

CHAPTER ONE

The Heart of the Matter

“THE GUARDIAN ANGEL OF THE ANGLO-SAXON”

Trusts play a vital role as protected pools of ring-fenced assets in British society and in countries governed by the British in earlier eras, for example USA, Canada, Australia, New Zealand and India. Even European and other countries which do not have the British concept of the trust in their domestic law are becoming prepared to recognise many aspects of foreign trusts as a matter of private international law when matters involving such trusts arise in their jurisdictions. Indeed, their legislation has provided protection for pools of ring-fenced assets in limited areas, *e.g.* those involving financial services.

One cannot even hazard a guess at the amount of trust funds world-wide. In the United Kingdom charitable trust funds and funds of charitable corporations have income of over £26,000 million a year, with assets exceeding £70,000 million, and the value of their tax and related benefits is over £3,000 million a year. Huge amounts are held on private trusts established by will or by deed for benevolent or paternalistic or dynastic reasons. Inland Revenue figures indicate that in the United Kingdom there are over 65,000 discretionary (and accumulation and maintenance) trusts with an aggregate value over £8,000 million. Most such trusts are of relatively small value, the really large trusts normally being off-shore trusts in places like Jersey, Bahamas and the Cayman Islands. It is commonplace for persons of ordinary means to take out a life policy to be held on trust for spouses and children. All land in England and Wales that is owned by more than one person is held on trust for the co-owners with power to sell. Assets of unin-

corporated clubs are held on trust for club members. Over £200,000 million is invested in United Kingdom unit trusts by nearly three million persons. Trade union funds of vast amounts are held on trusts. Over eight million employees are members of occupational pension schemes and pension fund trusts in the United Kingdom are worth over £700,000 million. Much property of companies is charged in favour of trustees as security to be held on trust for debenture holders who have lent money to the company in return for debenture stock. Eurobonds are issued under a "trust deed" and when the trustee intervenes in case of default to collect money due to the bondholders he holds such money on trust for the bondholders. Nations even combine to set up trusts. Thus, the United Kingdom, Australia and New Zealand in 1987 set up the Tuvalu Trust Fund (of £12 million) to help the inhabitants of Tuvalu, formerly the Ellice Islands, south east of Nauru, after winding up the British Phosphate Commissioners. The winning nations of the First World War, in implementing the Young Plan for German Reparations, arranged in 1929 for the creation of the Bank of International Settlements to act as trustee to whom payments should be made by Germany and by whom the distribution to the appropriate recipients should be managed.

This latter arrangement led Pierre Lepaulle, a renowned French lawyer, colourfully to write:

"Thus from settlement of the greatest of wars down to the simplest inheritance on death, from the most audacious Wall Street scheme down to the protection of grandchildren, the trust can see marching before it the motley procession of the whole of human endeavour: dreams of peace, commercial imperialism, attempts to strangle competition or to reach paradise, hatred or philanthropy, love of one's family or the desire to strip it of everything after one's death, all those in the procession being dressed either in robes or in rags, and either crowned with a halo or walking with a grin. The trust is the guardian angel of the Anglo-Saxon, accompanying him everywhere, impassively, from the cradle to the grave."¹

Earlier, the great legal historian and Equity lawyer, Maitland had written:

"If we were asked what is the greatest and most distinctive achievement performed by Englishmen in the field of jurisprudence I cannot think that we should have any better answer

¹ *Traité théorique et pratique des trusts en droit interne, en droit fiscal et en droit international*, Paris 1932, p. 113.

to give than this, namely the development from century to century of the trust idea."²

ANTI-TRUST LAW

Lepaulle's reference to Wall Street and attempts to strangle competition enables us to deal with the red-herring of anti-trust law which takes its nomenclature from the nineteenth century American Sherman Antitrust Act concerned to prevent monopolies developing. In those distant days laws in the USA prohibited the ownership by one company of shares in another company, but there was nothing to stop the trust being used as a device to avoid this restraint on the consolidation of economic power. A trust, or rather trustees since a trust is not a legal person, could own controlling shareholdings in several companies and perform the function now carried out by a "holding company". It was against this use of the trust in the development of monopolistic empires that the Antitrust Act was directed. The pejorative expression "anti-trust" is still used in America to denote "anti-monopoly" and is often thus used on this side of the Atlantic, for example to describe European Union anti-monopoly law as EU anti-trust law.

Of course, trusts, like companies or guns, can be used for good or bad purposes. Thus, for example, dispositions on trust intended to defeat the claims of the settlor's creditors or wife or dependants may be set aside.³ Also, if a particular type of trust is regarded as unfairly avoiding or minimising tax liabilities, then fiscal legislation may be enacted to rectify this situation.⁴ Furthermore, to prevent the dead ruling the living for too long, trusts (other than charitable trusts) cannot last for longer than a particular perpetuity period, nor can income be accumulated and rolled over into capital for longer than a particular shorter accumulation period.

WHAT IS A TRUST?

A trust is not a legal person, like an individual or a company, capable of owning property. For there to be a trust, property must be subject to a trust, so the property will be owned by a trustee or trustees (who may be individuals or companies) or by a nominee on behalf of the trustee (though here the trustee's rights against the nominee may be regarded as property held by the trustee). Trustees hold property as joint tenants, so on a trustee's death the property

² In *Selected Essays* (1936), p. 129.

³ See Insolvency Act 1986, ss.339, 341, 342, 423, 424, 425, Inheritance (Provision for Family and Dependents) Act 1975, s.10, Matrimonial Causes Act 1973 s.37.

⁴ As in Income and Corporation Taxes Act 1988, ss.663, 689, 739-745.

passes automatically by the right of survivorship (*ius accrescendi*) to the surviving trustees: if the last surviving trustee does not appoint more trustees, then on his death the property will be held by his personal representative who should appoint new trustees.

Unless otherwise authorised by the terms of the trust or by a statute, the trustees are under altruistic fiduciary obligations imposed by the law, so that they cannot exploit their position for their own benefit or where it is possible that harm may be caused to their beneficiaries. They also have equitable obligations to use reasonable care to manage the trust property for the benefit of beneficiaries or for charitable or other permitted purposes: this will involve the trustees in personal liabilities for taxes or in contract and in tort when dealing with outsiders. The trust property cannot be used as part of the trustee's property whether on death, since his interest ceases then, or on divorce or bankruptcy: the trust property constitutes an independent fund available only for the beneficiaries or the charitable or other permitted purposes. If trust property, whether in its original form or transmuted into some new form is wrongfully held out by the trustee as belonging personally to the trustee (for example where proceeds of the sale of trust property are paid into his private bank account and then out to purchase a painting) or wrongfully comes into the hand of a third party (as where the trustee donates the asset to his wife or brother) who is not a purchaser of it without notice of the trust, then it can be traced and recovered if not previously dissipated: compare subrogation rights in civil law jurisdictions to ascertain what property is commercial partnership property or property subject to a matrimonial regime.

Traditionally, it is as the result of a gratuitous disposition from the settlor to the trustees for the beneficiaries that the trust of property is constituted, so just as a donor's rights cease after making a gift so do the settlor's rights cease. Once a valid trust is created a bi-partite relationship arises: it is only the beneficiaries—and not the settlor—who can enforce it, so the trustees' duty is to keep the beneficiaries—and not the settlor—happy. A gift on trust is much more flexible than an outright gift, especially when one considers the possible range of beneficiaries under a discretionary trust (for example for such of the settlor's descendants as the trustees may decide to benefit with income or capital in their absolute discretion) over a lengthy period and the opportunities for the settlor to reserve certain powers. These might include powers to revoke the trust, or to remove the trustees and replace them with others, or to delete certain beneficiaries, or to add new beneficiaries, or to determine which members of a class of discretionary beneficiaries, such as grandchildren, will receive capital after expiry of a 21-year accumulation period or after the death of the beneficiary

entitled to income. If he wishes, the settlor may confer such powers on his widow or brother or on whoever happen to be the trustees from time to time, especially where the powers may be exercisable throughout the perpetuity period that is the duration of the trust, for example 80 years from the creation of the trust (see p.106 below).

The settlor in his trust instrument will set out how the trustees are to distribute at the end of the trust perpetuity period whatever capital then remains. The trust may terminate earlier, however, if the trustees have earlier exercised their discretionary powers to distribute capital so as to exhaust the trust fund, or if no beneficiaries or potential beneficiaries exist any longer, or if the trustees or other person with any express power to advance the closing date for the trust exercise such power.

The continuous trustee-beneficiary relationship is the foundation of the trust. The arrangement between the settlor and the trustees under the trust instrument (which will expressly give the trustees, as an incident of their holding and managing the trust fund, the power to pay themselves out of the fund for their services and expenses) confers extensive enforceable rights on the beneficiaries, though they neither provide consideration for the arrangement nor are parties to the arrangement. The trust concept thus overcame the weakness of the contract concept because until the Contracts (Rights of Third Parties) Act 1999, in English law to enforce a contract a person had to be a party to it and provide consideration for the other party's promise. Moreover, persons as yet unborn or unascertained may come to have rights under a trust for their benefit. The trust thus has tremendous utility, especially since it is so flexible and so simple to create and operate and terminate, or, perhaps, even to relocate abroad without any termination, unlike a company.

This flexibility led in the twentieth century to many trusts arising out of a contract arranging for collective investment of the payers' moneys, for example in a unit trust or debenture trust or a pensions fund trust where a payer may be not only a settlor but a beneficiary or even a trustee. However, because it is a nonsense to talk about a person having a relationship with himself or rights against himself, a settlor, S, cannot hold property on trust for himself alone but, otherwise, he may be interested in a trust in any capacity and so be a beneficiary and a trustee even if he himself created the trust. Thus, S can vest property in the names of X and Y or of S and Y on trust for S for life, with remainder to S's children in equal shares unless S by deed or will appoints the capital to his children in some different shares.

Although a settlor normally constitutes a trust by transferring specific property to a trust corporation or two or more trustees and declaring trusts, it is possible for a settlor to retain his property and

declare that he himself is now to be trustee of a certain specific item appropriated by him to be held on certain declared trusts. Thus, he might designate his personal deposit account with the Woolwich Building Society "Nephew Norman Nelson Trust Account", having written to his brother telling him that the money already in such account and such other money as he may add to it is being held by him on trust for one-year-old Norman, contingent upon Norman attaining 25 years of age, the income till then to be used for the maintenance, education or benefit of Norman. The subject-matter of such trust is a chose in action, S's legal right to whatever sum of money is credited from time to time to the account.

DEFINITION OF A TRUST

The fundamental features of the English trust have just been described. There is no statutory definition of the trust which can be used as a major premise from which rules relating to the trust can be deduced. It has been the courts that, over the years, have developed the rules relating to the trust, so all one can do is provide a description of the trust, which reflects those rules and which enables people in a general way to know what is meant when talking about a trust.

To this end, when the Hague Recognition of Trusts Convention was prepared Art.2 stated:

"For the purposes of this Convention, the term 'trust' refers to the legal relationship created—*inter vivos* [in lifetime] or on death—by a person, the settlor, when assets have been placed under the control of a trustee for the benefit of a beneficiary or for a specified purpose.

A trust has the following characteristics:

- (a) the assets constitute a separate fund and are not a part of the trustee's own estate;
- (b) title to the trust assets stands in the name of the trustee or in the name of another person on behalf of the trustee;
- (c) the trustee has the power and the duty, in respect of which he is accountable, to manage, employ or dispose of the assets in accordance with the terms of the trust and the special duties imposed upon him by law.

The reservation by the settlor of certain rights and powers, and the fact that the trustee may himself have rights as a beneficiary, are not necessarily inconsistent with the existence of a trust."

Article 11 then expressly provides that a trust created in accordance with the applicable law governing creation of the trust "shall

be recognised as a trust". It then states in a second and third paragraph:

"Such recognition shall imply, as a minimum, that the trust property constitutes a separate fund, that the trustee may sue and be sued in his capacity as trustee, and that he may appear or act in this capacity before a notary or any person acting in an official capacity.

In so far as the law applicable to the trust requires or provides, such recognition shall imply, in particular:

- (a) that personal creditors of the trustee shall have no recourse against the trust assets;
- (b) that the trust assets shall not form part of the trustee's estate upon his insolvency or bankruptcy;
- (c) that the trust assets shall not form part of the matrimonial property of the trustee or his spouse nor part of the trustee's estate upon his death;
- (d) that the trust assets may be recovered when the trustee, in breach of trust, has mingled trust assets with his own property or has alienated trust assets. However, the rights and obligations of any third party holder of the assets shall remain subject to the law determined by the choice of law rules of the forum."

In addition to the last sentence, Article 15 requires the court of the forum to apply the mandatory provisions of the law determined by the choice of law rules of the forum to:

- (e) the transfer of title to property and to security interests in property
- (f) the protection of third parties acting in good faith."

Article 15 and the last sentence of Article 11 thus properly restrict a beneficiary's right to trace, and so recover, trust property in the hands of donees or bankers or custodians (having title to intangible assets like shares) or purchasers from the trustee with notice of the trust. Under standard private international law principles the *lex situs* (the law of the place where property is situated) normally determines questions of transfer of title to property and whether or not a donee or a purchaser has obtained good title free from other claims. If the *lex situs* is the law of a state which has the trust in its domestic law and so has traditional tracing rules this will not matter very much, except to the extent that such state may have registration of title statutes which may confer a good title irrespective of notice. If the *lex situs* is the law of a state which does not have the trust in its domestic law and so has no equitable tracing rules, this will make the right to trace meaningless, except to the extent that a

recipient's actual knowledge of a breach of trust may make it possible to take advantage of rules of the *lex situs* concerning fraud. Such rules may make the fraudster personally liable for damages or, if he is solvent and still has the property, may require him to return it.

As just seen, Article 11 requires civil law states to recognise the trust as such rather than to try to transpose it into some analogous civil law concept. An understanding of the civil law's problems here is a means of understanding the essential characteristics of the common law trust. After all, in civil law states there often arises the same need for property to be entrusted to T for the benefit of B.

Civil Law States

In the civil law, which is derived from Roman law, ownership is an abstract concept in absolute terms: it is axiomatic that ownership of property requires the owner to have all ownership rights, namely rights of disposition, management and enjoyment. Two or more persons cannot be owners of an asset except as co-owners when each co-owner is the absolute owner of his undivided fraction of the whole (*i.e.* is a tenant in common, and not a joint tenant, viewed from the perspective of a common lawyer).

Persons other than the owner of the asset can either have proprietary rights over that owner's asset or personal rights merely against the owner himself. The former rights against the thing itself are regarded as *in rem* or "real" rights and the number of such rights is regarded as definitive and closed (the so-called *numerus clauses*), and many such rights require to be registered. These rights cover servitudes (like easements and restrictive covenants over land), mortgages and usufructs (where the usufructuary is entitled to the enjoyment of property or its income for life or a lesser period).

Without breaking the absolute ownership principle or extending the list of "real" rights, a well-developed law of agency exists by virtue of the special contracts of deposit (bailment) and mandate (agency). Indeed, in many civil law jurisdictions, if an agent has used money of his undisclosed principal to buy an asset, such principal can recover such asset as his asset if the agent becomes insolvent. Moreover, bailment in those jurisdictions, as opposed to common law jurisdictions (see p.77) extends beyond tangibles to intangibles, so there can be a bailment of stocks and shares (impossible in English law where the custodian has to have the legal title). The concept of administration of another's property is also present in that part of the law of persons dealing with tutorship and curatorship and in the law relating to matrimonial property régimes. In the law of succession on the death of the deceased his heir becomes owner of the deceased's estate, standing

in the deceased's shoes, subject to certain personal obligations (for example to pay debts and give effect to legacies), though it is possible for a testator to appoint a testamentary executor (with more limited powers than an English executor), for example *exécuteur testamentaire* or *Testamentsvollstrecker*.

Civil law has developed certain concepts from the Roman law concepts of *fiducia* and *fideicommissum*. The gist of *fiducia* is that the owner transfers ownership to the fiduciary, who undertakes to use the ownership in a particular way only and then to retransfer it back to the original owner or to transfer it to a third party. Only a personal remedy lies against the fiduciary, so the position is unsatisfactory if the fiduciary wrongly sells the property or goes bankrupt. In the Netherlands, however, a special application of the *fiducia cum amico* has developed so that if a lawyer maintains a nominee account with a bank for the benefit of his clients, such account is a separate fund for the clients and is not available for creditors of the lawyer if he becomes bankrupt. In Germany the *Treuhand* has developed from the *fiducia*: the beneficiaries of a *Treuhandkonto* or a *fiduziarische Treuhand* are protected against creditors of the fiduciary (*Treuhandler*).

Civil law has developed fideicommissary substitutions from the Roman *fideicommissum*: by *inter vivos* or testamentary disposition S may transfer ownership to O (the institute) to take as owner but subject to ownership passing to P (the substitute) on O's death or a specified earlier event. Unlike the case of transferring ownership to P subject to a usufruct in O, it is not necessary for P to be alive or ascertainable at the date of S's disposition. It will be necessary for O to preserve the property intact for P, but if P predeceases O (or the specified event) then O's interest really is absolute. There are restrictions on substitutions, for example consanguinity limits or generation limits.

Indeed, one has to remember that there are also restrictions on dispositions as a result of matrimonial property régimes, while by virtue of forced heirship rights (reserve hereditaire, *Pflichtteil*) under which, for example, children have rights on a parent's death to indefeasible fixed shares in the parent's estate, taking into account earlier donations, such forced heirs can sue earlier donees to obtain sufficient money to make up the full amount of their forced shares as a fraction of the parent's actual estate plus the notionally added-back earlier gifts.

The civil law concept of contract is much broader than the common law concept with its doctrine of consideration and, until the Contracts (Rights of Third Parties) Act 1999, of privity of contract. In civil law, "cause" or "causa" is required for a valid "contract", so that a contract may be gratuitous or for value and there can be a contractual *stipulatio per alterum*, *i.e.* for the benefit

of a third party which the third party may enforce. Thus, "contract" is extensive enough to cover the trust arrangement whereby a settlor gratuitously transfers property to trustees who accept that they are to hold the property for beneficiaries, who may then enforce their beneficial rights against the trustees. However, these rights under a "contract" will merely be personal, as opposed to proprietary, rights, so they will be unenforceable against the trustees' creditors or wrongful transferees from the trustees.

Alternatively, the trust (or at least a charitable purpose trust) may be regarded as a *fondation* or *Stiftung* which consists of the dedication of a fund to a specified object with an appropriate organisation for its administration so that it has legal personality. An alternative to legal personality is the concept of a *patrimoine affecté, une masse de biens affectés à un but*, an assembly of assets and liabilities earmarked for a specific function, for example for paying off an insolvent person's creditors so far as possible.

Common Law States

The common law never concerned itself with ownership of land since all land was—and still is—owned by the Crown! In the feudal hierarchy the King granted an *estate* in land, for example a life estate or fee simple estate, to his major supporters in certain types of *tenure* from him which involved various burdensome incidents. In turn, they granted part of this land in certain types of tenure from them (with burdensome incidents) to their supporters for particular estates and this process of subinfeudation repeated itself down the line until it was prohibited by statute in 1290. The incidents of tenure gradually came to have little economic significance so that the type of tenure, the quality of a man's holding of his land, lost its significance. It was the estate or quantum of a man's rights that became significant.

A man might have rights to dispose, manage and enjoy the land for the duration of his life (the estate for life), for so long as he had lineal descendants (the estate in fee tail), or for so long as he had heirs which become for ever when estates could be devised by will and when feudal escheat of the estate to his feudal lord for lack of heirs disappeared (the estate in fee simple). These were the three common law estates that became known as legal estates to distinguish them from equitable estates.

Equitable estates arose when it became the practice for a knight going off to the Crusades to vest his estate in land in a friend to hold "to the use of" the knight, and, until his return, the knight's lady and children, or if he died abroad to the use of the knight's eldest son. This was done because legal actions had to be brought by an adult male claiming a better right to possession of the land

than some interloper. The land would be defenceless against such interloper if the knight were abroad for 10 years without having earlier transferred his estate in the land to his friend. If the friend refused to retransfer the estate in the land on the knight's return there was no remedy in the common law courts because the friend was the estate owner in their eyes. The knight could only petition the King to remedy the wrong because in equity the "friend" should be forced to recognise the knight's interest and retransfer the estate. It was vital to the position of the knight in the feudal hierarchy that the King order the knight's friend to transfer the land back to the knight. Similarly, if vows of poverty prevented land being conveyed directly to an Order of Franciscan Friars so that it was conveyed to a knight to hold to the use of the Franciscan Order, and the knight retained the benefits for himself, the Order would petition the King to force the knight to disgorge the benefits and convey the land to a more sympathetic knight or bishop to hold to the use of the Order.

In equity, the King, as the *fons et origo justitiae* (fountain and source of justice), was also petitioned about the injustices resulting from defects in the common law or its courts whether due to intimidation or the absence of an appropriate procedure or writ (there being no remedy without a writ). The King and his Council referred these petitions to the Chancellor as the King's closest adviser. He was an ecclesiastic usually learned in Roman law and canon law, and so well qualified to advise on these matters of conscience and equity: it is likely that he was influenced by the Roman *fiducia* and *fidei commissum*. The Chancellor then began to make decrees on his own authority and failure to obey the decrees resulted in the offender being committed to prison till the decree was obeyed. The Chancellor came to sit in what became known as the Court of Chancery where he began systematically to develop rules of equity, so that the court was also known as a Court of Equity. By 1615, in the *Earl of Oxford's Case*, it was established that orders of the Court of Chancery prevailed over orders of common law courts and that rules of equity prevailed over common law rules if there was any conflict between them, a position preserved by statute now that since 1875 all courts administer equity and common law rules. In 1818 the Chancellor, Lord Eldon, remarked, "Nothing would inflict on me greater pain than the recollection that I had done anything to justify the reproach that the equity of this Court varies like the [size of the] Chancellor's foot." As Bagnall J. said in 1972, "In the field of equity the length of the Chancellor's foot has been measured or is capable of measurement. This does not mean that equity is past child-bearing; simply that its progeny must be legitimate—by precedent out of principle."

The Chancellor in the Court of Chancery recognised legal estates in land just like the common law courts, but went further by compelling the legal estate owner to use his legal ownership for the benefit of the beneficiaries, who in equity were supposed to benefit exclusively from the land vested in the legal estate owner. The beneficiaries could thus have equitable estates corresponding to the types of legal estate.

What began life as the "use" came to be known as the "trust" as the result of the Statute of Uses 1535. Uses of land were then very common. The prohibition against devising land by will could be evaded by conveying land (by feoffment with livery of seisin) to feoffees to the use of the settlor for life, remainder to the uses declared by his last will. Furthermore, burdensome feudal incidents arising as the result of death, especially if there was an infant heir, could be avoided if land was conveyed to a number of feoffees (who would ensure that the land was never left vested in a sole surviving feoffee to uses since only on his death would feudal burdens arise). To prevent avoidance of the valuable feudal incidents, Henry VIII had the Statute of Uses enacted. Under this 1535 statute the use was "executed" so that where A, B and C (the feoffees to uses) held land to the use of X (the *cestui que use*) the legal estate was taken out of A, B and C and vested in X, so that on his death the feudal incidents would be leviable. In 1540 the Statute of Wills was enacted as a result of a rebellion against Henry VIII so that it became possible to devise land by will at common law.

What if land were conveyed to A and B to hold to the use of A and B to hold to the use X? At first, the first use was executed and the second use was treated as void as repugnant to the first use: thus A and B were legal owners for their own benefit. Later, the second use came to be enforced, first as an exceptional matter to prevent fraud perpetrated by A and B or to remedy a mistake and, then, as a matter of standard practice, the feudal incidents having by then lost all economic significance. The enforced use came to be known as the trust to distinguish it from the "executed" use and the drafting formula became "Unto and to the use of A and B and their heirs in trust for", for example, X for life, remainder to his eldest son and the heirs of his body.

Over the years X's equitable interest came to be enforced in the Court of Chancery not just against the trustee or a donee from the trustee, but as a proprietary interest against anyone having the legal estate other than a bona fide purchaser of it for value without notice. Such person is traditionally referred to as "Equity's darling" as if equity specially looks after him but, in reality, "Equity" in the form of the Court of Chancery simply had no jurisdiction to deal with such bona fide purchaser and prevent him from exercising his straightforward legal rights in the common law courts. Equity can

only intervene⁵ if there is a special equitable ground to compel the legal owner to hold the benefits of ownership for another since to retain the benefits for himself would be unconscionable, for example because the legal owner had innocently received trust property as a gift from a wrongdoing trustee or had purchased trust property with notice of the trust or had taken it upon himself to act as trustee of property known by him to be trust property.

A person has notice of an equitable interest if he has actual knowledge of it ("actual" notice) or would, as a person of reasonable intelligence, have had such knowledge if he had made such inquiries and inspections as ought reasonably to have been made ("constructive" notice): actual or constructive notice of a person's agent is imputed to him ("imputed" notice). In the case of purchases of land there are many standard inquiries and inspections that must reasonably be made, but for movables a purchaser may take things at their face value unless there are suspicious circumstances and yet he deliberately or recklessly fails to make the further investigations that an honest and reasonable man should make (so he exhibits a lack of honesty).

To simplify matters for purchasers of land, so long as a purchaser pays the purchase moneys to two trustees or a trust corporation (as defined in English law: see p.163 below) the interests of the beneficiaries, whether or not the purchaser has notice of them, are "overreached", *i.e.* detached from the land and attached to the proceeds of sale.⁶ The beneficiaries then have a right to trace and claim the proceeds or the specific property purchased therewith. Thus, the purchaser obtains a good title free from the equitable interests of the beneficiaries even if he knows of them: the beneficiaries are protected since the value of their interests is unaffected, being reflected in cash (or property purchased therewith) held by the trustees instead of an equivalent land value. This serves to emphasise the concept of the trust *fund* in which the beneficiaries are interested irrespective of what particular investments happen from time to time to be the trust property comprised in the trust fund. Thus, a life tenant has throughout his life an entitlement to the income from the trust fund, while his entitlement to the income from particular property comprised in the trust fund is a temporary one until that property is sold and replaced by other property.

Originally, a trust fund would have consisted solely of land (with some cash) because land was the main source of wealth. The trust concept proved so useful and worthwhile in respect of land that

⁵ Prevailing over the common law courts in case of conflict since the *Earl of Oxford's Case*, 1615.

⁶ See Law of Property Act 1925, ss.2, 27 and *City of London Building Society v Flegg* [1988] A.C. 54.

when other forms of property (like shares in companies, antiques, paintings) became significant sources of wealth, the trust was a well-known convenient receptacle for holding such property without the need to rely on common law concepts like agency, bailment or guardianship that would otherwise have had to be utilised.

Full Transposition of Trust by Analogues Impossible

The systems of law in civil law states were satisfactory without the need for an additional equity jurisdiction so no concept of equitable ownership arose, nor was there any feudal doctrine of estates since there had been a thorough reception of Roman law with its concept of absolute ownership. Major problems therefore arose when civil law courts had to try to fit the trust into civil law systems and consider who should be the absolute owner in the case of foreign trusts: the trustees, the beneficiaries or one of them, the settlor, the personified trust itself? Must it depend on which type of trust is in question? Should the variety of equitable interests possible under trusts all be capable of being real proprietary rights enforceable against the trust property held by the "owner"? What a cuckoo in the nest this might be! Does the trust pertain to the law of property or to the law of obligations (a broad civil law category covering tort, contract, unjust enrichment and alimentary obligations arising by operation of law from family relationships)?

In *Harrison v Crédit Suisse*⁷ the Swiss Federal Court held that a trust of Swiss assets held by a Zurich bank as "trustee" related to the law of obligations, being a mixed contract of mandate, of donation, of a fiduciary transfer of property, and of a contract for the benefit of a third party. Since such mixed contract could be given effect to as such in Switzerland, Harrison's "trust" was not void or voidable. This prevented Harrison's wife from having his Zurich "trust" set aside and claiming the property as sole legatee under his will, though it would give no proprietary rights to the beneficiaries under the trust, for example if the trustee became bankrupt or the property wrongfully came into the hands of third parties. Nowadays, reforms to the Swiss Code of Private International Law have led foreign trusts to be treated as if companies.⁸

In France the Tribunal de Grande Instance de Bayonne⁹ has held that the trustee is the owner of the trust property, but with powers limited by the trust instrument and rules of equity, and that the

⁷ A.T.F. 96, 1970, II, 79.

⁸ "The Trust in Switzerland-Revisited" [2000] J.T.C.P. 141, DG Forbes-Jaeger and E Stormann.

⁹ 28 April 1975 Rev crit de dr. int.pr. 1976 p.331. On recognition of trusts in civil law States see further my chapter in Glasson: *International Trust Laws* (Jordan Publishing Co Ltd).

beneficiaries have no ownership rights though their interests are "guaranteed" by equity.

The Hague Convention recognises that non-trust jurisdictions, as they adopt the Convention, must recognise the trust as such as a matter of their private international law but without the need to introduce the trust and a division between legal and equitable ownership into their own domestic law for their own citizens. Article 2 of the Convention deliberately does not mention legal and equitable ownership, countries like Scotland, India and South Africa already having the trust concept without such a division of ownership: Italy, Malta and the Netherlands have therefore implemented the Convention.

PRINCIPLES OF EUROPEAN "TRUST" LAW

To encourage the development of a trust-like ring-fenced fund concept in Europe, which is already present to some extent in most jurisdictions and which will be useful for collective security trusts supporting loans for all sorts of valuable purposes, for managing property for the benefit of minors and other persons lacking capacity, for protecting client accounts of solicitors, estate agents and other temporary custodians of client moneys and for creating more harmony in an increasingly federal Europe, an international working group has produced eight articles set out in the Appendix hereto, supported by a general commentary and various national commentaries. It is hoped that such principles,¹⁰ especially if coupled with implementation of the Hague Trusts Convention, will lead to increasing flexibility in the laws of mainland European jurisdictions which will maximise opportunities for wealth preservation and wealth generation.

The key is Article 1, which has as the core of the European "Trust" concept a segregated trust fund owned by the trustee apart from his private patrimony and so immune from the claims of his creditors, spouse or heirs. The idea of a segregated fund is already represented in various civil law systems, for example the segregation of a deceased's assets vested in the heir until he accepts them with the benefit of an inventory of assets and liabilities, the assets of an undisclosed principal in the hands of his agent are protected against the agent's insolvency under Swiss and Italian law, the Italian *fondo patrimoniale* under Arts 167-171 of the Civil Code which concerns assets held by the spouse(s) for satisfying the needs of the family, and the Dutch notary's client account. However, it is up to each

¹⁰ *Principles of European Trust Law* (eds Hayton, Kortmann & Verhagen; Kluwer Law International, 1999).

jurisdiction how far it develops special personal or even proprietary rights against the trustee or third parties.

Encouragement is given to regarding trusts not as contracts because of the dangers that it might then be thought that a breach of trust could, like breach of contract, provide grounds for treating the trust as at an end, or that the settlor must have rights of enforcement, or that the death or mental incapacity of the settlor or the trustee might affect the existence of the trust, or that all the beneficiaries have to be in existence at the creation of the trust. To categorise the trust as a type of contractual obligation would too much inhibit the scope for its growth over the next century. A trust obligation is an independent type of obligation, normally involving continuous duties for a lengthy period and having a life of its own, although having no legal personality: the trustees are the legal personalities who alone can sue or be sued, but the office of trustee remains to be filled by another person if the current trustee dies or becomes mentally incompetent or commits a breach of trust. Where compensation is sought for a breach of trust a beneficiary is not normally suing for loss to himself but is, in essence, bringing a representative action on behalf of all beneficiaries for the trustees to restore to the trust fund value lost through their breach of trust (see p.28 below).

EXPRESS TRUSTS OF PROPERTY

The vast majority of trusts are expressly created in the sense that a settlor expressly transfers property to trustees to hold on declared trusts or, exceptionally, declares himself trustee of his own property specifically appropriated for satisfying certain declared trusts. The existence of a separate trust fund is the key to a trust: the recipient of property cannot be a trustee if he is free to mix the property with his own property as part of his own assets, so that he is simply a debtor of the transferor. It is a simple matter to create a trust, no formalities being required (above those required for the transfer of property or for making a will) except that trusts of land must be evidenced in writing at some stage. There is no register of trusts to ascertain how many hundreds of thousands of trusts there are, although there is a register of charitable trusts (other than exempt and excepted charities) on which over 170,000 charities are registered so that tax privileges may then be claimed.

Express trusts will be fixed trusts or discretionary trusts. A fixed trust is one where the beneficiary has a fixed entitlement to demand net income or capital from the trustees, for example on trust for A for life (so A can demand to receive net income), remainder to A's children equally (so on A's death the children can demand to receive the capital). A discretionary trust is one where the bene-

ficiaries only obtain income or capital when the trustees exercise their discretion which they must exercise in favour of one or more particular beneficiaries, for example property held on trust for distributing income between such of the issue of A as the trustees shall see fit until the expiry of the perpetuity period whereupon the capital shall be distributed between such of A's issue then alive as the trustees shall select in their discretion.

A trust instrument may create a fixed trust and then a discretionary trust (or vice versa) for example on trust for A for life, remainder for such of A's children as the trustees shall select in their discretion (or as A's widow shall select in her discretion). A similar result may be achieved by a fixed defeasible trust for A for life, remainder to his children equally unless the trustees (or A's widow) by deed appoint the capital amongst the children in such unequal shares as they shall select in their discretion.

RESULTING TRUSTS OF PROPERTY

The orthodox view, expressed by Lord Browne-Wilkinson, is that a resulting trust arises in two sets of circumstances to give effect to presumed intention.¹¹

First, where A makes a voluntary transfer to B of money or shares (but not land because it seems¹² s.60(3) of the Law of Property Act 1925 ousts a presumption of resulting trust where gifts of land are concerned) or pays wholly or partly for the purchase of property which is vested in B alone or jointly in A and B, there is a presumption that A did not intend to make a gift or loan. It is thus presumed that the property is held on trust for A absolutely as the sole provider thereof or, in the case of a joint purchase by A and B, for A and B in shares proportionate to their contributions. This is only a presumption which can easily be rebutted either by direct evidence of A's intention to make a gift or loan or by the counter-presumption of advancement (applying where B is A's child or wife or fiancée or probably, in these days of equality, A's husband or fiancé).¹³

Secondly, where A transfers property to B on express trusts but the trusts declared do not exhaust the whole beneficial interest, for example A transfers property to B on trust for C for life or on trusts for present and future members of the C Club for Club purposes

¹¹ *Westdeutsche Landesbank v Islington LBC* [1996] A.C. 669 at 708, and in his Holdsworth Club Lecture 1991 "Constructive Trusts and Unjust Enrichment" (1996) 10 Trust LI 198.

¹² *Lohia v Lohia* [2001] W.T.L.R. 101 at 112, endorsed in *Ali v Khan* [2002] EWCA Civ 974.

¹³ *Nelson v Nelson* (1995) 184 C.L.R. 538; Art.5 of Seventh Protocol to European Convention on Human Rights.

only when, after the death of C or the dissolution of the C Club, B will hold on trust for A. This presumption can be ousted or rebutted by evidence that A had abandoned any beneficial interest in the trust property, so that such property will pass to the Crown as *bona vacantia* (ownerless property) unless intended by A to pass to Club members at the time of dissolution of the Club as part of the Club's assets.¹⁴

Lord Browne-Wilkinson cites *Barclays Bank v Quistclose Investments Ltd*¹⁵ as falling within this second head. The principle established in this case is that if money is loaned by A to B for a specific purpose intended to benefit B which is then carried out, B is simply a debtor of A, but otherwise B holds the money on a resulting trust for A (if, indeed, an express trust for A has not been agreed for such circumstances). From the outset A has the right to prevent the money being used for anything but the specific purpose¹⁶: A has no right to compel performance of the purpose or terminate the purpose or the loan, unless the purpose was for A's benefit or he reserved such rights.

Lord Browne-Wilkinson¹⁷ usefully made clear that: "A person solely entitled to the full beneficial ownership of money or property, both at law and in equity, does not enjoy an equitable interest in that property. The legal title carries with it all rights. Unless and until there is a separation of the legal and equitable estates, there is no separate title." It follows that if A transfers property to B in circumstances where an express or resulting trust arises in favour of A, while one can say that A remains absolute beneficial owner one cannot say that A retains an equitable interest because he never had any equitable interest before the transfer: the transfer creates a new equitable interest in favour of A,¹⁸ so that A becomes equitable beneficial owner, having been legal beneficial owner.

Lord Browne-Wilkinson in *obiter dicta*¹⁹ firmly rejected extending the law on resulting trusts so as to provide a plaintiff with a proprietary equitable interest as a restitutionary response to the unjust enrichment of a defendant. However, Robert Chambers in his book, *Resulting Trusts*,²⁰ in which he develops many ideas of

¹⁴ *Westdeutsche Landesbank v Islington LBC* [1996] AC 669 at 708; *Re Bucks Constabulary Fund* [1979] 1 W.L.R. 936.

¹⁵ [1970] A.C. 567.

¹⁶ Further see *Twinsectra Ltd v Yardley* [2002] UKHL, [2002] 2 A.C. 164, paras 77 to 102.

¹⁷ *Westdeutsche Landesbank v Islington LBC* [1996] A.C. 669 at 706.

¹⁸ *ibid*, at 706 and 714, in explaining *Chase Manhattan Bank v Israel-British Bank* [1981] Ch. 105; *DKLR Holding Co. (No. 2) Pty Ltd v Commissioner of Stamp Duties* (1982) 40 A.L.R. 1.

¹⁹ [1996] A.C. 669 at 709, 716. See also Lord Goff at 689; WJ Swadling (1996) 16 *Legal Studies* 110; C Rickett & R Grantham (2000) 116 L.Q.R. 15 at 19.

²⁰ Published by Clarendon, Oxford, 1997.

Professor Peter Birks, has put forward a well argued case (but unlikely to be judicially accepted) for so extending resulting trusts.

He contends that the resulting trust arises not out of the presumed intention of A to create a trust but out of A's lack of intention to benefit the recipient, B, so leading to a resulting trust arising by operation of law. If lack of intention to benefit B is at the core of the imposition of a resulting trust, then resulting trusts should be capable of extending to a transfer of A's property where A did not really want to make the transfer because his intent to benefit B was absent or was vitiated by mistake, duress, or undue influence, or was conditional on the happening of certain events which failed to materialise, so long as such property had never been a freely available part of B's general assets before the right to the restitution arose.²¹ He also maintains that a resulting trust should arise where A is equitable owner of property vested in T as trustee who wrongfully transfers it to B without A's consent, where B is not a bona fide purchaser of the property without notice of A's equitable interest. A's equitable interest affects the property as a matter of the law of priorities affecting interests in property, but most consider that, on appreciating this, B becomes constructive trustee under a duty to transfer the property to A or to A's order so as to vindicate the original express or resulting trust for A.

This is an immensely complicated area, full of difficult case law, particularly when some of such alleged resulting trusts instances would simply take over areas already covered by orthodox property principles or constructive trusts to prevent unconscionable conduct, and when other instances not involving an insolvent defendant²² might be better covered by the imposition of remedial constructive trusts which can be tailored retrospectively or prospectively to the circumstances of a particular case so as not to prejudice innocent third parties.²³

CONSTRUCTIVE TRUSTS OF PROPERTY

A constructive trust is imposed by law,²⁴ although the content of some types of constructive trust depends primarily on the intentions

²¹ R Chambers, *Resulting Trusts*, p.234; *Westdeutsche Landesbank v Islington LBC* [1996] A.C. 669 at 689-90, 712. However, the better view seems that not only a real, but also a mistaken, intent of A for B to treat A's assets as a freely available part of B's general assets should be inconsistent with any proprietary trust relationship arising: Lord Millett (1998) 114 L.Q.R. 399 at 406-407 and 416, and in *Twinsectra Ltd v Yardley* [2002] UKHL 12, [2002] 2 A.C. 164 at para.91, so that the focus is then on the equitable remedy of rescission for mistaken intent.

²² *Re Polly Peck International plc (No2)* [1998] 3 All ER 812, CA; *Commonwealth Reserves v Chodar* [2001] 2 N.Z.L.R. 374.

²³ See *Westdeutsche Landesbank v Islington LBC* [1996] A.C. 669 at 716; p.20 below.

²⁴ Generally, see A J Oakley, *Constructive Trusts* (Sweet & Maxwell, 3rd ed., 1997).

of the parties involved (for example secret trusts, mutual wills, common intention constructive trusts of family homes, constructive trusts of land subject to a specifically enforceable contract of sale); the defendant who reneges on what was intended is forced to give effect to what was intended. Currently, English law only recognises an institutional constructive trust as a response to specific types of circumstances, so as to perfect a relied upon expectation, to deter and remedy wrongful conduct or to respond to unjust enrichment. As Lord Browne-Wilkinson states²⁵:

“[It] arises by operation of law as from the date of the circumstances which give rise to it: the function of the court is merely to declare that such trust has arisen in the past. The consequences that flow from such trust having arisen (including the possibly unfair consequences to third parties who in the interim have received the trust property) are also determined by rules of law, not under a discretion. A remedial constructive trust is different. It is a judicial remedy giving rise to an enforceable equitable obligation: the extent to which it operates retrospectively to the prejudice of third parties is in the discretion of the court ... whether English law should follow the United States and Canada by adopting the remedial constructive trust will have to be decided in some future case when the point is directly in issue.”

It is easy to talk of express, resulting and constructive trusts of property as if they are similar substantive institutions. This is not the case. Where there is an express or a resulting trust the court compels an objecting trustee to give effect to the beneficiaries' rights because he knows that the settlor-transferor did not intend him to be a beneficiary himself so that he is an express or resulting trustee with consequences automatically flowing therefrom. If, for example, the trustee uses trust property or his position as trustee to make a profit for himself (for example by investing trust income in purchasing assets for himself or by obtaining a bribe) then the beneficiaries have a right to the profit or the new assets representing the profit, so such will be held on constructive trust for the beneficiaries. Similarly, if a trustee purchases for himself something which he should have purchased for the trust, he will hold it on constructive trust for the trust beneficiaries. Again, if the trustee wrongfully disposes of the trust property to a stranger, who is not a bona fide purchaser for value without notice, the beneficiaries have the right to this property or its traceable equivalent (for example a painting or shares purchased with the proceeds of sale of trust property) in the hands of the stranger who will be constructive

²⁵ *Westdeutsche Landesbank v Islington LBC* [1996] A.C. 669 at 714. Also see *Abacus (CI) Ltd v Grupo Torras*, Jersey Royal Court, June 13 2003, paras 136-149.

trustee thereof for them once he knows of the claim. He will have to transfer the property to them, if they are of full capacity and between themselves absolutely entitled, or to trustees for them.

Here, the constructive trust is dependent upon and ancillary to a valid express or resulting trust. It arises and exists independently of any order of the court just like the trust to which it is a vital remedial adjunct. In other cases, where someone is not a trustee of a valid express or resulting trust of property, equity (meaning the body of principles developed by the Court of Chancery) in special limited circumstances prevents such person from retaining all or part of the beneficial interest in his property by constructively treating him as if he were a trustee of the property for another. It is because some principle of equity in special limited circumstances compels the defendant to hold property wholly or partly in equity for the plaintiff that the defendant is constructive trustee thereof: it is not because the defendant is a constructive trustee that he is compelled to hold his property in equity for the plaintiff.

The special limited circumstances which give rise to a constructive trust by way of remedy are circumstances where equity considers it unconscionable for the owner of particular property to hold it purely for his own benefit. It is necessary to prove a case which fits the accepted special circumstances directly or by analogy, since the court cannot impose a constructive trust to provide a remedy on grounds of “justice and good conscience”.

Examples of the special circumstances which justify the imposition of a constructive trust are as follows. To prevent K from taking advantage of exercising undue influence upon B, K will hold property thereby acquired upon constructive trust for B. If K unlawfully kills B, then K will hold property thereby acquired under B's will or intestacy for those who would be entitled if K had predeceased B (except to the extent that relief may be afforded under the Forfeiture Act 1982 if it was not murder for which K was convicted).

When property is stolen or obtained by fraud, the property and its traceable product can be recovered in equity if common law remedies are inadequate, a constructive trust arising.²⁶ However, where a loan is obtained by fraud (for example £1 million borrowed by virtue of a fraudulent misrepresentation) because there was an intent only to create a debtor-creditor relationship, the lender cannot be better off than if the loan had been valid (for example he can only recover the £1 million and not specific property purchased with the loan which has increased in value).²⁷

²⁶ *Westdeutsche Landesbank v Islington LBC* [1996] A.C. 669 at 715; *Bishopsgate Investment Management Ltd v Maxwell* [1993] Ch. 1 at 70; *Foskett v McKeown* [2001] 1 A.C. 102 at 113 & 128.

²⁷ *Halifax B.S. v Thomas* [1995] 4 All E.R. 673.

Where B receives money, not as a loan or contractual consideration, from A or A's agent in circumstances where honesty requires B to repay the money forthwith to A, then first instance decisions indicate that an equitable interest in favour of A springs up at the time of receipt of the money and B will become constructive trustee thereof. Examples are where A's agent mistakenly pays B a second payment of £1 million, A having already paid B the money,²⁸ or where B Ltd receives money from A, to pay for services provided by C to A, at a time when B Ltd has decided to cease trading because of insolvency problems so that if such money became part of B Ltd's assets available generally for creditors the money would be lost, leaving A to find further money of its own to pay C.²⁹

Here, however, one sees the overlap with resulting trusts of the *Quistclose* variety. The former example can be regarded as one where the mistaken payer, A, paid the money for a purpose which was incapable of fulfilment because the debt had already been discharged, while the latter can be regarded as one where A paid the money to B Ltd for the purpose of an equivalent sum being paid by B Ltd to C but in circumstances where it was probably unlawful for the directors of B Ltd to pay such sum to C because that would have amounted to unlawful trading.

If H and W make mutual wills which they agree not to revoke, and H leaves his property to W for life remainder to X, and W leaves her property to H for life, remainder to X, then X has an interest under a constructive trust as soon as H dies. As beneficiary under such a trust, X can enforce it against W's personal representatives if she makes a new will purporting to leave the property to someone else: as a third party, due to the doctrine of privity of contract before the Contracts (Rights of Third Parties) Act 1999, X would not have been able to enforce the contract for his benefit.

As will be fully explained in Chapter 9, a constructive trust can also be imposed on a house registered in M's name in order to give effect to the express or inferred common intention of M and W that W is to have a beneficial interest therein, so leading W to act to her detriment in reliance on that intention, which makes it unconscionable to allow M to deny W the beneficial interest by pleading absence of the necessary statutory written formalities. Here, it may

²⁸ *Chase Manhattan Bank v Israel British Bank* [1981] Ch. 105; but its validity is uncertain due to comments of Lord Browne-Wilkinson in *Westdeutsche Landesbank v Islington LBC* [1996] A.C. 669 at 714-715 and to Lord Millett's preference for reliance, instead, on the equitable remedy of rescission subject to the usual equitable bars thereon: (1998) 114 L.Q.R. 399 at 406-407, 416-417. It was applied in *Papamichael v National Westminster Bank plc* [2003] 1 Lloyd's Rep. 341.

²⁹ *Neste Oy v Lloyds Bank* [1983] 2 Lloyd's Rep. 658 and *Re Japan Leasing (Europe) plc* [2000] W.T.L.R. 301.

be said that the constructive trust represents the remedy by which W seeks to vindicate an informal express trust founded upon a common intention which M later repudiates.

The same may be said of secret trusts where T by will devises Blackacre to S absolutely on S's oral undertaking to hold it on trust for B for life, remainder to her child, C, absolutely. After T's death S cannot take advantage of the absence of the necessary written formalities to keep Blackacre for himself: he must hold it for B and C since "Equity will not allow statute to be used as an instrument of fraud." By the Law of Property Act 1925, s.53(1) trusts of land must be evidenced in writing, but by section 53(2) this does not apply to the creation or operation of resulting or constructive trusts. The better view³⁰ is that S holds Blackacre on constructive trust under section 53(2) so that section 53(1) is inapplicable: others take the view that S holds Blackacre on express trust within section 53(1) but that the equitable maxim above quoted means that S is not allowed to plead section 53(1) in court, so that the express trust is enforceable despite section 53(1). The same result is reached under either view.

PROPRIETARY LIABILITY AND PERSONAL ACCOUNTABILITY

If a person has an equitable interest under an express, resulting or constructive trust of property, then the owner of that property (or a person claiming under the owner other than as bona fide purchaser of the owner's legal title without notice of the equitable interest) holds such property to give effect to the equitable interest under the trust, just as he would hold such property, if land, subject to equitable easements or restrictive covenants (servitudes) or equitable charges to secure payment of a sum of money.³¹ Thus, the owner has an interest in property from which are subtracted equitable interests under trusts (or charges, easements or restrictive covenants) which are proprietary liabilities, affording priority to the equitable owners over the legal owner's general creditors on his bankruptcy.

In most cases the trustee of an express, resulting or constructive trust of property will know he is such. However, in exceptional cases³² even the trustee of an express trust may not know he is such,

³⁰ *Kasperbauer v Griffith* [2000] W.T.L.R. 333 at 343, *Paragon Finance v Thakerar* [1999] 1 All E.R. 400 at 409.

³¹ *Westdeutsche Landesbank v Islington LBC* [1996] A.C. 669 at 706-707.

³² *Fletcher v Fletcher* (1844) 4 Hare 67; *Childers v Childers* (1857) 1 De. G. & J. 482; *Re Vinogradoff* [1935] W.N. 68. A testator may create testamentary trusts without the trustee's knowledge, while title to some property may be the subject of a lifetime transfer to a trustee without the latter's knowledge.

yet the beneficiaries thereunder will have an equitable interest capable of binding the trustee and his successors (other than bona fide purchasers without notice). While an outright gift from A to X is not complete until X accepts it,³³ a transfer of property from A to X on trust for C is regarded as creating a perfect completed trust for C once A has completed the unilateral action necessary for him to transfer the relevant property to X; even if X disclaims as soon as he discovers the position, equity will not allow a trust to fail for want of a trustee so that A himself will become trustee for C.³⁴

Where X knows he is trustee of an express trust, then he is under a personal liability to account to the beneficiaries for the value of the property and for what he has done or failed to do with it, which is at least co-extensive with his proprietary liability to hand the property over to, or hold it for the benefit of, C. However, Lord Browne-Wilkinson states,³⁵ "Innocent receipt of property by X subject to an existing equitable interest does not by itself make X a trustee, despite severance of the legal and equitable titles" so that, although X is subject to a proprietary liability, no personal liability can arise until X knows he is trustee. Similarly, no personal liability as a resulting or constructive trustee can arise until X knows he is such a trustee, although the personal duties of such a trustee are normally fairly light (like nominee duties) compared to those of an express trustee who, by accepting his trusteeship, thereby voluntarily accepts fairly extensive continuing duties.

In Lord Browne-Wilkinson's view a beneficiary will have an equitable proprietary interest under an express, resulting or constructive trust of property owned by X, but X will not be a trustee thereof and personally accountable as such until he knows he is a trustee. Previously, it was generally thought that X objectively was a trustee as soon as his property became subject to an express, resulting or constructive trust, although he could not be personally liable as a trustee until he knew he was a trustee. This is a semantic distinction without any practical difference.

EXTENSION OF PERSONAL ACCOUNTABILITY

As just seen, personal accountability of trustees of express, resulting or constructive trusts of property vested in them goes hand in hand with proprietary liability in relation to such property once the trustee knows he is trustee of such property. However,

³³ *Hill v Wilson* (1873) 8 Ch. App. 888 at 896.

³⁴ *Mallott v Wilson* [1903] 2 Ch. 494; *Re Rose* [1949] Ch. 78.

³⁵ *Westdeutsche Landesbank v Islington LBC* [1996] A.C. 669 at 707.

once the trustee has wrongfully parted with the trust property in circumstances where such property is not replaced with other property, in which the beneficiaries will be treated as having an equitable proprietary interest, the trustee cannot be subject to any proprietary liability. He can, however, be subject to a personal liability to account if he knew he was a trustee when he wrongfully parted with the property, but as Lord Browne-Wilkinson stated: "unless he has the requisite degree of knowledge he is not personally liable to account as trustee." In case it be thought that a person who innocently receives trust money, due to a wrong act of the trustee, and then spends it innocently on paying off his old secured or unsecured debts will escape liability and so be unjustly enriched, the beneficiaries have the equitable restitutionary remedy of being subrogated to the claims of such secured or unsecured creditors: they will then have proprietary or personal claims (as the case may be) against such innocent defendant by standing in the shoes of his creditors.³⁶ Of course, if the defendant dishonestly dealt with the trust property he received he will be personally liable to the beneficiaries.

Exceptionally, as a fiction to provide an equitable remedy to a claimant against a defendant who would otherwise escape personal liability, a defendant, who never had property vested in him of which he could be a constructive trustee, but who was a dishonest instigator of, or accessory in, a breach of trust or other fiduciary relationship in respect of particular property, can be made personally liable to account to the plaintiff as if he had been a wrongdoing trustee of such property.

For example, a father produced a forged marriage certificate to trustees so that they innocently believed his children were legitimate and so entitled to trust property which was duly distributed to them. When it transpired that the children were non-marital, those really entitled to the trust property sued the trustees, the non-marital children and the father. It was held that the father was personally liable to account (as constructive trustee) for whatever could not be recovered from the children.³⁷ No trust property had ever been in his hands: the imposition of constructive trusteeship so that he became personally accountable in the same fashion as an express trustee was merely a fictitious formula for equitable relief.

Similarly, if a solicitor, accountant or banker is suspicious that his trustee client may be committing a breach of trust in requesting

³⁶ *Boscawen v Bajwa* [1995] 4 All E.R. 769; *Wenlock v River Dee Co.* (1887) 19 Q.B.D. 155; *McCullough v Marsden* (1919) 45 D.L.R. 645, 646-647; *Banque Financiere de la Cité v Parc (Battersea) Ltd* [1998] 1 All E.R. 737, HL; *Dubai Aluminium Co Ltd v Salaam* [2002] UKHL 48; [2003] 1 All ER 97 para. 87; further see p.174.

³⁷ See *Eaves v Hickson* (1861) 30 Beav 136.

him to arrange for the transfer of trust assets to a third party, but he deliberately or recklessly fails to make such inquiries as an honest and reasonable man would make in suspicious circumstances, he will be liable for dishonest assistance in a breach of trust if the arrangement turns out to be a breach of trust.³⁸

A person like a solicitor, accountant or banker worried about this potential liability can seek directions from the court as to what to do and these directions can override any professional confidentiality.³⁹

For a dishonest facilitation of a breach of trust to be dishonest he must not only do something objectively regarded as dishonest by honest people but he must subjectively know that what he is doing would be regarded as dishonest by honest people.⁴⁰

KNOWLEDGE AND NOTICE

It is vital to appreciate the difference between “knowledge”, as requisite to establish dishonesty for personal accountability, and the doctrine of “notice”, relevant to proprietary liability. Once a defendant’s conscience is affected by knowledge that he is about to assist in a breach of trust or has received trust property in breach of trust or is about to deal with trust property in breach of trust, then he must not so assist or he must not deal with the property inconsistently with the terms of the trust: otherwise he will be acting dishonestly and so be personally accountable to the beneficiaries. It suffices that the defendant has actual knowledge or deliberately shut his eyes to the obvious (as Admiral Nelson did when putting his telescope to his blind eye, so as to ignore flag signals at the Battle of Copenhagen, hence the expression “Nelsonian knowledge”) or, in the face of suspicious circumstances, deliberately or recklessly failed to make the inquiries an honest and reasonable man would make in such suspicious circumstances (let us call this “naughty knowledge”).⁴¹

In the law of property an equitable proprietary interest will bind everyone except a bona fide purchaser of the property affected by such interest, who did not have notice of such interest when he

³⁸ *Agip (Africa) Ltd v Jackson* [1990] Ch. 265. the director of a company which is a trustee and which, with the assistance of the director, commits a breach of trust can be made personally liable for dishonest assistance: *Royal Brunei Airlines v Tan* [1995] 2 A.C. 378.

³⁹ *Finers v Miro* [1991] 1 W.L.R. 35.

⁴⁰ *Twinsectra Ltd v Yardley* [2002] UKHL 12; [2002] 2 A.C. 164 paras 20 and 32.

⁴¹ *Eagle Trust v SBC* (No. 2) [1996] 1 B.C.L.C. 121 at 152; *Hillsdown plc v Pensions Ombudsman* [1997] 1 All E.R. 862 at 902. *Assets Co Ltd v Mere Roihi* [1905] A.C. 176 at 201; *Manifest Shipping Co Ltd v Uni-Polairs Shipping Co Ltd* [2001] UKHL; [2001] 3 All E.R. 743 paras 23-26 and 112-116; *Armitage v Nurse* [1998] Ch. 241 at 251 (reckless indifference).

purchased the property. This doctrine developed in respect of purchasers of land who are expected to make various inspections of the land and various inquiries as to the documentary title so as to reveal whether any equitable interests subsist in the land. This enables them or their agents whose notice is imputed to them, to have actual notice of an equitable interest or, if they fail to make such inquiries and inspections as ought reasonably to have been made, constructive notice of an equitable interest so as to be bound by such interest. There is no scope for constructive notice in ordinary commercial dealings in property other than land, only in out-of-the-ordinary dealings where the circumstances are such that a defendant can be treated as having actual “Nelsonian” or “naughty” knowledge of a breach of trust or other fiduciary obligation.⁴²

If the defendant still has the original trust property or has its traceable product, then he must deliver it up for the benefit of the beneficiaries if he is not a bona fide purchaser of it for value without notice (actual, constructive or imputed) of the equitable interest of the beneficiaries, i.e. if he is a donee or a purchaser with notice. He is simply returning something to which he is not entitled and “the cold calculus of constructive and imputed notice”⁴³ is an appropriate artificial instrument to achieve this end. It is self-evidently just that someone who obtained property, belonging in equity to another, by way of gift or with actual or constructive notice, and who still retains such property or its traceable product should deliver it up.

OVERREACHING

To simplify the purchase of land where beneficial co-ownership or successive interests often subsist under trusts, so long as a purchaser pays purchase moneys to two trustees or an EU trust corporation (see p.163 below) it is immaterial that he has notice of any such beneficial interest. Such interests are overreached by statute,⁴⁴ so that they are detached from the land and attached to the proceeds of the sale in the hands of the trustees. Overreaching authorised by the trust instrument will occur where the trustees do what they are authorised to do, such as sell X plc shares and buy Y plc shares, so that the beneficiaries’ interest are detached from the X plc shares and attached to the Y plc shares.

⁴² *Polly Peck International plc v Nadir* [1992] 4 All E.R. 769; Lord Browne-Wilkinson in “Equity in a Fast-Changing World”, New Zealand Commonwealth Law Conference Papers, p. 177; *Macmillan v Bishopsgate Investment Trust plc* (No. 3) [1995] 1 W.L.R. 978 at 1044.

⁴³ *Re Montagu’s Settlements* [1987] Ch. 264 at 273.

⁴⁴ LPA 1925, ss.2, 27, 205(1)(xxi), *City of London BS v Flegg* [1988] A.C. 54.

It is noteworthy that the individual or corporation owning property as trustee has full power as such individual or corporation to transfer ownership (legal title) to a purchaser even if such transfer amounts to a breach of that person's obligations as a trustee. Beneficiaries would be entitled, if they learnt in time, to restrain the transfer in breach of trust. If they only discovered the breach after the transfer, the transferee, if he took with notice (and the statutory overreaching provisions for sales of land were not applicable) would be obliged to restore the property to the trust fund and so to transfer the property back to the original or replacement trustee(s) for the beneficiaries, but the transfer to the transferee by the original trustee(s) would not have been a nullity.⁴⁵ Otherwise, the transferee obtains a good title⁴⁶ and the beneficiaries' claims are only against the wrongdoing trustees.

MEASURE OF PERSONAL ACCOUNTABILITY TO BENEFICIARIES

While a defendant in a common law action such as in contract or tort is liable to pay damages, a trustee or other fiduciary liable under the equitable jurisdiction must produce accounts of his stewardship of the trust property and is liable to account for any unauthorised profits made by him or for losses flowing from his conduct. "The Court of Chancery never entertained a suit for damages occasioned by fraudulent conduct or for breach of trust. . . . It was a suit for the restitution of the money or thing, or value of the thing, of which the cheated party had been cheated."⁴⁷

The "cheated party" is really the personified trust since a beneficiary (unless a bare trust for him has arisen) is not suing just on his own behalf but to restore to the trust fund what is properly due to it. He is seeking to make the trustee account to the trust fund for money or other assets which the trustee has not received but ought to have received ("surcharging" the accounts in essence) or for money or other assets which the trustee has disposed of or dissipated when he ought not ("falsifying" the accounts in essence).

When a beneficiary falsifies the accounts because the trustee has done what he is not authorised to do, the obligation of the trustee to restore to the trust fund the assets of which he deprived it or their value is of a more absolute nature than the common law obligation

⁴⁵ *Rolled Steel Products (Holdings) Ltd v British Steel Corporation* [1986] Ch. 246 at 303; *Hammersmith & Fulham LBC v Monk* [1992] 1 A.C. 478 at 493; *Vigier v IRC* [1964] 2 All E.R. 907 at 914.

⁴⁶ An exception exists under Trusts of Land and Appointment of Trustees Act 1996, ss.8(1), 16(3).

⁴⁷ *per James and Bagallay L.JJ. in Re Collier, Ex p. Adamson* (1878) 8 Ch.D. 807 at 819.

to pay damages for tort or breach of contract. It suffices that the ultimate loss would not have occurred but for the initial unauthorised conduct of the trustee. As Lord-Browne-Wilkinson states⁴⁸:

"the basic rule is that a trustee in breach of trust must restore or pay to the trust estate either the assets which have been lost to the estate by reason of the breach or compensation for such loss. Courts of Equity did not award damages but, acting in personam, ordered the defaulting trustee to restore the trust estate: see *Nocton v Lord Ashburton* [1914] A.C. 932 at 952, 958, *per Viscount Haldane L.C.* If specific restitution of the trust property is not possible, then the liability of the trustee is to pay sufficient compensation to the trust estate to put it back to what it would have been had the breach not been committed: *Caffrey v Darby* (1801) 6 Ves. 488; *Clough v Bond* (1838) 3 My. and Cr. 490. Even if the immediate cause of the loss is the dishonesty or failure of a third party, the trustee is liable to make good that loss to the trust estate if, but for the breach, such loss would not have occurred: see *Underhill and Hayton, Law of Trusts and Trustees* (14th ed., (1987)) pp.734-736; *Re Dawson decd.*; *Union Fidelity Trustee Co Ltd v Perpetual Trustee Co Ltd* [1966] 2 N.S.W.R. 211; *Bartlett v Barclays Bank Trust Co Ltd (Nos. 1 and 2)* [1980] Ch. 515. Thus, the common law rules of remoteness of damage and causation do not apply."

Thus, if T wrongfully pays £x to Y or invests £x in unauthorised investments the expenditure and any assets purchased will be disallowed in the accounts. T will be strictly treated as having been a good man and spent his own £x, so that T is treated as retaining the £x in the trust fund and so has to restore £x. Indeed, if he had wrongfully sold an authorised investment worth £x to purchase an unauthorised investment now worth half of £x, when the authorised investment if retained would have been worth £2x, T must restore such investment or its value to the trust by selling the unauthorised investment and making up the balance of £2x (after taking account of the proceeds of sale) out of his own pocket.⁴⁹ The beneficiaries have a right to elect whether or not to falsify the accounts and so will not complain if the unauthorised investment has appreciated in value, although they can insist on it being sold and replaced with an authorised investment.

When a beneficiary surcharges the trustee's accounts for doing

⁴⁸ *Target Holdings Ltd v Redfems* [1996] A.C. 421 at 434; *Hoagkinson v Simms* (1994) 117 D.L.R. (4th) 15; *Re Duckwari plc* [1999] Ch.253 at 262-267.

⁴⁹ *Phillipson v Gatty* (1848) 6 Hare 26, 7 Hare 516; *Re Bell's Indenture* [1980] 3 All E.R. 425 at 437-439.

badly what he is authorised to do, he will make T account for what the value of the trust fund ought to have been but for the failure of T to act with due diligence. Thus, T is accountable for losses caused by his lack of skill and care but it is necessary to prove that the loss would not have happened but for his negligence or recklessness.⁵⁰ However, the losses have to be restored to the trust estate as a gross sum, not a sum net of tax that the beneficiaries would have had to pay if the breach of trust had not occurred: the beneficiaries' liabilities do not enter into the picture because they arise not at the point of restoration of value of the trust fund but only at the point of distribution of capital or income out of the trust fund.⁵¹ Otherwise, equity applies similar rules to the common law rules on causation and remoteness of damage⁵² except that Lord Browne-Wilkinson has suggested, that, to encourage high standards in trustees, losses may be assessed with the benefit of hindsight,⁵³ even if hindsight cannot be used to determine whether or not conduct amounted to a breach of trust.⁵⁴

Deterring trustees from breaking their fiduciary duty of undivided loyalty to the beneficiaries are strict rules preventing trustees from exploiting their strong position against vulnerable beneficiaries and so making them liable for profits made out of trust property or out of their position.⁵⁵ They are under a strict proprietary liability under a constructive trust of the profits made out of trust property or their position as trustee, while also under a strict personal liability to account for such profits. It is immaterial that the beneficiaries suffered no loss and that the trustee acted honestly in the interests of the beneficiaries who also benefited but would not have profited but for the trustee's conduct.⁵⁶ Equity makes every presumption against a trustee who breaches his fiduciary duties. Thus, if he improperly takes for himself property for which he is accountable to the beneficiaries he cannot escape liability merely by delivering up the property (with any income received therefrom) where the property has fallen in value. He is, instead, presumed to have sold the property at its highest value between the date of his breach of duty and the date of judgment.⁵⁷

⁵⁰ *Target Holdings Ltd v Redfems* [1996] A.C. 421.

⁵¹ *Bartlett v Barclays Bank Trust Co. Ltd* (No. 2) [1980] Ch. 515 at 543.

⁵² *Bristol & West B.S. v Mothew* [1998] Ch.1; Sir Peter Millett, "Equity's Place in the Law of Commerce" (1998) 114 L.Q.R. 214.

⁵³ in *Target Holdings v Redfems* [1996] A.C. 421 at 439.

⁵⁴ *Re Chapman* [1896] 2 Ch. 763 at 774; *Nestle v National Westminster Bank* (No. 2) [1993] 1 W.L.R. 1260.

⁵⁵ *Boardman v Phipps* [1967] 2 A.C. 46; *Att.-Gen. of Hong Kong v Reid* [1994] A.C. 324.

⁵⁶ *Warman International Ltd v Dwyer* (1995) 68 A.L.J.R. 362; *Boardman v Phipps* [1967] 2 A.C. 46.

⁵⁷ *Nant-y-glo & Blaina Ironworks Ltd v Grave* (1878) 12 Ch.D. 738.

An example of the interaction between falsifying and surcharging the trustee's accounts is provided by *Target Holdings v Redfems*,⁵⁸ as explained by Millett L.J.⁵⁹ In that case the defendant, a solicitor, held the plaintiff's money on trust for the plaintiff, but with authority to use it to enable the defendant's client to buy premises in exchange for a duly executed mortgage of the premises in favour of the plaintiff and the supporting documents of title. The defendant paid the money over to the client's order without obtaining the documents. This was an unauthorised application of trust money which entitled the plaintiff to falsify the account, so that the money would be treated as retained by the defendant and still available for the authorised application. The subsequent obtaining of the relevant documents three weeks later perfected the authorised task, so that the plaintiff could not falsify the account. There only remained the possibility of surcharging the account if the plaintiff proved that the loss caused to it by the client's mortgage fraud (resulting in the plaintiff lending one and a half million pounds on premises subsequently sold for half a million pounds) would not have happened but for the defendant's failure to obtain the relevant documents before paying over the plaintiff's money. Thus, the plaintiff could not obtain summary judgment for one million pounds but would have to prove at a full trial that its loss was caused by the defendant's failure to obtain the relevant documents before parting with the plaintiff's money.

The rate of interest payable by trustees in respect of capital that they have to replace is the rate payable by the court's special account for funds invested with the court.⁶⁰ However, a higher rate will be charged where the trustee actually received a higher rate (for example in respect of misappropriated capital) or should have received a higher rate (for example sold an authorised investment bearing 10 per cent for an unauthorised investment bearing five per cent) or the commercial rate (one per cent above the London clearing banks' base lending rate) is applicable. Such rate applies where he has made, or is presumed to have made as a result of falsifying the account, unauthorised use of trust moneys for his own purposes but the actual return from such use is unascertainable: compound interest is payable.⁶¹

⁵⁸ [1996] A.C. 421. Further see *Youyang Pty Ltd v Minter Ellison* [2003] H.C.A. 15.

⁵⁹ "Equity's Place in the Law of Commerce" (1998) 114 L.Q.R. 214 at 225-227.

⁶⁰ *Court Fund Rules* 1987, rr.26, 27.

⁶¹ *Wallersteiner v Moir* (No. 2) [1975] Q.B. 373 at 388, 397; *Westdeutsche Landesbank v Islington LBC* [1996] A.C. 669.

TRUSTEE'S PERSONAL LIABILITY TO OUTSIDERS

Trusts have no legal personality so it is the trustees who are personally liable, jointly and severally, to the full extent of their own private property for debts, contracts, torts or taxes arising in respect of their acts or omissions as trustees,⁶² unless they specifically contract that they shall not be under personal liability but shall only be liable to the extent that recourse may be had to the trust assets or unless legislation so provides, for example the Inheritance Tax Act 1984, s.204. The beneficiaries are not liable to such creditors since the trustees are not regarded as the beneficiaries' agents (though where the beneficiaries of full capacity are between themselves collectively entitled to the trust property the trustees normally have a personal right of indemnity against them⁶³ and it seems that this right may be exercised by the creditors by way of subrogation).

Where the trustees' obligations were incurred in the authorised administration of the trust they have a right of indemnity with an equitable lien against the trust assets, so reducing the assets available for the beneficiaries. This right enables a trustee to pay expenses out of the trust assets or to reimburse itself after personally paying the expenses, assuming that the state of accounts between the trustee and the beneficiaries (taking into account any losses flowing from breaches of trust) is such that there is some balance in the trustee's favour to which the right of indemnity may attach.

If the trustee does not pay up then the creditors have a claim by way of subrogation to the trustee's right of indemnity. Since the creditors stand in the shoes of the trustees their right is no better than the trustee's, so they will need to show that their debt was incurred in the authorised administration of the trust and that the state of accounts between the trustee and the beneficiaries leaves a balance for satisfying the debts.

Exceptionally, in the case of charitable or public trusts where members of the organisation or employees in improperly carrying out the charitable or public purposes commit torts the charitable or public corporation or the charitable trustees will be obliged to resort to the charitable or public funds to compensate victims of the torts.⁶⁴

⁶² *X v A* [2000] 1 All E.R. 490.

⁶³ *Balkin v Peck* (1998) 1 I.T.E.L.R. 717, (1998) 43 N.S.W.L.R. 766.

⁶⁴ *Mersey Docks & Harbour Board Trustees v Gibb* (1866) LR 1 HL 93; *Re Christian Brothers of Ireland in Canada* (2000) 184 D.L.R. (4th) 445, 3 I.T.E.L.R. 34.

BENEFICIARIES' RIGHTS AGAINST OUTSIDERS

It is the trustees who manage the trust property, and rights and duties thereby arising involve only them and not the beneficiaries, unless they have given possession of a trust asset (for example a painting or necklace) to a beneficiary who may then bring a common law action against outsiders to protect his better legal claim to possession. The trustees have full powers under s.15 of the Trustee Act 1925 to compromise claims and compound liabilities.

If the trustees have not exercised or do not properly exercise such powers then it may be that they can be replaced by new trustees who will obtain for the trust, for example, the benefit of a settlor's or borrower's covenant (a promise in a deed) or of a claim in negligence against some adviser. Instead, especially if replacement by the court will be messy and protracted then, exceptionally, the beneficiaries may bring an action as claimants against the outsider but joining the trustees as co-defendants, so that all interested parties will be present and be bound by the judgment.

If outsiders dishonestly assist trustees to commit a breach of trust then, even though trust property no longer is in their possession or never was in their possession, the outsiders will be personally liable to account for resulting losses, though this will be of little value if they are bankrupt.

If outsiders, who are not bona fide purchasers of the trust property without notice or who have not paid the purchase price of land to two trustees or a trust corporation (which has the statutory effect of detaching the beneficiaries' interests from the land and attaching them, instead, to the proceeds of the sale), have trust property or its traceable product in their possession then they hold it on constructive trust for the beneficiaries, who will thus be fully protected even if the outsiders are bankrupt. In reality, however, most persons who become insolvent realise all assets at their disposal to pay off pressing creditors, who will be bona fide purchasers without notice of the beneficiaries' interests, so often there will be no traceable trust property.

PATERNALISTIC FUNCTION OF COURT OF CHANCERY

Under Part 64 of the Civil Procedure Rules it is a straightforward matter for the trustees or beneficiaries to apply to the Chancery Division of the High Court for guidance on any aspect of the trust relationship, the costs to be paid out of trust funds. Trustees can only recover their costs if acting reasonably so, to ensure that the trustees may charge to trust funds any costs of any legal proceedings against outsiders involving them as claimants or defendants, the leave of the Chancery Court will always be sought to take part

in such proceedings.⁶⁵ The court has power under s.61 of the Trustee Act 1925 to relieve a trustee from what is or may be a breach of trust but only if he acted honestly and reasonably and ought fairly to be excused for the breach *and for omitting to obtain the directions of the court in the matter in which he committed such a breach or possible breach*. It is thus expected that the directions of the court will be sought in all matters of doubt.

SUPREMACY OF THE TRUST INSTRUMENT

The settlor in his trust instrument may modify or exclude the non-mandatory rules otherwise applicable to trusts, so, for example, allowing a trustee to profit from the trust without accounting therefore if an independent co-trustee approves, or exempting a trustee from liability for losses so long as he acted in good faith, or directing the trustee to retain a controlling shareholding in a private company (which comprises 80 per cent of the value of the trust fund) and not to diversify the trust fund, unless advised otherwise by a person specified as a "protector" or the majority of a designated committee. The settlor may give the trustees exclusive power to determine issues of fact and to determine what expenses should be charged to capital and to income, and what receipts should be allocated to capital or to income, irrespective of whether such receipts be characterised as of capital or income nature, but he cannot oust the jurisdiction of the court to determine legal issues concerning the validity and construction of the trust and the extent of rights thereunder or to characterise expenses or receipts as capital or income in nature.

Indeed, if the settlor goes too far in exempting his trustees from duties and liabilities to the beneficiaries so that the beneficiaries really have no rights to enforce, the court will characterise the trustees as trustees only for the settlor or as themselves, full legal and beneficial owners. The essence of the trust is that there are beneficiaries who can enforce their rights against the trustees, the Attorney General exercising these rights on behalf of the Crown as *parens patriae* in the case of charitable purpose trusts. Thus, non-charitable purpose trusts have often been stated to be void for lack of beneficiaries capable of enforcing them.

As Millett L.J. stated in *Armitage v Nurse*⁶⁶: "I accept that there is an irreducible core of obligations owed by the trustees to the beneficiaries and enforceable by them which is fundamental to the concept of a trust. If the beneficiaries have no rights enforceable against the trustees there are no trusts."

⁶⁵ *Re Beddoe* [1893] 1 Ch. 547; *Alsop Wilkinson v Neary* [1995] 1 All E.R. 431.

⁶⁶ [1998] Ch. 241 at 253.

Exceptionally, where there is a trust for beneficiaries and they are all of full capacity and between them absolutely entitled to the trust property, they can take advantage of their proprietary right as collective absolute owner to claim the property for themselves to do with as they wish, despite the terms of the trust instrument or the settlor's current wish that the trust continue.⁶⁷

Otherwise, the settlor's wishes prevail so that he can, in his trust instrument, make the exercise by the trustees of some of their functions subject to the consent of himself and after his death, of a protector (whether an individual or a company, for example owned by the settlor). However, if the real deal between the settlor and the trustee is that during the settlor's lifetime the income and the capital will be held to the order of the settlor despite the terms of the trust instrument, then the trust will be a sham.⁶⁸ Powers often reserved to a person normally referred to as a protector are the power to agree the trustees' remuneration, the power to remove a trustee and appoint new or additional trustees, and the power to change the law governing the validity and administration of the trust. It is even possible to structure a trust so that the trustees in managing the trust assets are responsible to a governing board responsible for an overall strategy, which the trustees have discretion to implement as they see best, although they are liable to be replaced by other trustees appointed by the board if the board loses confidence in them. Another possibility is for the trust instrument to require that the discretionary portfolio manager of the trust assets is to be the settlor (though expressly restricted from using that position to benefit himself or his spouse) with provisions to protect the trustee from liability in respect of the settlor's activities.

DYNAMIC ROLE OF EQUITY AND TRUSTS

A renowned equity judge, Sir George Jessel M.R. said of the rules of equity⁶⁹:

"It is perfectly well-known that they have been established from time to time—altered, improved, and refined from time to time ... We can name the Chancellors who first invented them and state the date when they were first introduced into Equity jurisprudence ... The doctrines are progressive, refined and improved."

He contrasted the rules of equity with the rules of the common law which were "supposed to have been established from time imme-

⁶⁷ See below pp.51, 101.

⁶⁸ *Rahman v Chase Bank (CI) Trust Co* [1991] Jersey LR 103.

⁶⁹ *Re Hallett's Estate* (1880) 13 Ch. D. 696 at 710.

morial". As his use of the word "supposed" reveals, this is a fiction to which no-one even pays lip-service nowadays, when it has become very obvious that rules of the common law can and do change and when the House of Lords' Practice Statement of 1966 makes clear that their Lordships can overrule their earlier decisions. However, the courts in their equitable jurisdiction have more scope for developing the law in a conscionable manner than they have in their common law jurisdiction. Thus, relatively recent decisions⁷⁰ on common law principles of contract and commercial law reveal the technical nature of the judicial function ignoring morality and conscience, while Chancery judges are increasingly putting less weight on technical rules and more weight on underlying principles of conscionable and unconscionable behaviour,⁷¹ taking advantage of equity's "inherent flexibility and capacity to adjust to new situations by reference to mainsprings of the equitable jurisdiction".⁷²

Barristers who specialise in equity generally practise in Lincoln's Inn and it is from their ranks that judges are normally chosen for the Chancery Division of the High Court where cases primarily concerned with equity are heard. However, all lawyers and judges need to be well aware of equitable principles and remedies which reflect in refined fashion as a source of law the notion of equity as the natural sense of discretionary justice inherent in conscience. It is crucial to be able to supplement common law normal vision with equity "spectacles" and also European Community law "spectacles". We all need to have some ability as equity lawyers.

In litigation, claimants are well supported by equitable *in personam* injunction orders⁷³ compelling disclosure of assets or of evidence, freezing of assets so preserving them till the outcome of litigation, or even compelling a defendant in the jurisdiction to bring assets or evidence outside the jurisdiction into the jurisdiction or to transfer title to an immovable outside the jurisdiction to the plaintiff demanding this as absolutely entitled beneficiary.⁷⁴ The equitable remedy of specific performance may well be appropriate

⁷⁰ *Kleinwort Benson Ltd v Malaysia Mining Corporation* [1989] 1 W.L.R. 379; *Bank of Nova Scotia v Hellenic Mutual War Risks Assoc.* [1989] 2 L.J. Rep. 238; *Banque Financiere de la Cité v Westgate Insurance Co Ltd* [1989] 2 All E.R. 952, [1990] 2 All E.R. 947; *Law Debenture Trust Corp v Ural Caspian Oil Corp.* [1995] 1 All E.R. 157.

⁷¹ *Re Montagu's S.T.* [1987] Ch. 264 at 278; *Gillett v Holt* [2001] Ch.210 at 232; *Wayling v Jones* (1993) 69 P. & C.R. 170.

⁷² *Lourho plc v Fayed (No. 2)* [1991] 4 All E.R. 961 at 969.

⁷³ *Mareva* "freezing" injunctions, *Anton Piller* "search" orders and ancillary orders.

⁷⁴ *Webb v Webb* [1994] Q.B. 696 (the father's action against his son, who owned a French house, related to the internal trustee-beneficiary in *personam* relationship, so the French court of the *lex situs* did not have exclusive jurisdiction under Art. 16 of the Brussels Convention).

or the remedy of personal liability to account as a fictitious or constructive trustee to impose secondary liability on a person involved in the primary liability of a fiduciary in breach of his fiduciary obligations. "Fiduciary" is an expanding accordion term: one can say that equity will regard a person as a fiduciary in his relationship with another when and in so far as that other is entitled to expect that he will loyally act in that other's interest (or in their joint interest to the exclusion of his own separate interest).

The archetypal fiduciary is a trustee of whom the highest standards of probity are expected: you ought to be able to trust a trustee! Indeed, notions of trust, embodied in the law relating to trustees, provide a key contribution to the commercial and social cement of society. A model of behaviour (for example in avoiding a conflict between one's fiduciary duty and one's private self-interest) is provided for fiduciaries like agents, employees, partners, company directors and some financial intermediaries, who, depending on the circumstances, will need to a greater or lesser extent to live up to the standards prescribed for trustees.

The fiduciary obligation is proscriptive, not prescriptive, and requires the fiduciary, unless otherwise authorised,⁷⁵ not to profit from his position and not to place himself in a position where there is a sensible possibility of a conflict between his self-interest and his altruistic duty or, if he is in such a position, he must prefer his duty over his self-interest. Nor must he put himself, unless authorised, into a position where his duty to one person or group of persons may sensibly conflict with his duty to another person or group of persons; while, if he is in such a position, he cannot prefer one over the other but must cease acting for both normally.⁷⁶ Breach of his fiduciary obligation of individual loyalty is strictly treated by the courts, with the fiduciary held responsible for all losses directly flowing from the breach, including losses increased by a general fall in land values or stock market values,⁷⁷ but breaches of a fiduciary's non-fiduciary obligations, like the duty to take care, are, however, treated in the ordinary way.⁷⁸

There is more scope for lawyers and judges to use equity rather than common law to move with the times. The trust has been a very powerful instrument of social experimentation. In effect, it enabled a landowner to devise his land by will until Parliament made this directly possible at law. In effect, through deed of settlement companies, it enabled entrepreneurs to form joint-stock companies

⁷⁵ *Kelly v Cooper* [1993] A.C. 205.

⁷⁶ *Bristol & West B.S. v Mothew* [1998] Ch 1.

⁷⁷ *Hodgkinson v Simms* (1994) 117 D.L.R. (4th) 151; (2003) 119 L.Q.R. 246, 267-268.

⁷⁸ *Smith New Court Securities Ltd v Scrimgeour Vickers* [1997] A.C. 254; *Bristol & West BS* (above).

within a limited liability framework⁷⁹ until Parliament made this directly possible at law. In effect, it enabled a married woman (whose property was wholly controlled by her husband at law) to have property for her own use until Parliament made this directly possible at law (so that there was then no longer one law for women with rich fathers and another for women without rich fathers). Currently, as Chapter 9 will show, constructive trusts and equitable proprietary estoppel are being utilised to provide a cohabitee (married or unmarried) with an equitable interest in a home belonging at law to the other cohabitee where to allow the legal owner full beneficial ownership would be unconscionable.

However, equity is man-made and so cannot be perfect; moreover, social and economic change requires the law to change. The procedures in the Court of Chancery were notoriously imperfect in the nineteenth century as Charles Dickens so vividly brought out in *Bleak House*. The courts, also, were too ready to find that precatory words created a trust, such officious kindness amounting to a cruel kindness indeed in some cases (for example where a widow was held not to have the capital for the benefit of herself and her children, but only to be life tenant interested in income, the capital passing to her children on her death), till the court's approach changed towards the end of that century. Equity's intervention to allow a mortgagor to redeem his mortgage (and so recover his property belonging at law to the mortgagee) even though the date for redemption had passed at law, was obviously just and conscionable, but it went too far in striking down all collateral advantages (for example, the mortgagor of an inn buying beer for an agreed period from the mortgagee) negotiated between the parties once the mortgage had been redeemed. In the twentieth century it had to adapt to commercial realities and allow the advantages to continue unless this would be unconscionable in the circumstances or in restraint of trade.

After the Second World War Lord (later Viscount) Simonds led the House of Lords to be very strict on what could rank as a valid charitable purpose trust. However, if the trust could be characterised not as a purpose trust (and so void if not charitable) but as a discretionary trust for a large class of people, it faced the problem that the test for certainty of objects of a trust was based on the formal distinction between a *trust* (imposing a mandatory duty on the trustees in favour of *beneficiaries*) and a *power* (giving trustees the option if they wished to benefit *objects* of the power). For a

⁷⁹ See F. W. Maitland, "The Unincorporate Body," *Collected Papers*, iii, 278, though nowadays the courts have become more sophisticate in preventing the exploitation of trading trusts: see my Chapter "Trading Trusts" in Glasson (ed.) *The International Trust* (Jordan Publishing, 2002).

power of appointment to be valid it simply sufficed if the trustees could say of any person who might be presented to them, that he was or was not within the class of objects of the power, but for a trust to be valid it was necessary to be able to draw up a definite comprehensive list of everyone within the class of beneficiaries of the trust. This meant that a discretionary trust for a large class of people, not amounting to a section of the public so as to make the trust charitable, would often be void because of the impossibility of drawing up a comprehensive list of each and every member of the discretionary class. Thus, many socially desirable trusts were void.

Lord Wilberforce therefore led the House of Lords by a 3:2 majority in 1970 to make the certainty test for discretionary fiduciary powers apply also to discretionary trusts, leaving fixed trusts (*i.e.* for distribution of property equally between a class of beneficiaries) alone subject to the comprehensive fixed list test. He was fortified in moving the goalposts by some very old case law and by the reality that the weak position of B, a member of a large discretionary class of *beneficiaries* of a trust or of *objects* of a fiduciary power, is actually in practice almost the same whether interested under a trust or a power.

Where the "conscience" of the Court of Equity has developed beyond a "crystallised" living conscience and, most exceptionally, become a "fossilised" conscience with no scope for regeneration, then the legislature has to intervene, as it did in 1964 in lengthy complex fashion in respect of the Rule against Remoteness (or Perpetuities) which in many cases had become a capricious snare for the unwary, though there was some need to prevent the dead ruling the living for too long through the medium of trusts. Some consider that the effect of the beneficiary principle as a rule against pure purpose trusts, unless they are charitable, needs to be changed because it prevents the implementation of desirable social, professional or commercial purposes. However, any change will need to take into account, through consultation and research, of wide-ranging policy issues and the problems of enforcement. It may be that legislation will be necessary, as for example in Bermuda, Jersey, the Isle of Man and the Cayman Islands, where legislation requires appointment of an "enforcer" before non-charitable purpose trusts can become enforceable if the English courts are to go beyond construing some apparent pure purpose trusts as in substance trusts for the benefit of beneficiaries with a right to enforce the trust.⁸⁰

On the other hand, such foreign non-charitable purpose trusts

⁸⁰ *e.g.* *Re Denley's Trust Deed* [1969] 1 Ch. 373; *Re Lipkin's W.T.* [1976] Ch. 235. On the amazingly flexible Cayman "STAR" trusts for purposes or for people or both, see D.J. Hayton (1998) 8 *Offshore T.R.* 43.

with expressly appointed enforcers have to be recognised as such under the Recognition of Trusts Act 1987 unless this would be manifestly incompatible with English public policy.⁸¹ It is hard to see the manifest incompatibility of a non-charitable purpose trust enforceable by an expressly appointed enforcer with a charitable trust enforceable by the Attorney General or the Charity commissioners or an "interested person",⁸² or with a private trust for beneficiaries enforceable by the beneficiaries or, if they are minors, unborn or otherwise unascertained, enforceable against third parties by the trustees or by replacement trustees if the original trustees had been acting in breach of trust. In each case there is an enforceable obligation as required at the core of the trust concept: just as a car needs an engine so a trust needs an enforcer, one could say.⁸³

Once an otherwise English trust is valid as a non-charitable purpose trust because, say, Jersey law has been made the governing law and an enforcer has been appointed, one wonders why such a trust should not be allowed to develop as a valid English trust if limited to a valid perpetuity period and the purposes are certain and workable: the old cases rejecting non-charitable purpose trusts can be explained as really void for perpetuity or for unworkability.

Similarly, under the trust laws of some jurisdictions the settlor retains rights to enforce the trust, although not under English domestic law, but it would seem English private international law would afford the settlor *locus standi*. Indeed, since a person holding the office of protector appears to have *locus standi* before the courts in matters affecting that office,⁸⁴ there seems no reason why the settlor should not be expressly appointed protector with the right to see trust accounts (with supporting information) and to make the trustees account for their stewardship of the trust property so long as there are any unborn or unascertained beneficiaries: adult beneficiaries must have the right to decide for themselves what they do.

The Court of Equity in dealing with trusts has a liberal facilitative approach within limits set by the formalities requirements; by the 1964 Perpetuities and Accumulations Act; by the practical need for the enforceability by someone of certain and administratively workable trusts; and by the collective property right of a group of beneficiaries, between them absolutely entitled in equity to

⁸¹ Art.18 of The Hague Trusts Convention incorporated into English law by Recognition of Trusts Act 1987. A non-assignable life interest valid in Scots, but not English, domestic law was upheld by the Court of Appeal in *Re Fitzgerald* [1904] 1 Ch. 573.

⁸² Charities Act 1993, s.33 (1).

⁸³ D J Hayton (2001) 117 L.Q.R. 97 reprinted and updated in D J Hayton (ed.) *Extending the Boundaries of Trusts and Similar Ring-Fenced Funds* (Kluwer, 2002).

⁸⁴ Pt 64 Civil Procedure Rules; *Re Hare Trust* (2001) 4 I.T.E.L.R. 288.

the property, to divide the property between themselves (or otherwise dispose of it as they unanimously agree), regardless of the settlor's wish that a trustee should administer their property for purposes benefiting them. Once a valid trust has been created the court generally allows the trustees plenty of autonomy in their distributive functions to pay or apply capital and income for the benefit of the beneficiaries. The court will not interfere with the exercise of distributive discretions unless, in essence, bad faith is proved, which is very difficult. In commercial trusts like pension fund trusts where members of the trust scheme to secure⁸⁵ their benefits have earned their interests, there is a little more scope for intervention by the court taking into account the purpose of the trust in the employer-employee contractual relationship. However, the flexibility that allows the duties of trustees to be dramatically cut down from the 100 per cent imposed by equity in the absence of contrary intention in the trust instrument, to an irreducible core of, say, 25 per cent has led to statutory intervention insisting on a greater irreducible percentage for pension trusts. Indeed, pension trustees and any discretionary portfolio managers employed by them cannot be exempted from liability for negligent investment.⁸⁶ There are also statutory restrictions⁸⁷ preventing trustees of unit trusts or debenture trusts from exempting themselves from liability for negligence. Because trust law is so facilitative, statute has to intervene from time to time to set limits in the public interest. The Law Commission, indeed, is currently considering whether professional trustees should be prohibited from exempting themselves from liability for breach of trust.⁸⁸

⁸⁵ *Wrightson Ltd v Fletcher* [2001] UKPC 23, para.28.

⁸⁶ Pensions Act 1995, s.33.

⁸⁷ Companies Act 1985, s.192, Financial Services and Markets Act 2000, s.253.

⁸⁸ Consultation Paper No.171 required responses by May 1, 2003.