ought the beneficiary's right in the trust property to fall? We know from above that the rule is already established—the bona fide purchaser takes free of the beneficiary's interest—but is there a sound reason, sound as a matter of justice, for this result? The author shall not press his views on the bona fide reader for value, but will only say that choosing to benefit someone by placing property on trust for them creates a risk: the risk that one's trustee is an incompetent or a rogue who will deal with it in ways that to the rest of the world look perfectly legitimate, but are, in truth, not. Perhaps, since a settlor creates this risk, the results of things going wrong when the risk materialises should fall on the beneficiaries rather than on third parties who have acquired the trust property innocently *and* paid good value for it, ie bona fide purchasers.

What counts as 'giving value' for the bona fide purchase rule?

2.64 When a trustee transfers trust money in breach of trust, the common law bona fide purchase rule for money applies (**2.61**). Under this rule, the value which a purchaser can give is 'any consideration which would support a contract' which 'includes an unconditional promise to pay money' (Smith (2013c), 355). So if a trustee in breach of trust pays trust money into his own bank account, the bank will be a bona fide purchaser under this rule because it promises, in return for the money, to pay the trustee his now higher bank balance.

2.65 With respect to other property, in particular land and chattels, the case is different. In the case of land the rule has largely been displaced by legislation; we shall not go into the details here, which are extensively considered in courses on land law. In the case of chattels, the judge-made equitable bona fide purchase rule will apply, which has a slightly different meaning for value than in the case of money. Here value is defined, as money or money's worth or marriage consideration. 'Money's worth' means anything that has monetary value, including the provision of services (*Secretan v Hart* (1969), 1603; *Regina v Burt & Adams Ltd* (1999), 253, 256). Purchase at an undervalue does not defeat the defence (*Basset v Nosworthy* (1673); *Midland Bank v Green* (1981)). Also, receiving a trust asset as the discharge of an existing debt counts as giving value under the rule (*Taylor v Blakelock* (1886)). However, unlike the common law rule for money a mere unconditional promise to pay *does not* count as value for the defence—the money for the purchase must actually be paid in full for the defence to apply (*Story v Windsor* (1743)). So, if a trustee sells a trust asset for an agreed price of £1,000 but the purchaser has only paid £500 of that amount, then the purchaser cannot make out the defence if before paying the full purchase price he acquires notice (Smith (2013), 358; Lewin (2020), 44–120).

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'Notice' in different contexts

2.66 Finally, about the formulation of the rule: the rule as stated refers to the bona fide purchaser's having 'notice' of the trust. This formulation accurately describes the working of the rule in the context of its historical development, where land was transferred by deed. These transfers were carried out according to a standard conveyancing practice. For example, in the case of the sale of the fee simple of Blackacre, the buyer's solicitor would inspect the past title deeds and the property itself to discover any proprietary interests in Blackacre held by third parties. The neighbouring owner of Whiteacre might have an easement, such as a right of way, over Blackacre. If it were a *legal* interest, this easement would most probably have been created by deed and the solicitor should discover it when inspecting the deeds. Nevertheless, being a legal interest, the rule was that it would bind the purchaser of Blackacre whether her solicitor was able to discover it or not. (Of course, following the purchase, the buyer could bring an action against the seller for damages for not disclosing that Blackacre was subject to this easement.) Blackacre might also be subject to some equitable proprietary interests. For example, the owner of Blackacre might have granted another of his neighbours an *equitable* easement, say a right of way over Blackacre. Such an *equitable* right would only bind the purchaser if her solicitor actually discovered it or ought to have discovered it by making the proper investigations and, if so, then the purchaser would take Blackacre subject to this equitable right. The purchaser or her solicitor might be held to have constructive notice of the easement if the inspection of the property showed that there was a gate in the wall between Whiteacre and Blackacre, giving access to the owner of Whiteacre. In essence, then, 'notice' in this context refers to the sort of knowledge one would normally acquire about the title to goods one wants to purchase based on standard procedures of investigating title. The purchaser's legal estate was limited by or subject to all the valid legal interests in the land and all the valid equitable interests in the land of which he had actual, constructive, or imputed notice—if he wanted to buy the land free of those interests, he had to deal with those interest holders themselves, to buy them out, as it were. On the other hand, those equitable rights not caught by actual, constructive, or imputed notice did not bind him at all. So, the doctrine of notice here was not so much being caught out by unknown trusts of the property, but determining exactly how extensive or how limited was the property one was getting.

2.67 The rule's operation is quite different in the case of other property (see Bridge (2002), 137–138). There is no standard 'conveyancing' practice for the sale of other property, such as chattels, or company shares. Individuals are not expected to investigate the title as they would do if they were buying land, for the simple reason that third parties do not generally have a variety of interests in chattels or shares. Therefore, the practical effect of the rule in most circumstances is that the purchaser is only bound if he has actual, constructive, or imputed *knowledge* that he is dealing with a trustee of the property who is selling the property in *breach* of trust. For example, brokers who buy shares from pension fund trustees will know, of course, that the shares are the property of the pension fund. But that does not mean that they take these shares bound by the rights of the pension fund beneficiaries just because they know they are acquiring
p. 39 property from a pension fund trustee. Having actual notice of the trust in this case does not require them to hold any shares they buy from the pension fund trustees on trust for the pension fund beneficiaries. They will only take the shares bound by the equitable rights of the pension fund beneficiaries if they have notice that the trustees are selling the shares in a way inconsistent with the beneficiaries' rights, ie in breach of trust. (Prior to the legislative property law reforms of the late nineteenth century and 1925, a purchaser from the trust *would* have to inquire into the terms of the trust to make sure that there was no breach by the trustees, and to make sure the trustees applied the purchase money properly as part of the trust fund. For obvious reasons this rule, though imposed to protect beneficiaries, was not really to their advantage—it made it very difficult for trustees to invest trust property, because people would not deal with trustees because they did not want to expose themselves to this burden of investigation and the risk that the trustee was acting wrongfully, and so the rule operated to 'sterilise' trust assets, making them much less valuable than if they could be traded freely. For this reason, the rule was changed, and nowadays there are no such duties: a purchaser from a trustee is entitled to assume that he is complying with the trust unless he has knowledge otherwise (see Swadling (1987); Harpum (1990)).)

2.68 Thus in the case of sales of trust assets that are not land, like shares or other investments, which are the sort of assets trusts typically contain nowadays, with respect to the issue of notice you should think of the rule as follows: a bona fide purchaser for value of the legal title without actual, constructive, or imputed knowledge that the transaction is made in *breach of trust* will take free of the beneficiary's interest.

Tracing trust property

2.69 Although the beneficiary's proprietary right to follow (**2.54**) *the original trust property* is obliterated by its sale to a bona fide purchaser, all is not necessarily lost, because the beneficiary may acquire a substitute proprietary right by operation of law, the availability of which depends upon what are called 'tracing rules'. If my rogue trustee sells the trust property, say shares, to a bona fide purchaser for £1,000, my equitable interest in the shares is extinguished. But since it is clear that the trustee has received the £1,000 in exchange for the shares, the law will trace the my interest in shares into the £1,000. The principal is ancient (*Bale v Marchall* (1457)), and, as we have seen (**2.50**), this is no more than an application of the idea that the trust is a substitutional fund. The law will keep track of the exchange of rights if it occurs again, for example if the trustee buys a car with that money, tracing through one exchange substitution after another. Tracing will only stop when either the proceeds of an exchange are lost or destroyed, or the evidence of what substitutions were made runs out, or the property is exchanged for non-property, for example where the trustee blows the trust money on a holiday. The rules of tracing will be discussed in detail in **Chapter 12**.

2.70 The thing to notice here is that the idea of having property in a fund (**2.49**), where one's property interest remains but the actual item or items of property change, goes hand in hand with tracing, in which the property interest of the beneficiary shifts automatically from one item of property to the proceeds acquired in exchange for it. (Such proceeds, called the 'traceable proceeds' of the exchange, are also sometimes called the 'exchange product'.) As we shall also see in **Chapter 12**, not only can the beneficiary trace into the exchange products where the trustee exchanges trust property, the beneficiary can also trace against any non-bona fide purchaser who receives trust property in breach of trust. So, for example, if the trustee in breach of trust gives a trust painting to his nephew, the beneficiary can of course *follow* the painting into the nephew's possession and claim it back. (The nephew is obviously not a bona fide purchaser because he gave no consideration for the painting; it was a gift; he is a *volunteer*.) But if the nephew sells the painting for £5,000 cash, the beneficiary can also *trace* into the cash, and then into the motorcycle the nephew buys with that cash, and so on.

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Third party personal liability to the beneficiaries in cases of breach of trust

2.71 Secondly, all may not be lost even if the beneficiary's proprietary rights run out because the original trust property can no longer be followed because acquired by a bona fide purchaser, or it can no longer be traced into substitute property. The beneficiary will still have *personal* rights against the original trustee, who is strictly liable for breach of trust, and must pay out of his own pocket the full value necessary to restore what was lost to the trust; the beneficiary may also be able to make similar personal claims against others. We shall discuss these rights in **Chapter 15**; in general they arise against anyone who dishonestly participates in a breach of trust ('dishonest assistance'), and against anyone who receives trust property transferred in breach of trust or its traceable proceeds and spends it having the knowledge that it was trust property ('knowing receipt').

Trusts of assets in non-trust law jurisdictions

2.72 A trustee may hold assets in countries which do not recognise trusts. It is sometimes thought that this possibility shows that the trust is 'obligational', rather than 'proprietary' (**2.73 et seq**), but it doesn't. Take a simple example. T, an English trustee, holds French land absolutely for B. B asks T to transfer the title to him, and T refuses. What can B do? Well, one thing B cannot do is go to a French court and prove the trust relationship and get a French court order against T to transfer the title. (Under French law, B *may* be able to characterise and prove T's obligation to B as a kind of obligation, say a contractual obligation, which a French court might recognise; in that case, B may be able to obtain some kind of legal remedy in France.) But B can sue T in England and the English court will order T to transfer the land, doing whatever is necessary

according to French law to do so (*Webb v Webb* (1994)). But there is a sense in which land in France or company shares in a non-trust jurisdiction are a kind of 'flawed' asset from B's perspective, because his ability to enforce his rights may be limited or non-existent. In *Akers v Samba Financial Group* (2017) the trustee transferred Saudi shares in breach of trust to a third party. Under Saudi law, only legal beneficial title (**2.8**–**2.9**) to shares is recognised, so the beneficiary had no possible action against the recipient of the transfer in Saudi Arabia, whether a bona fide purchaser or not. In this respect, then, one 'proprietary' facet of the
p. 41 beneficiary's rights is that the ability to pursue third party recipients of property transferred in breach of trust is diminished when the third party holds those assets in non-trust law jurisdictions. But note: where a third party leaves the jurisdiction where the trust is administered and moves to a *trust law jurisdiction*, B can bring an action against him in this jurisdiction, because its courts will recognise the trust.

The nature of the beneficiary's right

2.73 There is a long-standing historical debate about what sort of right the beneficiary has under a trust. In particular, the dispute concerned the application of Roman law's categorisation of rights into rights *in rem* and rights *in personam* to the English law of property, where it is ill-fitting. Rights *in rem* are rights that 'bind all the world', that is all persons, because of the sort of right that they are. One example is the property right in a chattel, like a motorcycle. Because anyone can, in principle, interfere with your right to possession of your motorbike, everyone is under a duty not to do so. Another example is your right to bodily security. Again, in principle, anyone can interfere with your body, touching you or putting you in a cage, so everyone is under a duty not to interfere with your body. So, because the motorbike and your body are things in the world subject to these sorts of depredations, your right *in rem* correlates with a duty imposed upon all others not to interfere with your motorbike or body. By contrast, a right *in personam* is a right that correlates with a duty that, typically, only one other person owes another. The classic example is the debtor–creditor relationship. The creditor has a right that the debtor pays him a sum that is owed, say £10, and the debtor has the correlative duty to pay the £10 to the creditor. The creditor has that right only against the debtor, and the debtor, correlatively, owes the duty only to the creditor.

2.74 For some commentators, the beneficiary's right was a right *in rem*, because it bound almost all the world, ie it bound all successors in title (**2.55**) to the trustee with the exception of the bona fide purchaser. For others, it could not be, because it did not bind mere successors *in possession* to the trustee of the trust assets. Where a thief stole a trust chattel or an adverse possessor took possession of trust land, the trustee, and only the trustee, could bring an action for conversion against the thief or seek to evict the adverse possessor. The trust beneficiary could not, although as we have also seen (**2.16**) he could by legal action require the trustee to enforce his legal rights to bring an action for conversion against the thief or require him to evict the adverse possessor. From this perspective then, the beneficiary had no right (or at least no direct right) vis-à-vis the trust property itself, or against those who interfered with it. So the right could not be a right *in rem*, and therefore, since the right had to be either a right *in rem* or a right *in personam*, it must be a right *in personam*; on this view, a trust is essentially 'obligational', not 'proprietary', the idea being that the beneficiary has no true interest in the trust assets themselves, but only has the right that the trustee, or third-party recipient from the trustee, perform a personal obligation owed to him. Perhaps the most famous advocate of this view was Maitland (Maitland (1929)).

2.75 Notice, however, that the *in rem/in personam* either/or is not particularly helpful here. From one
p. 42 perspective, the fact that the beneficiary's right binds all successors in title with the exception of a bona fide purchaser means that his right has a genuine *in rem* aspect, for anyone in principle might acquire the trustee's title by way of gift, or by way of contract, or as the trustee's trustee in bankruptcy, and so on. Because there is a *bona fide* purchaser exception to the *nemo dat* principle (**2.62**) in the case of money does not mean that we say that our title to the coins in our pockets is not a right *in rem* which binds the world. Rather, it would seem better to say that the '*in rem*' aspect of the right is somewhat diminished. Turning to the *in personam* side of the distinction, this doesn't work either. Genuine rights *in personam* bind people, not assets—they cannot 'run' with or be attached to any particular property rights, but we have already seen that the beneficiaries do 'run' with the trust assets.

2.76 The upshot of these considerations is that it is not really very helpful to try to characterise the beneficiary's interest using the *in rem/in personam* terminology. Partly in response to the difficulties in applying this terminology, commentators have proposed a different way of characterising the beneficiary's right, as a 'right *in* a right' or a 'right *to* a right' or a 'right *against* a right' (Chambers (2013c), para 13.90; Smith (2008); McFarlane and Stevens (2010)). The idea is the following: as we have seen, the beneficiary's interest binds *successors in title* to the trustee, that is, persons who acquire the trustee's rights to the trust assets. But the beneficiary has no (direct) claim against mere *successors in possession* to the trustee, for example the thief who acquires possession of a trust asset by stealing it, or the adverse possessor who takes possession of trust land. Thus, it is proposed that the best way to understand the beneficiary's right is as a right to the trustee's right to the property. So conceived, such a right obviously implicates certain third parties, those who acquire the trustee's right in the trust assets. And since thieves and adverse possessors do not acquire the trustee's right in the trust assets, the beneficiary has no direct claim against them when they interfere with the trustee's right.

2.77 Your present author endorses this view. Following on from what we have discussed throughout this chapter, you can think of the beneficiary's interest as being in, or to, or against the trustee's title, to the trust assets. In the case of tangible property, land and chattels, the title has a basic 'tripartite' structure (Penner (2021a), 26–36): the trustee's right to immediate exclusive possession of the property plus his power to license others to possess it and his power to transfer it. The beneficiary is clearly interested in each of these aspects of the trustee's title. As we have seen, the trustee may benefit a beneficiary by licensing him to occupy trust land. For that to work the trustee must exercise whatever rights against third parties he has to make sure he can put the beneficiary into possession, for example by evicting squatters. And he must have the power to license the beneficiary to enter into possession. The beneficiary's interest in the power to transfer is also obvious. When, for example, the trustee pays money representing the trust income to the income beneficiary he uses that power to transfer. He uses that power when he makes investments.

2.78 Of course beyond this basic structure of title for chattels there may be other or different aspects of title that go with particular kinds of property. In the case of land, title also gives you the power to grant easements,
p. 43 mortgages, and so on. In the case of chattels, an asset can be pledged, creating a kind of security interest. Title to 'ordinary' shares in a company gives the shareholder the right to vote in general meetings, the right to dividends when declared, and to participate in any division of assets when the company is wound up. And so on for other kinds of property such as bank accounts or intellectual property rights.

Trusts and the fusion of law and equity

2.79 We are now in a position to see why the trust can appear to pose a problem for the fusion of law and equity (**1.18**). The trust appears to depend upon maintaining a clear distinction between legal and equitable interests, and so would appear to require that the rules of law and the rules of equity stay 'unfused', at least in this area of law. But that doesn't actually follow. The trust is, certainly, a very particular (perhaps peculiar) property device. The point, however, is that characterising the nature of the trust does not depend upon using the terms 'legal' and 'equitable', although of course these are convenient labels (always remembering that some trusts are not trusts of legal interests (**2.44**)). We could just as easily refer, respectively, to the 'beneficiary's equitable interest under a trust' as just a 'trust interest', so long as it was clear how the label applied and so long as it accurately represented the various personal and proprietary rights, powers, and duties that constitute the trust as the legal creature it is. There is no reason on earth to think that it is impossible to do this without maintaining two divided 'systems' of property law or property rights.

2.80 Moreover, it is doubtful whether we should want to retain the notion of an 'equitable' interest which requires all equitable interests of whatever kind, from the beneficiary's interest under a trust to the rights of an equitable easement holder to share certain features, any more than the common law should require, eg all common law property interests to be either subject to a *bona fide* purchaser rule or not, which we have seen it does not (**2.61**–**2.62**). Consider the case of the easement, say A's right of way over Blackacre, which is owned by B. It is clearly the law that if a third party, X, blocks up the entrance to the right of way, A can bring an action for nuisance against X, *if A's easement is a legal easement*. There is no clear authority if A can do the same if his easement is an equitable one. But there seems to be no reason to deny this claim to A, just because (as will generally be the case) his easement was created informally (ie not by the execution of a deed), so long as A can prove his easement. (For discussion see Gardner (2013).) Perhaps there should be some rules which apply differently to rights created by deeds and those created informally, but again this doesn't require calling the former rights 'legal' and the latter rights equitable. We make such distinctions *within* the common law. Promises contained in deeds are valid without consideration, whereas those not so formally created are not. Within equity, we similarly draw distinctions. As we have seen the rules about 'notice' operate differently when the equitable interests are in land than when they are trust interests (**2.67**).

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The express trust in legal context

2.81 One of the ways in which the express trust is often characterised is in relation to legal devices, like gifts under wills or security interests. In this part then, we will be concerned with differentiating trusts from these other legal forms. But more than that, we will also explore how the conceptual underpinnings of these devices reveal the peculiar character of the trust, the beast that it is.

The law of succession and testamentary trusts

Testamentary gifts

2.82 A *testamentary* trust is one created as a gift under a will. Many trusts are created in this way, so a passing familiarity with the rudiments of the law of wills and of intestate succession is very useful. The property of a dead person is called the 'deceased's estate', and it passes to the living in one of two ways: either according to the deceased's will or, if he has no valid will, that is if he dies 'intestate', then according to the rules of intestate succession. The rules of intestate succession are essentially 'default' rules that distribute the property in the way that most people would have distributed it had they made a will; to their spouse first, then to their children; if there is no spouse or children, then to their parents, siblings, and finally to more distant relations. The person who makes a will is a 'testator' (male) or 'testatrix' (female), and the will normally nominates one or more 'executor(s)' (male) or 'executrix (executrices)' (female) who will 'prove' the will, ie have the will declared valid by a Court of Probate. The title to the property of the deceased passes to the executors who will pay off the deceased's debts, and then distribute the deceased's estate to those to whom he has given it under his will. In the case of intestacy, there is no will to execute; the court will instead appoint one or more 'administrators' who will, like executors, receive title to the deceased's assets, pay his debts, and then distribute the estate according to the rules of intestate succession. Both executors and administrators are called the 'personal representatives' of the deceased. (Technically speaking, there is no longer any 'inheritance' of property under English law. The only things that are now inheritable are titles of nobility and, of course, the crown. To 'inherit' was to receive land as an 'heir' of the deceased, not by a will, but by the rules of descent existing prior to the property law reforms of 1925.)

2.83 For historical reasons, different terms apply to testamentary gifts of different kinds of property. Land is 'devised' by will, and therefore the gift is called a 'devise' and the donees 'devisees'. Generally, personal property or 'personalty', ie anything other than land, is 'bequeathed', and such gifts are 'bequests', but gifts of sums of money are called 'legacies' and their recipients 'legatees'. 'Gifts' will suffice for a compendious term. The gifts under a will do not take effect from the time the will is made, but only when it comes into operation on the testator's death. Thus, if one of the intended recipients dies before ('predeceases') the testator, his gift 'lapses', or fails. With respect to that piece of property, it is as if the testator made no specific gift of it at all. p. 45 Intended testamentary gifts, including intended trusts that are to take effect on the testator's death, may fail for a number of reasons. Because intended gifts under wills can fail, a very important clause in any will is the one in which the testator gives 'the rest and residue' of his estate; this 'residuary' clause gives all the property left over after the specific gifts, of Blackacre to A, of 500 shares in X plc on trust to C for life and then to D absolutely, and so on, are distributed. The recipients under this clause, the 'residuary legatees' (so called whatever kind of property they get) will get more to the extent that any of the specific gifts fail. If there is no residuary gift or for some reason it fails, for example because the named residuary legatees have predeceased the testator, then any property not disposed of by specific gifts in the will will be distributed as if the testator made no will at all, ie under the rules of intestate succession. Thus, it is apparent that there is always an incentive for a good fight over the validity of specific gifts in the will—the residuary legatees or, failing them, the intestate successors, will always look carefully at their validity, because they will take the property if a specific gift fails. This applies just as much to specific testamentary gifts that are trusts; indeed, most of the cases concerning the validity of trusts concern testamentary trusts.

2.84 The 'formal' requirements of wills, principally that a will be signed by the testator and attested by two witnesses, are prescribed to ensure that the will truly represents the testator's intentions and, in general, the law will allow no departures from this method. If an entire will is invalid for not being correctly formally made, the deceased's estate is distributed under the rules of intestate succession, no matter how obvious it might be that this was contrary to his actual intentions. Here again is an opportunity for a good fight. Those who would take as intestate successors, if not well provided for in the will, have the incentive to press every reasonable argument that the will is invalid.

2.85 The deceased's personal representatives are not trustees for the people who will take the property under the will or on intestate succession (*Stamp Duties Comr (Queensland) v Livingston* (1965); Maitland (1929), 48–49); they are the full legal owners of the deceased's property, although they are under stringent obligations to dispose of his property properly, and for this reason, their role is very trustee-like. Furthermore, prospective beneficiaries under a will or under the rules of intestate succession, although they do not have an interest in the deceased's estate itself as does a beneficiary in the property of a trust, have a right against the personal representatives to administer the estate properly, and this right, like the beneficiary's right to his interest under a trust, can be assigned or bequeathed (*Re Leigh's Will Trusts* (1970)). Executors are often appointed to be the trustees of the testamentary trusts that a testator specifies in his will.

2.86 Whilst the role of a personal representative of the deceased is 'trustee-like', it is important to note the differences in his legal position from that of a trustee. The purpose of a personal representative is essentially to 'wind up' the deceased's economic existence. He takes over title to the deceased's assets, but also, in a sense, takes on the deceased's liabilities. Thus, he discharges the deceased's outstanding debts, and only then distributes the surplus to the donees under his will or by the rules of intestate succession. He is not under further duties to manage the property over time in order to provide structured benefits to a class of
p. 46 beneficiaries. The role of the personal representative is in some ways like that of the principal heir under true regimes of inheritance as in civil law legal systems. An heir, in these systems, is regarded as immediately succeeding to the economic personality of the deceased, taking on both his assets and his liabilities. By accepting the inheritance, the heir is under an obligation to discharge the liabilities of the deceased. Also, the heir must pay out of his inheritance any gifts the deceased made under his will. (The ability to make a will is not incompatible with a regime of inheritance—it is just that in regimes of inheritance the deceased is entitled to give only a portion of his assets by will.) Of course, unlike the personal representative, the heir is entitled to all the assets that remain after he has discharged the deceased's debts and distributed any assets given by the deceased's will.

Security interests and the context of insolvency

2.87 One of the main reasons why proprietary rights are valuable is that people and companies can become insolvent. One is insolvent if one has insufficient assets to meet one's liabilities—in other words, if one does not have enough financial resources to meet the demands of all one's creditors. In the case of individuals, the legal device of bankruptcy allows the insolvent individual to get out of this mess and start again afresh. It works roughly as follows: the property of the bankrupt, including any rights to be paid any debts owing to him or any interests he has under trusts, becomes the property of his 'trustee in bankruptcy', whose job it is to distribute these assets, the bankrupt's 'estate in bankruptcy', in proportionate shares to the bankrupt's creditors. Thus, if the bankrupt's estate is worth £10,000, and his total debts are £100,000, each creditor will receive 10 pence in the pound for the debt he is owed. Following this distribution, and after a period of time, such as three years, the bankrupt is 'discharged' from all his debts, and can begin economic life again, albeit without much in the way of assets. (Certain assets of the bankrupt remain his, and are not used to pay off his creditors: roughly, the property personally required by him in the pursuit of his employment or trade and such property as is required to meet his and his family's basic domestic needs.) The analogous process with respect to a company is called liquidation. The liquidator distributes all of the assets of the company to its creditors on a proportionate basis. Following this distribution, the company no longer exists. There is no compendious term that covers both the trustee in bankruptcy and the liquidator of a company, so henceforth when the term 'trustee in bankruptcy' is used it will, for our purposes, comprise both.

2.88 Proprietary rights become very important in the case of insolvency. If a bankrupt owes you £100, then you are likely to see little money, because as a general creditor you will only be paid a proportionate share of the bankrupt's assets. You might be lucky to see any money at all. To the extent, however, that your rights against the bankrupt are proprietary, then you are in a much stronger position: an asset of the bankrupt that is subject to the proprietary right of someone else is, to the extent of that right, not the bankrupt's own property, and therefore not part of his estate in bankruptcy to be used for distribution to his general creditors —it belongs to the person with the proprietary right. The beneficiary's *equitable* rights to property held on p. 47 trust stand on the same footing as legal title in this respect in the case of insolvency. The trustee has no beneficial interest in the property he holds on trust, and so neither can his trustee in bankruptcy who acquires title to all the trustee's legal assets should he become bankrupt—the trustee in bankruptcy takes these assets as a volunteer, so is not a bona fide purchaser of the assets from the trustee (**2.56** et seq); thus, trust property is not available to the trustee's trustee in bankruptcy for distribution to the trustee's own creditors. In other words, a beneficiary's equitable rights bind a trustee in bankruptcy. Obviously then, personal rights to be paid sums of money (eg a claim for money damages for breach of contract) are not as valuable in a bankruptcy as proprietary rights, because they give the right holder no special claim on any particular asset of the bankrupt. For this reason, claimants who have a claim for money against a bankrupt will often try to claim that their past dealings with him created a trust over some of the bankrupt's property, because then they can simply withdraw this property from the bankrupt's estate.

Security interests and trust interests

2.89 A beneficiary's equitable title is, in some ways, functionally similar to a 'security interest' in the context of insolvency. A security interest is a right that a creditor holds in particular property of his debtor. The classic example is a mortgage over land. In return for providing money, the lender (the 'mortgagee') makes sure that the borrower (the 'mortgagor') grants him a mortgage over the borrower's land. (Contrary to common parlance, it is the lender, then, who gets a mortgage.) A mortgage is a right that the lender has in the land of the borrower, and it has the effect of securing repayment of the loan. If the borrower defaults on his contractual repayments of the loan, then (roughly) the lender has the right to take possession of the land and sell it to pay off the loan. All security interests work in essentially the same way. They entitle the creditor who has one, called a 'secured' creditor, to sell the property in question if the borrower defaults on his repayments and take as much of the proceeds of sale as is necessary to discharge the outstanding balance on the loan. Because security interests 'charge' the property with the repayment of a loan in this way, they are often just called 'charges'. The vital point about charges is that they are proprietary rights. They attach to the property itself. If the property passes out of the hands of the borrower into the hands of his trustee in bankruptcy, the lender will still be able to 'realise' his security, ie sell the property to pay off the debt, even though it is no longer held by the borrower. Any of the money proceeds of sale that are not required to pay off the outstanding debt belong, of course, to the trustee in bankruptcy—in other words, the security interest only charges the property to the extent of the sum owed. Security interests are not only created by two parties to a loan agreement. A court can make a 'charging order' against a defendant's property, which gives the claimant a charge over the property to secure a judgment debt (eg a court's award of damages).

2.90 The justice (or lack thereof) of the beneficiary's right to withdraw his property from the bankrupt's estate should be judged in view of the fact that a trust, like a contract, is a private arrangement. Whilst it is working, more or less, the beneficiary enforces his rights against the trustee, like a contracting party pressing
p. 48 for performance against the other contracting party. When things go badly wrong because the trust property is transferred away in breach of trust, the beneficiary takes the trust public, and tries to get the property back from third parties. You can make an analogy here with a secured loan. The loan contract is private, but when the borrower goes into bankruptcy, the lender goes public with the contract and claims possession of and sells the charged asset to satisfy its debt, thus removing that asset from the debtor's estate in bankruptcy, to the disappointment of all the other creditors. You can see why, in these circumstances, Parliament has tried to make things as fair as possible by putting in place public registration systems both for many equitable proprietary rights in land and for security interests, to protect third parties who would otherwise be hurt if caught out by the proprietary effect of these private arrangements. But there is no registration system as such for interests under trusts; they remain private. Thus, in order to avoid surprising innocent third parties, the law must be judicious in accepting claims by those who would argue that their past dealings with a bankrupt gave rise to a trust over some of his property in their favour, as this will effectively give the claimant a priority over other creditors that may, in the circumstances, be quite unfair.

2.91 While interests under trusts and security interests share certain features in the context of insolvency, it is vital not to confuse trusts with security interests. A debtor subject to a security interest of his creditor, though subject to a powerful proprietary right, is not a 'trustee' of the asset subject to the charge. The asset is 'encumbered' to the extent of the value of the outstanding debt he owes, but the asset remains beneficially his. Therefore, any increase in the value of the asset is something the debtor can realise. So, for example, if A grants to B a charge over shares worth £10,000 to secure A's repayment of a loan from B of £5,000, and the shares rise in value to £15,000, B is not entitled to any increase in the value of these shares. As the shares rise in value, B benefits practically in the sense that they are now better security for his loan, for if A defaults it is clear that by exercising a power to sell the shares in that circumstance B will get all his money back, but in any case he will have to remit to A the full surplus not needed to pay off B's loan to A. For this reason, A is sometimes called the 'residual claimant' (**2.14**) of the assets he has charged. He gets the residual value of them, that is, he is entitled to realise the value of them after any charges on the assets are extinguished when he pays off the debts they secure. By contrast, by *extreme contrast*, a trustee is not the full beneficial legal owner of assets which are just 'encumbered' by the beneficiaries' equitable interests under the trust. The trustee is not beneficially entitled to the trust assets at all. He has no interest in any increase in the value of the trust fund—that all enures to the benefit of the beneficiaries. Unlike the chargor (the one who grants a charge over his assets), it is not the case that the trustee could possibly comply with his obligations to distribute the trust assets to his beneficiaries leaving a surplus that he could keep for himself, so he is not to be conceived of as any sort of residual claimant to them (Penner (2014a)). As we have seen (**2.14**), if there is anyone who would count as a residual claimant to the trust assets, ie a person who would claim any remainder after all the valid beneficial interests have been 'discharged', it not the trustee, but the settlor, by operation of the automatic resulting trust (**2.14**).

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Further reading

Brownbill (1992)

Gardner (2013)

Matthews (1996, 2005)

McFarlane and Stevens (2010)

Penner (2002, 2006b, 2010b, 2014a, 2014b)

Smith (2008, 2013b)

Swadling (1997)

Self-test questions

1. What is an express trust? How is one created?
2. What is the difference between the concepts of 'legal interest', 'equitable interest', and 'beneficial interest'?
3. What is the significance of 'equity's darling'?
4. What are the features of an express trust? How do these features together work to explain the beneficiary's interest under a trust?
5. What is a security interest, and in what respects is it comparable to a trust?
6. Explain the role of a deceased's personal representatives. In what respects are they like trustees?
7. How is the nature of the beneficiary's interest under a trust best described?
8. Why does a trustee's transfer of a legal title of the trust property in breach of trust to a bona fide purchaser extinguish the equitable interest of a beneficiary?

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