Chapter 2: Property, obligations, and trusts

Equitable Title

- Equitable title exists whenever equity will require the legal owner of property to hold the property for the benefit of some other person or group of persons.
- The trust is the particular obligation under which the legal title holder is to hold the property for the benefit of the equitable title holders.

The express trust

- An express trust is a trust that is intentionally set up.
- The original legal owner is the ‘settlor’.
  - Can either create a trust by a ‘self-declaration’ where he would be the trustee or by transferring legal title to someone else.
- Where an express trust is created in writing, the document containing the terms of the trust is typically called the trust instrument.

Beneficial title

- Note that it is incorrect to think of the outright owner of a piece of property as having both the legal and equitable title. He has the title _simpliciter_ and per LBW in _Westdeutsche_, there is no equitable title at all.
- Nonetheless, he will have the beneficial interest of the property. The mistake is thinking he has both a legal and an equitable title to the property.

Exercising powers to create an express trust

- An express trust is created when a settlor effectively exercises his powers of ownership to do so.

Powers

- A power is the capacity to change or create rights, duties, and other powers.

Trusts that arise by operation of law (TABOLs)

- The law only recognises capacities to create new rights, duties, or powers where the law wishes to provide a facility to do things in particular ways.
  - The right to sue someone for damages arises by operation of law on the occurrence of your negligently caused injury because the law regards it as just that you should be able to bring an action for compensation.

Revocability
If the settlor has a power to revoke the trust or to appoint new trustees, that power must be an express or implied power in the terms of the trust itself; the power derives from the trust terms, not from the settlor’s position as the one who originally owned the property.

**Fiduciary Obligations**

- Fiduciary obligations are obligations owed to another person to act with loyalty in dealings that affect that person. Essentially, this means the fiduciary must act solely in the interests of his principal.
- Someone who owes that obligation is called a ‘fiduciary’ and the person to whom the duty is owed is generally called the ‘principal’.
- Typically, equity will regard trustees as owing beneficiaries fiduciary obligations (in addition to the explicit obligations under the terms of the trust).
- Strictly defined, a fiduciary relationship exists when one person, the fiduciary, has agreed to undertake legal powers to affect the legal position of another, the principal, and the fiduciary has a discretion in the way he will exercise those legal powers.
- Or put alternatively, a fiduciary is one who voluntarily undertakes to act as a decision-maker for someone else: the fiduciary is empowered to make decisions (legally binding decisions) for his principal’s benefit (decisions that, therefore, alter the principal’s legal position).

**The personal and proprietary nature of the trust**

**The personal duties of the trustee**

- As the trustee has the legal title to the property, he has all the legal rights and powers associated with the property.
- He must however act upon these rights and exercise those powers in accordance with his personal obligation to exercise his ownership of the property according to the trust terms.
- The trustees obligations are often subcategorised into ‘administrative’ and ‘dispositive’ duties.
  - Administrative duties govern the trustee’s power to make contracts and his power of ownership to maintain the value of the trust property (also called the ‘trust corpus’ or ‘trust fund’).
  - Dispositive duties are those that require the trustee to dispose of the trust property to the beneficiaries according to the terms of the trust.

**A trustee contracts in his own name**

- Note they are typically indemnified from loss providing they carry out the terms of the trust properly.
- Note also that while the trust relationship and agency relationship are different, nothing stops them from occurring together and while beneficiaries are not normally liable for loss, if the trustee is their agent, they can be. (see *Royal Brunie Airlines* and *Trident Holdings*).

**Bare Trusts, special trusts, and nomineeships**
- Under a bare trust, a trustee holds property for a beneficiary on no specific trust terms; the trustee’s only obligation is to transfer the property to the beneficiary or to a third party as he directs.
- A special trust is one created by a settlor with specific terms

**Bare Trust**

Typically comes about in 3 circumstances

- When interests under a special trust ‘fall into possession’ (e.g. the state of a trust for A to life then B after A dies)
- By operation of law (e.g. a CT for family homes)
- The intentionally created, i.e., express bare trust also called a nomineeship. This combines the bare trust with a contract. A nominee is a bare trustee who has contractually agreed to comply with various orders the beneficiary makes with respect to the trust property (e.g. a solicitor who holds his client’s money prior to the purchase of land)

- It is said that the nominee or bare trustee holds the trust property ‘to the order’ of the beneficiary. While this is correct note that in a simple bare trust, the only order the beneficiary can make is to convey it to himself but in a nomineeship the trustee may have contractually undertaken to carry out different sorts of orders.

**Legal and equitable title compared**

- The trustee is the owner at law, and has legal title, while the beneficiary is the owner in equity, and has equitable title
- Equity relies upon the legal owner’s powers that go with legal title in order to secure the benefit of the beneficiary’s equitable title

**The nature of the beneficiary’s right**

- The beneficiary has the personal right that the trustee comply with his duties, and as a fiduciary he must exercise all his powers over the property with the best interests of the beneficiary in mind
- The beneficiary’s right is proprietary in so far as it is a right in the trust property itself, i.e. in so far as its fate is tied up with the fate of the trust property. If the property is stolen or lost etc... the trust essentially evaporates as there is no property to which the beneficiary’s rights under a trust can attach.

**Property in a fund**

- Another important aspect of the proprietary nature of the beneficiary’s interest in the trust is that, in most cases, the interest is an interest in a trust fund. In law, a fund is a collection or set
of properties in which an owner retains the same title although the individual items of property in it change for whatever reason.

- So in a typical trust, though the particular investments that the trust holds change from time to time, the beneficiary’s title to the property of the trust does not.

Claiming equitable title against third parties: following trust property

- As the right is proprietary, beneficiaries can, where possible, follow the trust property into the hands of persons to whom trust property was wrongly transferred.
- Note that following stops if the property is sold to a bona fide purchaser for value of a legal interest in the property without notice (of the trust), whether actual, constructive, or imputed.

The bona fide purchaser

Recipients of trust property can be divided into those who have given consideration and volunteers. With regards to volunteers, (those who receive property but do not give valuable consideration for it) their knowledge of the trust is irrelevant, as they will take the property subject to the beneficiary’s interest in any case. With regards to the former, they can acquire beneficiary ownership of the property free of the trust so long as they can establish they had no notice of it.

- Note the rule only applies to purchasers of a legal interest and not just legal title.
  - E.g. a legal security interest is covered

Bona Fide Purchasers of equitable interest

The rule only covers legal interests not equitable ones and so, only applies in a contest between a legal interest holder and an equitable interest holder. In a contest between two equitable interest holders, the general rule of equity is that the interest that was create first in time prevails.

Equitable interests as trust property

- A beneficiary’s equitable interest is itself a valuable right that can be assigned. Thus a beneficiary can declare a trust of it, which is called a ‘sub-trust’. Here the trustee of the legal property holds it on trust for the beneficiary, who in turn holds his right to it under the sub-trust for the sub-beneficiary
- Further other equitable rights such as equitable rights to land can be held on trust. If this is the case, again, the bona fide purchaser rule does not operate as one cannot acquire a legal interest in equitable property. Any interest in an equitable interest must itself be equitable and thus, the first in time rule operates.

Notice in different contexts

- In essence, ‘notice’ refers to the sort of knowledge one would normally acquire about the title to goods one wants to purchase based on standard procedures of investigating title.
- While there is a standard conveyancing procedure with land, this is not the case with other chattels.
- Therefore, the practical effect of the rule in most circumstances is that the purchase is only bound if he has actual, constructive, or imputed knowledge that he is dealing with a trustee of the property who is selling the property in breach of trust.
- So in reality, think of the rule as follows: a bona fide purchaser for value of the legal title without actual, constructive, or imputed knowledge that the transaction is made in breach of trust will take free of the beneficiary’s interests

**Tracing trust property**
- Though the right to follow is obliterated with the sale to a bona fide purchaser, a beneficiary may acquire a substitute proprietary right by operation of law, the availability of which depends upon ‘tracing rules’
- Tracing will only stop when either the proceeds of an exchange is lost or destroyed, or the evidence of what substitutions were made runs out, or the property is exchanged for non-property.
- The thing to notice here is that he idea of having property in a fund, where one’s property interest remains but the actual item or items of property change, goes hand in hand with tracing, in which the property interest of the beneficiary shifts automatically from one item of property to the proceeds acquired in exchange for it.
- The beneficiary can change into the exchange products not only where the trustee exchanges trust property but also, against any third party into whose hands he can follow the property.

**Personal remedies for breach of trust against third parties**
- Even if following or tracing comes to an end, the beneficiary will still have personal rights against the original trustee, who is strictly liable for breach of trust, and must pay out of his own pocket the full value necessary to restore what was lost to the trust
- The beneficiary may also have other personal claims available (Knowing assistance, knowing receipt)

**The nature of equitable title: property and obligations**
- Recall first the nature and workings of a trust
- In light of this dependence of the trust obligation on the continuing existence of the property to which the beneficiary has equitable title, and in view of the fact that the beneficiary can maintain his equitable title in the trust property against third parties into whose hands it comes (save for equity’s darling), it seems clear that the law has essentially taken the view that the trust is, fundamentally proprietary; i.e. the obligations by which the beneficiaries are entitled to the benefit of the property ‘run’ with the property
- In consequence, the creation of a trust is fundamentally regarded not as the voluntary undertaking of an obligation, but as a transfer of the beneficial title to property, from the
settlor, who has the legal beneficial title, to the beneficiaries, who together take an equitable beneficial title.

- Indeed, ‘a trust will not fail for want of a trustee’
- Further, while the parties to the trust agreement are the settlor and the trustee, it is the beneficiaries who are entitled to enforce the agreement again underlying the point that the rights they have are rights to the very trust property.
- Do take note however that the ‘obligational’ view of a trust still pops up from time to time.

**Trusts and the fusion of law and equity**

**The context of insolvency**

- Normally all assets go to the trustee in bankruptcy. However, if the property ‘belongs to someone else’, it goes to that person and not the trustee. I.e. if there is a trust over the property, someone else has the beneficial interest. Thus in the context of insolvency, creditors often try and assert that the facts give rise to a constructive trust

**Security Interests**

- A beneficiary’s equitable title is functionally similar to a ‘security interest’ in the context of insolvency. A security interest is a right that a creditor holds in particular property of his debtor.

Note generally that the law must be judicious in accepting claims by those who would argue that their past dealings with a bankrupt give rise to a trust over some of his property in their favour, as this will effectively give the claimant a priority over other creditors that may, in the circumstances, be quite unfair.

**Testamentary gifts**

- A testamentary trust is one created under a will (in contrast to *inter vivos* trusts)
- Note that the deceased’s personal representatives (executors) are not trustees for those who would take the property under the will. They are the full legal owners of the property, although they are under stringent obligations to dispose of the property properly thus making the role trustee-like.
- Further, though prospective beneficiaries under a will or under the rules of intestate succession do not have an interest in the deceased’s estate itself, they have a right against the personal representatives to administer the estate property, and this right can be assigned or bequeathed.

**Chapter 3: Express Trusts**

Express trusts are very flexible devices for structuring the benefits that property can provide, in particular ways, that are impossible or inconvenient to do so simply by making an outright gift.
Essentially, three ways of doing so can be employed – fixed trusts, discretionary trusts, and powers of appointment.

**Fixed trusts, discretionary trusts, and powers of appointment**

**Traditional and modern examples of express trusts**

- Take note that traditional trusts tend to be more structured and have relatively less discretion whereas modern trusts are left virtually to the discretion of trustees.

**Fixed trusts**

- The beneficial interests under fixed trusts are fixed which means that the share of the trust property the beneficiary will receive is defined by the terms of the trust.

**Discretionary trusts**

- The terms of a discretionary trust give the trustee, or someone else, a dispositive discretion
- This allows for increased flexibility
- Under a discretionary trust, no individual in the class of possible beneficiaries has any individual interest (individual ‘equitable title’) in the trust property, until the trustee actually exercises their discretion in favour of the beneficiary.
- Note that trustees still have a duty to exercise the discretion
- Note that as beneficiaries only have a hope (or expectancy) of receiving the testator’s bounty, the term objects is used and the group of objects whom the trustee may selected is the ‘class of objects’

**Powers of appointment**

- A power of appointment under a trust allows the power holder to appointment (give) property free of the trust
- As it is a power to give away property, it is a power of ownership, though limited by trust terms.
- Note that power holders (where they are individuals) are often called ‘donees of the power’ or ‘donees’ for short
- Note that the people whose interests diminish when the propertied is appointed are called ‘those who take in default of appointment’, or just ‘those who take in default’
- Powers are generally restricted, essentially in the same way that discretionary trusts are limited.
  - A ‘general’ power is the power to appoint to anyone in the world, including the power holder himself
  - A ‘special’ power is a power to appoint to a restricted class of person (which can include the power holder)
  - A ‘hybrid’ or ‘intermediate’ power is a power to appoint to anyone except for a restricted class

**Fixed trusts, discretionary trusts, and powers compared**
- With both types of trust there is a duty to distribute the property
- With DT’s and powers, the power holder has a discretion

**Duties and powers vurtute officii (powers given to office holders), personal powers (powers nominatum), powers ‘in the nature of a trust’, fiduciary powers, bare and mere powers**

- Duties and powers under a trust can be given not only to trustees, but to others
- Regardless of who they are given to, it is important to note that both sort of operators of instructions under a trust may be under fiduciary obligations to the objects of the powers or duties they have.

**A. Cases where there is a duty to distribute trust property**

(i) **Duties vurtute officii**: General duties to distribute. Called ‘virtute officii’ as they are held by a person in virtue of holding his office (the office of trustee in this case) and therefore stay with the office even if the actual individual changes.

(ii) **Powers ‘in the nature of a trust’**: Powers given to individuals by name but on the true construction of the terms of the trust, the individual holder of the ‘power’ is under a duty to exercise the power. In a sense, the individual becomes a kind of ‘one-off’ trustee of her particular right under a trust. (E.g. my wife for life and then to my 3 sons in shares as my wife shall decide by her will)

**B. Cases where there is no duty to distribute trust property**

(iii) **Powers virtute officii**: Essentially covers powers given to trustees. Gives a discretion whether to appoint the property at all. Also unless otherwise specified, a trustee given a discretion has to exercise it in keeping with a fiduciary obligation to consider the best interests of the objects. Thus;

- The trustee may not release the power (trustee wants him to have it thus it wouldn’t be in the interests of objects to release it)
- Though not bound to exercise it, he must consider using it from time to time
- In exercising the power, he must consider not only the best interests of the objects of the power but the best interests of those who take in default of appointment. (as any appointment takes money away from them)

(iv) **Personal fiduciary powers**: Similar to (iii) where a particular individual is given a power. If on its true construction the trust instrument imposes a fiduciary obligation upon him in the exercise of his power, he will be like (iii) except that he would be a ‘one-off’ fiduciary power holder.

(v) **Pure personal powers**: powers of appointment given to an individual where no obligations are imposed by the trust. Thus the power holder may ignore the power or release it and should he exercise it, he may do so in any way he pleases. (e.g. all my property to my wife for life with a power to appoint up to half to her relatives and then the remainder to my 3 children upon her death in equal shares – here the testator is presumably giving the power for his wife’s benefit and it’s likely to be purely personal)
(iii) and (iv) are sometimes distinguished from (v) by referring to the former 2 as ‘fiduciary’ powers and the latter as ‘bare’ powers.

- Note however that with regards to trustees, the fiduciary obligation stems from the trustee relationship and is irrespective of the actual terms of the trust or power.

- Also, irrespective of any fiduciary obligations, Category B cases are sometimes distinguished from those in category A by being called ‘mere’ powers indicating the lack of a duty to distribute trust property.

**Administrative duties and powers**

- Just as is the case with dispositive duties and powers, there can be fixed and discretionary administrative duties, and fiduciary and personal administrative powers.
  - Trustees have a fixed duty to keep trust accounts.
  - They have a discretionary duty to invest the trust fund to earn a reasonable rate of return where the discretion as to how they invest is fiduciary.
  - They have a power to delegate some of their functions, such as investment, but not an obligation to do so. They have a power to retire from the trust, and may have a power to appointment new trustees; note that as they receive all these powers *virtute officii*, they are fiduciary powers.

- (see 61 again perhaps) Admin powers can also be given to named individuals. (and can be fiduciary or purely personal)
  - A protector

- Note: certain fine distinctions often have to be drawn. Consider a duty to accumulate with a power to distribute and a duty to distribute with a power to accumulate. Roughly, powers are options while duties must be carried out. Thus in order to exercise a power to depart from a duty, trustees must agree unanimously to do so; in the absence of agreement there is no question but that they must comply with their duties.

- Also, in interpreting different trust instruments the different circumstances of different trusts, whether they are family trusts, pension fund trusts, or commercial trusts will obviously colour the initial presumption one might apply to determining whether duties are imposed or powers conferred, and whether powers are fiduciary or personal.

**Extensive power and duty holding by non-trustees: protectors**

Read again (62)

**Interests under fixed trusts**

**Capital and income interests**

- They can be divided any way the settlor likes though there are some common way of doing things.
- They go to capital and income beneficiaries respectively. E.g. a trust to my wife for life and then my 3 kids in equal shares. My wife gets the income interest and nothing else. My kids get nothing while my wife is alive but on her death, they get the capital interests

**Successive interests**

- Successive interests are interests in the same property that take effect one after the other. (typically following the successive death of the beneficiaries) Where there are income and capital beneficiaries, there are successive interests.
- They are not restricted to time periods equivalent to the life estate and fee simple
- The final successive interest is always the capital interest

**Exhaustive and non-exhaustive trusts of income**

- Trusts with a power to accumulate are called ‘non-exhaustive’, because when the power is exercised the distribution to the beneficiaries does not exhaust the entirety of the income
- Trusts of income with no power to accumulate are called ‘non-exhaustive’

**Conditional and defeasible interests**

- Conditions may be of 2 kinds: Conditions precedent and conditions subsequent
- A condition precedent is a condition that has to occur for the gift to take effect (to A if he graduates from X university)
- A condition subsequent is a condition of defeasance. (to A but if he marries, then to B)
- Finally, a determinable interest, while similar to a gift defeasible upon a condition subsequent, is conceptually different. It is regarded as being a gift of property for a lesser period than an estate like a life interest, this lesser interest being framed by the event which the interest comes to an end. (to A while unmarried)
- Note that this subtle distinction has been much criticised for its extreme artificiality

**Vested, absolute, and contingent interests**

- A person’s interest are ‘vested’ if he is entitled to receive the benefits of the property as matters stand at present
- A person’s interests are absolute if they cannot be defeated
- A person’s interests are contingent if they are contingent upon someone else’s vested but defeasible interests. (e.g. in the condition subsequent example, B has a contingent interest which will vest if A marries)

**The principle in *Saunders v Vautier***

- The principle can be stated as follows: wherever a beneficiary with an absolute interest under a trust is *sui juris* (i.e. of full age and sound mind), he may call for the trust property that represents that interest, and the trustees are obliged to transfer the title to him. (so if all the property in the trust is transferred, it results in the complete collapse of the trust)
While it limits the settlor’s freedom of trust, there are 2 main justifications

- ‘anti-trust’ justification. It is fine to structure a gift but sane adults should be treated as capable of running their own affairs, including their rights over property
- The idea of equitable ownership. The beneficiaries are the equitable owners and in theory in full control of it via the trustee thus there is no reason they wouldn’t be able to take it out of the trust if they so desire.

- The operation of the principle varies according to the type of the trust (see 3.33 on p67 till the top of p69)

The rule against perpetuities

- The rule requires that the beneficiaries interests in the trust property must vest in interest, and vest absolutely, within a certain period from the time the trust came into effect.
- The old rule was complicated. The Perpetuities and Accumulations Act 1964 introduced the notion of ‘wait and see’ by which … ? Also, it allows for a fixed period of 80 years rather than relying on lives in being + 21 years

The enforcement and judicial control of discretionary trusts and powers of appointment

The enforcement of discretions generally

- The objects of a trust or a power have locus standi, or standing in court, to sue trustees or other duty or power holders under a trust to ensure the latter do not violate the terms of the trust by which these duties or powers are granted and defined. Duty holders may act wrongly by either nonfeasance or misfeasance
- The main difficulties lie in controlling trustees and other power holders in the exercise of their discretion. The court’s control of trustees’ discretions is complex but broadly, the 5 points below outline the position.
  1. First, the courts will construe the actual precise terms of the trust in determining the bounds on the discretion. (Most obviously, the discretion may be absolute)
  2. If the discretion is fiduciary, (held by trustee or is more general fiduciary in nature), it must be exercised in good faith. While hard to prove in practice, the courts have adopted the overarching principle that it must not be used ‘capriciously’. (For reasons which could be said to be irrational, perverse, or irrelevant to any sensible expectation of the settlor)
  3. Some general purpose for the power can be determined from the trust and usages outside the purpose will be wrongful
  4. Under the Re Hastings-Bass (1975) principle the exercise of a power may be treated as void, or the non-exercise of power by a trustee may be overturned and the court will treat it as having been exercised. (more specifically see 73; in particular on the would/might have acted differently requirement – broadly, the former for family trusts and the latter for pensions)
  5. More recently, but so far only in the context of pension trusts, courts have begun to apply a standard of Wednesbury unreasonableness.

The enforcement of dispositive discretions: discretionary trusts and powers of appointment
- Till McPhail v Doulton (1971) it was fairly simple to distinguish the way would enforce compliance with a discretionary trust and oversee the exercise of powers of appointment. With both, any misfeasance would be invalid. As for nonfeasance, with regards to the former, the courts would order a distribution and after Kemp v Kemp, it typically did so in equal shares. (this is still typically the case for discretionary trusts with a small, complete, identifiable, class of objects)

Certainty of objects

- Certainty of objects is a requirement of both trusts and powers, and means nothing more than that the terms of the trust or power have to indicate with sufficient precision who is in the class of objects
- The test of certainty applied to objects of a discretionary trust changed in McPhail

The ‘complete list’ test and the ‘is or is not’ test

- The historical test for certainty of objects for trusts was that one had to be able to draw up a complete lists of all the objects. For powers, it was the ‘is or is not’ test. In IRC v Broadway Cottages Trust (1955), the CA had to decide which test applied to a discretionary trust for a large and fluctuating class. (similar to most classes which were typically only for powers)

Arguments for (stem from principle that to be valid a trust must be the one which a court can control and execute)

- Trustees duties are ‘illusory’; no duty to distribute to any subset and beneficiaries can’t use SvV
- If trustees fail to distribute, it is impossible to infer that the trustee intended shares to be equally distributed so the court wouldn't be able to order it further, they couldn't order unequal distribution as that would be exercising a dispositive discretion which is for the trustees alone
- Ability to execute must be judged to reference to ‘what might happen’ and it is possible that all the trustees might refuse to distribute and constantly replacing trustees is not execution by the court
- The trust requires selection from all possible beneficiaries and if a complete list cannot be drawn up, the trustee is always selecting from some and thus not properly executing the trust
- The court can’t cure the uncertainty by arbitrarily replacing the list with a more specific class as that’d be against the settlor’s intention

Arguments against

- Having undertaken a trust, trustees can generally be assumed to be willing and able to carry it out
- ‘is or is not’ is sufficient to prevent malfeasance by trustees
- Nonfeasance can be rectified by the court replacing the trustees and the chance of multiple trustees refusing to act is negligible. Further, if it did happen the court could if it so wished
declare a trust in default of distribution for a modified class of whose members a list could be made

In IRC however and indeed till McPhail, the arguments for prevailed.

**McPhail v Doulton**

- Concerned a discretionary trust for a large class compromising employees and ex-employees of a large company and their dependants and relations. Their lordships decided by a 3:2 majority that the ‘is or is not’ test was appropriate for discretionary trusts as well
- Lord Wilberforce emphasised that the difference between the practical tasks facing trustees who held a mere power of appointment and those of trustees who held property on a discretionary basis was a matter of degree of the extent of the survey undertaken. (and it was possible to overstate the survey required for a discretionary trust)
- While the sentiments in the judgment make sense, Penner points out it is not merely one of degree because with mere powers, the interests of the objects of the power must be weighed against those who would take in default of appointment.
- As regards court enforcement, Lord Wilberforce thought that no conclusions could be drawn from the fact that equal division was not a possibility and that enforcement should be tailored to the particular trust of power and the practicalities of the situation borne in mind
  - “the court, if called on to execute the power, will do so in the manner best calculated to give effect to the settlor’s or testator’s intentions. It may do so by appointing new trustees, or by authorising or directing representative persons of the classes of beneficiaries to prepare a scheme of distribution, or even, should the proper basis for distribution appear, by itself directing the trustees to distribute.
- (see 79 again on examples of enforcement)

**Excessive and fraudulent exercises of powers**

- A purported exercise of a power will also be invalid if it is excessive or fraudulent
- A power of appointment is excessive when the trustees purport to use the trust funds to benefit an object of the power in a way that is not provided for by the power
  - E.g. the word ‘advancement’ is discussed in *Re Pilkinton* (1964) and essentially means advancement in life. Previously this was by an apprenticeship or a commission, or marriage for women etc...
  - Similarly in *Re Hay’s Settlement Trusts* (1981), the word ‘appoint’ has been construed as not allowing a trustee to appoint trust property on new discretionary trusts for objects within the power.
- A fraud on a power occurs when the appointment is made to a person who is properly within the class of objects, with the purpose, however, of benefiting someone who is not a proper object
Leading case is the PC decision in *Vatcher* where it is said that ‘fraud’ does not denote conscious immoral or dishonest wrongdoing, but merely that the power has been exercised with the intention to benefit someone outside the class of objects.

The test appears to be that the power holder has deliberately set out to benefit a non-object by making the appointment to a valid object, and it is irrelevant that the appointee might not have actually complied with the appointer’s wishes.

Seen in the NZ CA case of *Wong v Burt* (2005). Under a testamentary trust, the testator’s grandchildren would receive no income payments for their support if their mother were to predecease another beneficiary, which, in the event, she did. In order to fix this ‘mistake’, the trustee exercised a power of appointment which had as its object the testator’s widow, providing her with $250,000 so that she could fund a trust for the grandchildren. The NZ CA held that the appointment was a clear fraud on the power, forming part of a ‘deliberate scheme to subvert the terms of the will’

**Interests under discretionary trusts and powers of appointment**

- READ AGAIN
- Good to know for essays

**Protective trusts**

- In short, a protective trust is a device that combines a determinable life interest with a discretionary trust to protect trust assets from (essentially) going into the beneficiary’s estate in the event of bankruptcy.
- Check if we need to know in depth

**Chapter 7: Certainty**

**The three certainties**

- *Per Knight v Knight* (1840) they are
  - Certainty of intention
  - Certainty of subject matter
  - Certainty of objects
- Note that certainty of intention concerns whether a trust was intended at all whereas with the other two, we know what was intended but are concerned with its workability

**Certainty of intention: the family gift context**

- No particular formula is necessary for the creation of a trust, not even the use of the word ‘trust’. Neither is it necessary for the settlor to know that, technically, that is what he is doing. (see *Paul v Constance* (1977) + notes on it on p179)
Many trusts are testamentary gifts, so finding a trust will often depend on construing wills to infer the testator’s ‘intention’.
   - E.g. Re Foord

**Trust or power of appointment?**

- It is often unclear which of the above 2 is intended; several rules of construction may determine whether a trust or a power of appointment is intended.

1. If there is an explicit ‘gift over’ in default of appointment, there is a power of appointment as if the settlor provides for the case where the trustees do not appoint, clearly they are under no duty to do so
2. Note that the gift over must specifically arise on default of appointment and so a residuary gift will not work for this purpose.
3. If there is no gift over in default of appointment, one must determine the true intentions of the testator by construing the will or settlement as a whole.
   - If words are used that clearly indicate an intention to create over a trust with respect to some of his gifts, but not the one under consideration, it is likely a power as he knew the language required (*Re Weekes’ Settlement*)
   - The use of words which seem imperative indicates the imposition of a duty and thus a trust. E.g. ‘shall’ or ‘to be’ (... divided amongst for example); nb the use of the word ‘power’ is less indicative and both sets of words aren’t determinative.
   - Where a trust is intended but fails for a reason that would not invalidate a power, the court will not save it by treating it as such

- Settlors may create a power of appointment ‘coupled’ with an implied trust in default of appointment. (check if required and see further 181)

**Two problems, one old, one new: precatory words and sham trusts**

- ‘precatory words’ are words of prayer or requests in wills. In the past they were sufficient to create a trust. In *Lambe* (1871), the CA refused to adopt this approach and in *Mussoorie Bank* (1882), the same attitude was adopted by the HL, and the ‘doctrine’ of precatory trusts was effectively abolished. Nevertheless in the proper context words that on their face look merely precatory may establish a trust. (see *Comiskey* (1905) and p182)

- ‘Sham’ trusts in this context are equitable property transactions the written terms of which purport to divest the settlor of his interest in the trust property, but in reality do not, because he had no intention to create a trust of the kind that the written terms represent.

- E.g. in *Rahman v Chase Bank (CI) Trust Co Ltd* (1991) the settlor of the trust (an offshore trust used as an investment vehicle) is told that it is equivalent to a ‘living will’, in which he can order the trustees to deal with the property as he orders, during his life and after his death. There, regardless of the actual terms of the trust instrument, the settlor’s intention was not to create a trust by which he gave up the beneficial interest in the property, but instead to create a bare trust in which he has the full control and beneficial ownership of the property. It is therefore
claimable by his creditors, is treated as part of his assets on divorce, and falls into his estate at this death.

- A variation of this sort of cases arises in respect of the effect of a ‘letter of wishes’. Here a trust is often created by the settlor’s execution of a broad discretionary trust with wide dispositive powers. However, the settlor typically provides a letter that gives the trustee guidance on exercising his dispositive discretions, but which is not meant to be legally binding.

- In *Chen v Ling* (2000) the letter of ‘wishes’ was in such clearly imperative terms that the court had no difficulty in finding that the settlor intended the letter to bind the trustees: hence, the real trust of the assets transferred to the trustees on trust was found to be in the letter of wishes, not what the so-called ‘trust documents’ stated.

- Note also that occasionally it is difficult to tell whether someone intended to declare a trust or merely stated an intention to make a future gift. See *Jones v Lock* and the guy pressing a cheque into the baby’s hand and stuff

**Certainty of intention: the commercial context**

**Bailment and agency**

- Bailment is not a trust

**Retention of legal title**

- No trust. *Per Clough Mill v Martin*, legal title simply stays with the sellers

**Equitable Charges**

- No trust. Simply an equitable charge.

**A trust of the materials**

- If A can claim that he transferred the legal title to the materials to B ‘on trust’ for himself, so that he, A, becomes the equitable beneficial owner, he merely gets an equitable charge.

- It now appears to be orthodoxy that while legal retention of title clauses with respect to transferred chattels are effective, those that purport to ‘retain’ equitable title will be treated as charges.

**The Quistclose trust of money**

- The position is different with money as compared to chattels. In *Barclays Bank Ltd v Quistclose Investments Ltd* (1970) (recall facts), the HL held that RR held the money on trust to pay the dividend and that, upon its failure to do so, the money was held upon trust for Q.

- In the HL judgment of Lord Millett in *Twinsectra v Yardley*, he explained the trust as a case of a loan arrangement that incorporates a ‘bare trust with mandate’
Classic example is where a solicitor holds your money prior to the purchase of land and after the contract has been made. So with regards to certainty of intention, the main question will be whether the parties intended the normal loan arrangement, which create merely a debtor-creditor relationship, or a Quistclose trust loan. Loan contracts can stipulate a Quistclose trust but every trust must comply with the necessary features of a trust, and there the most significant feature is whether or not L requires, and B understands, that B must keep the loan monies separate from all his other monies. (*Maeling-McCleod*; where contract specified QT but transfer was to current account. *Twinsectra*; where contract specified QT but decided at first instance it was too vague on the facts however HL focused on contract. Penner thinks the phrase ‘acquisition of property’ is clearly too uncertain on the ‘is or is not’ test as it is not at all clear what ‘property’ encompasses) (note for this purpose, payment into B’s solicitor’s client account is sufficient as these have special rules. See *Twinsectra*)

- Note Cooper and tracing trusts (p188)
- As pointed out by Lord Millett in *Twinsectra*, if the intention to create a trust is clear, then any uncertainty in the purpose or instruction would mean that B would have no right to use the money for any purpose and thus, the vagueness, and hence uncertainty, about the purported trust as the regular ‘reflex action’ of generating a similar uncertainty as to whether a trust was genuinely intended to be part of the loan arrangement at all.
- With regards to the cases leading to Quistclose, (see second half of 189 to the end of this section again)

‘Prepayment’ trusts

- Trusts may also protect prepayment by customers even where the company or customers were unaware of it. (typically indicated by a separate fund)
- Note the extreme example in *Neste Oy* where a payment was made just after a company had gone bankrupt and the court held that it was held on trust for the payor.

Reform

- There are proposals to require registration of, broadly speaking, every individual thing in this section for them to be effective against TP’s.

**Certainty of subject matter and objects: common issues**

- The common sources of uncertainty of subject matter and objects into three categories:
  - Conceptual uncertainty
  - Evidential uncertainty
  - Whereabouts uncertainty
- Conceptual uncertainty concerns the problem of vagueness in the language used by the testator
- Evidential uncertainty may arise because, while the language used to identify the property or persons is precise enough, it seems unlikely or impossible to find the evidence that will allow the trustees to carry out a settlor’s, in particular a testator’s instructions.
Whereabouts uncertainty

- (Brown v Gould (1972)) No trust ever fails because the whereabouts of the property or the object is presently unknown.
- The problem is correctly thought of as one confronting the trustees when faced with their duty to distribute the trust property, not as a problem concerning the very existence of the trust.

Evidential uncertainty

- Evidential uncertainty of either subject matter or objects defats an outright gift, a trust for a specified individual, or a fixed trust. The reasoning being that if the settlor expresses his gift in such a way that evidence must be adduced to identify the property or the person and that evidence is not available, then the gift or trust simply cannot be executed according to its terms.

Conceptual uncertainty

- Conceptual uncertainty arises from the settlor’s use of imprecise or vague language to express his intentions.
- We can make a rough distinction between 2 types of vagueness:
  - Degree vagueness – tall, fast etc...
  - Category vagueness – furniture (would it include carpets/refrigerators?), vehicles
- In certain cases, courts are willing to determine a boundary for a vague term, but in others, they aren’t.
- Examples with certainty of subject matter
  - Palmer v Simmonds (1854); ‘bulk of my residuary estate’ – too uncertain
  - Re Golay (1965); ‘reasonable income’ – court was willing to stipulate a meaning
- Certainty of objects
  - Re Gibbard (1966), Re Barlow’s (1979); ‘my old friends’ and ‘my friends’ respectively were valid – note that in the latter the judge held it was too vague to have legal effect and stipulated criteria for its application
  - Re Gulbenkian (1970), Brown v Gould (1972); ‘old friend’ used as a paradigm example of conceptual uncertainty

Resolution of uncertainty by outside opinion

- Re Coxen (1948) stands for the proposition that an opinion clause cannot cure conceptual uncertainty, but may allow an individual to determine matters of fact as to whether the concept applies in any particular case. Thus Hayton (2001b) says that opinion clauses may cure evidential but not conceptual uncertainty.
- In Re Tuck’s Settlement Trusts (1978), the CA considered a condition on the inheritance of a baronetcy, that the wife of any heir must be of ‘Jewish blood’ and worship ‘according to the
Jewish faith’; in the case of doubt the decision of the Chief Rabbi in London was to be conclusive. Lord Russell did not consider the clause and can be ignored but Lord Denning and Eveleigh LJ had different views;

- Lord Denning seems to suggest that outside opinion can be used to resolve conceptual uncertainty. The problem with this is that while he specifically uses the phrase ‘conceptual uncertainty’, his language in the judgment suggests that we do not have 2 doctrines of uncertainty but rather a single question of: ‘is this certain?’ So the problem with relying on Denning to say that conceptual uncertainty can be cured by outside opinion is that he doesn’t seem to be pushing for that line.

- In Eveleigh LJ’s view the Chief Rabbi’s opinion is regarded not as determining the meaning of the settlor’s words by providing workable criteria for them; the Chief Rabbi’s opinion is merely evidence of the settlor’s opinion. So he doesn’t see it as the decision being delegated to the chief Rabbi but rather sees it as being that whoever the chief rabbi feels is of Jewish blood etc, the settlor would take that view as well and thus the opinion can be used in that sense. This avoids the issue of conceptual uncertainty as the specific concept of ‘jewish blood’ that the settlor meant was certain in so far as he meant exactly what the Chief Rabbi would think. (Penner feels that this amounts to letting the Chief Rabbi determine the meaning of the settlor’s words)

- Further, it seems that the ‘outside opinion’ which is to be supplied might not even have to be specified in the trust document. In *Re Tepper’s Will Trusts* (1987), gifts were subject to the condition that the recipients ‘shall remain within the Jewish faith and shall not marry outside the Jewish faith’. *Re Tuck’s* was used as a justification to allow the admissibility of evidence to elucidate the meaning of terms such as ‘the Jewish faith’.

- The best way to think of what the court does in these cases is not as them aiding the settlor in getting what he wants but rather, them trying to prevent the trust from failing where they think it’s feasible. (Per Lord Hamisham in *IRC v McMullen* (1980) – In general, courts try not to invalidate trusts if a reasonable construction can be placed on the words that will make them valid)

- When the court cannot tell what the settlor wanted beyond a trust is when an ART tends to occur but when courts come across a term they haven’t interpreted before it’s hard to decide exactly what they’ll do and individual judges vary in their willingness to find a ‘benignant’ construction. As a result, settlors are faced with uncertainty about the extent to which a court will allow the determination of a vague term.

- Ultimately though there are two options to prevent a trust failing for a vague term. Either the court resolves the vagueness or TP’s do it and in general, TP’s are probably more reliable, especially where specified.

- Take note of *Re Leek* (1969), the objects of the trust were ‘such other persons as [the trustee] may consider to have a moral claim upon’ the settlor. It does seem like conceptual uncertainty in every way nonetheless, this was apparently valid as a second party was deciding it. The problem is that trustees have a duty to perform and if they refuse to do so, the court will
execute the trust. In a typical proprietary sense they’d attempt equal distribution so this trust seems to fail on that basis. It seems to be able to survive as a McPhail (1971) trust but the case was decided before it.

- But in any case we rationalise from a traditional perspective. Remember the maxim that a trust will not fail for a want of a trustee. In this case they thought and decided no one had a moral claim which is fine. It doesn’t make it a power. It’s only if you’re required to dispose of it that the trustees are obliged to do it.

- What happens if none of the money is given to anyone? Ultimately, the property has to vest in the perpetuity period if not it goes to the default in appointment. (Probably ART in this case) (Difference b/w power and trust in this case is that in a power they don’t have to think about it and don’t have to give it but here they have to think about it but don’t have to give it)

Certainty of subject matter: particular issues

The ‘whatever is left’ trust

- It seemed clearly established in Sprange v Barnard (1789) that the ‘whatever is left’ trust is not valid. Similar negative attitudes are found in Lambe (1871) and Mussoorie Bank (1882)

- More recently however, in Ottoway v Norman (1972), the Australian (Birmingham (1936)) ‘floating’ or ‘suspended’ trust analysis was applied. The trust was for a house, its contents, and some money to the settlor’s housekeeper for life and whatever is left to his children on her death. The judge at first instance was content to assume there was a trust which was ‘in suspense’ (only for the house and its contents though) during the housekeeper’s life and attached to the property only on his death.

- It is not clear whether the floating trustee had any obligations to preserve the property. E.g. could she sell the house and spend the proceeds on herself? In Birmingham, it was said that fights ‘calculated to defeat’ the trust could not be made but that was meaningless.

- The floating analysis did not apply to the money as it would be ‘meaningless and unworkable’ unless the money was given with the obligation that it be kept separate from her own and there was none.

The identification of specific property out of a larger amount

- In the typical case, the failure generally turns on the failure of a seller of goods to choose particular goods to satisfy the buyer’s contract; once identified, but only then, may those goods serve as the subject matter of a trust if one was intended by the parties.

- In Re London Wine Co (Shippers) Ltd (1986), in a thorough review of the case law, it was decided for the same reasons that the company did not hold any of the wine on trust for the customers: it could not be said with any certainty which wines were the subject matter of a trust for any particular customer.

- In Re Goldcorp Exchange (1995), the PC reaffirmed that a right in property, whether legal or equitable, cannot exist in the air, hovering over an undifferentiated mass of property; it can only exist in relation to property which is specifically ascertained.
- Unfortunately, we have *Hunter v Moss* (1994), a CA decision. Mr Moss was the owner of 950 shares of a private company. In order to place his finance director, Mr Hunter, on the same footing as his managing director in respect of their interests in the company, he purported to declare (as the court found) a trust of 50 of those shares. He later sold the 950 shares when the company was taken over by a larger concern, keeping all the proceeds for himself. Hunter claimed a proportionate share of the proceeds of sale, i.e. the proportion that would be his in equity if the declaration of trust were valid. There was a problem however in that Moss had never done anything to segregate or identify any particular lot of 50 shares out of the whole 950 he was to hold on trust for Hunter. Though the case concerned ‘intangible property’ there seems to be no good reason to distinguish the clear rule that a trust cannot exist unless and until the property to which it relates is specifically ascertained.

  Dillon LJ drew an analogy to a will saying you don't need to specifically ascertain property there. But that analogy is irrelevant as the property is ascertained by the executor before it passes.

- The obvious problem here is that if such a trust exist we do not know where a breach has occurred. Martin (1997) suggests that the worry is insubstantial as tracing rules can be notionally employed. But this is a strange way to deal with a certainty problem, that is by assuming that in the very act of declaring a trust a person also makes himself a trustee in breach. The better view is Moss has not properly created a trust at all, and while he might have been contractually obliged to do so, it is conceptually confused to deal with his failure to make himself a trustee by treating him as a trustee in breach.

- Further, the case is argued as though Hunter is a volunteer so there seems no reason equity should bend over to accommodate him. If he provided consideration, the right response would probably not be to take Martin’s tracing approach but as Hayton suggests, impose an equitable charge on Moss’s shares in favour of Hunter to the value of the 50 shares. An alternative approach would be a CT on Moss over the whole 950 to hold them in favour 1/19 for Hunter 18/19 for himself.

- Hunter was followed in *Re Harvard Securities* (1997). See p201 and *Re Lehman Brothers* and the point about it.

**Trusts of residue**

- Testamentary gifts or trusts of the residue under a will are not uncertain as the executor ascertains the amount.

**Certainty of objects: particular issues**

**Outright gifts, fixed trusts, and Burrough v Philcox trusts**

- In these cases, the object or each individual member of a class of objects must be known with certainty, or the gift of a trust will fail. Thus the test applied here is the ‘complete list’ test.

**Powers and McPhail trusts**
Recall the test was decided to be the ‘is or is not’ test. It was then remitted to the HC to be
decided if it was still valid under that test. It then went to the CA as *Re Baden’s Deed Trusts (No
2)* (1973) The trust was for, amongst others, employees and their ‘dependants’ and ‘relatives’.
‘Dependants’ was not regarded as uncertain at all; it had been used in many other deeds and by
parliament to describe individuals financially dependent upon others for their support.
‘Relatives’ however led to a difference of opinion.
- See notes on the views of the 3 judges

**Conditions precedent defining a class**

- In *Re Barlow’s Will Trusts* appears to establish that, in the case of gifts with a condition
  precedent that defines a class, first, an ‘is or is not’ rather than a ‘complete list’ test is
  appropriate and, second, that the court will be liberal in determining criteria for vague terms.

**Administrative unworkability and capriciousness**

MUST READ AGAIN. Try and divide up into individual explanations for what administrative unworkability
could mean.

**Effects of uncertainty**

- With COI, the trust fails and it becomes an outright gift. (i.e. if I purport to give property to
  someone on trust but it fails for intention, it is an outright gift)
- With certainty of objects and subject matter, we know a trust was intended but we are not sure
  how the beneficial interest is to be held. Thus, the trustee will typically hold the property on an
  ART. (So in a testamentary trust, the subject matter of the trust will fall into residue)

**Chapter 9: Trusts and purposes**

In general, the law does not allow you to simply transfer money on trust to carry out a purpose, unless
the purpose is charitable. This is a corollary of what is known as ‘the beneficiary principle’

**The beneficiary principle and the invalidity of private purpose trusts**

- The beneficiary principle can be stated as follows: for a trust to be valid, it must be for the
  benefit of ascertainable individuals, i.e. specific beneficiaries. The principle is also framed as the
  ‘no purpose trusts’ rule.
- This is best stated in *Re Astor’s Settlement Trusts* (1952). “The typical case of a trust is one in
  which the legal owner of property is constrained by a court of equity so to deal with it as to give
  effect to the equitable right of another. These equitable rights have been hammered out in the
  process of litigation in which a claimant on equitable grounds has successfully asserted rights
  against a legal owner or other person in control of property. Prima Facie, therefore, a trustee
  would not be expected to be subject to an equitable obligation unless there was somebody who
could enforce a correlative equitable right, and the nature and extent of that obligation would be worked out in proceedings for enforcement.”

- The essence of the principle is that for a trust to exist there must be someone other than the trustee who has the real beneficial ownership of the trust property. If there is no such person, then not only is there no person to enforce obligations against the trustee, but more fundamentally, there are not rust obligations to enforce, for the legal owner owns it for his own benefit absolutely.
- Note that in cases of this kind, the settlor has clearly intended to create a trust by transferring the property so an ART arises.

**Re Denley’s Trust Deed**

- The case concerned an *inter vivos* trust of a piece of land to be used for recreation for the employees and others that the trustees may allow
- Here, Goff J appeared to narrow the ‘no purpose trusts’ rule considerably, while at the same time arguing that he was not diminishing the effect of the beneficiary principle. The gift was properly limited to a perpetuity period and it was held to be valid.
- He differentiated it from other purpose trusts on the basis that *Re Astor* is confined to purpose or object trusts which are abstract or impersonal. (where though carrying out the trust may benefit individuals, where the benefit is so indirect or intangible or which is otherwise so framed as not to give those persons any locus standing to apply to the court to enforce the trust, the trust will be invalid)
- Here he held that the class of ‘beneficiaries’ (not clear – either technical or just those who would benefit generally) was ascertainable at any given time.

- It has received obiter consideration in two cases; *Re Grant’s Will Trusts* (1979) and *Re Lipinski’s Will Trusts* (1976). Both have different rations and read it down. “They appear to be killing Re Denley with kindness”
- Also, applied in its broadest sense. i.e. humans get something barely more than an intangible interest and the beneficiaries can be identified (presumably on an ‘is or is not’ basis post McPhail), you drive a large hole through the ‘no purpose trust’ rule.
- Also, his manner in coming up with this broad wording is conceptually unsound (humans get a benefit thus they are beneficiaries. This seems questionable) Beneficiaries get an equitable (proprietary) right under a trust whereas in *Re Denley*, they get a benefit (a right to use the land for a particular purpose in this case). There’s no link between getting some sort of benefit and being a beneficiary.
- Note nonetheless that this case has not been overturned. If you face it in a problem question, limit to its facts and explain why you wouldn't broaden it. (Flawed reasoning, other cases don’t fit within the structure properly, it’d be better to get rid of it entirely)

**Anomalous valid purpose trusts (‘Pettingall’ orders)**

- The most significant exception to the ‘no purpose trusts’ rule is charitable trusts.
The other exceptions are all testamentary trusts. There are three broad categories
- Trusts for the maintenance of particular animals owned by the testator (a horse, *Pettingall v Pettingall* (1842); horses and hounds, *Re Dean* (1889))
- The construction and maintenance of graves and funeral monuments (*Mussett v Bingle* (1876); *Re Hooper* (1932))
- Private masses (*Bourne v Keane* (1919); *Re Heatherington* (1990)) (though under the equality act, probably services for all religions are allowed)
- In a sense we can see that they are typically close to charitable trusts but just lack a public benefit. So the point is that it is when you have something almost charitable that you see *Pettingall* orders
- These trusts are sometimes called ‘trusts of imperfect obligation’ because there are no beneficiaries of these trusts, and thus no obligations owed to any persons to carry out the purpose by the legatee of the gift who, as ‘trustee’ is the person to carry it out. If a testamentary gift is upheld as a purpose trust of this kind, the court will make a *Pettingall* order and the legatee must undertake to the court to carry out the purpose
- ‘interested’ parties can apply to the court if the trustee applies the money outside the purpose. These are typically those who are entitled to take any leftover money. It can either be stated explicitly in the will or as these are testamentary gifts, whoever takes the residue (again as stated or by intestate rules)
- This is akin to a bare trust with a mandate. When a trustee misapplies trust assets under a power, beneficiaries can sue for the misapplication. So *Pettingall* orders, though technically trusts, have the same enforcement technique as powers.
- So really, when people say they are ‘anomalous valid purpose trusts’, they actually function like powers.
- Importantly, *Pettingall* orders are confined to the above 3. *Re Thompson* (trust for the purpose of promoting fox-hunting) was allowed on the basis that there was a residuary legatee who as an interested party could apply to the court for enforcement. That is to misunderstand the situation and it is probably wrong.

**Powers for purposes**
- There are people who can enforce powers and who take in default so it does not generate ownerless property in equity. The courts have expressed their willingness to uphold powers to devote trust property to purposes.
- In *Re Shaw* (1957) (trust for the purpose of devising a 40-letter alphabet) Harman J accepted that a power to devote funds to the purpose would have been valid (but found that in the case it was a trust duty not a power)
- Some points on fiduciary duties but not that important. Basically there is no real positive fiduciary duty but merely a negative one not to use wrongly.

**An enforcer principle?**
One reason we can’t have private purpose trusts as there is no one to enforce them. With other trusts we assume the beneficiaries will.

An enforcer would be someone (or a class) who could enforce the trust against the trustees. The problem is that you can’t enforce the duty against the enforcer with leads to infinite regression. Further, there is nothing stopping the enforcer from choosing not to enforce the purpose, giving up the duty, and even from colluding with the trustee to divide the property. (though the last one is covered by the criminal law)

If beneficiaries don’t enforce a trust, there is no issue as it is they that will lose out.

Certain jurisdictions have intervened with legislation to allow enforcers

- Cayman islands

- It’s not like the protector which can be created by a provision with a trust and indeed, is compatible with the nature of a trust unlike enforcing private purposes.

- Hayton thinks we ought to allow the ‘purpose trust with enforcer’ mechanism on the basis that we already allow charities where the AG acts as the enforcer. Indeed there, the trustees have absolute title with the AG being able to enforce it.

- In a classical view of trusts though this doesn’t make sense as Penner for example would say they are stereotypically private trusts and must involve some party having legal title and some party having beneficial interest and if not, they aren’t trusts. Thus under this view, charitable trusts aren’t really trusts.

- Hayton’s view of trusts is more flexible. He would say that charitable trusts are trusts where the enforcer principle works. As long as the legal and equitable title rest with different groups, there’s a trust and there’s nor reason we shouldn’t import this logic to private purpose trusts.

- Gravelle’s has a 1977 article where his argument is that there should be no inherent objection to private purpose trusts. (So we see the enforce idea before it’s discussed in those terms) He says the problem is that we use the law of charities to do 2 different things. In addition to validating purpose trusts (often perpetual as well), it also provides tax benefits. He says the problem is we confuse the 2 and we assume the only type of valid charitable trusts are those that get tax benefits. He says that there is no link between the 2 and that you could have purpose trusts which are valid in general with a particular type, namely those which benefit a public purpose, getting tax benefits.

- So people like Hayton and Gravells are saying the system is not set in stone. One think Gravelle doesn’t deal with well is the issue of perpetuities in private purpose trusts. Should we put a time limit on it? Also, conceptually it doesn’t fit so the only way to do it would be legislation and the law commission is overworked and tends to focus on more important things. But places like Cayman Islands show it can happen without the system collapsing.

Valid trusts for persons limited by a purpose: *Re Sanderson’s Trust*

- In essence, these are trusts in which the subject matter is apportioned to the beneficiaries in reference to the costs of carrying out a well-defined purpose. The purpose in these trusts is not to be regarded as the replacement of the human object of the trust with a purpose; the purpose
is part of a device or formula that defines the subject matter of the trust for a particular object, an object who is fully human.

- So it is not a breach of the beneficiary principle as we know that the people in Sanderson trusts get a beneficial property right in some of the property held by the trustee.
- The old case law focused on determining whether the testator intended that the hold of the trust property should go to the beneficiary, the purpose merely indicating the motive of the gift, or whether he was creating a fund out of which money might be distributed out of meeting the purpose. If the former was the case, the whole it was an outright gift but not a Sanderson trust.
- The problem is what happens when the purpose is achieved in the latter case. Essentially, any property left when the purpose is accomplished will result either to the settlor or, in the case of a will, to the testator’s residuary legatees, unless a specific gift over of the remainder is made.
- The problem of inferring intention is particularly acute in cases where money is raised on ‘appeal’.
- In Re Osoba (1978) a more general solution was suggested. Namely, that the focus should be on the persons intended to benefit not the settlor. Essentially if the people are dead, the remaining money would be held on a RT for the settlor. If they are still able to benefit (alive), it would be an absolute gift with a direction about how it is to be spent with the direction being merely indicative and not restrictive.
- Don’t even try and find an intellectual basis for this, it just happens in practice.
- You could argue asober was badly reasoned as all he did was look at what was done. That’s not right cause as a judge when u looks at previous cases, you look for the ratio. The judge did what kind of a practitioner’s text would do.
- In theory it’s all about interpretation. How do we interpret the relevant trust? Was it intended solely as an absolute gift or a gift for the people only to achieve the purpose?

**The bare trust with mandate and Quistclose trusts**

- Recall how a bare trust with mandate works

**The mandate imposes a personal obligation (by way of contract)**

- So if B distributes the trust property in breach of the mandate (misfeasance), he commits a breach of trust but not because the mandate is a term of the trust but because he breaches the only trust term namely, to hold to property to A’s order or mandate.
- In the case of nonfeasance, he did not breach the trust but might have breached the contract and thus can be liable in contract law if L suffers a loss.
- Note also that L can’t assert SvV rights to get the property back. While trust law would allow it, it’d be a breach of the contract and B could sue.

- Note this is most important in insolvency. Indeed the whole point is to protect L from B’s insolvency.
Further, if B misapplies cash, there are normally only contractual remedies available. With a trust, L as a beneficiary can trace the money if misapplied.

Also, if a TP assists in the breach, they can be liable as well which is useful if B is insolvent.

The extent of the mandated purpose for the trust money

- In general, there is only one appropriate point at which to decide whether a trust has been properly carried out according to its terms: when the trustee applies the money by dealing with it with a third party.
- If applied to its terms as clearly set out, one would imagine the trust comes to and end. Courts however have confused the ultimate goal of the trust with a proper application of the property according to trust terms.
- See Re EVTR (1987) (L gives money to B to acquire machinery. B pays TP 60k, goes bust, gets a 45k refund. Held that TP is bound by the quistclose which really should have ended already, R v CPEB, ex p Maeling McLeod (2000) (L gives B money to pay into court as security against losing a case. B does and trust should end. After the case TP, the courts, acquires it for a different purpose. Held bound by quistclose) – both supposedly are based on a quistclose analysis but involve cases where the trust should have seemingly come to an end but nonetheless, the courts held it continued.
- The purpose of the loan that defines the extent of the trust cannot be made to encompass all the intended consequences that are expected to flow from the proper application of the loan money. On the CA’s broad reading, the quistclose trust would be useless (264)

Alternative interpretations of the Quistclose trust

There are essentially 4 theories

1. Lord Wilberforce in Quistclose (primary private purpose trust which results in a RT on the failure of the purpose) – Rejected in Twinsectra. You can’t have a private purpose trust amongst other points.
2. Chambers view (1997) L acquires an equitable right to require that B spend the money only on specific purposes, a right that equity will enforce by injunction. Where it becomes impossible to carry out that purpose of the loan, a RT arises due to the absence of intention of L that B was to take the beneficial interest, and at this point, B holds the funds on trust for L for the first time in this course of events. (Note: not recommended to discuss in a problem question. Only worthwhile in an essay)
3. Millett (1985 – Peter Millett QC writing an academic article); bare trust with mandate
4. Millett (2002 – Lord Millett in Twinsectra in a dissenting opinion but nonetheless, the other members of the HL do seem to agree with him. Lord Hoffman in the majority seemed to agree in principle but his analysis was brief)

View 4 requires elaboration
The main difference from his old view is that here, he states it as a resulting trust that arises from an operation of law whereas he previously stated it was a trust based on the intention of the parties. The way it was argued in Twinsectra, it had to be a resulting trust as there wasn’t an intention to create an express trust.

- So it got funnelled into having to be a RT based on an absence of intention to transfer the beneficial interest akin to chambers model.
- There are however Quistclose trusts created expressly and it is not clear how this analysis covers them. Millet says “I do not think subtle distinctions should be made between ‘true’ Quistclose trusts and trusts which are merely analogous to them.”

- The real difficulty is how we work out if there’s a Quistclose trust in a normal loan relationship and this is where which analysis we adopt becomes very important (express vs absence of intention) If we require an express intention from the parties, L must show the express intention. On the other analysis, L merely needs to show the absence of intention to transfer beneficial interest to B.

- In most cases in practice it won’t matter. How would you identify lack of intention?

  o Restriction on what they can do (will be there anyway typically)
  o Must put in separate account (also there with intention to create express)

- So it shifts the onus on where you’re looking. Changes the trust duty. But given that it’s a Quistclose trust, most express trust duties don’t apply anyway.

- In theory u have to say it’s a RT if you can’t tell. The evidence for them is probably similar.
- You can show you’re aware there’s a distinction.

Bit of technique advice. In prob q’s of qclose, you may think a quistclose trust doesn’t arise on the facts. (e.g. q5 penner). In an exam you can say working out whether a q trust is established is the hardest issue on these facts there seems to be none (no intention to create or absence of intention)

But go onto however… and they apply the rest of the quistclose logic. You should probably read millett (1985). Book called the quistclose trust available in the library.

**Gifts to unincorporated associations**

- An unincorporated association is a collective body of individuals which does not have its own legal personality.

- In Conservative and Unionist Central Office (1982), Lawson LJ stated four criteria for the existence of an unincorporated association. Essentially focusing on the existence of mutual undertakings giving rise to mutual duties and obligations (essentially the idea that they are bound by a contract *inter se* (amongst themselves)) and that any individual enters the contract *inter se* voluntarily.

- The purpose trust rule applies here the same way however things are a bit more confused as he may just be giving the property to the association absolutely in the hope he spend it as he wishes.

- The leading case on the application of the beneficiary principle to gifts to unincorporated associations (UA’s) is the PC decision in *Leahy v A-G for New South Wales* (1959). See notes
The contract-holding theory

- This is the dominant theory concerning gifts given to UA’s
- It is essentially a bare trust with mandate. The treasurer-trustees of the UA hold the UA’s funds on bare trust for the members of the UA, to deal with the funds according to the mandates, or standing orders, with arise from time to time under rules of the association created by the contract of the members inter se.
- By making a gift to an association or its members as members of the association, he indicates that it is to go to the treasurer-trustee of the association to hold the property under the same trusts as he holds all the other property of the association; thus the settlor simply defines the trust he imposes by reference to a trust that already exists. The fact that the trust is a bare trust with (contractual) mandate and so, the uses to which the property is put may be varied by the mandate, does not mean his intention to transfer the property on trust is uncertain. Because the trust is bare, it has perfectly certain terms namely, to hold it to the mandate.
- note that this does not mean that a gift to a UA, properly construed, may not be on trust to carry out a purpose and therefore invalid. Indeed, Re Lipinski’s Will Trusts (1976) seemed to be such a case but Oliver J found the gift valid for various reasons, one of which was that the purpose seemed to be to benefit the association and thus the beneficiaries and was ‘inward-looking’ in a sense.

- Difficulty if member purports to deal with their shares in their well. Accepted interpretation is that contract limits power to dispose of it. Or, they’re only members as long as they’re alive. If so, you lose your property (implied in contract holding theory). If you lose it as the moment you die, the moment the will takes effect, in some fictitious ‘immediately before’ moment, you’ve already lost your property.

Inward versus outward-looking purposes

- see above. That this is a requirement is doubtful. Per Re Bucks (no 2) (1979) as long as the ‘purpose’ framing the gift is one which the members themselves pursue by spending their own money under the rules of their association, the gift is to their ‘inward-looking’ benefit (even if it benefits non-members), and the court can construe such a gift as an accretion to the association’s fund.
- While requiring a gift framed as a purpose trust to be ‘inward-looking’ before finding it valid is thus necessary in the case of a UA, it may well be necessary if the class of beneficiaries are not members of such an association. If not a Re Astor trust could be made by naming a class of some vague beneficiaries ascertainable on the is or is not test but who could never get together to vary or end the trust under SvV.
Note that it must be the case that gifts expressed as trusts for outward-looking purposes may be valid if made to UA’s for the reason that the class of membership, being a class of ascertainable beneficiaries by its very nature, is capable of getting together and deciding whether to carry out the purpose or not. This prevents the possibility that a Re Astor abstract and impersonal trust will every actually gain an independent life.

**The dissolution of unincorporated associations**

- Per the contract holding theory, it is clear that the property is at all times beneficially owned by the members of the UA so there is no change upon dissolution. The charter might specify what happens in such a case. If it is silent, you just have a group of co-owners in equity who can then exercise their rights over property as co-owners.
- If one member, they get it absolutely as no contract. (*hanchett-Stanford*)

- See 275 onwards again. Take note of the old theory. ART and stuff. Note that it only made sense in practice and has nothing to do with intention so is conceptually flawed. Note the ways to treat such money per the other case.

**Less than unincorporated associations: the case of political parties**

See if necessary

**The rule against perpetuities**

See if necessary

**Chapter 10: The trust up and running**

- **The duty of investment**
- **The Trustee Act 2000**
- **The standard of prudence in making trust investments**
- ‘Social’ or ‘ethical’ investing
- **The delegation of trustee functions**
- **The power of maintenance**
- **The power of advancement**
- Appointment, retirement, and removal of trustees
Chapter 11: Breach of Trust

The array of claims that can arise when a breach of trust occurs

- Trustee’s personal liability for breach of trust
  - Surcharge
  - Falsify
- TP’s personal liability in assisting a breach (i.e. dishonest assistance)
- Proprietary claims against the trustee and TP’s who receive the property
  - Adopting transactions, tracing etc..., knowing receipt

Wrongs equivalent to breaches of trust and equity’s ‘concurrent’ jurisdiction

- Breaches of fiduciary duty are often equated with breaches of trust and thus we see many cases involving defaulting fiduciaries that elaborate the principles of liability for breach of trust
- Equity’s ‘concurrent’ jurisdiction refers to the provision of equitable remedies for wrongs breached with are not equitable wrongs (i.e. the wrong did not breach a relationship that equity developed and took care of – trustee/fiduciary). The most important example being the case of frauds. Thus some decisions that elaborate the rules of tracing are made in cases where there was only a fraud.

The difference between breach of trust and breach of fiduciary obligations

- Essentially, a breach of a fiduciary obligation turns a rightful act into a wrongful one because of the existence of a conflict of interest. Therefore, there is no point in referring to any fiduciary obligation if the act was a wrongful one in any event, e.g. where a trustee breaches the trust in any manner as he is strictly liable. There is no need and no room for treating breaches of trust as breaches of fiduciary obligation where the breach is a breach of trust simpliciter

The trustee’s liability to account: personal claims against the trustee

- The trustee’s liability to account flows from the very nature of the trust relationship. The principal task of the trustee is to keep the trust property separate from his own and dispose of it according to the terms of the trust. In carrying out this task, he must keep track of what he does with the trust property. This is called ‘keeping the trust accounts.’

- If it appears that there has been a breach of trust, the beneficiary is entitled to ‘falsify’ or ‘surcharge’ the account.
- Per Millett LJ writing extrajudicially,
  - A beneficiary is entitled to surcharge “if the beneficiary is dissatisfied with the way in which the trustee has carried out his trust – if, for example, he considers that the trustee has negligently failed to obtain all that he should have done for the benefit of the trust estate... The trustee is made to account, not only for what he has in fact received, but what he might with due diligence have received.’
  - Where a beneficiary falsifies the account, it means that a misapplication of the trust property has taken place. “The unauthorised investment will then be treated as having been bought with the trustee’s own money and on his own behalf. He will be required to account to the trust estate for the full amount of this disbursement” (and not just for the amount of loss)
- So then if the account is falsified, the trustee must ‘restore’ the trust which requires that if possible, he needs to restore it ‘in specie’: i.e. he must return the very property misapplied, or the same kind of property, to the trust. (With shares for instance, an equivalent amount will be regarded as in specie). Where a trustee cannot restore the trust in specie, he must restore the trust in money, to the value of the misapplied trust property.
- Note: a beneficiary is not obliged to falsify and can ‘affirm or adopt’ the transaction. (Per Millet “That is not wholly accurate. The beneficiary has a right to elect, but it is really a right to decide whether to complain or not”)
- Each beneficiary is entitled to elect individually whether to falsify the account or adopt the unauthorised transaction in respect of the loss or gain to his own investment
- Note however that beneficiaries do not have an individual right to allow property to stay in a state of breach. So when a breach comes to light, unless the beneficiaries are all sui juris and consent to the unauthorised investment, the trustee must ‘realise’ it. i.e. dispose of it and apply the money to an authorised investment

**The personal liability of the trustee when the account is surcharged or falsified**

- Important to realise that the liability is personal and that in no case does surcharging or falsifying give rise to any proprietary liability against anyone.

**Equitable compensation**

- In cases of surcharging or falsifying the account, it was traditionally said that a trustee’s personal liability was his ‘liability to account’
- However, he doesn’t always account directly to the trust. In cases where a trustee pays his beneficiaries directly to make up for his default, he has been said to make ‘equitable compensation’ to the beneficiaries. The idea is that the beneficiaries are compensated directly for the loss of their interest under the trust. Similarly, in certain cases a fiduciary who has breached his fiduciary obligations will be liable directly to his principal for causing him loss.
- Nevertheless, whether a trustee or fiduciary must pay his beneficiary or principal directly, or a trustee is personally liable to restore a trust fund, in all cases we are looking at equity’s
imposition of a personal liability to compensate for a loss. Therefore, all cases where equity imposes such a liability may be referred to as cases of ‘equitable compensation’.

The measure of liability in cases where the account is surcharged

- Per Millet LJ in *Bristol and West Building*, “equitable compensation for breach of the duty of skill and care resembles common law damages in that it is awarded by way of compensation to the plaintiff for his loss. There is no reason in principle why the common law rules of causation, remoteness of damage and measure of damages should not be applied by analogy in such a case.”
- Thus when an investment loss is caused by a trustee’s negligence, the problem is to determine what the trust property would have been worth ‘but for’ the negligence. In *Nestle*, the beneficiary failed to prove a loss however had she done so it was said *obiter* that they’d have to pay ‘fair compensation’ i.e. the amount that would have been made if a proper investment policy had been followed and not just the bare minimum.

The measure of liability in cases where the account is falsified

- In principle it is straightforward. I.e. either *in specie* or the money value representing the value of the property misapplied plus interest. However, the issue is complicated where the breach takes place a while before it is discovered. Note that the rules of causation here are different. Indeed, here the trustee appears to be liable for all risks that attend the ownership of the property involved in the unauthorised transaction. (e.g. if a trustee misapplies a trust painting from a collection and sells it in breach but the next day all the other paintings are stolen anyway, when the painting is discovered, on ‘but for’ principles the beneficiaries would still have lost the sold painting. However if falsified, the painting is essentially treated as being the trustee’s from the moment of breach and he is still liable)
- Note that it is important to remember that these (causation )principles relate specifically to the risks and subsequent events concerning what happens to property and its value for the purpose of determining its ‘replacement cost’ (and hence are not relevant to surcharging which do not involve the misapplication of trust property and the risks that go with it)

- **Measure of Compensation**
- Old cases were inconsistent (e.g. with misapplications for the purposes of unauthorised investments, some said that the trustee had to return with the most favourable interest and others said otherwise)
- Today, it is most likely the courts would try and follow the approach stated by Dillon LJ in *Nestle*; the courts should try fairly to assess what the trustees might reasonably have earned by properly investing.

- **Remoteness**
- In *Target Holdings v Redferns* (1996), LBW stated that at both common law and equity the principles of compensation for loss are fundamentally the same – a plaintiff may only recover
for a loss caused by a defendant’s wrongful act, and the compensation is calculated to put the plaintiff in the position he would have been but for the defendant’s wrong.

- With regards to remoteness, he said the rules were slightly different in equity, allowing claims even if the immediate cause of the loss “is the dishonesty or failure of a TP” as long as the loss would not have occurred but for the breach, the trustee is liable. However he says that ‘but for’ causation still has to be established. On this principle, target would have suffered the loss regardless of the breach and thus rederfs did not have to compensate for it. (though they were potentially liable for fraud)

- This decision can be criticised; the court seems to have misunderstood the nature of restoration. Millet LJ writing extrajudicially says that there was no loss not because the rules of causation indicated there was none, but because the misapplication was fully corrected when the trust was properly restored according to its terms. He says the plaintiff was entitled to falsify when Redferns first paid away the money in breach but “the trustee’s obligation to restore the trust property is not an obligation o restore it in the very form in which he disbursed it, but in an obligation it in any form authorised by the trust” (and thus gaining the mortage, despite the breach, sufficed for restoration).

- Given these criticisms, the remarks on remoteness in Target should be viewed with caution.

Setting an unauthorised gain against an unauthorised loss

- Beneficiaries are generally entitled to treat each individual breach differently (thus not allowing a trustee to set off an unauthorised gain against an unauthorised loss). However, where the losing and gaining unauthorised transactions form part of one composite transaction, the transactions must be falsified together or not at all.

- E.g. in Bartlett, the court held that the disastrous investment in one property development was part of a larger investment policy favouring land development. (note it was not a falsification case as such but the principles are relevant)

A personal claim where the account is not falsified

- This is essentially ‘adopting’ a transaction but in the case where the transaction(s) involves money. If the trustee uses trust money in his own business, it will usually be impossible to trace the money into any particular property which the beneficiaries could adopt as trust assets. Rather, the beneficiaries can elect whether or not to adopt the ‘trustee’s loan’ of the trust funds. If they do so, they have a further choice of either electing for an accounting of the trustee’s business profits which are attributable to the use of the beneficiarie’s money, or for compound interest on the ‘loan’. (of course if the authorised transaction that the trustee was supposed to have made would be more profitable than these 2 options, they would merely falsify the account)

Confusions between cases of negligence, misapplication of trust property, and breach of fiduciary obligation

- See 333-334 for examples. Be wary of this
Liability of trustees *inter se* (amongst themselves)

- Typically trustees are only liable for their own breaches of trust. However, a trustee would be liable for breaches of their co-trustees to the extent that they were negligent or fell below the standard of prudence in monitoring their co-trustee’s behaviour. (equity does not recognised a ‘sleeping’ or ‘passive’ trustee)

- Where two or more trustees are each liable for a breach of trust, they are jointly and severally liable. However, there are certain circumstances where one may demand that his co-trustee indemnifies him:
  - Where one trustee has got the money into his own hands, and made use of it
  - Where a co-trustee is a solicitor, but only if the solicitor-trustee exercised a controlling influence over the conduct of a trust
  - Where a breaching co-trustee is also a beneficiary, special rules apply

Beneficiaries’ consent to a breach of trust

- An adult beneficiary who freely consents to, or participates in, a breach of trust, may not sue the trustee to make good any loss caused by that breach.

- To truly consent, a beneficiary must be fully aware of the facts, although not necessarily of his legal rights (*Re Pauling’s Settlement Trusts* (1961)) and this principle was applied in *Holder v Holder* (1968) (C did not know he had a legal right to block or set aside the sale till after completion but he knew all the facts at the time)

- Also, the court has an inherent power to ‘impound’ the beneficial interest of a beneficiary who has requested, instigated, or consented to a breach of trust. ‘Impoundment’ means that beneficiary’s interest will be applied to compensate for the loss incurred by the breach. So not only does it prevent him from suing for the breach, in effect, it indemnifies the trustee to the extent that the beneficiary’s interest can cover the loss.

- Case law indicated that with mere consent, the interest may only be impounded if the beneficiary himself benefited however s62 of the Trustee Act 1925 now allows the court to impound the interest with mere consent if they so wish provided the consent was made in writing.

- Where a beneficiary is a trustee, two rules come into operation
  - If a beneficiary and co-trustee are liable for a breach, *from which only the beneficiary has benefited*, the beneficiary-trustee’s interest is impounded to the its extent and the co-trustee only has to contribute if it is insufficient to cover the loss
  - Further, whether the interest is impounded or not, the beneficiary-trustee is not entitled to receive any part of the beneficial interest until his breach (as trustee) is remedied. (even if his benefit has been assigned to another before the breach. Thus it is dangerous to get an assignment from a beneficiary who is also a trustee)

Trustees’ relief from liability under Trustee Act 1925, s 61, trustee exemption clauses, and ouster of trustee duties
READ AGAIN

**De Factor trusteeship or trusteeship de son tort**

- Where an individual who is not a trustee ‘intermeddles’ with the trust affairs, although innocently, he may become liable as a trustee for any misapplication of the trust property or other loss caused to the trust. It typically arises where a trustee is not effectively appointed and believes otherwise or an agent of the trust who takes it upon himself to exercise trustee functions over the property beyond the scope of his agency.

**Liability for procuring or assisting in a breach of trust**

**Liability for procuring a breach of trust**

- The court weighs up competing principles (e.g. trustee should not be liable for loss or theft due to no fault of his own and that trustee is strictly liable generally) In the leading case *Eaves* (1861), the beneficiaries had to repay what they received with interest first, followed by the individual who procured the breach, and finally, only to the extent there was any deficiency, the trustee would be liable.

**Liability for assisting a breach of trust**

- This can be termed ‘dishonest assistance’, ‘knowing assistance’ or being an ‘accessory’ to the breach.
- The leading case is the PC case of *Royal Brunei Airlines Sdn Bhd v Tan* (1995) and the PC decided that the accessory’s liability should turn on his own dishonest participation in the breach, whether the trustee committing the breach did so dishonestly or not.
- Lord Nicholls here held that the standard of dishonesty was objective. It seems to cover cases where a honest person would know the act was wrong, where he wilfully did not investigate because he had a suspicion something was amiss, or even potentiall acting in reckless disregard of others’ rights or possible rights. (note: In *BCCI v Akindele*, a Nigerian businessman was not found dishonest simply because the agreement was in some respects unusual or artificial and that he benefited from an extremely high rate of interest on the transaction.)
- The *Royal Brunei* standard was then interpreted by the HL in *Twinsectra* (2002) to be a combined objective/subjective test similar to *Ghosh*. Indeed, Lord Hutton giving the leading speech talks about how a finding of ‘dishonesty’ is quite severe and thus the standard should be high.
- In a strong dissent, Millett argued that ‘dishonest’ was just a label and that it’s civil liability and should be treated differently saying that the objective standard was correct. (Indeed a point not made in *Twinsectra* is that if the objective/subjective standard remained the law, you’d effectively be having a civil court adjudicating upon a matter which would likely be relevant to the criminal law as that overly high standard of dishonesty meant the act would likely be a fraud at the very least.) Since then, there’s been a PC case, and a Chancery case.
The combined objective/subjective standard of dishonesty was ‘reinterpreted by the PC in *Barlow Clowes v Eurotrust International* (2005) to mean the objective test.

CA case *Abou-Rahmah v Abacha* (2006) which says that *Barlow Clowes* should be treated as an authoritative, and therefore binding interpretation of *Twinsectra*. (However here, only 1 of the 3 judges was clear on the point and it was agreed by counsel on both sides so it’s of low precedential value)

Chancery case *Statek Corp v Alford* (2008). Judge stated that the law is authoritatively found in the 2 PC decisions, *Royal Brunei* and *Barlow Clowes*. (*Twinsectra* not even mentioned)

So in an exam, while you have to at least acknowledge *Twinsectra*, it gives you a chance to say which test you think is better and why, and which view you think is stronger. (Millet + everyone else vs HL majority in *Twinsectra*)

- TP’s or agents to the trust are not liable as accessories when they merely negligently fail to discover they are assisting (rather than dishonestly). However, it seems they need not know of the exact transaction. PC in *Barlow* “someone can know, and can certainly suspect, that he is assisting in a misappropriation of money without knowing that the money is held on trust or even what a trust means.’ (note decision in *Agip* before this)

Though in CA decision in *Lipkin*, CA decided the bank could not be liable unless it was in breach of its contract to its client to operate and monitor the account properly as otherwise it’d impose an excessive burden on bankers to monitor all of their accounts to pick up suspicious withdrawals.

### Proprietary remedies for the misapplication of trust property

- A rogue trustee usually commits two distinct wrongs (note it is quite possible for him to commit just one):
  - [1] He misapplies the trust property
  - [2] He treats the proceeds of that misapplication as his own
- Where the trustee merely misapplies trust property, for example by hanging a trust painting in his office, the beneficiaries can obtain a court order for the trustee to carry out his duty properly; this is a proprietary claim (as they are asserting that it belongs to them)
- Beneficiaries do not claim equitable ownership of the misapplied property, but specific performance of the trust
  - They sue to make him carry out his trust duties properly
  - In such a case, there is no question about falsifying the account or adopting a misapplication, since misapplication in this sense applies when the trustee transfers title in breach

### Third party recipients of trust property

- In misapplication of trust property, a third party will receive such property
- The beneficiary has a right to claim property back from a subsequent recipient because he retains equitable title, unless the TP is a BFP without notice
- The beneficiary may (1) follow the trust property to TP, or (2) trace his equitable interest into the proceeds.
- The beneficiary may have a personal claim against recipients
A personal claim can only be made if the recipient has destroyed the trust property and no proprietary claim can be made.
- It is only of value if the recipient is solvent.
- A beneficiary may have three claims in respect of misapplication of trust property against a recipient:
  - (1) Proprietary claim for the actual trust property
  - (2) Personal claim to restore the trust
  - (3) Personal claim for his being an accessory to the breach
- There is a different basis of liability for knowing receipt and knowing assistance:
  - Knowing assistance – secondary liability where defendant is liable for participating in another’s breach
    - He himself cannot breach the trust (only the trustee can)
    - This can be a very extensive liability (as he can be liable for much more than he receives)
  - Knowing receipt – defendant himself breaches a custodian trustee relationship imposed by law
- Tracing has two purposes:
  - [1] Allows beneficiary to establish a proprietary claim in defendants’ hands
  - [2] Allows beneficiary to say that his property was received by the defendant to establish his personal liability

**Tracing**

- Most difficulty arises when the misapplied property is money
- Bank accounts are typically mixtures.
- E.g. trustee gives A £500 of trust property to add to his own £1000. There are two analyses:
  - [1] Series of individual debts – the bank owes the recipient at least two debts; the £500, and however many other debts make up the £1000
  - [2] Monolith – A exchanges his debt for £1000 with a more valuable debt for £1500
- In both cases, if it has no notice, the bank is a BFP for value
- The beneficiary must trace into the proceeds that the trustee acquires i.e. the new debt owed by the bank

**‘First in, first out’ rule**

- ‘Series of individual debts’ analysis is the CL view
- When a customer withdraws money, he extinguishes one or more debts that the bank owes him

**‘First in, first out’**

- *Clayton’s Case* – in the case of current/running accounts a ‘first in, first out’ rule applies
  - The first debt is paid off first
- For tracing withdrawals of trust money, if A had £1000 of his own money and then £500 of trust money, the beneficiary can only trace withdrawals after the £1000 debt has been extinguished
- *Pennell v Deffell* – the ‘first in, first out’ rule was applied to the detriment of the beneficiaries

*Presumption of honesty*
• **Re Hallett’s Estate** – the trustee first paid trust funds, then funds of his own, into his account. He then made withdrawals of money which he dissipated.
  o Held: the FIFO rule was not applied; a presumption of honesty was attributed to the trustee, treated as having withdrawn his own money first

**Cherry-picking**

• **Re Oatway** – the trustee purchased shares, the value of which could be covered by his money alone. He dissipated the subsequent money, which was the trust money
  o Held: the presumption was not applied; the trust money was used to purchase the shares
• **Hallett** and **Oatway** (and **Foskett**) create a ‘cherry-picking’ privilege for the beneficiary, for them to claim that their money was used for valuable, and not untraceable, expenditures
• **Armory v Delamirie** – the wrongdoing trustee created the problem by mixing, so the beneficiary can choose which unmixing withdrawals belong to who

**Lowest intermediate rule**

• This ‘cherry-picking’ control extends only to withdrawals
• Deposits by the trustee to his account subsequent to the paying out of some trust funds are not presumed to be repayments to replace the paid out trust monies – this is because if a trustee wanted to make good his breach, he would not deposit money in his own account (*Roscoe v Winder*)

**Tracing amongst innocents**

• Different rules apply to tracing where the mixed funds come from different trusts, or where an innocent volunteer receives trust money and adds it to his own account
  o This is because there are no presumptions justified by a party’s wrongdoing
• Wrongdoer/innocent distinction is not the same as trustee/TP recipient
  o A trustee is always a wrongdoer, his state of mind is irrelevant
  o With TP recipients, state of mind is essential to establish whether they knew the property came from a breach
• If no wrongdoer’s money is involved i.e. the wrongdoer mixes two innocents’ funds together, the FIFO rule applies
  o It is suggested that the rule to ‘fluid’ mixtures should be applied; the innocent owners co-own the whole in proportion to the amounts they contributed (*The Ypatianna*)
• The FIFO remain the general rule, but will be easily departed from – ‘proportionate share’/*pari passu* solution:
  o *Barlow v Vaughan*: the FIFO rule is not to be applied blindly. Contributors entitled to be traced as co-owners
  o *Russell-Cooke Trust v Prentis, Commerzbank Aktiengesellschaft v IMB Morgan*
• Alternative approach – ‘rolling charge’/North American solution:
  o Money contributed by innocents is traced into mixtures so that they become proportionate co-owners of the whole
  o Lowest intermediate balance rule is taken account of
  o The *Foskett* presumption against the wrongdoer is also taken account of
• Note that FIFO and the rolling charge are expensive to implement as it requires extensive investigations into the bank accounts. (one reason against implementing the rolling charge in *Barlow Clowes*)
• Note also that FIFO prejudices early contributors but *Barlow Clowes* proportionate shares prejudices late contributors

**Backwards Tracing**

• **Backwards tracing** – tracing into property purchased by the recipient before he receives the money that is being traced
  
  o E.g. If A buys a table on credit, then uses trust money to pay off the debt, the table is clearly the traceable proceeds of the trust money
  
  o **N.B.:** This is **not** how the law sees the situation

**Overdraft**

• Paying money in an account: bank takes title to money, giving value in exchange in the form of an increased bank balance (traceable proceeds)

• In the case of overdraft, if £500 is paid into an account that is £500 in overdraft, and the resulting balance is £0, what are the traceable proceeds? There are no rights that become the proceeds.
  
  o However, this is **not** the end of the tracing exercise
  
  o The overdraft was incurred by some expense, so the funds are traceable into that expense

• The courts have **backwards traced** before:
  
  o *Foskett v McKeown* (2000) – to pay for property rights in instalments is to discharge one’s debt to the transferor in consideration of his transfer. Thus, backwards tracing is used here.
  
  o *Law Society v Haider* (2003) – claimant traced from a payment discharging a mortgage into a house purchased with a mortgage loan, into the proceeds of the sale of that house, and into another house purchased with those proceeds.

• *Bishopsgate Investment Management v Homan* (1995)
  
  o **Vinelott J:** backwards tracing can happen in limited circumstances:
    
    ▪ [1] Asset acquired with money borrowed from an overdrawn account, where the defendant intended to repay that money with misappropriated funds
    
    ▪ [2] Misappropriated funds were used to reduce an overdraft to make it possible to buy a particular asset
  
  o **Penner,** these two points violate the principles of tracing:
    
    ▪ [1] There is no requirement of intention in tracing, only actual expenses
    
    ▪ [2] Tracing the payment of an overdraft leads to the asset for which the debt was incurred, not any future purchases. This is because new purchases use the bank’s money, not the claimant’s

**Proprietary claims to traceable proceeds: charges and equitable ownership**

• On successful tracing of his interests, the beneficiary may make a claim

• A wrongdoing trustee may at any stage do his duty and reinstate/restore the trust, but he must do so properly
  
  o i.e. If he uses £1000 trust money for an unauthorised investment which increases in value to £2000, he must restore £2000 because he had no right to ‘borrow’ trust money. Cestuis *sui juris* may consent to the retention of shares.
If the investment makes a loss, he must make up the difference

- This is similar to a beneficiary’s remedies for misapplication of trust property

- Options:
  - [1] Falsification of accounts: denies proprietary interest in the proceeds, saying the transaction never took place, and looking to the trustee for a personal remedy
  - [2] Adopting the transaction: in any form most favourable to the beneficiary

- Where the asset acquired is less valuable than the misapplied funds (note that these are 2 ways of framing what is substantially the same claim):
  - [1] The traditional phraseology is that the beneficiary can bring a personal claim for breach of trust and enforce an equitable lien on the proceeds to secure restoration (Lord Millett points out the flaw in this in Foskett)
    - Wrong in principle: personal claim → falsification → beneficiary disowns interest in proceeds of transaction, so should have no right to claim a lien over them
  - [2] Adopt as a secured loan: Beneficiary adopts the misapplication in any form most valuable to him → here, he adopts the transaction as a secured loan to the trustee, secured against the property acquired. The beneficiary claims an equitable lien over the asset.
  - If the trustee fails to repay the ‘loan,’ the beneficiary can sell the asset. If the sales proceeds do not satisfy the full debt, the trustee is personally liable to make up the shortfall.

- A beneficiary must choose between claiming ownership of the asset, and falsifying the account for personal liability against the trustee; he cannot have both

- Same principles apply against TP-reception of trust property, except against innocent contributors

- Each innocent party is entitled to a proportionate equitable co-ownership of the proceeds, where:
  - [1] An innocent TP recipient purchases an asset with a mixture of trust money and his own money
  - [2] A trustee purchases an asset with a mixture of money from several trusts

Claiming followed property, ‘clean’ traceable proceeds, and ‘mixed’ traceable proceeds

Claiming followed property

- No substitutions: where there have been no substitutions of trust property requiring tracing, and the property can be simply followed into the hands of the trustee, the beneficiary simply specifically enforces the trust. The beneficiary vindicates his continuing equitable title

‘Clean’ traceable proceeds (clean substitutions)

- Clean substitutions: where only trust property was used to acquire traceable proceed, and there are no mixed funds, the beneficiary can adopt the misapplication as:
[1] The purchase of the proceeds for the trust – where proceeds are of equal/greater value → equitable ownership of proceeds

[2] A secured loan of the trust funds to the wrongdoer – where proceeds are of lesser value → personal claim + lien

- **Innocent TP**: a beneficiary can trace proceeds into TP hands and enforce his equitable interest in this property, but the beneficiary is restricted to claiming the asset, the TP will not be required to make up a shortfall.
  - **N.B.**: if after receipt, the TP learns he has received trust property, and subsequently enters a transaction, he will be liable a knowing ‘dealer’ and will be personally liable

- **Mixed traceable proceeds (mixed substitutions)**

  - **Trustee/trust funds**: where an asset is purchased with a mixture of trust money and wrongdoer’s money, the beneficiary is entitled either to a lien over the proceeds, or a proportionate equitable co-ownership interest of the proceeds.

  - **Foskett v McKeown**
    - **Facts**: a trustee used his own money to purchase the first two premiums, trust funds to pay the next two premiums, on a life insurance policy in favour of his wife and children. The beneficiaries claim a share of the proceeds of the policy, paid when the trustee committed suicide.
    - **Lord Millett**: the insurance company’s contractual duty to pay the £1m payout was a single chose-in-action acquired on formation of the contract, but was paid for in instalments. The number of instalments is unknown at the outset, and the total purchase price is only determined on death of the insuree. Thus the beneficiaries could rightly trace from the instalment payments and claim a proportionate share of the proceeds.
    - **This judgment depends on backwards tracing**

  - **Mixed substitutions**: beneficiaries’ choice of co-ownership share or charge will depend on whether the proceeds have increased or decreased in value
  - **In the case of a lien, it extends to the whole property, not just the appropriate proportionate share.**
  - **TP receives asset purchased with mixed funds**: beneficiaries have the same choice as in E.
  - **Here, TP is not a contributor to the mixture; he is only entitled to what remains of the trustee’s share:**
    - **Co-ownership = TP entitled to share proportionate to trustee’s contributions**
    - **Lien = TP entitled to what is left after satisfaction of the lien. N.B.: TP is not personally liable to make up a shortfall**

- **Hayton and Mitchell**: where trustee buys an asset with mixed funds, yet ‘but for’ the trust money he could have not purchased the asset at all → the beneficiaries should be entitled to claim ownership of the whole asset, subject to a charge in favour of the trustee of the value he put in
• i.e. the misapplication is adopted as a purchase of trust property assisted by a secured loan from the trustee

• **Penner:** this analysis is doubtful for two reasons:
  
  o [1] Principle – relies on correctness of a ‘but for’ approach to tracing, rather than upon strict transactional links
  
  o [2] Policy – beneficiaries rely on proprietary rights against insolvent recipient, so if adoption of transaction is too generous, creditors will be harmed

• **Contributions from 2+ innocent parties:** each party is only entitled to a co-ownership share of the proceeds in proportion to their contributions. It is impossible to allow one an advantage over the others.

• **Hayton and Mitchell:** there may be one justified departure from this rule

  *Argument based on Re Tilley’s Will Trusts (1967)*

• **Facts:** Widow of a testator is made trustee of his testamentary trust, and thoroughly confused hers and the trust funds. She made several profitable property investments.

• **Held:** Because the trustee (1) did not deliberately use the trust monies, and (2) had ample overdraft facilities to make the property purchases, and so, on a ‘but for’ basis, did not rely on any of the trust value to fund her purchases, the beneficiaries were entitled at most to a charge over the acquired properties.

• **Penner:** It is wrong in principle to use this for an ‘innocent’ trustee, because trustees are strictly liable for misappropriations.

• **Hayton:** Recognises that it is wrong in principle for an innocent trustee but argues that it could be justified for an innocent volunteer recipient of trust funds, and that in such cases (trust value not relied on on a ‘but for’ basis), the beneficiary should be restricted to a personal claim for repayment secured by a lien or charge.
  
  o Argument seems to prove too much. If this is the case, why allow any proprietary claim at all (with the charge)?
  
  o The argument seems to have a different starting point (focuses on the fact that the innocent recipient is merely wealthier than he was before, and not on the fact that he received any trust property). Conversely, with tracing, the intentions of the party who acquires the proceeds are irrelevant and thus, so should any other facts about his financial position.

**The multiplication of claims and the ‘exchange product theory’/‘power in rem’ theories of claiming**

• The claimant can trace his equitable interest into multiplying tracks of substitutions
  
  o E.g. Trustee sells a trust asset to X (no BFP) for £2k, who then sells it to Y (no BFP) for £3k
  
  o The beneficiary can trace into the £2k, £3k, and into his equitable title in the asset

• Two different theories of claiming:
  
  o (1) **Exchange product theory** – does the beneficiary have all these property claims at once, but can only enforce one, because he is limited by the principle of double/multiple recovery
  
  o The right to election is part and parcel of the beneficiary’s equitable interest – he may elect between treating the property acquired by the wrongdoer either as items of the trust fund or as security for a loan to the wrongdoer
(2) **Power in rem theory** – are his rights against these different defendants ‘inchoate’, in suspense, until he elects which party he will pursue, at which point his property right crystallizes.

- The beneficiary has a power to vest himself with the equitable interest (ownership share or lien) he elects. When a beneficiary chooses to pursue a defendant, the property rights against the others are extinguished, since this amounts to adoption of particular proceeds as the assets of the trust.

**Subrogation claims reliant on tracing**

- **Subrogation** – the acquisition of another person’s rights against a third party upon the making of a payment i.e. the plaintiff ‘purchases’ another’s rights (e.g. right to payment of a debt, right to sue).
- The classic example of this is in insurance. E.g. in a personal injury case, the insurance company is said to be subrogated to my claim against the tortfeasor.
- We’re dealing with a different sort of subrogation here, one that can be termed ‘revived subrogation’ (Mitchell):
  - In certain circumstances, when X pays Y’s debt to Z, X will by operation of law be subrogated to Z’s right as a creditor. The right against Y that X acquires by subrogation is a new right that arises by operation of law. In essence, Y’s debt is revived in favour of X.

**Boscawen v Bajwa (1995)**

- **Facts**: Bajwa wanted to sell his mortgaged land for a price equal to what he owed under the mortgage to Halifax. On sale, Bajwa would have to use the purchase money to pay off the mortgage. The purchasers raised £140k on a mortgage from Abbey National, which was transferred to solicitors in advance of the completion of the sale. In breach of trust, the money was advanced before completion, and was applied to pay off the mortgage with Halifax. The sale never occurred → Bajwa had an unmortaged property, and AN had advanced funds in return for no mortgage.
- **CA**: AN was entitled to be subrogated to Halifax’s mortgage on the land, thus entitling them to priority over a charge on the land.
- **Millet LJ**: If the plaintiff succeeds in tracing his property, he is entitled to a remedy. Tracing is the process by which AN established its money was applied to discharge Halifax’s charge, subrogation is the remedy which it sought in order to deprive Bajwa of the unjust enrichment.

- **Penner**: doubts the result. Note first that subrogation is the opposite of backwards tracing:
  - BT – one traces into items purchased with borrowed funds
  - S – claimant can stand in the shoes of the lender
- But note also that with subrogation, the claimant doesn’t have the option to acquire an ownership or co-ownership share. So if backwards tracing ad been authoritatively recognised and applied in this case, the issue of subrogation would never have arisen, because a claim based on backwards tracing would have been superior.

- Millet LJ says the right to be subrogated arises by operation of law as a restitutionary remedy – does this case thus recognise the restitutionary nature of the beneficiary’s claim against TP recipients?
- **Issue**: is/does the beneficiary:
• (1) entitled to be subrogated to a charge over the property; or
• (2) have a right either to elect an ownership claim or a lien following backwards tracing?

• This is an important distinction in the case of an innocent recipient
• The subrogation claim does not turn on the fact that the money paid off was a secured debt. The right to be subrogated applies to the payment of any debt
• A personal right of subrogation is pointless against trustee/knowing recipient, because they are strictly liable anyway
• But an innocent recipient is not personally liable. However, if the subrogation claim is available, he will be liable to a large extent, because most expenditures of money pay off contractually incurred debts.
• Thus if a beneficiary can be subrogated to the rights of all debtors whom a recipient pays off, the innocent recipient is largely personally liable to restore the trust out of his own pocket.
• This general right to subrogation cannot stand alongside conventional law under which an innocent recipient is not personally liable

• N.B.: in Foskett, Lord Millet specifically denied that tracing had anything to do with unjust enrichment, and didn’t even mention Boscawen
• In Boscawen, Millett LJ considers that a beneficiary is entitled to a charge over land that has been improved with traceable value – but such a charge was denied in Re Diplock; the consequences of imposing a charge would do more than restore the plaintiff, but cause the charity a significant actual loss.
• This case is not the same as an innocent recipient ‘mixing’ trust property, because there is no purchase of an asset but a payment of service which results, not necessarily, in raising the value of something already owned.

Tracing at common law and the quest for a fiduciary relationship

- Not super important. See again if time. P375 onwards

Personal claims against recipients of trust property or its traceable proceeds

Knowing receipt and knowing dealing

- A recipient of trust property transferred in breach of trust or its traceable proceeds will be personally liable to account for his handling of that property, just like the breaching trustee is, if he knowingly deals with the property as his own. (i.e. inconsistently with the beneficiaries’ equitable title to it)

  o Knowing receipt (receipt with knowledge of the breach); in essence, the knowing recipient will be treated as if he is a custodian trustee of the property. He has no obligations to carry out the terms of the trust, but must hold the property to the order of the rightful trustees for the trust and, if he acts otherwise, will be personally liable for his breach of the trust.

    ▪ “Liability for knowing receipt is a distinctive, primary, custodial liability, which closely resembles the liability of express trustees to account for the trust property with which they are charged” (Mitchell and Watterson)
Knowing dealing (gains knowledge after receipt); he will be treated as a knowing recipient (custodian trustee) from the point he gets knowledge but will not be liable for any untraceable dissipations of the trust property he makes up to that point.

- With regards to knowing recipients being liable 'as constructive trustees', it is worth noting that some people say the words (constructive trustee) don't mean much and are an empty formula which indicate that the defendant is under a personal duty to restore the amount transferred.

- Mitchell and Watterson however think the courts use that phrase with a very technical meaning and that defendants will be placed under a continuing duty to account until they discharge this duty. (Explain which view is preferred and why)

The current standard of knowledge

In BCCI v Akindele, created the test of unconscionability for knowing receipt. In doing so, he seems to specifically be rejecting the test of dishonesty and purposely creating a wider test. While the test has come under criticism, it has been followed multiple times by the court of appeal (most recently in Charter Plc v City Index limited [2007]), and is firmly entrenched in the law. Nonetheless, the test itself is extremely vague and from a sceptical point of view, knowing receipt cases essentially turn on the judge’s assessment of the facts. In summary it seems fair to say that at the moment, the fault requirement for knowing receipt cases, is one where the defendant has actual knowledge of the breach of trust or sufficient knowledge to ‘affect his conscience’ (in the words of Megarry VC in Re Montagu’s).

It is helpful however to undertake a brief review of the law leading up to Akindele

Re Montagu’s Settlement Trusts (1987)

- Megarry VC clearly distinguishes between notice (including ‘constructive notice’ that will satisfy in conveyancing transactions) and knowledge and seems to require ‘actual knowledge’ for liability in knowing receipt (here, no liability as he’d genuinely forgotten)

- He also says that there is a difference between suing a defendant in knowing receipt to make them personally liable to compensate you for the value of your lost property, and a claim to assert your existing proprietary rights.

- He regards this personal liability as a constructive trusteeship and thus in the former case, says there has to be fault (i.e. the defendant has to actually breach his trusteeship) for liability.

Baden v Societe Generale (1992)

- Peter Gibson J distinguished five categories of knowledge. Knowledge in any of the categories was sufficient to fix a defendant with ‘notice’ and per Nourse LJ in Akindele, knowledge in the first three categories is generally taken to constitute ‘actual knowledge’ and the last two, ‘constructive knowledge’.

- While somewhat helpful in identifying situations where there might be knowledge, the categories on their own do not answer the question as to the degree of knowledge required for liability in knowing receipt.
Further while the ‘Baden categorisation’ attempts to give the court a pseudo-scientific method of identifying degrees of knowledge, the cases have incredibly complicated facts and the categories themselves are not clear cut. All this leads to difficulty in application.


- Here, Nourse LJ goes through the history of knowing receipt cases points out how while *Re Montagu’s* requires actual knowledge, there are a number of cases which suggest that something less, akin to constructive knowledge, will suffice (e.g. *Agip, El Ajou*).
- Further, he sums up the categories of *Baden* as being merely to assist the court in determining whether the recipient “can conscientiously retain the funds”.
- Clearly influenced by Lord Nicholls who created a single test of dishonesty for ‘knowing assistance’ in *Royal Brunei*, Nourse LJ created the test of unconscionability for knowing receipt. In doing so, he seems to specifically be rejecting the test of dishonesty and purposely creating a wider test. While the test has come under criticism, it has been followed multiple times by the court of appeal (most recently in *Charter Plc v City Index limited [2007]*), and is firmly entrenched in the law. Nonetheless, the test itself is extremely vague and from a sceptical point of view, knowing receipt cases essentially turn on the judge’s assessment of the facts.
- In summary it seems fair to say that at the moment, the fault requirement for knowing receipt cases, is one where the defendant has actual knowledge of the breach of trust or sufficient knowledge to ‘affect his conscience’ (in the words of Megarry VC in *Re Montagu’s*).

**The restitutionary analysis of recipient liability**

**The impulse towards fusion**

Equity’s remedies against third party recipients of trust property

- Proprietary liability
- Fault-based personal liability

Common law remedies against a person who receives the property of another in flawed circumstances

- Strictly liable for the tort of conversion
- Strictly liable to make restitution for unjust enrichment

- This difference in treatment between equity and the CL suggest that like cases are not being treated alike, and thus that the current law does not provide a workable, coherent, justice. There are arguments advocating analysis liability for receipt of trust property in harmony with CL liability for UE.
- The question is whether the case of receipt of trust property is really a case sufficiently like the traditional cases of restitution.
Conversion and restitution

While it has been said that equity’s treatment of the recipient of trust property is an equitable version of conversion, the disanalogies are clear

- In equity, the beneficiary has the right to get the trust property or its traceable proceeds back – he is not limited to a claim for compensation for loss.
- The recipient’s personal liability is not strict in the sense that by merely acquiring the beneficiary’s property he will be liable to pay its money value back to the beneficiary. Knowledge of the beneficiary’s rights is required. (I.e. some fault standard)
- From the restitutionary perspective, the recipient of trust property is liable simply because he has been *unjustly enriched*. Thus he should reverse the situation by paying back the same amount to the beneficiary.
- Thus the claim is not for compensation for a wrong as in conversion but restitutionary. The analogy here is with CL restitutionary actions such as ‘for money had and received’

The now largely accepted formula for determining whether a person is liable to a restitutionary claim is framed in a series of questions

1. Has the defendant been enriched?
2. Was the enrichment at the claimant’s expense?
3. Was the enrichment unjust?
4. Does the defendant have any defence to the claim?

The defence of change of position

- Firmly established as part of English law only relatively recently in the HL decision in Lipkin Gorman (1992)
  - Lord Goff “where an innocent defendant’s position is so changed that he will suffer an injustice if called upon to repay or to repay in full, the injustice of requiring him so to repay outweighs the injustice of denying the plaintiff restitution.”
- The main points to be aware of are, first, that the defence arises on the basis that the defendant has made an extraordinary expenditure on the faith of his greater wealth due to the enrichment, or has suffered an extraordinary loss because of it.
  - The defence applies because the recipient can argue that had he not received the money, he would not have spent it on these things, and it would now be unjust to require the full amount back, because that would leave him in a worse position than if he had never received the money at all.
- Second, this defence is only available to innocent recipients.
- Finally, he gives an example of ‘extraordinary loss’ (due to the additional wealth)
Judicial support for the restitutionary analysis

1. Lord Nicholls in Royal Brunei Airlines
   “Recipient liability is restitutionary-based, accessory liability is not”.

   “[KR] is the counterpart in equity of the CL action for money had and received. Both can be classified as receipt-based restitutionary claims.”

3. Lord Goff in Lipkin Gorman:
   “The recognition of change of position defence should... enable a more generous approach to be taken to the recognition of the right to restitution in the knowledge that the defence is... available.”

4. Millet LJ in Boscawen (subrogation) affirmed Lord Goff in Lipkin Gorman
   o Talks about the value of the change of position defence

   “Restitutionary liability, applicable regardless of fault but subject to a defence of change of position, would be a better tailored response to the underlying mischief of misapplied property than personal liability which is fault-based.

   Personal liability would flow from... having been unjustly enriched at the expense of another. It would be triggered by the mere fact of receipt, thus recognising the endurance of property rights.

   But fairness would be ensured by the need to identify a gain, and by making a change of position available as a defence in suitable cases.”


   CF: Nourse LJ: I doubt whether strict liability coupled with a change of defence position defence would be preferable to fault-based liability.

   Note that it does seem odd that with regards to a trust, upon proof of some ‘internal’ misapplication of funds, the burden of proof should shift to the recipient to defend the receipt (by change of position or otherwise)

7. Re Diplock (1948)
   Case revealed that equity is not constitutively averse to awarding a person restitutionary liability
But it is a weak case because it was an anomalous remedy involving ecclesiastical jurisdiction over wills. (The *Re Diplock* claim has been described as an anomalous remedy)

*Judicial opposition for the restitutioanalytic analysis*

   - Affirmed in *obiter* the traditional equity proprietary and personal formulation:
     - i. Even if the third party recipient of trust property is not aware that what he has received is trust property, B is entitled to assert his title in that property. (Proprietary claim defeats all but a BFP with notice)
     - ii. If X has the necessary degree of knowledge, X may himself become a constructive trustee for B on the basis of knowing receipt. But unless he has the requisite degree of knowledge he is not personally liable to account as trustee.
   - Note: this statement is only directed to the possibility of whether the third party recipient should, without knowledge, be regarded as having a trustee’s duties and liabilities.
   - It leaves open to the possibility that the third-party recipient might have personal liabilities arising on the different basis of unjust enrichment.

2. **Nourse LJ** in *Akindele* doubted whether a restitutioanalytic approach should be taken to knowing receipt

3. In Australia, in *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* (2007), the Australian HC unanimously rejected the restitutioanalytic approach.
   - Unhistorical (see Smith on Birks below. Same sort of comments)
   - Conceptually inaccurate
     - “the restitutioanalytic basis was imposed as a supposedly inevitable offshoot of an all-embracing theory. To do that was to bring about an abrupt and violent collision with received principles without any assigned justification.”
   - Note: restitutioanalytic analysis proponents find this decision deplorable
   - **Chambers** (2007):
     - Law in Australia is frozen as it stood in 1975.
     - Considers that the law on recipient liability would be enhanced if the occasion of UE, rather than the fact of notice, were the accepted basis of legal liability.
     - Confers greater protection on trust assets and stronger response to capital laundering
   - **Hayton** (2007):
     - “it would not be surprising if... the House of Lords refuses to strengthen equitable rights through developing UE principles so as to wholly undermine the knowledge requirements that restrict personal liability [of the recipient]
     - Possession and the right to possession are at the core of the notion of legal ownership of land and chattels, meriting protection in their own right irrespective of any fault on the defendant’s part. That is not the case for equitable interests in property, lower down the hierarchy of property”
Concurrent Liability (Birks + Lord Millet in Dubai Aluminium)

- Birks initially argued that KR was simply a yet to be realised form of UE and argued for strict liability in knowing receipt subject to a change of position defence.
- He feels many of the earlier cases were decided the way there were as there was no such defence available.
- However in 2002, he retracted his opinion with regards to this point in part. (This was noted in Say-dee)
- Birks' altered view is that there is concurrent liability in knowing receipt cases. That is, both the more traditional fault-based liability for knowing receipt coupled with strict restitutionary liability for unjust enrichment.
- This is also the view of Lord Millett in obiter in Dubai Aluminium v Salaam (2003).
- As Smith points out, should the earlier view of Birks be taken, it would mean that all the previous knowing receipt cases were wrongly decided.
- Should the concurrent liability view be taken, it would mean that though the earlier cases were rightly decided, there was a claim available to the claimants and that absolutely no one realised it.
- While theoretically these positions may seem appealing, the fact that it does not fit the historical reality makes it hard to put them into practice (Another point raised in Say-Dee).

If one accepts however that knowing receipt claims are restitutionary, there are further difficulties relating to the elements of unjust enrichment.

The recipient’s enrichment

- Questions 1 & 2 amalgamated say that for a claimant to establish the restitutionary liability of the defendant, he has to establish that the defendant has been enriched at his expense.
- In the classic unjust enrichment scenario, say A pays B twice, the second payment being by mistake, it is clear that B is enriched as he receives the full payment. (Both the legal and equitable interest in it).
- With the case of a third-party recipient of trust property however, the situation is not so simple. Leaving aside the case of a bona fide purchaser for value without notice, the beneficial interest in the property will continue to rest in the beneficiaries and from a traditional stance, it would seem that a restitutionary claim would not work in such circumstances.
- As such, in this sort of situation, claimants would generally bring a ‘title’ claim rather than a restitutionary claim. This distinction between the two claims seems to be endorsed by Lord Millett in Foskett v Mckeown [2001] but nevertheless, there is still potential to dispute this. The point is merely to highlight the difficulty in applying a traditional unjust enrichment analysis in these circumstances.
- Note that Chambers (2009) rejects this view
The unjust factor

- The typical unjust factors are mistake and duress. This is clearly not the case in KR cases.
- Birks (1985) suggests that ‘ignorance’ could be the unjust factor.
- Chambers and Penner (2008) specifically dispute this. They say it is a very nature of trust arrangements that beneficiaries are ignorant of the bulk of the activities of trustees. As such, if anything it would only make sense to frame the factor in terms of ‘unauthorised transactions’ of which a beneficiary is ignorant.
- The problem with this way of framing it is that it would not seem to accurately describe what happens in the cases. Trustees are strictly liable for breaching a trust whether the beneficiaries are aware of it or not and thus the beneficiaries’ knowledge is irrelevant.
- They propose that the only unjust factor which seems to work would then be the trustee’s ‘want of authority’ in carrying out the transaction. However at that point, the situation seems to mirror the common law claim for conversion rather than unjust enrichment.
- Liability for conversion is strict and this may seem to lend support to not requiring fault in liability for knowing receipt.
- However at this stage, we seem to be totally out of the unjust enrichment analysis and into an area where only parliament can bring about such a change.
- Again here, the debate is far from settled. Indeed, In Say-Dee, one of the strongest criticisms by the High Court of Australia of the decision of the Court of Appeal was that they failed to identify an unjust factor. Further, the high court authoritatively reaffirms that ignorance has never been recognised as an unjust factor in English law.
- Additionally, in view of the battery of claims that a beneficiary can make, it may make sense that the ‘conversion’ claim in equity is more restrictive, fault-based rather than strict
- A similar point is put forward by Smith (2000)
  - The fact that someone is only back to where he started (after repaying the enrichment) does not justify liability (otherwise all gifts would be recoverable subject to a change of position)
  - D might validly ask why the claimant should not look to the trustee. Arguments for strict liability consistently ignore the essential fact that there is a trust, and seek to treat the trust beneficiary like the legal owner.

Untraceable expenditure of trust property

- It is suggested that the restitution analysis might be able to step in where the TP has spent the property on untraceable expenditure
  - At this stage, the beneficiary’s title is extinguished, in a way that legally, not just factually benefits the recipient
  - The problem again has to do with the lack of unjust factor. Here, if the TP was liable, it’d be simply for interfering with the beneficiary’s equitable title to that property
At CL, someone who interferes with ones title can be liable in certain circumstances to 'disgorge' a profit earned from the wrong.

However, coming to this conclusion depends upon saying that the innocent recipient of trust property commits a wrong. But this is precisely what the cases do not say.

Smith says that a beneficiary's interest under a trust is not legal ownership. Equitable proprietary rights are not protected in the same way as legal ones

- bfp, overreaching etc...
- the argument for strict liability would make the most sense as part of one to destroy trusts generally
- Certainly as the law is now, the beneficiary's interest under a trust attracts different incidents from legal ownership and it is not clear that it makes sense to abolish only some of the characteristics of equitable property rights

The trustee is usually the legal owner and if he makes, a mistaken payment or is defrauded for example, he will have at his disposal all the strict liability claims which protect his legal title

It does not follow from this that we must give the beneficiaries, in a breach of trust, the same rights as a trustee would have had, had he acted properly.

It is in the nature of the trust institution that beneficiaries are vulnerable to breaches of trust, in ways which they would not be if they were the legal owners of the trust property. To complain about this is to complain about the incidents of the institution of the trust.

Additionally, unlike the typical two-party case of restitution at CL, the beneficiary has an array of claims including a defendant who is strictly liable for the entire loss without a change of position defense

Another point is that it seems fair that beneficiaries should take the bad with the good regarding the interest being in a fund.

good
- TP recipient is bound by the beneficiary's interest not only in property he receives but in anything he receives in exchange for it

bad
One cannot treat the recipient's transaction with one of the items in the fund as the disposition of one's title in that property, as if one were the legal owner of it, equivalent to conversion.

tracing and restitution

Limitation of actions

Chapter 12: The law governing fiduciaries

- It is essential to realize (as Millet makes clear in *Bristol and West Building Society v Mothew* (1996) that just because A stands as a fiduciary to B, that does not mean that every duty he owes B is a fiduciary duty:

- "A fiduciary is someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence. The distinguishing obligation of a fiduciary is the obligation of loyalty.

- The nature of the obligation determines the nature of the breach. The various obligations of a fiduciary merely reflect different aspects of his core duties of loyalty and fidelity. Breach of fiduciary obligation, therefore, connotes disloyalty or infidelity. Mere incompetence is not enough. A servant who does his incompetent best for his master is not unfaithful and is not guilty of a breach of fiduciary duty."

The 'no conflict' rule

- The 'no conflict' rule is the basic rule governing fiduciaries. A fiduciary must not place himself in a position where his own interests might conflict with those of his principal.

- Under the no conflict rule, a fiduciary is liable to account for any profit he obtains in circumstances where his interests may conflict with his duty to his principal.
Keech v Sandford (1726); The trustee took the new lease for his own benefit. King LC required the trustee to hold the lease on trust for the beneficiary even though his interest when he acquired it could not, strictly speaking, be in conflict with his duty to the beneficiary, since the lessor absolutely refused to renew to a minor.

Lord king accepted that the consequence was that "the trustee is the only person of all of mankind who might not have the lease; but it is very proper that the rule should be strictly pursued, and not in the least relaxed; for it is very obvious what would be the consequences of letting trustees have the lease, on refusal to renew to the cestui que trust.

The leading modern case is Boardman v Phipps (1967)

"The only defence available to a person in such a fiduciary position is that he made the profits with the knowledge and assent of the trustees. It is not suggested that the trustees had such knowledge or gave such consent.

First, this simple equation of liability with Boardman's having profited from information acquired in his conduct of the trust would not have led to the liability of Tom Phipps, because as a beneficiary under the trust he could well argued that he obtained any information in that capacity, not as a fiduciary to the trust.

Second, Lord Guest speaks of the consent of the trustees (no informed consent as third, senile trustee, was not informed at all).

Slightly odd. Normally, consent of b's required to authorise bot. If Tees employ a fiduciary agent, tee can authorise what'd otherwise be a breach of his fiduciary duty. If tees do not have valid reasons for doing so, they'd be liable to b's for bot. Here, Boardman was liable to the beneficiaries directly, so it can only be the case that because of his close relationship with the trustees and the beneficiaries he owed a fiduciary duty directly to them.

Lord Hodson took a similar line. Referencing Keech, he says that any profit obtained by a fiduciary made possible by his fiduciary position was to be accounted for unless consented to, though he made clear the consent required was that of the complaining beneficiary.

Lord Cohen did not rely wholly on Keech and his opinion has the virtue of specifying the precise way in which Boardman's purchase of the shares for himself can be interpreted as an act undertakin in conflict of interest., becuase given Boardma's personal intention to acquire the shares, counselling the trust to acquire the rest of the shares would conflict with his own interests.
• Lord Upjohn dissented. In his opinion, the 'no conflict' rule was not to be applied automatically, because that would only lead to the harsh and inequitable consequences of the majority decision. He reasoned that to be accountable, the fiduciary must have made a profit
  o earned within 'the scope and ambit of his duty', and
  o in circumstances where he had placed himself in a position where there was a 'real sensible possibility of conflict' between his duty and his interest.

• Viscount Dilhorne also dissented. He reasoned that when the trustees firmly insisted they would purchase no further shares, they no longer sought to rely upon Boardman as an advisor to the shares' value, but rather from that time, Boardman and Phipps and the trustees acted in a sort of JV to get the value out of the company.
  o His reasoning is plausible on the facts and delivers the same result Lord Upjohn preferred without watering down the 'no conflict' rule, requiring the court to engage in an inquiry as to whether a conflict arose in the eyes of a 'reasonable' person.
  o The essence of his argument is that a fiduciary can be released from his fiduciary role by his principal(s) if done in full knowledge of the circumstances

• The majority decision can be criticised for what appears to be an unjustifiably harsh result.

• What should a fiduciary do when he finds himself in a position of conflict of interest?

• In Public Trustee v Cooper (2001), Hart J laid out three ways in which a conflict might 'in theory, successfully be managed'; Hart J speaks only of trustees but we can assume it applies to fiduciaries generally
  o For the trustee concerned to resign
  o To surrender their discretion to the court
  o There may be situations where trustees honestly and reasonably believe that, notwithstanding a conflict, they are able fairly and reasonably to take the decision. It will usually be prudent to apply to court. If they do not do so, they run the risk of having to justify the exercise of their discretion in subsequent hostile litigation and then satisfy the court that their decision was not only one which any reasonable body of trustees might have taken but was also one that had not in fact been influenced by the conflict.

• Hilton v Barker, Booth and Eastwood (2005) is a forceful reminder that a fiduciary who acts in conflict of interest does so at his own peril
Here the HL unanimously held that the fact that it would also have been a breach of their duty of confidentiality to their other client to impart this information provided no excuse: the solicitors had placed themselves in this position of conflict and failed to deal with it properly by refusing to act for one of the parties; they therefore put themselves in the position that they had no choice but to breach their contract of retainer to one of their clients, and were liable for any consequences of doing so. They were therefore liable to My Hilton for his entire loss resulting from his entering into the contract.

The 'no conflict' rule and company directors

- The leading case applying the 'no conflict' rule to company directors is Regal (Hastings) Ltd v Gulliver (1942)
- The HL unanimously rejected the decision of the lower courts and applied Keech in its full rigour
  - "The liability arises from the mere fact of a profit having, in the stated circumstances, been made. The profiteer, however honest or well intentioned, cannot escape the risk of being called to account.

- None of the non-director subscribers of shares in the subsidiary, including the solicitor, was accountable, because none was a fiduciary subject to the rule.'
  - "i know if no principle or authority which would justify a decision that a solicitor must account for profit resulting from a transaction which he has entered into on his own behalf not merely with the consent, but at the request of his client."

- In the middle of the last century, NA courts began to take the view that a genuinely good faith decision by a board of directors not to take up a corporate opportunity frees individual directors or other company fiduciaries to take up such opportunities themselves.

Authorised Profits

Most trusts are today undertaken by professional trustees, so it is clear that there is no rule of equity that prevents a trustee from profiting from his position as trustee. The rule is that a trustee may not make any unauthorized profits.
The rule in *Cradock v Piper*

- This is the only true exception to the rule disallowing unauthorized profits.

- Here, a solicitor-trustee is allowed his usual charged for his litigation work done for the body of trustees, which include himself, so long as his being one of the parties has not added to the expense of the litigation.
  - Illogical and of little practical significance as a competent solicitor undertaking a trust will typically insist the instrument contain an appropriate provision allowing him to charge for his professional services.

The inherent jurisdiction to authorise remuneration

- The court has inherent jurisdiction to authorise remuneration for trustees and other fiduciaries, and to increase the remuneration beyond that provided in the trust terms.
- In the leading case, *Re Duke* (1982), the CA decided that the inherent jurisdiction covered not only the power to allow remuneration for past services, and to allow remuneration for future services upon the appointment of a trustee, but to increase the level of remuneration beyond that fixed in the trust instrument.
- 2 arguments against this.
  - First, the idea that the remuneration provision is a contract between the settlor and the trustee.
    - “But very frequently executors and trustees of wills know nothing of the terms of the will until the testator is dead... it is difficult to see with whom, in such cases, the trustees are to be taken as contracting.”
    - Nonetheless, no one is forced to undertake a trust
    - As such, court should be slow to upset the ‘bargain’ represented by the remuneration clause, because, especially in the case of a professional trustee, his voluntary acceptance of the trusts is very close to contractual. The court should not exercise its inherent jurisdiction simply to allow him to escape from a bad bargain, i.e. an agreement to undertake a trust that later turns out not to be as profitable as expected. If he wishes to retire, so be it, and if a new trustee will only undertake the trust on better remuneration terms, it may be better to consider increasing the remuneration for him, not for the original trustee. Such an approach would prevent a trustee from being in the position, by reason of his incumbency, to hold the trust to a ransom.
  - Second, it was argued that by increasing the level of remuneration, the court would vary the beneficial interests under the trusts.
    - With regards to this, the CA held that in authorising a trustee’s increased remuneration the court was exercising its jurisdiction to ensure the adequate administration of the trust. In doing so, the court did not concern itself with the beneficial interests as such, and so cannot be regarded as varying them.
Fox LJ noted that the court has to balance two influences; that the office of trustee is gratuitous and the need for proper administration of a trust which might require higher remuneration.

- There principles were applied in Foster v Spencer (1996) in which trustees of a cricket club were awarded remuneration for having tackled various problems ‘vigorously and unremittingly’ over the course of 20 years to enable the club to sell its ground.

- The court disagreed with the proposition that it could only allow remuneration (whether for past or future service) in order to engage or retain the services of the particular trustees for the future
  - [where as in this case...] “the refusal of remuneration... would result in the beneficiaries being unjustly enriched at the expense of the trustees…”
  - Here, one trustee was awarded a retrospective annual fee, and another a percentage of the sale price of the ground, which took into account his successful effort in obtaining planning permission for the development of the site.

- Note that a trustee seeking remuneration is clearly in a position where his interest and duty are in actual conflict. The court therefore must be astute to assess the trustee’s claims that he ‘requires’ such and such a level of remuneration.

- Finally, the court may even award unauthorised remuneration to trustees or fiduciaries in breach of their fiduciary duties. In Boardman v Phipps (1967), fiduciaries who acted in breach of the no conflict rule, although they did so honestly and in so doing created a large profit for the trust, received remuneration on a ‘liberal scale’

Unauthorised profits and the liability to account for them

- The classic statement of the rule is from Lord Herschell in Bray v Ford (1896) “It is an inflexible rule of the court of equity that a person in a fiduciary position... is not, unless otherwise expressly provided, entitled to make a profit; he is not allowed to put himself in a position where his interest and duty conflict. It does not appear to me that this rule is, as has been said, founded on the principles of morality. I regard it rather as based on the consideration that, human nature being what it is, there is danger, in such circumstances, of the person holding the fiduciary position being swayed by interest rather than by duty, and thus prejudicing those whom he was bound to protect.”

- It is clear from this statement that the prohibition on unauthorised profits arises to avoid conflicts of interest.

- Normally, it is said that a fiduciary is ‘liable to account‘ for any unauthorised profits that he receives as a result of his fiduciary position. The difficult question that this formulation of the fiduciary’s liability raises is whether the principal’s right o make his fiduciary account for an unauthorised profit is personal or proprietary.
Incidental profits

- A typical example of an incidental profit is a commission a trustee receives by directing the trust business to a particular company
  - In *Williams v Barton* (1927), a trustee had a contract with a brokerage firm under which he received a commission on works for clients that he introduced to them; he was accountable to the trust for the commission he earned by directing trust business to the firm.

- Another example is directors’ fees. Trustees must safeguard the trust investments and it will be appropriate and sometimes necessary for a trustee to be appointed to the board of directors of a company in which the trust has a large shareholding.
- The general rule is that their directors’ fees are incidental profits of their position for which they must account to the trust (*Re Macadam* (1946)) unless of course their retention of the fees is authorised.
- In *Re Gee* (1948), Harman J explained the law as follows
  - “[A] trustee who either uses a power vested in him as such to obtain a benefit (as in *Re Macadam*) or who (as in *Williams v Barton*) procures his co-trustees to give him, or those associated with him, remunerative employment must account for the benefit obtained.
  - Further, it appears to me that a trustee who has the power, by the use of trust votes, to control his own appointment to a remunerative position, and refrains from using them with the result that he is elected to a position of profit, would also be accountable.
  - On the other hand, it appears not to be the law that every man who becomes a trustee holding as such shares in a limited company is made ipso facto accountable for remuneration received from that company independently of any use by him of the trust holding, whether by voting or refraining to from doing so.”
- In *Re Gee*, the trustee-director was not liable to account for his remuneration as a director because the company resolutions to appointment and pay him were unanimously voted by the shareholders, and since there was only a minority of shares held on trust, the resolutions did not turn on the voting of the trust shares.

Secret profits

- One important subset of incidental profits are what are sometimes called ‘secret’ profits; while the term might be regarded simply as a synonym for unauthorised commission or profits, including, for example, the commission in *Williams v Barton*, it is useful to restrict the term to bribes and hidden commissions that the trustee knowingly obtains in breach of his fiduciary position.
- In *A-G for Hong Kong v Reid* (1994), Reid, the action DPP accepted bribes to obstruct the prosecution of criminals. Reid was liable to account for the bribe money to the Crown.
- Note that the fiduciary is accountable for the money to the principal whether or not the principal has himself suffered loss; the effect of the rule is to strip the fiduciary of his profits, not to compensate the fiduciary for any loss.

- The CA muddled the liability of the fiduciary to account for secret profits with liability to make equitable compensation caused by a breach of fiduciary duty.
- In *Murad v Al-Saraj* (2005) the defendants entered into a JV with the claimants to purchase and run, and then eventually sell, a hotel. The venture was profitable both as a hotel business and on the final sale.
- The court held that the claimants relied upon the defendant’s experience and advice in the venture, and so the defendant acted in a fiduciary capacity towards the claimant, and there was no appeal as to this finding. The fiduciary knowingly breached his fiduciary obligations in two ways: first, he took a secret commission from the vendor on the sale of the hotel; second, he failed to disclosed to the claimants that his share of the acquisition price of the hotel would not be paid in cash – rather, the vendor would simply set of debts that he owed to the defendant, including the value of the secret commission.
- The CA held he was liable to account for all profits. The decision appeared to turn on the view that it did not matter whether the case was analysed as one of a failure to disclose, or the making of a secret profit.
- He was undoubtedly liable to account for the secret commission but the second breach, the failure to explain the way in which he was contributing to the purchase of the hotel, had nothing to do with any secret profits.
- He should have been made to pay equitable compensation for the second breach (for any loss) but not to account for profits. Arden LJ seems to have reasoned that because of the non-disclosure, which bore on the profit shares under the JV, no profit of any kind for the defendant was thus authorised, and he should be stripped of it all.
- MAYBE COME BACK O THIS (428)
- The better approach would have been to distinguish the two distinct breaches, and appreciate that the first, the secret commission, required the defendant to account for that receipt no questions asked, while the second, the non-disclosure, was a matter of equitable compensation requiring full attention to issues of ‘but for’ causation.

**The self-dealing and fair dealing rules**

**The self-dealing rule**

- The self-dealing rule makes voidable any transaction in which a trustee purchases the trust property or, more unusually, sells his own property to the trust, unless the transaction is specifically authorised, and explicit authorisations are strictly construed (*Wright v Morgan* (1926))
- In these 2 situations, the sale may be set aside (voidable) at the insistence of any beneficiary, regardless of how fair the transaction is.

- *Holder v Holder* (1968) is quite an exceptional case. Harman LJ argued that the purpose of the rule was to prevent any sale by a person acting as both vendor and purchaser, but here the property was prepared for sale by the two proving executors of the will with no input from the purchaser.
  
  o “I feel the force of the judge’s reasoning that if the [purchaser] remained an executor he is within the rule, but in a case where the reasons behind the rule do not exist, I not feel bound to apply it.”

- The other 2 judges went further and questioned whether the rule should ever be applied automatically, doubting that it was beyond the court to determine whether the trustee had taken unfair advantage of his position. (Though the problems of determining good faith are the same as with the ‘no conflict’ rule and there it is clear the traditional position is favoured – note also that Vinelott J in *Re Thompson’s Settlement* (1985) favoured the traditional approach)

The fair dealing rule

- The fair dealing rule applies to purchases not of the trust property itself, but of a beneficiary’s interest in the trust property.

- The rule is less harsh, for the simple reason that the danger here is less: since there are two real parties to the transaction with their own interests at stake, not a trustee selling to himself, the bargain is much more likely to be a real one.

- See eg, the characterisation of Megarry VC in *Tito v Waddell (No 2)* (1997), cited in *Re Thompson’s Settlement* (1985)
  
  o “The fair-dealing rule is that if a trustee purchases the beneficial interest of any of his beneficiaries, the transaction is not voidable *ex debito justitiae* but can be set aside by the beneficiary unless the trustee can show that he has taken no advantage of his position and has made full disclosure to the beneficiary, and that the transaction is fair and honest.”

The application of the self-dealing and fair-dealing rules to other fiduciaries

- The rules apply to other fiduciaries who, like trustees, have the discretion or power to enter into property sales or other contracts on behalf of their principals.

- E.g. the self-dealing rule applies to a company director who enters into a contract to buy goods for his company from another company in which he is interested (see eg, *Aberdeen Railway Co v Blaikie Bros* (1854))

- The rule also applies where someone close to the director, eg his spouse, has an interest in the second company.
- The fair dealing rule would apply where the director enters into a contract between himself and the company, so long as the company is represented by some other person or persons. Eg. Where the director sells land he owns to a company for development by negotiating the contract with the board of directors.

- Because it is not uncommon for company directors to have outside interests of various kinds, company law and company articles generally provide for a director to escape liability for breach of these rules by making full disclosure of his interests under such a transaction.

- The self-dealing rule applies to all contracts. The fair dealing rule typically only applies to contracts for land. (The reason being that in other cases, the principal will typically be negotiating with the fiduciary to perform a further service for the principal, and thus, will not involve a transaction involving the existing fiduciary relationship, but will be a contract establishing a new one.)

- If a fiduciary attempts to circumvent the application of either the self-dealing or the fair dealing rules by collusively selling to a TP, the sale is liable to be set aside as if the fiduciary were a party himself.

- Where a sale is liable to be set aside, the transaction is voidable, not void at the outset, so an innocent TP purchaser of the property from the fiduciary before a principal acts will take good title; in these circumstances, the fiduciary will be liable to account for any profits made on the resale, or if it is shown that the resale was at an undervalue, the difference between the sale price and the true value.

- Where the transaction is avoided while the property is still in the hands of the fiduciary, the principal may require the return of the property in return for the purchase price received, or may require a resale of the property on the open market – if the property fetches more on the open market than the price paid by the fiduciary, the difference is the principal’s of course.

The proprietary and personal nature of the liability to account

- Penner notes the fund analysis and the proprietary nature of the beneficiary’s interest.
- But this perspective cannot apply easily to all fiduciaries because, not all fiduciaries are accounting parties, much less trustees.
- An accounting party is someone obliged to render an account. It is generally a matter of contract and the relationship need not be fiduciary. E.g. a publisher. They are merely personally liable to ‘account for’ certain funds (depending on the relationship)
  - E.g. a solicitor is a fiduciary to his client, but unless he is dealing with his client’s property, he is not an accounting party because his service is to provide legal advice, not to manage his client’s property.
- In determining whether the fiduciary holds any unauthorised profit on trust, or rather is personally liable to pay over the value of such a profit, we should look to the basic rationale of the fiduciary’s liability for unauthorised profits.
The possible confusion arising from the terminology

- In *Williams v Barton*, Russel J decided that the trustee held the commission as a 'constructive trustee' and was 'liable to account' as if this meant the same thing. The language used in *Boardman* was similar.

- It does appear that whenever judges refer to the trust over a fiduciary's profits, even in the case of an express trustee, they always speak of a constructive trust, but the use of 'constructive' in these circumstances may be little more than a judicial tic.

- Per Millet LJ in *Paragon Finance v DB Thakerar* [1999] "The second class of case is different. It arises when the defendant is implicated in a fraud. Equity has always given relief against fraud by making any person sufficiently implicated in the fraud accountable in equity. In such a case he is traditionally though I think unfortunately described as a constructive trustee and said to be 'liable to account as constructive trustee'. Such a person is not in fact a trustee at all, even though he may be liable to account as if he were. He never assumes the position of a trustee, and if he receives the trust property at all it is adversely to the plaintiff by an unlawful transaction which is impugned by the plaintiff. In such a case the expressions 'constructive trust' and 'constructive trustee' are misleading, for there is no trust and usually no possibility of a proprietary remedy; they are 'nothing more than a formula for equitable relief'"

- In *Dubai Aluminium Co Ltd v Salaam* [2003], Lord Millet returned to the point, saying that, in the second class of case which he had identified, "the expressions 'constructive trust' and 'constructive trustee' create a trap", that they are "nothing more than a formula for equitable relief", and that "we should now discard the words 'accountable as constructive trustee' in this context and substitute the words 'accountable in equity'."

- Indeed as noted in *Sinclair Investments*  
  - 45. As this suggested reformulation implies, the traditional way in which a non-proprietary claim is assessed in equity is through the medium of an equitable account, which in turn leads to equitable compensation. The right to an account is dependent on the existence of a fiduciary relationship, so that it can be sought, for instance, by a principal against his agent, or even by a claimant in a passing off claim.
  - 46. The right to equitable compensation through an equitable account will often produce the same answer, in terms of the ultimate value to the claimant, as a proprietary interest, but it has the disadvantage of being a personal claim

*Lister v Stubbs*

- In *Lister v Stubbs* (1890), the CA clearly regarded the fiduciary's liability to account for a bribe to be personal, not proprietary.

- The CA appeared to decide that the false fiduciary would only hold property in his possession on trust for his principal where the funds were previously funds of the trust; or rather, funds that prior to his misappropriation were already trust property, and so remained trust property although wrongly dealt with by the trustee.

- Presumably the court would also have agreed that dividends payable on shares sold by the trust and paid to the trustee would be trust property the moment they were received, so that if
A trustee put them into this own pocket rather than into the trust’s bank account he would hold them on trust the moment he received them. Although not property of the trust prior to their receipt by the trustee, such income is payable by virtue of the ownership of the capital, and the beneficiaries are beneficial owners of that, and so proceeds of trust property dividends are captured by the trust fund the moment the trustee received them.

_A-G v Reid_

- In 1994 however, the PC in _A-G for Hong Kong v Reid_ (1994) decided that the recipient of a bribe held it on trust for his principal. There were two bases for the decision.
- Two bases for the decision
- Firstly, Lord Templeman quotes Sir Peter Millet speaking extrajudicially who says essentially that if a trustee places himself in a position of conflict, and accepts a bribe for example, equity insists on treating it as a legitimate payment intended for the benefit of the principle.
  - This analysis suggests that _Lister_ must be conceptually incorrect
- Lord Templeman goes on to say that “equity considers as done that which ought to have been done. As soon as the bribe was received, whether in cash or in kind, the false fiduciary held the bribe on constructive trust for the person injured”
  - Further, his application of the equity maxim is nonsense. A debt can be repaid in any way not merely _in specie_. The payment over of the bribe itself is thus not that ‘which ought to have been done’ (Swadling:1997)
- Furthermore, unlike in _Lister_, the PC was not willing to distinguish between situations where unauthorised profits are held on trust by the fiduciary from the outset, and those in which they are not. They appear to suggest that in line with the general application of the ‘no conflict’ rule. Any and all such profits will be held on trust from the outset.
  - So this decision appears to pretty much abolish the merely personal liability to account for an unauthorised profit.

_Criticisms of Reid from Penner_

- It is one thing for equity to require a fiduciary to hold on trust a profit acquired by misappropriating his principal’s property, or the income arising on it, but quite another thing to do the same for any property acquired in breach of any of his fiduciary duties, especially in the case of someone like Reid who was not even an accounting party such that there would be any prior basis in his relationship to justify him holding the bribes on trust.
- After all the rationale behind profit stripping is to strip the fiduciary of any profit earned in conflict of interest: this is typically called a ‘disgorgement’ remedy, and its purpose is to ensure that the fiduciary who places himself in a situation of conflict of interest cannot benefit thereby.
- The most compelling justification for according the right to the principal is simply that he is the only appropriate plaintiff as he has been wronged by the fiduciary’s act. The rationale follows the maxim ‘no one should profit from his own wrong’, and the principal’s claim is one for ‘disgorgement’ or ‘restitution’ for a profit acquired in the commission of a wrong.
In view of this, the primary remedy against the fiduciary should be personal not proprietary. Our goal should be to ensure that B does not profit from his wrong against the principal. To accomplish this, there is no need for the principal to acquire a proprietary interest in those profits, for that simply allows him to gain priority over B’s other creditors when B, *ex hypothesi*, has not interfered with the principal’s property.

- Because of these considerations, restitution lawyers typically argue that, except in cases where the fiduciary’s profit can be treated as in some way a misappropriation of his principal’s property, the remedy should be personal not proprietary. (see eg, Burrows)

- A final point is that one of the concerns seems to be that if only personally liable to account, he may not have to return all profits made but merely the amount + interest. But a personal liability might include liability for all profits so this isn’t a valid consideration.

*Sinclair Investments v Versailles Trade Finance* [2011] EWCA Civ 437 (Judgment of 29 March 2011)

The CA in *Sinclair* doubted whether *Reid* was correctly decided and the law as it stands today in UK is that the obligation to disgorge the bribes is personal.

The CA in *Sinclair* opined that in order to deprive the fiduciary of any benefit an order of an equitable account would be sufficient; there was no need for a proprietary remedy. Further, the PC in *Reid* failed to differentiate between a fiduciary enriching himself by depriving a claimant of an asset (where the asset is then the property of the beneficiary) and a fiduciary enriching himself by doing a wrong to the claimant. Finally, the decision in *Reid* gave insufficient weight to the potentially unfair consequences to the interests of the other creditors of the fiduciary should the fiduciary be insolvent; the beneficiary is preferred at the expense of the creditors.

The decision in *Sinclair* could be considered a preferable approach to that in *Reid*. It still achieves the same policy grounds of depriving the fiduciary of any benefit from his breach (via equitable accounting) yet does not prefer the unsecured creditors.

1. There are 5 CA decisions spread over 95 years which conclude that the liability should be personal
2. With regards to the concern about the fiduciary not having to return all the profits – “[the concern] might well be met by ordering an equitable account: there was apparently no argument before the Privy Council to that effect.”
3. The decision in *Reid* may be unsound. In cases where a fiduciary takes for himself an asset which he was under a duty to take for the beneficiary, it is easy to see why the asset should be treated as the property of the beneficiary. However, a bribe paid to a fiduciary could not possibly be said to be an asset which the fiduciary was under a duty to take for the beneficiary. There can thus be said to be a fundamental distinction between (i) a fiduciary enriching himself by depriving a claimant of an asset and (ii) a fiduciary enriching himself by doing a wrong to the claimant. Having said that, I can see a real policy reason in its favour (if equitable accounting is not
available), but the fact that it may not accord with principle is obviously a good reason for not following it in preference to decisions of this court.

4. Within scholarly articles, there seems to be greater support for *Lister* than *Reid*.

5. As for textbooks, while most support *Reid*, they typically do not analyse it. He quotes one that does and says it doubts the soundness of the decision.

6. It seems that Lord Templeman may have given insufficient weight to the potentially unfair consequences to the interests of other creditors and stands in rather stark contrast with what was said in *Lister* and more recently, in *Westdeutsche*. In that case, LBW disapproved extending the reach of resulting trust as it could produce "most unjust results", namely "conferring on the plaintiff a right to recover property from, or at the expense of [for example] the lender whose debt is secured by a floating charge and all other parties who have purchased an equitable interest only".

7. The point about *Daraydan Holdings* [2005]
   - First instance decision
   - On the facts, the decision was not inconsistent with the reasoning in *Lister*

88. In my view, Lewison J was right to reject TPL's proprietary claim... there is a consistent line of reasoned decisions of this court (two of which were decided within the last ten years) stretching back into the late 19th century, and one decision of the House of Lords 150 years ago, which appear to establish that a beneficiary of a fiduciary's duties cannot claim a proprietary interest, but is entitled to an equitable account, in respect of any money or asset acquired by a fiduciary in breach of his duties to the beneficiary, unless the asset or money is or has been beneficially the property of the beneficiary or the trustee acquired the asset or money by taking advantage of an opportunity or right which was properly that of the beneficiary.

89. For the reasons I have given, previous decisions of this court establish that a claimant cannot claim proprietary ownership of an asset purchased by the defaulting fiduciary with funds which, although they could not have been obtained if he had not enjoyed his fiduciary status, were not beneficially owned by the claimant or derived from opportunities beneficially owned by the claimant. However, those cases also establish that, in such a case, a claimant does have a personal claim in equity to the funds. There is no case which appears to support the notion that such a personal claim entitles the claimant to claim the value of the asset (if it is greater than the amount of the funds together with interest), and there are judicial indications which tend to militate against that notion.

90. Mr Miles suggested (with Lord Millett's extrajudicial support) that, essentially as a matter of equitable policy, a fiduciary should not be allowed to profit from his breach of duties, even to the extent of retaining any profit from such an asset after compensating a claimant in full. If that is indeed correct (as Mr Collings appeared to accept), then it seems to me that this should be dealt with by extending, or adjusting, the rules relating to equitable compensation rather than those relating to proprietary interests. Such a course, as I see it, would do less violence to the law as consistently laid down (where it has been specifically addressed) in a number of domestic cases of high authority, whereas it would involve little interference with established authority relating to equitable compensation. In addition, the law relating to proprietary interests, being within the law of property, is inherently rather less flexible
than the law relating to equitable compensation. Furthermore, extending the law relating to equitable compensation in such a case would interfere far less with the legitimate interests of other creditors than extending the law relating to proprietary interests.

Equitable compensation for breach of fiduciary obligation

- In certain circumstances the breach of fiduciary obligation will not give rise to any profit to the false fiduciary, or not only do that, but may actually give rise to a loss on the part of the fiduciary’s principal. In such a case the fiduciary must compensate his principal of the loss, and this compensation for the loss is styled equitable compensation.

- The principles underlying equitable compensation for breach of fiduciary duty were considered by LBW in Target Holdings (1996), although in the context of the measure of liability to restore the trust when the account is falsified. Ultimately though, it does seem that ‘but for’ causation is required. (See eg Gwembe Valley (2003) – unauthorised profits were stripped but no causation between the breach and the ultimate losses so he was no liable to compensate the company for the resultant losses.)

Secondary liability for breach of fiduciary obligation

- Where a fiduciary misappropriates his principal’s property, say where a company director fraudulently draws a cheque from the company bank account in his own favour, equity regards this as equivalent to a breach of trust and the normal breach of trust remedies against TP’s, i.e. for KR or KA, will apply.

- Making TP’s liable in the case of a true breach of fiduciary obligation is a bit more confusing. There are of course cases where the breach of fiduciary obligation itself involves misappropriation of the principal’s property. There the analogy with KR and KA is straightforward.
  
  o E.g. in CMS Dolphin (2001), by a straightforward analogy of the rules governing secondary liability for breach of trust, a TP with knowledge was liable. (Though here, the reasoning that a maturing business opportunity is a company’s ‘property’ is questionable)
  
  o Nonetheless, the case law isn’t consistent. Satnam Investments (1999) seems to suggest that merely receiving a benefit with knowledge of another’s breach of fiduciary obligation is insufficient to render one liable to the wronged principal.

- It seems doubtful that a TP could be held liable in a case where the unauthorised profit does not represent in any way a ‘taking’ from his principal, as in Reid, which one might call a ‘pure’ gain-stripping case.

- A TP who participates in a transaction in which the fiduciary acts in conflict of interest, but who acquires no gain himself, has no gain to be stripped of. And where he does acquire a gain, but does not himself owe any fiduciary obligations, there seems to be no reason to strip him of the gain.
  
  o This reasoning may justify the result vis-à-vis the TP’s in Regal Hastings. E.g. neither the solicitor nor the TP were stripped of their profit though, they clearly participated in the
scheme. (which they were in a position to realise, if they thought about it, was a scheme reflecting a conflict of interest)

The Scope of fiduciary obligations

- Trustees, agents, and company directors are the classic cases of fiduciary relationship, but the concept has been stretched to cover other cases, sometimes appropriately, sometimes not. A sensible extension of the concept brings the solicitor and client relationship, and similar cases of authoritative advice-giving into the fold.

- However, various inappropriate extensions of the concept have been made, typically in cases where the person named as a ‘fiduciary’ has committed a legal wrong that shows an abuse of loyalty or good faith.
  o *M(K) v M(H)* (1992) the Canadian SC found that a father breached a fiduciary obligation in sexually assaulting his daughter.
  o *Reading v A-G* (1951) a sergeant in the British Army who assisted smugglers, on a very strained rationale, was found to have breached a fiduciary obligation to the crown. The better explanation is that the terminology of fiduciary was fictitiously applied to provide a basis for stripping him of his ill-gotten gain. The case would better have been dealt with openly as one in which the principles of the law of UE applied to deny the gain made by committing a wrong.
  o E.g. a security guard may have no legal right to admit anyone to the building on his shift, but if he is bribed to let in some thieves, we should surely wish to strip him of that profit; but that is no reason retroactively to characterise him as a fiduciary. He should be stripped because otherwise he’d be unjustly enriched by his wrong, no because he breached a fiduciary obligation, as he had none.

- Consider Millet LJ in *Mothew*, there he emphasised the particular nature of fiduciary obligations to distinguish them clearly from a duty to take care. His separate treatment of breach of trust also indicated that he does not regard all breaches of trust as breaches of fiduciary obligations.

- Fiduciary obligations are intended to ensure that a fiduciary takes decisions that he is otherwise legally empowered or obliged to undertake in one way or another under his trust or agency or retainer in a manner that best serves the interests of his principal.

- As Millet said in *Dubai Aluminium*, “sexually assaulting a boy is not an improper mode of looking after him. It is an independent act in itself, not an improper mode of doing something else”

- Thus if your trustee favours his own interests over yours by beating you up or slandering you or stealing your bicycle, he certainly commits a wrong, but does not breach his fiduciary obligations to you.

**Bare Trusts**

- For fiduciary obligations to arise, there must be some scope for discretion or leeway in the fiduciary’s performance of his duties. No such discretion or leeway arises in the case of the nomineeship because the trustee is only to follow his beneficiary’s instructions exactly.
- In other words since there are no decisions that he could legitimately take off his own bat, while he can commit various wrongs (breaches of trust) there is nothing that he can do which can amount to a breach of fiduciary obligation.

- While this line of reason is appealing, and seems to flow from a cogent characterisation of the rationale behind the imposition of fiduciary obligations outlined above, it was not accepted by Cross J in *Re Brooke Bond* (1963). The case concerned a custodian trustee, a nominee who takes directions from a managing trustee. (nominee was an insurance company. MT instructed it to take out insurance for the beneficiary’s. If the custodian trustee was the managing trustee it’d be self-dealing but there seem to be no direct fiduciary obligations owed by the custodian trustee to the beneficiaries)

- The case seems to indicate that in all cases of trusts, the trustee will be characterised as a fiduciary regardless of whether the trustee has undertaken to take discretionary decisions in the beneficiaries’ best interests. Thus even in the case of a nomineeship, a wrong committed by the trustee that reveals the trustee favouring his own interests over the beneficiary may be regarded as a breach of fiduciary obligation.

- Being in charge of someone else’s property gives a trustee such scope for doing wrong, and provides such a temptation to commit a wrong for one’s own benefit, that a court may think it right to treat any wrong he commits in respect of his stewardship of the property that reveals a preference for his own interests over those of his beneficiaries as a breach of fiduciary obligation.

However…. Paragon Finance

• A clearly wrongful act by a trustee fiduciary who dealt under a bare trust with mandate clearly manifested his acting in his own interests in total disregard of the beneficiaries

• But he was not regarded as breaching any fiduciary obligation

• There can be no breach of fiduciary duty except where a person acts to favour his own self-interest within the scope of a discretion undertaking to permit him to serve the interests of another

**Chapter 13: Charitable trusts**

- Charity has no essential connection with the law of trusts.

- Charitable trusts are
  - Trusts for purposes that benefit the public, which
  - On the authority of statute and common law are ‘charitable’

- Charitable trusts are valid purpose trusts that are enforced not by beneficiaries, but by the AG or, more recently, by the Charity Commission

- Charitable trusts are not subject to the rule against perpetuities.

**Fiscal benefits**
Charities are generally exempt from: income tax, capital gains tax, corporation tax, inheritance tax, stamp duty
- Can claim 80% rebate on council tax, and refund remaining 20% on discretionary basis
- Not taxed on profits as long as these are applied to charitable purposes

Disassociating validity from exemption from taxation

- In *Dingle v Turner* (1972) Lord Cross suggested *obiter* that
  - ‘the courts cannot avoid having regard to the fiscal privileges according to charities. If not for them, there’d be no reason for the courts not to look favourably on the claim of any ‘purpose’ trust to be considered a charity if it seemed to confer some real benefit on those intended to benefit by it whoever they may be.
  - It is of course unfortunate that the recognition of any trust as charitable should attract fiscal privileges, for the question whether a trust to further some purpose is so little likely to benefit the public that it ought to be declared invalid and the question whether it is likely to confer such great benefits on the public that it should enjoy fiscal immunity are two quite different questions’
- Misgivings about the automatic provision of fiscal benefits to charities has a long history (see eg the dissenting judgments of Lord Halsbury LC and Lord Bramwell in *Pemsel* (1981))
- See also Gravells (1977)
- The idea is sometimes mooted that the state ought o give money directly to those ‘true’ charities which confer a genuinely public benefit (eg Chesterman (1999)). But the difficulties with dissociating fiscal advantages from charitable status must also be acknowledged.

**Difficulties**

- If only charities providing certain public benefits were to receive fiscal advantages, a new definition/graded scale of ‘public benefit’ would be required.
  - Might be complex and hard to apply
  - Raises the question why purposes with insufficient public benefit should be treated as charitable at all, never mind the fiscal advantages
- The problem is not only disassociating fiscal advantage from charitable status, but rather that charitable status has (with the expansion of purposes deemed to be charitable), become only weakly connected to the public benefit.
  - If qualifying as a charity indeed entailed that the purpose provided a genuinely public benefit, then every charity would deserve its advantaged drawn from the public purse because every charity would indeed genuinely benefit the public
- If a government were to subsidise charities with different amounts, we would question the independence of charities to pursue public goals, or to make them tailor their purposes for political reasons.
- Smaller charities unable to muster political support would be disadvantaged.
- NB. No settlor of a charitable trust personally receives any on-going tax advantages from doing so. It is the charity that receives them.
The conditions for charitable status

In order for a purpose trust to be charitable:

- The **character** of the purpose must be charitable;
- The **purposes** must, on balance, be beneficial rather than detrimental;
- The trust must benefit a **section of the public**, not a collection of private individuals;
- The purposes must be **exclusively charitable**, and in particular, the purposes must not be political; and
- The trust must **not be profit-distributing**

The charitable character of public purpose trusts

- The Charities Act 2006 provides a list of purposes which the law regards as charitable (though the old case law needs to be referred to)
- Per s2(1), a charitable purpose is a purpose which fails within s2(2) (provides a long list) and is for the public benefit (s3).
- Further, s2(4) makes clear that any other purpose which is not in the list in s2(2) but is recognised as a charitable purpose under existing charity law or by virtue of s1 of the Recreational Charities Act will count as a charitable purpose.
- Additionally, any purpose analogous to any other recognised purpose will count
- Prior to the 2006 Act, the law recognised as charitable those purposes found in the Preamble to the Charitable Uses Act 1601
  - It seems that the initial list at the time it was created consisted almost entirely of purposes that would directly work a public benefit by lowering the local rates
  - There is a school of thought that holds that even today tax relief afforded to charities can only be justified to the extent that these charities provide services that would otherwise require the allocation of state funds. (cf. fiscal advantages)
- Guided by the preamble, in *Income Tax Special Purposes Comrs v Pemsel* (1891), Lord Macnagthen produced his four-fold characterisation of what is charitable
  - Charity in its legal sense comprises four principal divisions:
    - trusts for the relief of poverty;
    - trusts for the advancement of education;
    - trusts for the advancement of religion;
    - and trusts for other purposes beneficial to the community, not falling under any of the preceding heads.

Growth by analogy

- See eg *Scottish Burial Reform and Cremation Society Ltd v Glasgow Corp* (1968)
  - “The benefit must be of a kind within the spirit and intendment of the 1601 Act... The courts appear to have proceeded first by seeking some analogy between an object mentioned in the preamble and the object with regard to which they had to reach a decision. Then they appear to have gone further, and to have been satisfied if they
could find an analogy between an object already held to be charitable and the new object claimed to be charitable.”

- It had been criticised for being outmoded but regardless, has now been given statutory footing
- The history of this expansion by analogy is somewhat dodgy
  - Mortmain and Charitable Uses Act 1736 made most gifts on land to trust void
    - Due to worries about testators disinheriting their families through gifts to church and other charities (land out of circulation)
    - Thus, religion in particular was given a wide scope
- Occasionally, a purpose ceases to be regarded as charitable.
  - The City of London Rifle and Pistol Club (1993): rifle associations no longer charitable in view of changed social circumstances
  - Both the Charity Commission and the courts (Southwood v AG) will look beyond an organisation’s stated purposes and consider its actual activities when trying to determine organisations charitability.

**Trusts for the relief of poverty**

- Poverty does not mean destitution, so they merely have to be for those who would otherwise ‘go short’ (Re Coulthurst (1951) – widows and orphaned children of bank officers was valid)
- The charity can be limited to particular classes so long as it does not name individuals nor include those who might not be poor
  - poor employees (Re Dingle), poor relations (Re Scarisbrick) were fine
  - ‘working classes’ (Re Sander’s Will Trusts) failed

**Trusts for the advancement of education**

- Includes conventional education and training but also extends to cover research, artistic and aesthetic design (Royal Choral Society), museums (British Museum Trustees), student unions, and professional bodies so long as they advance education (Royal College of Surgeons)
- However, courts are careful to ensure that this head is not used to provide charitable status for political purposes masquerading as education or research.

- Education of the young must be taken in a broader sense than mere classroom learning. (E.g. sports McMullen)
- Student unions too (Baldry); but the devotion of funds to political campaigns by student unions on issues not related to university education was not, and could be restrained by injunction (Webb)

- Dissemination of useful knowledge is covered as well (Law Reports – Incorporated Council of Law Reporting) and promotion of culture too (Re Delius)

- Carrying out useful research is charitable under the education head as well, but the limits of charitable research are unclear (Re Shaw failed; cf. McGovern v A-G; see principles)
In *McGovern*, Slade J summarised the principles. Broadly, a trust for research will qualify as a charitable trust if
- The subject matter of the proposed research is a useful subject of study
- It is contemplated that knowledge acquired thereby will be disseminated to others;
- The trust is for the benefit of the public, or a sufficiently important section of the public.

- The production of mere propaganda is not the advancement of education (*Re Hopkinson* (1949)) – ‘political propaganda... masquerading as education is not education within the statute)
- However, a trust for general political debate which doesn’t further any viewpoint may suffice (*Re Koeppler’s Will Trusts*)

### Trusts for the advancement of religion

- In general, the law of charities assumes that any religion is better than none but, as between religions, stands neutral (*Neville Estates Ltd v Madden*)
- Case law prior to the 2006 Act held that religion required a spiritual belief or faith in some higher unseen power, and some worship or veneration of that higher power; the consequence was that promoting morality or particular ethical ways of life did not count as religious purposes.
- S2(3)(a) shows that in bringing in the new Act, the government did not question whether the recognition of the advancement of religion as charitable was justified in a predominantly secular society.
- If charitable status had been withdrawn from religion that would not, of course, have meant that religious organisations would lose all association with charity. Many religious organisations carry out non-religious charitable activities such as the relief of poverty, the provision of education, etc..., and so, religious organisations carrying out these activities would retain such association to the extent they remain charitable.
- A proposal to deny charitable status to religion *per se* would only deny that status to those activities such as the performance of religious rights etc... *It is the according of charitable status to activities of that kind to which a reform of charities law would be directed*, simply because it is not clear how these activities benefit the public, rather than just the adherents of the particular religion, whose beliefs are often very controversial.
- As gad been said before, the problem with the ‘death of God’ is not that people believe in nothing, but that people will believe in anything; one might question where the public benefit in such belief is. It will be interesting to see which faiths now come to be registrable as charities.

### Trusts for other purposes beneficial to the community

- For obvious reasons, this is the most difficult category for which to define what counts as charitable, and the ‘growth by analogy’ approach is most evident here. Perhaps the easiest case is a gift to a locality, which will be treated as a gift for charitable purposes unless non-charitable
purposes for the gift are clearly specified. (e.g. *A-G Cayman Islands v Wahr-Hansen* – objects included ‘worthy individuals’)

- Thus for a purpose under the fourth head to be charitable, it must be one of those in the Preamble, or one that had already been decided to be analogous to one in the Preamble, or one of those listed in s2(2) of the Act, or one that the courts are prepared to hold for the first time is analogous to one of those. Simply because the gift is beneficial to a particular community is entirely insufficient.

- Preamble mentions ‘aged, impotent and poor people – construed disjunctively as reflected in s2(2))
  - Trusts for the provision of housing for the aged are charitable
  - Trusts for hospitals, even if they charge fees to patients, so long as they are not profit-distributing (*Re Resch’s Will Trusts*);
  - The same reasoning applies to make independent schools that charge fees charitable

- New criteria for what constitutes ‘public benefit’ has altered this position somewhat and the Charity Commission strongly advises those considering launching an appeal to consider whether the funds sought are to be used exclusively for charitable purpose or not and to inform prospective donors accordingly (especially with say trusts for disaster victims)

- Note that the public benefit requirement was considered particularly important in the case of charities under the fourth head. In *IRC v Baddeley*, a trust for Methodists in an area failed for insufficient public benefit. Viscount Simmonds said that one must observe the distinction:
  - “…between a form of relief accorded to the whole community yet by its very nature advantageous only to the few, and a form of relief accorded to a selected few out of a larger number equally willing and able to take advantage of it”

**The Recreational Charities Act 1958**

- Lord Reid dissented in *Baddeley* and the law was felt to be in confusion so this was passed
  - It is not clear it does more than to restate the existing law bar s1(2A)(b) perhaps having a slightly wider meaning than poverty
  - Does not seem to overturn *Baddeley*

- In *IRC v McMullen*, the HL decided that the gift for sports fell under the education head so did not consider the Act, but in the CA case, it was considered and the majority held that the gift was not ‘provided in the interests of social welfare,’ because it did not merely provide facilities for those deprived; secondly, it was not intended to ‘improve the conditions of life of those for whom the facilities were primarily intended’, because it was intended as a gift for pupils generally, but would only benefit those who played, irrespective of their conditions in life.
  - Bridge LJ dissented from this ‘deprived class’ saying ‘Hyde Park improves the conditions in life for residents in Mayfair and Belgravia as much as for those in Pimlico or the Portobello Road.’ His dissent won the day in the HL in *Guild v IRC* (1992), where a gift for a public sports centre was held to be charitable.

**New charitable purposes under the 2006 Act**
- See s2(2)(e) and (h)
- Charities carrying out these purposes are, because of their character, likely to benefit most from the Commission’s facilitative attitude towards political campaigning by charities.

**The public benefit requirement**

- Two aspects
  - Purpose must be beneficial to the public, not detrimental
  - The purpose must be of benefit to a section of the public
- The 2006 Act removes any more or less ‘automatic’ presumption of public benefit that would attach to any given purpose. A charity that operates abroad satisfied the public benefit test if its activities would be charitable if carried out in England (*Re Carapiet’s Trust* (2002))

**A detrimental purpose cannot be charitable**

- Although a purpose is public in nature, it must be to the public benefit, not to its detriment, to be charitable. Occasionally the courts seem willing, or perhaps feel they are forced, to make decisions about the ultimate benefits of certain purposes.
  - *National Anti-Vivisection Society v IRC*; decided that on the balance of factors, the suppression of vivisection was not beneficial to the public.
  - In *McGovern v A-G*, the court considered the possible detriment that Amnesty International’s activities might have in the conduct of foreign affairs by government.
  - In the case of religion, the court appears to allow charities that it regards as having no benefit whatsoever (*Thornton v Howe*)
    - But scientology seems to be considered detrimental (*Church of Scientology*)

**The requirement that a section of the public must benefit**

- Public benefit set out in ss3-4 of the act
- S3(2) removes the presumption
- In view of the Charity Commission’s guidance published pursuant to s4 and its analysis of the law this seems primarily to concern the question whether a section of the public benefits. In particular, the commission emphasises that charities which charge high fees, i.e. which are unaffordable to many people, must ensure that opportunities to benefit from the charity’s activities are not denied to those people. (hardship funding 9.7% of gross fee income was held sufficient in one case)
- The commission’s guidance and legal analysis seems to be that in other respects, the public benefit requirement is as it was before the act.

- In the case of trusts for the advancement of religion, the requirement that a section of the public benefits has been minimal, though not non-existent. (*In Gilmour v Coats*, contemplative nuns didn’t qualify)
There must be some engagement with the public. In Neville, a gift to a synagogue was good as the court “...is entitled to assume that some benefit accrues to the public from the attendance at places of worship of persons who live in this world and mix with their fellow citizens.”

In Re Hettherington, a gift for the saying of masses for relations was charitable as the masses were said in public.

The public benefit requirement is more crucial in the case of trusts for the advancement of education.

In Oppenheim v Tobacco Securities, a trust for the education of children of employees or former employees of the British-American Tobacco Company, the employees of which numbered over 100,000, was held to be not charitable by the HL, on the ground of insufficient public benefit, employing what has been called the ‘personal nexus’ test: if a class is defined by a personal nexus to someone, and in this case the children’s connection with their parent’s employer stands on the same footing as one’s connection with a relation, then the class is not a section of the public.

- Lord MacDermott dissented, asking whether there should be a difference between a trusts for the children of coalminers before all the pits were nationalised, which would be charitable (trust for children for members of various professions have been held to be valid) and one for the same children afterwards, which would fail since they would all be joined by the employment nexus to the NCB.
- He rejected the test and said the court must consider all the circumstances of the case, and would have held the gift to be charitable.

In Dingle v Turner, Lord MacDermott’s criticism of the personal nexus test was accepted by the HL, although this was obiter, as the gift in that case was a gift to relieve poverty, in respect of which there are no similar tests on the extent of the class.

- Lord Cross however considered that certain schemes such as the one in Oppenheim might be considered akin to fringe benefits for employees and thus, should not be subsidised by the taxpayer.

The ‘fringe benefit’ issue appeared to be central in two cases that concerned the preferential treatment of a private class in educational trusts. (come back to this — 469)

Indeed, with regards to trusts to relieve poverty, it appears that the public benefit test means no more than that the trusts cannot be for named individuals. A trust for one’s poor relations is perfectly valid (Re Scaribrick) (Dingle v Turner; poor employee’s)

The public benefit requirement is very much of the essence in respect of trusts under the fourth head. In particular, trusts will fail if the benefit appears to be unnecessarily or artificially restricted (Baddeley) or restricted to what amounts to a class of private individuals (Glasgow Police)
A charity must be exclusively charitable purposes

- This has always been the case. E.g. Morice v Bishop of Durham (1805), where a trust for ‘charitable or benevolent’ purposes failed, since not every benevolent purpose would count as a charity under the law. The rule now has a statutory footing in s1(1)(a).
- However charitable trusts may engage in subsidiary purposes or activities that are not themselves charitable, such as fund-raising, which contribute to the fulfilment of their main purposes.

- In general, political purposes are not charitable
  
o Per Lord Simmonds in National Anti-Vivisection Society: “However desirable the change may really be, the law could not stultify itself by holding that it was for the public benefit that the law itself should be changed. Each court in deciding on the validity of a gift must decide on the principle that the law is right as it stands”
  
o Further, in that the AG might have to enforce it, he should not be put in the position of forwarding a purpose that he and his government might feel to be quite against the interests of the general welfare.

- In McGovern v AG Slade J held that where the political purpose was one of a change in the laws of a foreign country, there was no danger of the court ‘stultifying’ itself, by having both to regard a law that it was bound to apply as both right and needing to be changed, since the law was a foreign one.
- But such a trust would still fail the public benefit test for the court would in such a case have even less means of judging whether the proposed change in the law was of benefit to the local inhabitants.
- Further, the court would have to take into account the risk that such activity by a UK charity would prejudice foreign relations.
- Therefore trusts whose central purposes involved a change in the law, government policy, or administrative practice either in the UK or abroad were political and thus not charitable.

- On the requirement that trust purposes must be wholly and exclusively charitable, Slade J said:
- “Each and every object or purpose designated must be of a charitable nature. Otherwise, there are no means of discriminating what part of the trust property is intended for charitable purposes and what part for non-charitable purposes and uncertainty in this respect invalidates the whole trust.
- Nevertheless, a distinction of critical importance has to be drawn between
  
o The designated purposes of the trust,
  
o The designated means of carrying out these purposes, and
  
o The consequences of carrying them out
- Trust purposes of an otherwise charitable nature do not lose it merely because, as an incidental consequence of the trustees’ activities, there may enure to private individuals benefits of a non-charitable nature. (E.g. Incorporated Council of Law Reporting)
Similarly, trust purposes of an otherwise charitable nature do not lose it merely because the trustees, by way of furtherance of their purpose, have incidental powers to carry on activities which are not themselves charitable (e.g. throw a gala dinner).

The distinction is... one between (a) those non-charitable activities authorised by the trust instrument and which are merely subsidiary or incidental to a charitable purpose, and (b) those non-charitable activities so authorised which in themselves form part of the trust purpose. In the latter but not the former case, the reference to non-charitable activities will deprive the trust of its charitable status.”

Slade J found that both securing the release of prisoners of conscience (principal purpose) and securing the abolition of torture and other degrading or inhuman punishments were not charitable purposes (including abolition of capital and corporal punishment by procuring legislative change).

The general orientation of Slade J’s approach continued in the CA decision in Southwood v AG.

The Charity Commission produces guidance from time to time on the allowable political activity by charities. The guidance has become less and less restrictive of political activities over the years.

Most recently, the Charity Commission has emphasised the positive aspects of political advocacy by charities: owing to the high regard in which they are held, their strong links to local communities, and the diversity of their activities, it is argued that they are well situated to comment on government policy and offer alternative ways of engaging in public debate and give voice to otherwise under-represented groups or interest. The 2008 guidelines suggest that, in the eyes of the Charity Commission at least (although it is difficult to know how far the courts would go), the ambit of acceptable political activity by charities is now very wide, up to and including supporting the policies of a particular political party and devoting all of their resources, for a time, to political campaigning if this best serves the purpose of the charity.

A charity must be non-profit distributing

- They may raise funds, charge fees (Re Resch’s Will Trusts) etc... but;
- They must absolutely not distribute profits. This goes for charitable companies as well as charitable trusts.
- The general rule is that the profit-earning activities of the charities are liable to the same rates and taxes, such as VAT, as are any other businesses, although various exceptions exist. (e.g. where proceeds are used solely on charitable purposes)

Preservation from failure: the cy-pres doctrine

- Where a charitable purpose would fail because the means chose for its implementation are either impractical or impossible to carry out, the cy-pres doctrine (and ss13-14 of the Charities Act 1993) can be applies so that it will not fail.
- The cy-pres power of the courts allows the court to direct that the trust property be applied to a purpose as close as possible to the one intended by the settlor.
  
  o It saves the trust from failure at the outset, or from subsequent failure when carrying out the purpose becomes impossible or impractical
- It is not obvious why, when a charitable trust fails, the court ought to be empowered to devote the trust funds to a new charitable purpose, and it is, in fact, not an easy matter to justify the court’s jurisdiction to do so.

**Preservation from failure at the outset**

- The cy-pres doctrine can save a charitable trust from failure at the outset because the charitable purpose is impractical or impossible to carry out.
  
  o Nb. the doctrine only applies to a purpose that already counts as a charitable purpose
  o The court must find that the donor manifested a ‘general’ or ‘paramount’ charitable intention, i.e. an intention to give the money to charitable purposes of which the particular gift was but a specification.
- Per Buckley J in *Re Lysaght* “A general charitable intention... may be said to be a paramount intention on the part of a donor to effect some charitable purpose. In contrast, a particular charitable intention exists where the donor means his charitable disposition to take effect if, but only if, it can be carried into effect in a particular specified way.”
- The courts have employed cy-pres effectively to strike out conditions on trusts for scholarships. (E.g. in both *Re Lysaght* and *Re Woodhams*, the condition was regarded as an inessential element of the testator’s bequest, specifying particular means of carrying out his general charitable intention to fund the said scholarships, and the conditions were deleted.

- Many cases in which charitable gifts are saved from failure at the outset concern testamentary gifts to charitable institutions or bodies that operated when the testator made his will but have since been amalgamated with others or have gone defunct. Three cases must be distinguished.
  
  o Gifts to particular named charities that no longer exist in their own right, but the purposes of which are continued by other charities; this is not an example of cy-pres because the gift is regarded as being successfully made to the intended charity. This is so even in the circumstances were, as in *Faraker*, the continuing charity has substantially different overall purposes. (poor widows vs poor generally)
  o Where the particular charitable institution named to be the recipient of the gift no longer exists, the gift will not fail if on a true construction of the testator’s intentions he intended to create a charitable purpose trust and merely indicated this institution to serve as the trustee. This too is not an example of cy-pres since a trust will not fail for want of a trustee, the court will find another trustee to carry out the charitable purpose.
    - This construction is much more likely in the case of a gift to an unincorporated charitable body than an incorporated one. Per Buckley J in *Re Vernon’s Will Trusts*
“Every bequest to an unincorporated charity by name without more must take effect as a gift for a charitable purpose. No individual or aggregate of individuals could claim to take such a bequest beneficially. If the gift is permitted to take effect at all, it must be as a bequest for a purpose, viz, that charitable purpose which the named charity exists to serve. A bequest which is in terms made for a charitable purpose will not fail for a lack of trustee”

- The reasoning is unpersuasive (as surely most testators do not know if they’re incorporated or not) but the distinction is accepted as good law. It was applied in *Re Finger’s Will Trusts*, so that a gift to a now defunct UA was valid as a purpose trust, whereas a gift to a defunct incorporated body failed, though the latter was saved by applying the money cy-pres. *Re Vernon* and *Re Finger* were both cited by approval by the CA in *Re Koeppler’s Will Trusts*. Such a purpose trust is a trust for that specific purpose only; a particular charitable institution serving as trustee must not treat the gift as a general accretion to its funds, but must apply it only to the specific purpose.
  - True cases of cy-pres only occur where the intended charitable gift actually fails as in the gift to the incorporated body in *Re Finger’s Will Trusts*.

  - *Re Harwood* established something of a general rule that a gift to a particular charity that once existed but is now defunct, is interpreted, unless there are indications to the contrary, as a gift intended for that body alone, disclosing no general charitable intention, whereas in the case of a gift to a named charity that never existed it is much easier to find a general charitable intention.

  - In *Re Spence*, Megarry VC extended the principle to the case where the testator has selected a particular charitable purpose. “I think the essence of the distinction is in the difference between particularity and generality. If a particular institution or purpose is specified, then it is that institution or purpose, and no other, that is to be the object of the benefaction. It is difficult to envisage a testator as being suffused with a general glow of broad charity when he is labouring, and labouring successfully, to identify some particular specified institution or purpose as the object of his bounty. The specific displaced the general. It is otherwise where the testator has been unable to specify any particular charitable institution or practicable purpose, and so, although his intention of charity can be seen, he has failed to provide any way of giving effect to it.”

*Preservation from subsequent failure*

- S13 Charities Act 1993