DEVELOPING ISSUES IN TRUST LAW AND PRACTICE

Hon Mr Justice David Hayton, Caribbean Court of Justice

1. DRASTIC RESTRICTION OF HASTINGS-BASS RULE

According to later interpretations of *Re Hastings-Bass*[1], where trustees had exercised a discretionary power to change the beneficial ownership of trust property, but the effect or consequences of the exercise had turned out to be different from that intended, the court would interfere with the trustees' action if they would not have acted as they did but for failing to take into account considerations which they ought to have taken into account or but for taking into account considerations which they ought not to have taken into account: *Sieff v Fox*[2].

In the conjoined appeals[3] in *Pitt v Holt* and *Futter v Futter* the Court of Appeal explained the narrow ratio of *Re Hastings-Bass* where trustees had exercised their power of advancement to create a sub-settlement for the benefit of William H-B for life, with remainders over, which they had not appreciated were void for perpetuity. The trustees' purpose was to avoid 80% death duties payable on the death of William's father, life tenant under the head trusts, because the sub-settled property would be safe if his father survived for seven years. This purpose was achieved even though the remainders were void, and, overall, the advancement was "for the benefit of" William and so intra vires. Thus the Revenue's claim that the

[1] [1975] Ch 25
[2] [2005] 1 WLR 3811
[3] [2011] EWCA Civ 197

advancement was void failed. No issue arose[4] as to "whether the exercise of the trustees' power might have been vitiated by some fault which rendered it voidable at the instance of a person affected, i.e. a beneficiary, rather than entirely void."

The Court of Appeal set out the position as follows:

1) If the trustees' purported exercise of a discretionary distributive power is outside the scope of the power it will be void[5] e.g. advancement not "for benefit of" beneficiary (Re Abrahams[6]); or appointment to non-object or by way of a fraud on the power so a non-object actually benefits rather than the nominal object; or failure to obtain a necessary consent.

2) If the exercise of a discretionary distributive power is within the scope of the power

(a) but in breach of the trustees' duties in respect of that exercise, it will not be void, but it may be voidable at the instance of a beneficiary who is adversely affected, though subject to equitable defences and discretionary factors[7]. Only rarely will it be appropriate for the trustees to take the initiative in the proceedings[8] e.g. if as in *Abacus* v *Barr*[9] they need to seek directions if a beneficiary alleges a breach of trust but does not bring his own proceedings.

(b) and there is no breach of the trustees' duties in respect of that exercise (e.g. because advice, in general or specific terms, is sought

[4] Ibid at [67]
[5] Ibid at [96], [222(i)], [229], [231], [233], [237]
[6] [1969] 1 Ch 463
[7] *Pitt* at [99], [127], [222(ii)], [229], [231], [234], [236]
[8] Ibid at [130], [231(e)]
[9] [2003] Ch 409

from apparently competent advisors as to the implications of the proposed exercise and such advice is followed) the exercise is valid, even though not achieving what was intended due to overlooking a relevant matter[10]. A remedy lies not in the realms of equity but by way of a claim for any professional negligence of the relevant advisers[11]. "The cases set a high test for the ability of the court to intervene where trustees have exercised a discretion that is within the terms of the relevant power."[12]

3) The trustees' duty in respect of the exercise of a distributive power is to take relevant but not irrelevant, matters into account so as to give "a fair consideration" to the issues[13]. Relevant matters include[14] the settlor's wishes, the circumstances and needs of beneficiaries as known to the trustees, fiscal consequences. Often the duty of care and skill will require taking professional advice[15]. No breach of duty occurs if because of inadequate advice the trustees do not take account of a relevant matter e.g. concerning tax consequences[16].

The impact of these principles is that it will be exceptionally rare for the exercise of a distributive power to be void, and, if the exercise is voidable, only a beneficiary, not the trustee, will be able to take advantage of this. Trustees will become particularly careful to obtain advice from an apparently competent professional so that they cannot be found to have acted in breach of trust, so

[10] *Pitt* at [127]
[11] Ibid at [220]
[12] Ibid at [113], [222(ii)], [229], [231], [238]
[13] Ibid at [109], [110], [229]
[14] Ibid at [114], [115], [234], [238]
[15] Ibid at [119]
[16] Ibid at [120], [127], [139], [238]

increasing the costs of running the trust. This taking of advice is likely to lead to an increase in negligence claims against those advisers and so an increase in their insurance premiums to be passed on to their clients. Thus the costs in running trusts will increase.

The above principles were applied as follows to reverse the judgments that had applied the H-B rule.

Futter v Futter

Trustees had enlarged a life interest into an absolute interest in one trust and had made advancements to beneficiaries under another family trust, having taken and followed advice from solicitors that the capital gains tax thereon could be offset using the beneficiaries personal losses and annual exemptions. The advice was incorrect.

Held: enlargement and advancement were not void because they were intra vires, and no breach of trust by trustees had occurred, so the trust was not voidable.

Pitt v Holt

Mrs. Pitt, widow and personal representative of Mr. Pitt, was his receiver appointed by the Court of Protection to look after his damages after he had been badly injured. She created for him a discretionary trust having taken and followed advice from financial advisers, who told her there were no adverse tax implications in what they proposed (though they had not considered inheritance tax implications e.g. £100,000 initial charge that could have been avoided if a disabled person trust had been set up under s. 89 1HTA 1984).

Held: creation of discretionary trust was not void because it was intra vires, and no breach of fiduciary duty had occurred, advice having been taken, so trust not voidable.

2. SETTING ASIDE A VOLUNTARY TRANSACTION FOR MISTAKE

In *Pitt v Holt* the Court of Appeal clarified in restrictive fashion the requirements if a settlor-donor is to set aside his voluntary disposition. Millett J in *Gibbon v Mitchell*[17] had held that for a settlor-donor to do this, his mistake had to be as to the legal effect of his act: if the legal effect of his deed was not that which he intended he was entitled to have it set aside. A mistake merely as to its consequences or the advantages to be gained by it was insufficient. Millett J did not have cited to him a broad test put forward by Lindley L.J. in *Ogilvie v Littleboy*[18] requiring the donor to show "that he was under some mistake of so serious a character as to render it unjust on the part of the donee to retain the property given to him", nor did he have cited to him *Lady Hood of Avalon v Mackinnon*[19]. Here, Lady Hood, having forgotten an appointment made to her elder daughter 16 years earlier, made another appointment to her intending to bring about equality with a younger daughter to whom an appointment had just been made, and Eve J. set aside the appointment to her elder daughter as made under a mistake as to existing facts.

[17] [1990] 1 WLR 1304
[18] (1897) 13 TLR 399 endorsed by HL on appeal in *Ogilvie v Allen* (1899) 15 TLR 294
[19] [1909] 1 Ch 476

The Court of Appeal clarified the position in the same way as suggested by me in my paper to this Conference in June 2010, appearing in (2010) 24 Trust L I 217. It held[20] "there must be a mistake on the part of the donor either as to the legal effect of the disposition or as to an existing fact which is basic to the transaction. Moreover, the mistake must be of sufficient gravity as to satisfy the *Ogilvie v Littleboy* test ... The fact that the transaction gives rise to unforeseen fiscal liabilities is a consequence, not an effect, for this purpose, and is not sufficient to bring the jurisdiction into play."

Three things need to be shown for a settlor-donor to succeed[21] "first, that there was a mistake, secondly that it was a relevant type of mistake, and thirdly that it was sufficiently serious to satisfy the *Ogilvie v Littleboy* test".

In *Pitt v Holt*

(1) Mrs. Pitt was under a mistaken belief at the time of creating the trust that there were no adverse tax implications.

(2) This was, however, not a mistake as to the legal effect of the transaction but as to its consequences, so the claim failed even though

(3) The mistake was of sufficient gravity to satisfy the *Ogilvie v Littleboy* test, which[22] "requires the court to consider the effect of the mistake upon the conscience of the recipient ... it points to a need to protect the recipient in his possession and enjoyment of the property given. In that respect it sets a very high test as to the gravity of the mistake." In *Re Griffiths*[23] the *Ogilvie v*

[20] *Pitt* at [210]
[21] Ibid at [211]
[22] Ibid at [203]
[23] [2009] Ch 162

Littleboy test should not have been held to have been satisfied. Mr. Griffiths had made a transfer into a trust which was potentially exempt if he had survived for seven years. If he had known at the time that he was suffering from terminal lung cancer he would not have made the transfer – he had made a mistake of fact as to his good health. He had, however, been advised to take out term insurance in case he should die within seven years, but he rejected the advice and so accepted the risk. Thus[24] "it was not against conscience for the recipients of the gift to retain it."

The Court of Appeal refused leave to appeal to the Supreme Court. Leave may, perhaps, be sought from the Supreme Court itself e.g. in *Pitt* v *Holt* to try to extend the mistake of fact jurisdiction to a mistake of law, as in other areas the distinction no longer matters.

3. THE EXTENT OF LOCUS STANDI IN TRUST LITIGATION

Procedural Rules

In disputes involving trustee-beneficiary relationships to what extent may other persons having various powers under the terms of a trust instrument be brought in as defendants or, even, themselves institute claims? It is necessary first to consider the ambit of the procedural rules governing trust litigation.

Under the English Civil Procedure Rules, CPR 64 (reflecting in shorter fashion the wording of Order 85 r 2 of the old Rules of the Supreme Court that is mirrored in

[24] *Pitt* at [198]

many offshore jurisdictions) governs "claims for the court to determine *any question arising in* (i) the administration of the estate of a deceased person, or (ii) *the execution of a trust*." (CPR 64.2) while CPR 64.4 provides that in such claims

a) all the trustees must be made parties;

b) if the claim is made by the trustees, any of them who does not consent to being a claimant must be made a defendant; and

c) the claimant may make parties to the claim any persons with an interest in or claim against the estate, or *an interest under the trust*, who it is appropriate to make parties having regard to the *nature of the order sought*.

In context it appears that "interest" is used in the broadest sense, not restricted to the interest of a beneficiary, but encompassing anyone having a legitimate interest in seeking to invoke the court's inherent jurisdiction (as set out *Schmidt v Rosewood Trust Ltd*[25]) to supervise, and if necessary to intervene in, the administration of trusts. Significantly, so far as concerns the Everest Trust in *Schmidt,* the applicant was merely the object of a power to add him to the class of beneficiaries, though it was clear that his deceased father, the settlor, expected the trustee to exercise this power in favour of his son after his death.

Practice Direction 64A instances as claims within CPR 64 claims for "an order requiring a trustee to provide and, if necessary, verify accounts, or to do or not to do any particular act" or an order directing "any act to be done which the court could

[25] [2003] UKPC 26, [2003] 2 AC 709

order to be done if the estate or trust were being administered or executed under the direction of the court."

General rules in CPR 19 are also relevant. By CPR 19.2(2) the court on its own initiative or upon the application of an existing party or a prospective new party may order a person to be added as a party if

a) it is desirable to add the new party so that the court can resolve all the matters in dispute in the proceedings; or

b) there is an issue involving the new party and any existing party which is connected to the matters in dispute in the proceedings and it is desirable to add the new party so that the court can resolve the issue.

Joining as defendant

Clearly, in an action between beneficiaries and trustees, a protector or other power-holder could be added as a defendant if this was needed to resolve all matters in dispute between the beneficiaries and the trustees or to resolve an issue connected to the matters in dispute. This will be the case where the issue is whether the involvement of a protector in the trustee's conduct protected the trustee who had acted at the direction of the protector or who had omitted to act when his proposed action was vetoed by the protector, when it is alleged that the protector in exercising his powers acted in breach of his equitable duties, perhaps also threatening the trustee that the protector would exercise his power of replacing the trustee if the trustee did not fall in with the protector's views. In some circumstances it may well be that the court will need to consider whether to replace a bullying protector or a weak trustee. It clear that the courts must have an inherent jurisdiction[26] to remove a person fulfilling a significant fiduciary role under the terms of a trust instrument so as to be regarded as an office-holder, albeit not normally of as much significance as a trustee office-holder. Both office holders need to be parties so as to be bound by the decision of the court and in an extreme case disciplined by the court eg as to payment of costs, repayment of fees, removal from office.

Acting as claimant

Can, however, a protector or other power-holder, "P", institute a claim? It seems so where "any question arises in the execution of a trust" and it is necessary to obtain "an order requiring a trustee …. to do or not to do a particular act".

(A) Examples appear to be as follows ***where T has ignored P's function*** and a court order is needed to require T to do what is necessary to recognise and enforce P's function.

(i) T refused to disclose documents and supporting information to P entitled to such under the trust deed expressly or by necessary implication or refused to pay P expenses and fees to which P was similarly entitled.

(ii) T had ignored P's replacement of T by T2, so P could seek a declaration that he had validly exercised his power to replace T by T2 and an order that T transfer the trust assets to T2[27].

[26] *Re Papadimitriou* [2004] WTLR1141 at [71], *Re Circle Trust* [2007] WTLR 631 at 639, *Bridge Trustees Ltd v Noel Penny (Turbines) Ltd* [2008] EWHC 2054 (Ch) at [28]-[29], *Centre Trustees (CI) Ltd v Pabst* [2009] JRC 140

[27] See *Von Knierem v Bermuda Trust Co* (1994) Butts OCM Vol. 1 116 , [1994] Bda LR 50 and *Virani v Guernsey International Trustees (No 1)* [2004] WTLR 1007 (Guernsey CA) and *Re Omar Family Trust* [2000] WTLR 713,714 (Cayman Grand Court)

(iii) If T had purported to replace itself with T2 without giving P an expressly required 60 days' notice in which period P could appoint a new trustee, P could seek a declaration that T2 was not the trustee but T remained trustee[28].

(iv) P, who had exercised his power to direct T on investment of the trust portfolio[29] by directing T to sell X plc shares and buy Y plc shares, could, if he was ignored, surely seek a declaration that he had validly exercised his power and, in furtherance of this, obtain an order that T sell the X plc shares and buy the Y plc shares now costing 20% more so as to reconstitute the fund in respect of which P held office as protector. Position be clearer if P's fee hinged on value of trust fund, if trust deed provided for P to get indemnity costs out of fund, if no sui juris beneficiary with a fixed interest in the fund.

(v) P, whose requisite consent to the sale of Z Ltd Co shares had not been obtained, could surely seek an injunction to restrain the sale or, if it had gone ahead, seek a declaration that his consent had not been given and, in furtherance thereof, obtain an order that T augment the trust fund by the amount by which the now enhanced value of Z shares exceeded the amount of the proceeds of sale thereof or their traceable product.

(vi) P, whose requisite consent to a discretionary distribution of £500,000 by T to B had not been obtained, could surely seek a

[28] *Re Hare Trust, Ukert v Interface Trustees Ltd* (2001) 4 ITELR 288
[29] A not so uncommon situation eg *Vestey's Executors v IRC* [1949] 1 All ER 1108, HL, *Manoogian v Sonsino* [2002] EWHC 1304 (Ch). Other powers of direction may also be conferred eg *Citibank v MBIA Assurance SA*[2007] EWCA Civ 11 at [17],[28], [68]

declaration that the payment was ultra vires and T was liable to account as if the trust fund still contained the £500,000, and, in furtherance thereof, obtain an order that T must augment the trust fund with £500,000 and interest.

In all the above cases the relevant court orders seem necessary in order to recognize and enforce P's function: in cases (ii) to (vi) a mere declaration on its own that T had wrongfully ignored the exercise of P's power would not be of much help, leaving it to the beneficiaries to follow it up if then ascertained and of full capacity. This, of course, might not be the case.

After all, a settlor can create a flexible "black hole" discretionary trust taking advantage of a perpetuity period of 125 years during which period the income must be accumulated before being paid to the corporation incorporated in England on the most recent working day before expiry of the period and which would appear last in a list in alphabetical order of such corporations, if more than one. Within the period, however, and subject to that corporation receiving no less than the current equivalent of £1,000, the trustees have powers in their absolute discretion to appoint income or capital to anyone other than the settlor and his spouse and the trustee and a defined class of persons associated with the trustee (with a letter of wishes providing some guidance as to appropriate appointees). A corporate protector, P, has power to replace the trustee and the governing law and the accounting currency of the fund and has the right to charge fees and recover its expenses and to obtain from the trustee whatever accounts and information it needs to monitor the trustee's conduct and fees, having also an ancillary power to employ investigative accountants at the expense of the trust fund.

(B) ***Where T has duly observed the T-P relationship*** but P has discovered that T appeared to have acted in breach of trust could P, in the absence of any ascertained beneficiary, itself bring a breach of trust action so that the trust fund could be restored to its proper value, or is it restricted merely to replacing T with T2 and leaving it to T2 to pursue T – or, if it did not have the common express power to replace the trustee, is it restricted to applying to the court under s 41 of the Trustee Act 1925 for the court to replace T?

It can be argued that where P's obligations relate to the whole trust fund it needs to be able to have the trust fund reconstituted so that it can fully carry out such obligations, while what is the point in conferring powers on P to monitor the conduct of the trustees if P cannot make the trustees account for misconduct? On the other hand, the role of a trustee is much greater than that of a protector. The inherent obligation of a trustee or a new trustee is to preserve and develop the value of the whole trust fund and to distribute it in accordance with the terms of the trust (subject to any powers of direction or veto of a protector), so requiring due reconstitution of the whole fund by way of substitutive performance where necessary. The lesser powers and duties of protectors, however, depend upon terms in the trust instrument as construed in the relevant circumstances.

If P merely had power to replace trustees with new trustees with the ancillary right to see trust documents and obtain information from the trustees so that P discovered breaches of trust, it may well be that the court would hold that, while P could replace the trustees, he could do no more, leaving it to the new trustees to pursue the breaches of trust. Arguably, this gives adequate substance to P's power. Would P's position, therefore, be significantly stronger if ***the trust instrument had purported expressly to confer on P***, in the event of discovering a breach of trust, not just the power to replace the trustee but also " ***a general enforcement power***", the power, at the expense of the trust fund, to make the trustee account for restoring the trust fund to its proper value, whether or not there was an ascertained beneficiary (and unless and until there were beneficiaries entitled between them to own the trust fund under the *Saunders v Vautier* principle so that P could not then interfere with their fund). After all, even if some money had been distributed to a discretionary object he might not be prepared to undertake costs risks in suing for breaches of trust[30], relying on a major beneficiary at some subsequent stage or at the end of the trust to make the claim, the limitation period not applying against a discretionary beneficiary in respect of trust property until acquiring an interest in possession in such property[31].

Where no ascertained beneficiary exists under the "black hole" trust there ought to be a presumption that the court should fulfil the settlor's intentions and expectations and let P bring T to account under P's general enforcement power, so as to prevent matters spiralling out of control, *unless* the court can find some justification for holding that P's right to replace T by T2 suffices because T2 can then

[30] See *Armitage v Nurse* [1998] Ch 241 at 261
[31] Ibid and *Lemos v Coutts (Cayman) Ltd* (2006] 9 ITELR 616

bring T to account. It could find that, while as part of the core obligation underlying the trust concept, beneficiaries and a new trustee have a fundamental inherent power to enforce a trust against a trustee, a protector has no such inherent power. Moreover, there is no need to allow effect to be given to an express general enforcement power conferred on P when P has an express power to replace T (or a power under s 41 to apply to the court to replace T). After all, P cannot be trustee of the trust of which he is protector, so the reconstitution of the fund would have to be in the hands of T, or, more realistically, in the hands of T2 who, as such, is under a duty to check that P has duly recovered for the trust fund what ought to have been recovered. Thus T2 should directly take the requisite action against T, with P only being joined if T disputes P's replacement of T by T2.

Where, however, P has power to direct or veto specific conduct of T in relation to specific trust property and T ignores P's exercise of such a power, it seems that P should not only be able to obtain from the court *declarations* that (i) the scope of his power is within a particular range, (ii) he has duly exercised his power within this range in accordance with his fiduciary duties, (iii) T in breach of trust has ignored this due exercise and so is liable to augment the trust fund in a specific way, P should also be able to obtain an *order* that T do augment the fund in such way, so as to give meaningful substance to the preceding declarations.

4. PROPRIETARY LIABILITY ONLY FOR SOME SECRET PROFITS?

The conventional position

It had been considered that the Privy Council advice to Her Majesty in *Att-Gen for Hong Kong v Reid*[32] had clearly settled that a trustee or other fiduciary, who exploited his *office* so as to receive a bribe or secret profit, held such sum and its traceable proceeds on a constructive trust for the beneficiaries or other persons to whom he owed fiduciary duties, just as if he had exploited *property* subject to a trust or other fiduciary obligation. After all, Lord Templeman, on behalf of the Privy Council, had carried out a thorough examination of the contrary view that only a personal liability for the amount of the bribe arose, as held in 1890 by the Court of Appeal in *Lister v Stubbs*[33] , and concluded

> "The decision in *Lister* v *Stubbs* is not consistent with the principles that a fiduciary must not be allowed to benefit from his own breach of duty, that the fiduciary should account for the bribe as soon as he receives it and that equity regards as done that which ought to be done ... the bribe and the property from time to time representing the bribe are held on constructive trust for the person injured."

Thus three New Zealand properties purchased with bribe money were held on trust for the State injured by its senior prosecuting counsel taking bribes to obstruct the administration of justice.

This decision as to bribes was much influenced by the House of Lords' decision in *Boardman v Phipps*[34] which, according to Lord Templeman[35], "demonstrates the strictness with which equity regards the conduct of a fiduciary and

[32] [1994] 1 AC 324
[33] (1890) 45 Ch D 1
[34] [1967] 2 AC 46
[35] [1994] 1 AC 324 at 338

the extent to which equity is willing to impose a constructive trust on property obtained by a fiduciary by virtue of his office". He concluded[36]

> "If a fiduciary [like the solicitor to the trustees in *Boardman*] acting honestly and in good faith and making a profit for himself [by virtue of his office] becomes a constructive trustee of that profit, then it seems to their Lordships that a fiduciary acting dishonestly and criminally who accepts a bribe must also be a constructive trustee and must not be allowed by any means to make any profit from his *wrongdoing*."

Earlier Lord Templeman had paid tribute to the assistance derived from a paper of Millett J (as he then was) in the *Restitution Law Review*[37], though Millett J's view that bribes were held on constructive trust by the fiduciary was not based upon any *wrongdoing* of the fiduciary. It was based upon equity treating the fiduciary as a good man who had rightfully performed his paramount obligation to act exclusively to further his beneficiary so as to hold the acquired property as an authorised receipt to be held on trust for his principal: the fiduciary was disabled as a fundamental incident of the fiduciary relationship from asserting that he had acquired the property for himself as a bad man. Millett J stated, in a passage cited by Lord Templeman[38], that where a fiduciary is in breach of the proscriptive 'no profit' rule

> "equity insists on treating him as having acted in accordance with his duty; he will not be allowed to say that he preferred his own interest to that of his principal. He must not obtain a profit for himself out of his fiduciary position. If he has done so equity insists on treating him as having obtained it for his

[36] [1994] 1 AC 324 at 338
[37] [1993] RLR 7 at 20
[38] [194] 1 AC 324 at 337

principal, he will not be allowed to say that he obtained it for himself....equity insists on treating it as a legitimate payment intended for the principal. "

In accordance with this, Lord Templeman stated[39], "As soon as the bribe was received, whether in cash or in kind, the false fiduciary held the bribe on a constructive trust for the persons injured." Of course, this does incidentally prevent a fiduciary from getting away with "wrongdoing", but the basis of the proprietary liability is not the fiduciary's wrongdoing in accepting the bribe but his inability to deny the claimant's claim that, by way of substituted performance of his overriding fiduciary obligation to act in the best interests of his principal to the exclusion of making profits for himself, he holds the bribe as his principal's property.

Underlying this core duty is an express or necessarily implied acceptance of the fiduciary that he cannot make any profit out of the opportunities provided by his fiduciary office, but, if he does, eg by taking a bribe, he cannot deny his principal's claim that he dutifully made the profit as an authorised profit to be held on trust for his principal. In the case of this completely constituted fiduciary relationship Equity provides for the situation to be the same as if, in consideration of taking up a particular paid office for the exclusive benefit of B , F contracted that he was unable to make any profit for himself (other than the payment for his services), but, if he actually did make such a profit eg by taking a bribe, he would hold the profit as soon as received on trust for B as if an authorised receipt for B[40] The claimant is not

[39] [1994] 1 AC 324 at 331.As Browne-Wilkinson V-C started in *Guinness Plc v Saunders* (1987) BCC 271 at 287, "One of the fundamental disabilities of a trustee , a director or anyone else in a fiduciary capacity is that they cannot make a personal profit out of their position."
[40] See *Reid Newfoundland & Co v Anglo-American Telegraph Co Ltd* [1912] AC 555 at 559. Cp if V is paid 5 million by P for future income from specified property or performances of V to be received by V in a particular period, and when received by V to be held upon trust for P: *Re Lind* [1915] 2 Ch 354 at

alleging that it was wrong for the defendant to receive the bribe and complaining about that. His complaint is that the defendant failed to acknowledge that he rightfully received the property as his principal's property[41].

At the core of the fiduciary obligation is the express or necessarily implied undertaking of the fiduciary to use his role exclusively for the profit of his principal and not himself, so that any profit he obtains by virtue of his role can only belong to his principal and not himself. If he cannot perform his primary obligation to deliver the profit or its traceable product over to his principal *in specie* because he has dissipated it, he must personally account to his principal so as to make a money payment. His principal, however, has the option, if the defendant is wealthy enough, to pursue a money judgment eg if, in order to have the defendant transfer a profit in the form of a purchased shareholding, it is necessary to reimburse the defendant the cost of the shareholding and the principal would rather have the net profit as in *Boardman v Phipps*.

It thus appeared that a fiduciary's liability to account for profits as a constructive trustee was inability-based and gave rise to a proprietary liability unless the claimant was happy with a personal liability of a wealthy fiduciary. Relatively recent Court of Appeal cases, however, concerned with limitation periods for persons liable as constructive trustees have raised the issue whether exploitation of a fiduciary position, as distinct from exploitation of property subject to a fiduciary obligation, amounts merely to wrongdoing giving rise only to a personal (or

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360, *Palette Shoes Pty Ltd v Krohn* (1937) 58 CLR 1 at 16. For after-acquired property in marriage settlements see *Pullan v Koe* [1913] 1 Ch 9

[41] See Lord Millett 'Proprietary Restitution' in S Degeling & J Edelman (eds) *Equity in Commercial Law,* Law Book Co, Sydney 2004 309 at 324

monetary) claim for which there is a six year limitation period rather than an unlimited period. They much influenced Lewison J[42] and then the Court of Appeal in *Sinclair Investments Ltd v Versailles Trade Finance Ltd*[43] to reject *Reid* and reinstate the authority of *Lister v Stubbs.*

Sinclair Investments

In *Sinclair Investments Ltd. v Versailles Trade Finance Ltd* Cushnie, in breach of his fiduciary duty as a director of TPL, misused money given by investors to TPL on trust for investment purposes. Instead, he used the money to finance a Ponzi scheme fronted by his company VGP. Before the fraud was discovered Cushnie sold some of his VGP shares for £28 million and used £9.9 million to buy a house in central London. The assignee of TPL's rights sued on the basis that Cushnie's breach of fiduciary duty had created a proprietary constructive trust of his profits sufficient to justify proprietary claims against the traceable products of those profits.

Lewison J (not a trust specialist) and the Court of Appeal (not containing any trust specialist) in a judgment delivered by Lord Neuberger MR held that they were not bound by the House of Lords in *Boardman v Phipps* which they (unlike the Privy Council) considered was concerned only with the personal liability of the wealthy defendants to account for profits made from their position. They were, however, bound by the doctrine of precedent as laid down by the Court of Appeal in *National Westminster Bank v Spectrum Plus Ltd*[44] to follow the reasoning of the Court of

[42] [2010] EWHC 1614 (Ch)
[43] [2011]EWCA Civ 347
[44] [2004] EWCA Civ 670 at [58]

Appeal in *Lister v Stubbs* as to there only being a personal liability for profits made by a fiduciary not from fiduciary property but from his position.

Uncertainties created by recent Limitation Act cases on constructive trusts

Lewison J and the Court of Appeal were not unhappy to follow the approach in *Lister v Stubbs* because the Privy Council in *Reid* had not been able to consider the impact of subsequent Court of Appeal cases. They considered that these cases concerned with the position of constructive trustees in s 21(1) of the Limitation Act ("LA") 1980 could throw new light upon whether a constructive trust of property had arisen as opposed to a mere personal liability to account as constructive trustee even though these cases did not discuss *Reid* or *Lister v Stubbs*. The cases hinge upon a distinction between class 1 and class 2 constructive trusts drawn by Millett LJ (as he then was) in *Paragon Finance plc v Thakerar & Co*[45], so as to help provide an underlying justification for his decision. Subsequently, this distinction has created confusion rather than clarity.

By s 21(1) no limitation period applies to actions by a beneficiary under an express, resulting or constructive trust[46]

> "(a) in respect of any fraudulent breach of trust to which the trustee was a party or a privy or
>
> (b) to recover from the trustee *trust property* or the proceeds of trust property in the possession of the trustee [a proprietary claim], or previously received by

[45] [1999] 1 All ER 400

[46] See s 38(1) LA 1980 referring to s 68(17) Trustee Act 1925 for definition of "trust" and "trustee"

him and converted to his use" [a personal claim[47]dependent upon having established an initial proprietary interest].

By s 21(3) a six year period applies to other actions by "a beneficiary of a trust to recover *trust property* [a proprietary claim] or in respect of any breach of trust", with a possibility under s 32 for time not to run till the claimant has discovered - or could with reasonable diligence have discovered – the defendant's fraud or deliberate concealment of his rights. It will be noted that both proprietary and personal claims can fall under s 21(1) or s 21(3) so the fact that a claim is proprietary or is personal is immaterial except that for s 21(1)(b) to apply there must initially have been a proprietary interest under a trust.

In *Paragon Finance Plc v Thakerar* Millett LJ was concerned with the position of constructive trustees under the LA 1980 when the claimant mortgagee was seeking to amend its statement of claim more than six years after the impugned transactions to raise allegations of fraud against its solicitors, so that its claim could extend to losses caused by a fall in the property market. Its solicitors, in breach of their contract of retainer, had not disclosed that the price agreed to be paid by the purchasing borrowers to a subvendor was much greater than the price payable by the sub-vendor to the vendor and, indeed, the loans were for greater amounts than that price. The amended statement of claim alleged that the solicitors had fraudulently not disclosed crucial information that would have led the claimant not to transfer the requisite mortgage money to them on express trusts for the completion of purchases. These trusts had been discharged in accordance with their terms, but

[47] See *JJ Harrison (Properties) Ltd v Harrison* [2001] WTLR 1327, [2001] EWCA Civ 1467 at 1348C

were alleged to have been ousted by an earlier constructive trust of the money in the claimant's favour that arose as soon as the solicitors had received the money.

Assuming that the solicitors had become constructive trustees of this money, though it was then dissipated, Millett LJ indicated that the solicitors' circumstances fell outside s 21(1)(a).

This was because their liability as constructive trustees arose as a direct consequence of the fraudulent transaction impeached by the claimant. Section 21(1) contemplated only the case where the defendant had assumed the duties of a trustee by a lawful transaction which was independent of and preceded the impugned transaction. Therefore the six year period should bar the personal claim based upon the fraud of the solicitors, just as it would a common law claim for deceit.

The solicitors fell within a class that Millett LJ regarded as a class 2 constructive trustee, such being a person who[48]

> "never assumes the position of trustee[49], and if he receives 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 [assumed[50]] trust and usually no possibility of a proprietary remedy; they are 'nothing more than a formula for equitable relief'. "

[48] [1999] 1 All ER 400 at 409E
[49] The solicitors had never assumed the position of constructive trustee of the money obliged to return it immediately to the lender and not hold it on express trust for due completion of the purchases.
[50] See note 52 below

In contrast, Millett LJ characterised a class 1 trustee as one who[51]

> "does not receive the trust property in his own right but by a transaction which both parties intend to create a trust from the outset and which is not impugned by the plaintiff. His possession of the property is coloured from the first by the trust and confidence by means of which he obtained it, and his subsequent appropriation of the property to his own use is a breach of that trust ... the plaintiff does not impugn the transaction by which the defendant obtained control of the property. He alleges that the circumstances in which the defendant obtained control make it unconscionable thereafter to assert a beneficial interest in the property."

This is consistent with Millett LJ's paper in the Restitution Law Review. A trustee or company director who, in breach of his undertaken duty to act exclusively in the interests of the beneficiaries or company and not of himself, exploits trust or company property or his position so as to make a secret profit, cannot claim that he received the profit in his own right. He is unable to deny the claim of the beneficiaries or company that he properly acquired the secret profit as an accretion to the property of the trust or the company.

Millett LJ went on to reject an amendment to plead a breach of fiduciary duty when, as he explained, the defendants had not exploited any fiduciary relationship with the claimant to misappropriate money entrusted to them. The fiduciary relationship only arose in the course of the fraud when receiving the claimant's

[51] Ibid at 409B

money as the incidental means by which the fraud was perpetrated and then wrongfully not returning it to the claimant but using it to complete the purchases.

Indeed, the defendants were dishonest facilitators of a fraudulent scam, though they had incidentally become constructive trustees in respect of the claimant’s money, and so were in a similar position to a dishonest assistant in a breach of fiduciary duty or a dishonest receiver of trust property who no longer had the property or its traceable product. These are the obvious instances of a class 2 constructive trust created as a remedy to afford relief against fraud where, as Millett LJ stated, “there is usually no possibility of a proprietary remedy” (as in the key case of dishonest assistance) but it is noteworthy that there may be as, for example, when the claimant acts before any received property held on a constructive trust[52] becomes dissipated.

Unfortunately, Lewison J in *Sinclair Investments* overlooked this in concluding his examination of Millett LJ’s judgment by stating[53], “A case falling with the first class [of constructive trustee] is a claim for recovery of trust property. A case falling within the second class is simply a claim for breach of trust.” This coloured his examination of subsequent cases that dealt with the distinction between the two classes of trustee.

[52] A constructive trust will be imposed upon misdirected trust property in the hands of a knowing recipient (*Green v Weatherill* [1929] 2 Ch 213 at 222-223,*El Ajou v Dollar Land Holdings plc* [1994] 2 All ER 685 at 700) or a deceased’s property taken over by X forthwith for himself, as opposed to the deceased’s heirs (*Nolan v Nolan* [2004] VSCA 109 at [73]), or property inherited by a murderer from his victim (*Rasmanis v Jurewitsch* [1970] 1 NSWR 650)
[53] [2010]EWHC 1614 (Ch) at [68]

In *J.J. Harrison (Properties) Ltd. v Harrison*[54] a director had bought property from his company without disclosing to it that a valuer had told him that it had good development potential, so he was able to sell the property on at a large profit. The company sued him for his personal liability to account for the proceeds of trust property received by him as constructive trustee and converted to his use, so that no limitation period applied by LA 1980 s. 21(1)(b). The Court held that his liability arose from a pre-existing fiduciary relationship with the company and its property, so s. 21(1)(b) was clearly applicable to the defendant as a class 1 constructive trustee. Thus his limitation defence failed.

Gwembe Valley Development Co. Ltd v Koshy (No. 3)[55] was a complex case where the Court of Appeal reserved judgment for seven months before Mummery LJ delivered its judgment. Koshy ("K") was managing director of Gwembe and also a director and controlling shareholder of Lasco, which was project manager of a Gwembe project with K as Lasco's agent. K arranged for Lasco to lend 56.4 million Zambian Kwacha to Gwembe, which acknowledged it as a debt of US$5.8 million. Lasco had actually acquired the Kwacha for only about $1 million, so making a massive $4.8 million profit. K did not disclose to Gwembe his interest in Lasco, so Gwembe sued the very wealthy K as constructive trustee personally liable to account for the profit he had made from Lasco's loan. He alleged the claim was barred as over six years had expired since the cause of action had arisen.

Gwembe argued that s 21(1)(b) ousted time limits or, if not, then s 21(1)(a) ousted them because K's conduct was fraudulent. Although K was in a pre-existing

[54] [2001] WTLR 1327
[55] [2003] EWCA Civ 1048, [2004] 1 BCLC 131

fiduciary relationship with Gwembe as managing director[56], the Court of Appeal held that he was not liable as a class 1 constructive trustee and therefore his circumstances fell outside s. 21(1)(b). It held[57]

> "the only thing wrong with [the payments from Gwembe to Lasco] was Mr Koshy's failure in his separate capacity as director of [Gwembe] to make full disclosure to the Board of the nature and extent of his own financial interest. [119] If that is the correct analysis then it is clear in our view that any trust imposed on Mr Koshy is a class 2 trust ...Mr Koshy's liability to account for undisclosed profits, and *any constructive trust imposed on them*, do not depend on any pre-existing responsibility for any property of the company. They arose directly out of the transaction which gave rise to the profits and the circumstances in which it was made. The fact that Mr Koshy was in a pre-existing fiduciary relationship with the company was not enough by itself to bring the case within class 1."

The Court went on to state[58] that Gwembe's case "stands or falls on s 21(1)(a) and that depends on establishing fraud" which was held to be established[59]. Satisfying s 21(1)(a) must, however, have also depended upon there being a class 1 constructive trust based on a pre-existing fiduciary relationship because *Paragon Finance* had pointed out that s 21(1)(a) could not apply where the fiduciary relationship giving rise to liability as a constructive trustee only arose at the time of the fraud, so creating a class 2 constructive trust. How could K be a class 1 trustee for s 21(1)(a) but a class 2 trustee for s 21(1)(b)?

[56] See [112]
[57] At [118(iii)] and [119]: the italics are mine
[58] At [120]
[59] At [161(9)]

It will be noted that the above cited [119] passage in focusing upon Koshy's wrongdoing is inconsistent with the then accepted position established by *Reid.* This is that the fiduciary's conduct is regarded as rightful conduct to benefit the beneficiaries of the pre-existing fiduciary relationship, so that the secret profits from the exploitation of a fiduciary office automatically belong in equity to the beneficiaries of that office under a constructive trust that the fiduciary is unable to deny. This may have been subconsciously recognised in *Gwembe* when the Court later stated[60], "It is true that Mr Koshy received profits indirectly from Lasco rather than directly from [G], but, in our judgment, that fact does not affect the application of the doctrine that the profits made by him, as result of his dishonest breach of fiduciary duty, *belong in equity* to [Gwembe]."[61] On this basis, Gwembe's action should have fallen within s 21(1)(b) as one "to recover from the [constructive] trustee trust property or the proceeds of trust property in the possession of the trustee or previously received by the trustee and converted to his use."

Gwembe is thus an unsatisfactory decision, but the above criticised [119] passage was applied by the Court of Appeal in *Halton International Inc. v Guernroy Ltd*[62] so that the claimants' action did not fall within s 21(1)(b) but was barred. Shareholders in an airline company had entered into an agreement with one of their number, the defendant, to further their interests in a manner that led them to give him a power of attorney for exercising their voting rights. He exercised it in ensuring that new shares were issued, but so as to increase his shareholding and diminish the

[60] As [138]
[61] At [137] CA accepted that the profits extended beyond actual payments to K eg from Lasco, but also to the enhanced value of K's Lasco shareholding once Gwembe's debt to it arose.
[62] [2006] EWCA Civ 801, [2006] WTLR 1241

claimants' shareholding so that he profited from that increase. The claimants alleged that he held a portion of the increase in his shareholding on constructive trust for them[63] and that he should be ordered to transfer the requisite numbers of shares to the claimants in return for being reimbursed their cost price. It was common ground[64] that this proprietary claim[65] was barred unless falling within s 21(1)(b).

On the assumption that there was a preceding fiduciary relationship, and after consideration of *Harrison* (profit from company's property) and *Gwembe* (profit from office of director), the Court of Appeal held s. 21(1)(b) to be inapplicable because the defendant's liability as a constructive trustee fell outside class 1. The CA held[66] that for there to be a class 1 constructive trust "there must be a trust (or trustee-like responsibility) for specific existing property, not merely for the means to obtain it in the future".

It is noteworthy that none of these four CA cases focused on the distinction between proprietary liability as a constructive trustee of property and personal liability to account as a constructive trustee. Indeed, *Gwembe* and *Halton* in some places appear implicitly, but inconsistently, to accept that a proprietary constructive trust may have arisen but that the circumstances still fall outside s 21(1). They seem to treat the limitation rules as a self-contained area of the law.

[63] See similar view of CA in *Gwembe* in text to fn 61
[64] See [10]
[65] See the end of [9] where also it appears that no allegation of fraud was made
[66] At [23]

In *Sinclair Investments Ltd. v Versailles Trade Finance Ltd*[67] , however, which did not involve the limitation rules, Lewison J considered that these cases indicated that a proprietary constructive trust fell within class 1 but a personal liability to account as a constructive trustee fell within class 2. He held that the case fell within class 2 so that there was no proprietary liability in respect of the proceeds of sale of Cushnie's VGP shares, whose value had been greatly enhanced by huge sums paid to VGP through Cushnie's breach of fiduciary duties owed as a director of TPL. He summarised the position as follows.

> "[80(v)] The first class of case concerns a real trust in which the property concerned really is held on trust and counts as trust property. The second does not; and is no more than a way of expressing a liability to account in equity. In the first class of case the claimant is entitled to enforce his proprietary rights.
>
> (vi) The distinction between the two is whether the defendant has assumed pre-existing fiduciary duties in relation to the specific items of property in issue. The expression 'pre-existing' means duties which precede the events of which complaint is made. If he has, then the case falls within the first class. If he has not, and in particular the fiduciary duty arises only as a result of the transaction being impugned, the case falls within the second class.
>
> (vii) A claim made in relation to unauthorised profits made by a company director otherwise than by acquiring and subsequently exploiting property owned (or formerly owned) by the company itself falls within the second class of case."

[67] [2010] EWHC 1614 (Ch) at [80]

Critique

Is not Lewison J exaggerating the impact of the three Court of Appeal cases wrestling with the application of the *Paragon Finance* distinction between class 1 and class 2 constructive trusts? The position established by those cases seems to be that s 21(1)(a) covers a beneficiary's personal or proprietary actions against someone who, after undertaking a fiduciary relationship, fraudulently breaches any of his proscriptive or prescriptive obligations under that relationship. Section 21(1)(b) covers a beneficiary's personal or proprietary actions against someone who, after undertaking a fiduciary relationship in respect of specific *property*, breaches the proscriptive 'no profit' fiduciary obligations in respect of that *property* (so becoming liable as a class 1 constructive trustee), but (rather strangely) does not extend to such actions against someone who, after undertaking a fiduciary relationship that concerns property, goes on to exploit not the property but his relationship or office so as to breach his proscriptive obligations and become liable as a class 2 constructive trustee.

Section 21 (1)(a) and (b) never cover personal or proprietary actions against someone who has not undertaken a fiduciary relationship but who, by virtue of his wrongful conduct towards the claimant, is constructively regarded as if he had undertaken such a relationship and so become liable as a class 2 constructive trustee eg a third party who dishonestly assists a breach of fiduciary duty[68] or who

[68] See *Cattley v Pollard* [2007] Ch 353 endorsed by Lord Hoffmann in *Peconic Industrial Development Ltd v Lau Kwok Fai* [2009] WTLR 999,[2009] HKFCA 16

unconscionably receives trust property[69] or who otherwise becomes a fiduciary for the first time on his involvement with some wrongdoing that affects the claimant[70].

It seems to me that Lord Millett would not be amused that his distinction between the two classes of constructive trustee has been misconstrued so that fiduciaries who exploited their office to make a secret profit fall outside s 21(1)(b) by being construed as class 2 constructive trustees instead of class 1. As revealed in his extra-curial publications[71], no distinction should be made between fiduciaries who for personal gain exploited the trust property and those who exploited their office. Both types are unable to claim they acted wrongfully on their own behalf because they are not permitted to deny that they acted rightfully so as to fulfil their core obligation to use their role to act exclusively to further their beneficiaries' interests and not their own.

How unrealistic it would be to regard a fiduciary as entering into two different undertakings on accepting his fiduciary position: (1) that he *cannot* make a profit out of exploiting *property* subject to his fiduciary obligation so that any profit so made must belong to his principal; and (2) he *must not* make a profit out of exploiting his fiduciary *position* but, if he does, the profit belongs to him subject to a liability to compensate his principal. Indeed, some fiduciaries have no fiduciary position extending to property, so that they can only exploit the fiduciary role itself that they are obliged to play eg a DPP or a Chief Superintendent of Police (unless, with

[69] Eg *Taylor v Davies* [1920] AC 636

[70] Eg taking over property of a deceased for his own benefit to the exclusion of those entitled under the deceased's intestacy or taking over the property of his murder victim

[71] 'Proprietary Restitution' in S Degeling & J Edelman (eds) *Equity in Commercial Law,* Law Book Co 2004 at pp 309-310; 'Bribes and Secret Commissions' [1993] Restitution LR 7; Book Review [2002] 2 OUCLJ 291 at 295

further artificiality, one distinguishes the case where the “bribe deal” to let off a criminal is arranged via meetings in the office of the DPP or Superintendent and using office telephones /faxes and the case where the deal is arranged at home or in the briber’s office or home). The constructive trust imposed on such a bribe surely represents a specific substitutive performance of the core obligation[72] placed upon a fiduciary that obliges him exclusively to further his principal’s interests, not his own, and so disables him from making any profit out of his position and requires such profit to be delivered to the principal as soon as received, whether the position of fiduciary is exploited in the narrow sense or the wide sense. The narrow sense covers taking a bribe not to fulfil a fiduciary prosecutorial role. The wide sense, covers a trustee taking a bribe or secret commission so as to sell trust property at an undervalue or buy at an overvalue, or a company director not disclosing to the company information that would have prevented him from acquiring company property at an undervalue or that would have prevented his corporate alter ego from making a large profit at the expense of his company.

Returning to the limitation cases, it is noteworthy that Carnwath LJ in *Halton*[73] refers to the rationale for the unlimited exception to the six year limitation period: “It is about deemed possession: the fiction that the possession of a property by the trustee is treated from the outset as that of the beneficiary. In the words of Millett LJ, the possession of the trustees is ‘taken from the first for and on behalf of the beneficiaries’ and is ‘consequently treated as the possession of the beneficiaries’. An

[72] On substitutive performance liability as distinct from reparation for loss from wrongdoing see D Hayton, P Matthews & C Mitchell (eds) *Underhill & Hayton*, *Law of Trusts & Trustees*18th ed LexisNexis 2010, Art 87 and C Mitchell (ed) *Constructive & Resulting Trusts* Hart Publishing 2010 pp 132-137

[73] [2006] EWCA Civ 801, [2006] WTLR 1241 at [22]

action by the beneficiary to recover that property is not time-barred, because in legal theory it has been in his possession throughout".[74]

Precisely, is it not the case that property acquired by the trustee from purportedly exploiting for himself the trust property or his office is taken from the first for and on behalf of the beneficiaries (as emphasised in *Reid*) and so treated as in the possession of the beneficiaries so that their claims against the trustee cannot be barred by any limitation periods? It is clear that where someone has (i) assumed a trustee-like position before (ii) he received an unauthorised profit, no time limits apply to a proprietary or personal action in respect of that profit if he acted fraudulently within the meaning of s 21(1)(a). Why should the position be any different where he did not act fraudulently but he has the profit or its traceable product in his possession or has converted it to his use within s 21(1)(b)? The problem with *Gwembe* and *Halton* is that the courts focused on class 1 and class 2 constructive trustees as if concerned with a self-contained issue, instead of addressing the issues of when proprietary liability arises and what was then the significance of the language in s 21(1) and in *Paragon.*

It is open to regard *Boardman v Phipps* as authority that a fiduciary who abuses his office of trust is liable as constructive trustee of property purportedly acquired for himself instead of for his beneficiaries: if they claim he rightfully acquired the property on their behalf for themselves absolutely or as an accretion to their fund, he cannot deny this. All members of the high-powered Privy Council in *Reid* treated *Boardman* as holding that the fiduciary was subject to such proprietary liability and

[74] A justification first brought out in *Hovenden v Annesley* (1806) 2 Sch & Lef 607 at 633-634 as Millett J explained in *Paragon*

also a personal liability, albeit that counsel and judges[75] focused upon whether or not the wealthy defendants were personally liable to account as constructive trustee in respect of their profits allegedly made by abusing their fiduciary position: such claim would succeed whether or not there was also a proprietary liability as constructive trustee of the shares producing the profits. The pleadings, however, claimed (i) a declaration that the defendants held five eighteenths of the relevant shareholding as constructive trustees for the claimant and (ii) an account of the profits for which the trustees were liable as constructive trustees - and Wilberforce J made orders giving the relief under (i) and (ii)[76] requiring accounts to be taken of the profits less a liberal allowance for the good work of the defendants. It seems the claimants did not want to have the relevant shares transferred to them in return for reimbursing the defendants for the cost of the shares. These orders remained when the Court of Appeal and the House of Lords dismissed the appeals.

In *Reid* the Privy Council, relying upon *Boardman v Phipps* as justifying proprietary liability for secret profits, did focus on proprietary liability of a fiduciary for bribes, even mentioning the priority this would give the injured principal if the fiduciary had become insolvent. It is therefore difficult to see how Lewison J could ignore the Privy Council's interpretation of *Boardman* especially when such interpretation had been accepted earlier by Rimer J (as he then was). [77]

The Court of Appeal endorsement of Lewison J

[75] Starting with Wilberforce J at [1994] 2 All ER 200B & 201H
[76] See *Boardman* v *Phipps* [1964] 2 All ER 187 at 189G-H, 1999H, on appeal [1965] Ch 992 at 1006D-E and 1021E, and [1964] 2 AC 46 at 99C-D and 112G.
[77] *Sinclair Investments (UK) Ltd v Versailles Trade Finance* [2007] EWHC 915 (Ch) at [105]

While Lord Templeman and Lord Millett had a lifetime of experience as specialist trust practitioners, Lewison J and, on appeal, the Court of Appeal comprising Lord Neuberger MR (:the MR") and Richards and Hughes LJJ had not. The latter two came from the QBD and agreed with the judgment delivered by the MR, who had been an outstanding property lawyer.[78]

The MR in a characteristically clear judgment pointed out at [32]:

> 'TPL's first proprietary claim is based on the proposition that, in his capacity as a director of TPL, Mr. Cushnie misused the funds provided by traders, that this amounted to a breach of trust and that the proprietary interest which TPL had in the funds can be traced through the proceeds of sale of the Shares [in VGP].'

It thus appears that the case was not pleaded as one where Cushnie could not deny that he had acted rightfully in accordance with his duty to use his fiduciary role exclusively for the profit of TPL and not of himself, being unable to make a profit for himself, so that such profit belonged in equity to TPL via a constructive trust for it. Treating the case as based on wrongdoing via a breach of trust, the MR then pointed out at [40] that where a trustee or fiduciary commits a breach of trust[79] the

[78] Some, indeed, consider his dissenting speech in *Stack v Dowden* [2007] 2 AC 432 more impressive than the majority speeches.

[79] Counsel did not direct the MR's attention to trustees or directors being under a disability to make a personal profit out of their position as per Browne-Wilkinson V-C in fn 39 above, with Lord Porter in *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134 at 159 stating that 'Directors occupy a fiduciary position towards the company whose board they form. Their liability in this respect does not depend upon breach of duty but upon the proposition that a director must not make a profit out of property acquired by reason of his relationship to the company'; and *Gwembe* at [44] endorsing Rich, Dixon & Evatt JJ in *Furs Ltd v Tomkies* [1936] HCA 3 stating that the principle of an undisclosed profit belonging in equity to the company rests 'upon the impossibility of allowing the conflict of duty and interest involved in the pursuit of private advantage in dealing with the affairs of the company'.

beneficiary's remedy against him is normally a personal one[80]. He then asked at [52]:

> 'Why should the fact that a fiduciary is able to make a profit from his breach of his duties to a beneficiary, without more, give the beneficiary a proprietary interest in the profit? After all, a proprietary claim is based on property law, and it is not entirely easy to see conceptually, how the proprietary rights of the beneficiary in the misused funds should follow into the profit made on the sale of the Shares [in VGP]. Although its receipt derived from his fiduciary position and was a plain breach of his fiduciary duties, it was not money which was part of the assets subject to his duties, or derived from such assets.' (at [55]).

The MR then examined the case law up to the Privy Council advice in *Att-Gen for Hong Kong v Reid* and decided not to follow it, especially in the light of the subsequent Court of Appeal cases, *Gwembe* and *Halton International* 'where the reasoning in *Lister* was followed' (at [85]), though, with great respect, no mention at all was made of *Lister v Stubbs*, those cases focusing upon *Paragon Finance's* classes of constructive trusts as seen above.

The MR stated at [80]:

> '.. that there is real case for saying that the decision in *Reid* is unsound. In cases where a fiduciary takes for himself an asset which, if he chose to take, 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

[80] The primary liability, however, of a trustee, who cannot deny that he was a good man, is to deliver in specie as trust property whatever profit he obtained from not observing his inability to make a profit out of his fiduciary role: see text after text to fn 41 above

a fiduciary could not possibly be said to be an asset which the fiduciary was under a duty to take for the beneficiary.'

But what if this was required pursuant to the beneficiary's undeniable assertion that the bribe had legitimately been obtained under the fiduciary's paramount duty to act to further the best interests of the beneficiary to the utter exclusion of his own interests?

Unfortunately, it seems that the case had not been made to the MR that the good man philosophy underlying equity entitles the claimant to assert that the bribe was acquired by the fiduciary in accordance with his duty to act as a good man and deliver it in specie to the claimant, and the fiduciary is unable to deny this by relying on himself being treated as a wrongdoer. This approach underlies substitutive performance of the trustee's duty to make authorised distributions and investments, so that if he takes unauthorised actions his accounts will be falsified and he will have to augment the trust fund as if he had acted in authorised fashion (unless the beneficiary finds it better to treat the unauthorised activity as if authorised, eg if more profitable, taking account of tracing principles). Similarly, in any tracing exercise the beneficiary can pick and choose what payments or acquisitions are to be regarded as authorised substituted performance of the trustee's duties.

If such submissions had been made the MR might have come to a different conclusion[81]. As it is, he held at [88]:

[81] He was influenced by interpreting 'the density of the judgments' in *Tyrell v Bank of London* (1862) 10 HL Cas 26 differently from the PC in *Attorney-General for Hong Kong* so as to be inconsistent with it, but, in any event, the Supreme Court, having to resolve the current uncertainties, will not be bound by *Tyrell* which did not deal with the points raised herein.

> ‘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 has been beneficially the property of the beneficiary or the trustee acquired the asset or money by taking advantage of an opportunity or right that was properly that of the beneficiary.’

The key question, however, is whether the beneficiary is entitled to claim that the beneficial interest in the bribe was his or that the opportunity to take a bribe, that was afforded to the fiduciary by his role as fiduciary, is not ‘properly that’ of the fiduciary when the beneficiary alleges that the bribe was taken in accordance with the fiduciary’s duty to further the interest of the beneficiary to the exclusion of his own interest and the fiduciary is precluded from denying this as a core incident of the fiduciary relationship.

A strong case can thus be made that *Sinclair* leaves the law is in a most unsatisfactory state and undermines the integrity of the trust concept. At its heart is the fundamental duty of a trustee of property to act exclusively in the best interests of the beneficiaries in fulfilling the role of trustee so as to profit the beneficiaries and not himself (unless duly authorised). To protect the beneficiaries from the trustee’s creditors, there is a ring-fenced fund for the beneficiaries that extends beyond the original trust property to property acquired from time to time in the role of trustee. Property acquired in authorised fashion automatically becomes part of the trust fund, while is it not the case that the beneficiaries can also claim that property purportedly acquired howsoever for himself by the trustee through his role of trustee is also part of the authorised trust fund as if acquired in accordance with his core duty?

It is accepted that there cannot be adequate ring-fenced security if the trustee could sell trust property and with the proceeds of sale buy assets for his patrimony available to satisfy his creditors' claims, but what if he could sell off trust assets at an undervalue and retain for himself bribes received from the purchasers, or if he could cause the trust to enter into disadvantageous transactions with his alter ego company so that his company could make profits for himself. Moreover, as Lawrence Collins J (as he then was) has stated,[82] 'There is no injustice to the creditors in their not sharing in an asset for which the fiduciary has not given value and which the fiduciary should not have had.'

Indeed, where the fiduciary has been given value (eg as trustee or director or DPP) for undertaking always to act in the best interests of his beneficiaries to the utter exclusion of his own interests, so as never to be in a position to retain for himself any profits made from exploiting his role, would it not be unjust to deny the beneficiaries' claim that in their best interests the fiduciary held the profits as their authorised profits as soon as received?[83] Of course, creditors of the fiduciary may be misled as to the extent of the fiduciary's private patrimony when extending credit to him but this is inevitable in a system permitting legal ownership and equitable ownership through the medium of a trust enhanced by tracing principles.

[82] *Daraydan Holdings Ltd v Solland International Ltd* [2005] Ch 119 at [86].

[83] See fn 40 above. In Equity property can be derived not just from property but from an obligation in respect of property, existing or after-acquired.

In summary, it thus appears that a strong case can be made out that where the trustee abuses his role exclusively to further the beneficiaries' interests by purporting to make a profit for himself, the beneficiaries are entitled to substitutive performance of his obligation to deliver such profit to them as soon as received. They can treat him as a good trustee who rightly did his best for them by acquiring for them the profits that he made and he is unable to assert that he was a bad trustee and made the profits for himself.

The above understanding of the trust concept is at the heart of the Privy Council holding in *Att-Gen for Hong Kong* that secret profits made by a trustee or other person fulfilling a trustee-like function in his role as trustee or trustee-like person are held on constructive trust for the beneficiaries. It justifies the House of Lords in *Boardman* declaring that the defendants, who had exploited their fiduciary position to acquire a particular shareholding, held five-eighteenths thereof on trust for the claimant, and the Court of Appeal in *Bhullar v Bhullar*[84] declaring that the defendant fiduciary's alter ego company held land adjoining land of the claimant company, of which the defendant was a director, on trust for the claimant, and must transfer it to the claimant, the defendant having exploited his position to acquire the adjoining land via his alter ego.

As acknowledged by Lord Neuberger MR in *Sinclair* at [81] there are scholars favouring the interests of the fiduciary's creditors over the interests of the fiduciary's beneficiaries, but, if their views were canvassed, this would make this lengthy paper inordinately lengthy, while my purpose is to air arguments that have not been duly

[84] [2003] EWCA Civ 424.

ventilated. Ultimately, the Supreme Court will have to determine the issue with the benefit of full, detailed forensic argument from learned Queen's Counsel that is not available to me. Meanwhile, it may be that trust deeds and contracts with fiduciary employees will be drafted with an express term that, in consideration of the right to be paid for his role under the deed or contract, the trustee or employee agrees that he cannot use his role to make any unauthorised profit for himself so that if he does so purport to use his role the profit, as soon as received, will be held on trust for his beneficiaries or employer.

5. POSSIBLE IMPACT OF EU SUCCESSION REGULATION

The Background

There will be a "Regulation of the European Parliament and of the Council on jurisdiction, applicable law, recognition and enforcement of decisions and authentic instruments in matters of succession and the creation of a European Certificate of Succession."

Negotiating its terms is very complex and very difficult, it being necessary first to harmonise conflicts of law rules on the applicable law governing succession to a deceased's estate or patrimony, when there are huge differences between he approaches of common law and civil law States.

The European Commission issued a Green Paper in March 2005 for consultation and in October 2009 published detailed proposals. The UK House of Lords' European Union Committee strongly criticised these proposals in its Report published 24 March 2010 (HL Paper 75) and the UK Government decided not to opt in to the further negotiations before the Regulation can be finalised. This means that it will not be bound by the final Regulation but will have non-voting observer participation in its final negotiation.

The Council on 4 June 2010 issued a Press Release recognising that the UK (and Ireland and Denmark) had not opted in to the Regulation negotiations and “that a lot of work still needs to be done before an overall agreement can be reached.” On 30 June 2010 the Council published a revised text of the Commission’s proposals.

The European Parliament’s Committee on Legal Affairs on 23 February 2011 published a draft Report suggesting some amendments to the text of the draft Regulation.

The core proposals

The core proposals are as follows.

1. The lex successionis will be the law of the deceased’s habitual residence at death unless he made a will in which he chose the law of his nationality (or one of his nationalities).
2. The lex successionis will govern “claw back” or rather “add back” rules that add to the deceased’s estate for the benefit of forced heirship claims lifetime gifts within a number of years before the deceased’s death.

3. The courts of the law of the deceased's habitual residence at death have primary jurisdiction unless such courts at the request of a party consider that the courts of a chosen nationality law are better placed to rule on succession matters and so stay proceedings so that a party can invoke the nationality jurisdiction. Judgments of the courts will then be recognised and enforced throughout the EU as for judgments in other civil matters under the Brussels I Regulation EC No. 44/2001. No doubt, the EFTA countries like Switzerland will negotiate a parallel convention on succession just like the Lugano Convention and the revised Lugano Convention mirrored the Brussels Convention and then Brussels I.
4. The authentic instruments of notaries and a European Certificate of Inheritance are to be almost conclusive.

UK criticisms

These proposals have all been criticised by the UK's HL's EU Committee as follows.

1. There is no definition of 'habitual residence' which will therefore need to be developed on a case by case basis by the European Court of Justice. It could well be that too many English citizens working abroad could have a foreign lex successionis governing their estates if they had not made a will choosing English law as their nationality law. If a satisfactory definition could be found why should a testator not be able to choose the law of his habitual residence at the date of his will?

2. The impact of “claw back/add back” rules of a foreign lex successionis would drastically undermine gifts of UK property to trustees, charities and individuals that are currently unimpeachable under the applicable UK lex situs rules governing lifetime transfers of property.
3. The courts of the lex successionis should have jurisdiction so that the courts of the nationality law chosen as the lex successionis should have primary jurisdiction rather than the courts of the deceased’s last habitual residence.
4. Authentic instruments of notaries and a European Certificate of Succession should be treated as useful evidence but not as almost conclusive evidence.

Future Developments

Likely to be a year before the final version of the Regulation becomes law for the civil law EU jurisdictions which have already opted in.

Virtually certain that the final version will not be in a form that the UK and Ireland can unilaterally incorporate into their domestic legislation. Once the EU Regulation is in force, however, under English conflict of laws rules it appears that if D dies domiciled in an EU State but has chosen his English nationality law to be his lex successionis or, otherwise his habitual residence a death was in England is his lex successionis, English law will accept the renvoi to England of the domiciliary EU State, Thus the UK Parliament will have to amend the Inheritance (Provision for Family and Dependants) Act 1975 which currently only applies where the deceased died “domiciled in England and Wales”, the premise being that a deceased’s lex successionis is always the law of his domicile at death. This is already incorrect in certain cases where English conflict of laws’ rules apply to an English citizen dying domiciled in a State, like Switzerland, which permits a testator to choose the law of his nationality to be his lex successionis, so that the English rules accept a “renvoi” to English nationality law.

The 1975 Act ought to apply where “a person dies and succession to his estate is governed by the law of England and Wales”, but then one needs a provision making clear when the lex successionis is English law.

It will be necessary to move from the lex successionis for immovables being the lex situs and for movables being the law of the deceased’s domicile at death. One law should cover all property but there must be a restricted choice and one law in default of a choice. In view of the EU connecting factors it seems the lex successionis should be the law of the deceased’s habitual residence (as defined) at death unless the deceased in his will chose the law of his then nationality or one of his nationalities [or the law of his then habitual residence – though this would enhance the differences between UK law and EU law and so complicate matters for international estates, though it could provide an attractive option for citizens of civil law States working for a considerable period in England before retiring to their State of nationality].