

## A REVIEW OF CURRENT TRUST LAW ISSUES

The Honourable Mr Justice David Hayton\*

### Caveat

For anyone who reads these notes, it is crucial to realise that these are my provisional views without the benefit of any argument – and, as Megarry J emphasised<sup>1</sup>, when not following his own views as an author, “argued law is tough law”. Without the assistance of counsel’s submissions I am like a ship’s captain sailing in misty dangerous waters without the benefit of a pilot to warn of hazardous rocks and shoals. If such assistance is provided in some future case, dealing with the issues considered below, I may well find that I need to steer a different course.

### 1. “No-contest” forfeiture clauses in trusts

“No contest” clauses in wills have been used for centuries. Such a clause is inserted in his will by a testator to prevent or discourage a beneficiary going to court to contest the will by providing for the beneficiary’s interest then to be forfeited and pass to another. The clause may only cover contesting the will as a whole or it may extend to contesting the validity of any provision in the will<sup>2</sup>. It may even go so far as to extend to contesting the executor’s administration of the testator’s gross estate and the executor’s distribution of the testator’s net estate to particular beneficiaries<sup>3</sup>.

Nowadays, “no-contest” clauses are being used in trust deeds,<sup>4</sup> reflecting their use in the field of wills and estates, and, as in a 2007 Cayman case, extending to interests under discretionary trusts or powers as well as fixed interests, like life interests. Beneficiaries attacking the efficacy of “no-contest” clauses have alleged that such clauses either contravene public policy, which prevents ouster of the jurisdiction of the courts<sup>5</sup>, or are repugnant to the core attribute of a property interest which is the right to go to court to vindicate and protect that interest.<sup>6</sup>

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\*LLB,LLD (Newcastle), MA, LLD (Cantab), Justice of the Caribbean Court of Justice, Trinidad & Tobago

<sup>1</sup> *Cordell v Second Clanfield Properties Ltd* [1969] 2 Ch 9 at 16

<sup>2</sup> *Nathan v Leonard* [2003] 1 WLR 827

<sup>3</sup> *Adams v Adams* [1892] 1 Ch 389

<sup>4</sup> *AN v Barclays Private Bank & Trust (Cayman) Limited* [2007] WTLR 565

<sup>5</sup> *Re Raven* [1915] 1 Ch 673.

<sup>6</sup> *Re Dugdale* (1888) 38 Ch D 176, *Re Wynn* [1952] 1 Ch 271

The case law establishes the position as follows.

- (i.) If the validity of the whole will or the whole trust deed is contested successfully, so that the will or trust is void, then the “no-contest” clause within the will or deed is void<sup>7</sup>.
- (ii.) If there is a successful challenge to the validity of a particular provision in the will or trust or to the validity of the acts of the executor or trustee in administering or distributing the testator’s estate or the trust fund, the “no-contest” clause will be ineffective. This is either because the clause is construed as applying only to unsuccessful contests or because the claimant has just been enforcing the property rights afforded to him by law, and the testator or settlor cannot prevent his recourse to the courts to vindicate his fundamental property rights<sup>8</sup>.
- (iii.) If the claimant’s challenge is unsuccessful and the “no-contest” clause is an apparently absolute clause covering any contest, it will operate to forfeit the claimant’s interest<sup>9</sup> unless the challenge was justifiable. This will be the case if the court is prepared to construe the clause as applying only to “unjustifiable” contests and then to find the contest “justifiable”<sup>10</sup>. A legal contest will be justifiable if “taken bona fide, not frivolously or vexatiously, and with probabilis causa litigandi”<sup>11</sup>. But what if the clause expressly imposes forfeiture for “unsuccessful or substantially unsuccessful contests” as opposed merely to “unjustifiable contests”? Does this mean that one cannot construe the clause as applying only to “unjustifiable contests”? Presumably not, since one can simply insert “unjustifiable” before “unsuccessful”. In any event, as a matter of law, a settlor cannot provide for a forfeiture where the claimant had justifiable cause to exercise the essential attribute of his proprietary interest, namely his right to go to court to establish and vindicate that interest.<sup>12</sup>

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<sup>7</sup> *Evanturel v Evanturel* (1874) LR 6 PC 1.

<sup>8</sup> *Re Williams* [1912] 2 Ch 399, *Adams v Adams* [1892] 1 Ch 389.

<sup>9</sup> *Cooke v Turner* (1846) 15 M & W 727; *Evanturel* (above); *Nathan* (above)

<sup>10</sup> *Powell v Morgan* (1688) 2 Vern 90, *AN v Barclays* (above) at [175] and [188]

<sup>11</sup> *AN v Barclays* (above) at [187] – [188].

<sup>12</sup> *Ibid* at [154] citing dicta in *Adams v Adams* (above), [156] and [175.2]. Presumably this means that, in respect of English property, it would not help to have chosen a governing law like that in s 3329 of the Delaware Code under which a no-contest clause is effective unless the action is for construction or interpretation of an instrument or the claimant beneficiary is determined by the court to have prevailed substantially eg in a breach of trust action.

One would imagine that a beneficiary should not be expected to exercise his right justifiably to contest matters until he has the information he needs to make an informed choice, so it seems that the executor or trustee ought not to refuse to give him the information needed before he is in a position to exercise such right<sup>13</sup>. Alternatively, the refusal of the trustee to provide requested information could make the subsequent legal proceedings justifiable, so that it would be advisable for the trustee to provide the information.

Note that the forfeiture condition must be so framed that the beneficiaries and the court can know with certainty the exact event the happening of which will result in forfeiture. Such event need only be ascertainable, even though there may be difficulty in ascertaining whether or not the event has occurred<sup>14</sup>.

Note also the advantage of an automatic forfeiture under a “no-contest” clause. Where the trustee or a protector exercises fiduciary discretionary powers to penalise B from B’s viewpoint (e.g. by deleting him from the class of beneficiaries or appointing the whole trust fund out on trusts for the benefit of other beneficiaries or distributing virtually all the income to other discretionary beneficiaries) such exercise may be impeached by B e.g. as not an exercise of a power in good faith in properly informed fashion for the purposes for which the power was conferred by the settlor, taking account of any disclosed letter of wishes.

## **2. When are the powers of trustees, protectors and settlors fiduciary or personal?**<sup>15</sup>

The obligations attached to the exercise of a fully fiduciary power are

- (i) to consider from time to time as appropriate whether or not to exercise the power (though in the case of a discretionary trust the income or capital, as the case may be, must be distributed within a specified or otherwise reasonable period, though there is power to discriminate between the beneficiaries);

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<sup>13</sup> Cp *J & H Ritchie Ltd* [2007] UKHL 9, [2007] 2 All ER 353 at [16]-[19]. Reasons for exercising distributive decisions need not be disclosed

<sup>14</sup> *AN v Barclays (above fn 4)* at [87] and [93].

<sup>15</sup> Further see Underhill & Hayton, *Law of Trusts & Trustees* 17<sup>th</sup> ed paras 1.76- 1.92

- (ii) to exercise the power for the purposes for which the settlor conferred the power, so as not to commit a fraud on the power, and so as not to act perversely to the settlor's sensible expectations by exercising an equitable power to do something which would not have been done but for failing to take account of a material consideration or taking account of an immaterial consideration;
- (iii) to avoid any conflict of interest between the personal interests of the power holder and his altruistic duties to the beneficiaries;
- (iv) to act gratuitously (unless authorised by statute);
- (v) to act fairly and impartially;
- (vi) not to release the power;
- (vii) not to fetter the future exercise of the power.

It is possible for a power to be partly fiduciary so that the power holder is expressly exempted from (i) and/or (iii) and/or (iv) and/or (vi) (eg in relation to a power to add or subtract a beneficiary or a power to replace a trustee or a power to change the applicable law). Indeed, a power may be only slightly fiduciary as where there is a duty to consider adding or subtracting a beneficiary from time to time, but the exercise of the power is to be a personal function unchallengeable in the courts unless amounting to a fraud on the power.

There may also be an exemption clause as respects possible liability for breach of any duty.

It is possible for some powers of a particular power-holder to be fully fiduciary, some partly fiduciary, some slightly fiduciary. This will normally require express provisions in the trust instrument, though it may arise by necessary implication in all the circumstances.

Indeed, some powers could be personal powers, whether beneficial or non-beneficial. A personal power is *non-beneficial* when no duties at all exist in relation to the power other than the duty not to commit a fraud on the power: the power-holder eg a widow, is not able to benefit herself directly or indirectly, but, otherwise is able to ignore the power's existence or exercise it for spiteful or malicious reasons so as unfairly to discriminate between her issue, the objects of the power, without it being possible to call her to account before the courts.

A personal power is *beneficial* when conferred on the power-holder to enable him to act selfishly in his own interests for his own benefit eg to discharge his legal or moral obligations to persons or to refuse his consent to a course of action that would harm his interests though benefiting the other beneficiaries. There is no scope for the fraud on a power doctrine.

It should be noted that there is no agreed classification of different types of fiduciary or personal powers. There is a gradation of duties that can apply to the exercise of a power and it is a question of construction of the trust instrument, in the light of the role that the particular power-holder is to play, to determine the extent of relevant obligations. The trust instrument is supreme, subject to trustees and protectors that play key roles having an irreducible minimum content of duties attached to such roles, while the exercise of key powers (eg to appoint new trustees) is strongly presumed to be fully fiduciary.

Trustees play the most fundamental role at the heart of the trust. While they will be expected to have fully fiduciary duties in exercising their powers in favour of beneficiaries under a discretionary trust (except if there is some express protection for exercise of a discretion in favour of a Primary Beneficiary without the need to consider the interests of any other beneficiary), there is, in my view, no reason why their discretionary power to benefit objects of a power of appointment could not be non-fiduciary to a greater or lesser extent if this were to be spelled out in the trust instrument.

There can be different types of protectors to play different roles.

- (1) At one extreme there can be a paid independent trust company or professional person whose role under the trust instrument is to safeguard the beneficiaries' interests, vetting the accounts and stewardship of the trustees with power to replace them and, perhaps, with power to withhold consent to certain proposed actions of the trustees (eg as to selling particular assets or changing the applicable law or the applicable currency for the accounts). It would be repugnant to this core role to permit all liability to be avoided by an express provision that exercise or non-exercise of any power of the protector was to be regarded as the exercise or non-exercise of a non-fiduciary power, so that the conduct of the protector was to be

unchallengeable in the courts unless amounting to a fraud on the relevant power. It would, however, be permissible to have an express provision that the protector was not to be held liable for any conduct unless such conduct was dishonest or reckless.

- (2) At the other extreme, the settlor could be named as first protector (with power to nominate a successor protector to have similar power and so on for the duration of the trust period) with a provision that while the settlor was protector (or any widow or relative) the exercise or non-exercise of any powers vested in the protector was to be considered to relate to personal powers conferred on the protector purely for his own benefit and so to be unchallengeable in the courts.
- (3) As a half-way house, an independent professional person could be protector with powers as in (1) and with an express provision that in exercising the powers he is to be entitled to prefer the interests of the settlor to those of the beneficiaries in any matter concerning the X Co while the settlor was a director thereof, and that his conduct in exercising the power to replace the trustee by a new trustee is to be regarded as the exercise of a non-fiduciary personal power unchallengeable in the courts unless amounting to a fraud on the power (eg by obtaining a personal benefit therefrom) so long as the new trustee is a corporate trustee authorised to act as a trust corporation in its jurisdiction.

An illuminating recent case in this area (applying *Underhill & Hayton* paras 1.76- 1.77 and 1.81 – 1.83 and examining existing case law) is *Basel Trust Corporation (Channel Islands) Ltd v Ghirlandia Anstalt* [2008] Jersey Royal Court 013, 28 Jan 2008. The Deputy Bailiff made the following points.

At [80] there is general acceptance that the power to appoint new or additional trustees is regarded as a fiduciary power even where the power is conferred upon someone other than the trustee eg a protector who is an office holder<sup>16</sup>.

At [81] there was nothing in the terms of the trust deed before him to suggest that the power to appoint new or additional trustees was not a fiduciary one.

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<sup>16</sup> Or even a settlor: *Re Osiris Trustees* [2000] WTLR 933, 2 ITELR 404

At [82] it is a question of construction of the particular trust deed as to whether a particular power of a protector (eg to appoint a successor protector) is fiduciary or not: it may well be the case that some powers of a protector are fiduciary and others are personal.

At [90] there was no indication from the trust deed that the powers of the protector were to be regarded as personal powers.

The Court held the protector's power to appoint new or additional trustees was a fiduciary power to be exercised in good faith in the best interests of the Trust and the beneficiaries as a whole, as was the protector's power to appoint a successor protector. The exercise by the protector of a power to replace himself by a successor protector, and then the exercise by the new protector of its power to appoint two additional trustees to join the sole trustee, Basel, were both in good faith in the best interests of the beneficiaries as a whole.

Kaplan (K") had set up the Jersey Trust with himself as first protector, having made a fortune out of an internet bookmaking and gaming business known as BetonSports, but it was in alleged breach of USA gambling laws, so he was indicted in July 2006 for illegal gambling, coupled with associated counts of racketeering and tax evasion. The Jersey trustee, Basel, thus filed a Suspicious Activity Report ("SAR") with the Jersey Police, creating huge problems for making payments out of the Trust and for Basel communicating with K. In March 2007 K was arrested in the Dominican Republic and extradited to Missouri where he is in custody awaiting trial.

Back on 6 Sept 2006, K as protector appointed Ghirlandina, a Liechtenstein Anstalt (in which he had founder's rights giving him ultimate control) in his place as protector. On 8 Sept Ghirlandina as protector appointed as two additional trustees a Liechtenstein entity and a BVI Co. This happened "behind the back of Basel."

The Court rejected the allegation that K had had a broad intention to place the Trust assets outside the reach of the USA authorities. It accepted that because there was a likelihood K would be arrested and remanded in custody, so as to be unable effectively to act as protector, K's

intention in appointing Ghirlandina was to have a corporate body capable of acting through its officers (though ultimately K had some control) and this was in good faith and in the best interests of the beneficiaries as a whole. He also had a secondary intention that Ghirlandina would then appoint two additional trustees capable of outvoting Basel. This appointment was to make possible moving the control and administration of the Trust (with significant assets it had in Switzerland) to a jurisdiction where the trustees would be free to discuss matters with him and would be unfettered by the need to get the consent of the Jersey authorities, so that things would be as they were before the Jersey SAR. The secrecy was to enable the new trustees get control of the assets before Basel was aware, Basel not being able without the consent of the Jersey authorities to transfer control out of Jersey – and such consent would not have been forthcoming.

“We find that, in so doing, he was acting in good faith in what he believed to be the best interests of the beneficiaries of the Trust”

While the exercise of the fiduciary powers was to circumvent the effect of the Proceeds of Crime (Jersey) Law 1999, the exercise of the powers did not infringe the fraud on a power doctrine. K (and Ghirlandina), in having an intention to have a situation where the trustees (with the consent of the protector as necessary) were free to deal with the assets of the Trust as they thought in the best interests of the beneficiaries without having to seek the consent of the Jersey authorities, “far from having an intention which is beyond the scope of or not justified by the instrument creating the power...” had an intention “entirely consistent with the purposes for which the powers were conferred” (at [98] ).

### **3. The Hastings – Bass Principle**

#### **A. When does it apply?**

The principle summarised by Lloyd LJ

Nowadays one starts with Lloyd LJ (giving judgment in a Chancery Division case heard just before his elevation) in *Sieff v Fox*<sup>17</sup>

“Where trustees act under a discretion ... in circumstances in which they are free to decide whether or not to exercise that discretion, but the [direct or

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<sup>17</sup> [2005] 1 WLR 3811 at [119(i)]

consequential]<sup>18</sup> effect of the exercise is different from that which they intended, the court will interfere with their action if it is clear that they would not have acted as they did had they not failed to take into account considerations which they ought to have taken into account or taken into account considerations which they ought not to have taken into account.” The courts should<sup>19</sup> “take a reasonable and not over-exigent view of what it is that the trustees ought to have taken into account” and “adopt a critical approach to contentions that the trustees would have acted differently if they had realised the true position.”

### Clarifications of H-B principle

- (1) Despite the terminology of *Sieff* (above), *H-B* covers beneficiaries of a discretionary trust, even though discretionary trustees are not free to decide whether or not to exercise their discretion in favour of beneficiaries: they must exercise it, though having leeway as to who gets how much: *Smithson v Hamilton*<sup>20</sup>. Lloyd LJ was simply concerned to distinguish some pension cases where the trustees had to exercise their discretion to decide claims to entitlement to benefits and where it sufficed that the trustees might not (as opposed to “would not”) have acted as they did but for their failings. It is better to explain pension cases as ones where the beneficiaries’ rights to crucial retirement benefits had been earned and so the settlor-beneficiaries’ expectations were justifiably higher than beneficiaries under a patriarch’s family trust<sup>21</sup>.
- (2) “The effect of the exercise” was held in *Sieff* not just to be the direct effect (which will often be that intended) but also the consequential effect (eg severe overlooked tax consequences, whether because the trustee mistakenly failed to follow proper tax advice<sup>22</sup> or received erroneous advice<sup>23</sup>).
- (3) The discretion should only concern equitable powers exercisable in respect of trust property in favour of beneficiaries or objects of powers of appointment (to both of whom duties to be

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<sup>18</sup> This seems more accurate: cp *Smithson v Hamilton* [2008] 1 All ER 1216 at [53]

<sup>19</sup> [2005] 1 WLR 3811 at [82]

<sup>20</sup> [2008] 1 All ER 1216

<sup>21</sup> See D Hayton [2005] Conv 229

<sup>22</sup> *Abacus Trust Co v NSPCC* [2001] WTLR 953

<sup>23</sup> *Sieff v Fox* (above), *A v Rothschild Trust* [2006] WTLR 1129

adequately informed are owed by trustees when considering distributing trust assets), as opposed to legal administrative or management powers which have to be exercised with due care and skill<sup>24</sup>. The discretion to decide that beneficiary or object X is to benefit to the tune of \$100,000 or particular assets of that value is an equitable discretion conferred by the trust instrument and exercisable according to trust law, leading to X being entitled to call for legal title to be vested in him as regards the assets to which he has become equitably entitled under the exercise of an equitable discretion.

The exercise of legal contractual or dispositive powers of management in favour of third parties is a function of the trustee's own common law legal capacity to contract, or to dispose of owned property, as an individual or as a corporation with statutory powers. A contract or a transfer of property made by a trustee will be a legally valid one even if unauthorised and made in breach of trust law, though then the trustee cannot indemnify himself out of the trust fund (as is also the case where an authorised contract or transfer was made, but in negligent breach of the trustee's duties of care and skill). The power to appoint new trustees and transfer legal title to the trust property to them has been held to be outside *H – B*<sup>25</sup>.

A Jersey case, *Seaton Trustees Ltd v Morgan*<sup>26</sup> seems incorrect in applying *H-B* to a trustee accepting an assignment of contractual rights to it arranged by the settlor, which the trustee would not have done but for erroneously believing this to be tax-advantageous for (instead of detrimental to) the settlor: the settlor should have sought to set the assignment aside for mistake: see *Ogden*<sup>27</sup> in point (7) below. *Barclays Private Bank & Trust (Cayman) Ltd v Chamberlain*<sup>28</sup> also seems incorrect in applying *H-B*, where the trustee accepted a loan of £750,000 from a company controlled by the settlor, but would not have done so but for erroneously believing this to be tax-advantageous for the settlor when it was very detrimental to the settlor's tax position: see point (6) below.

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<sup>24</sup> See *Donaldson v Smith* [2006] EWHC 1290 (Ch), [2006] All ER (D) 293, noted M Conaglen & R Nolan (2006) 65 CLJ 499. Also see HW Tang in (2007) 21 Trust LI 62 and Underhill & Hayton, *Law of Trusts & Trustees*, 17<sup>th</sup> ed para 61.22

<sup>25</sup> *Re Duxbury's ST* [1995] 1 WLR 425 at 428, Rattee J referred to by Mummery LJ

<sup>26</sup> [2006] JRC 206, 8 Nov 2007, sub nom *Re Winton Investment Trust* [2008] WTLR 553

<sup>27</sup> [2008] 2 All ER 654

<sup>28</sup> [2007] WTLR 1697

(4) Where a mistake has led to the introduction of a clause which needs to be changed, rather than nullified, to correct the mistake, then if rectification is not available a claimant cannot obtain rectification by the back door by undertaking that, if the court applies *H-B* to nullify the mistaken clause, it will introduce an amendment into the trust deed pursuant to a power in that behalf in the trust deed: *Smithson v Hamilton* at [61].

Note that rectification will not be awarded if the relevant intention was accurately recorded in the document, there being no mistake about the terms, language or meaning of the executed document, only a mistake as to subsequently discovered consequences eg that such document has such adverse financial/tax implications that if these had been known when the document was being executed it would have been amended before execution<sup>29</sup>. Moreover, rectification will not be awarded if there is not clear evidence as to what such amendment would have been<sup>30</sup>.

(5) *H-B* can apply to strike out part only of what was done (*Burrell v Burrell*<sup>31</sup>) but only if what then remains after dealing with the deficiency does not upset the balance of the trust deed eg by creating any unintended deficiencies or anomalies: *Smithson v Hamilton* at [71].

(6) *H-B* cannot apply where the trustee did not originate the impugned transaction but merely joined in signing the settlor's deed of trust which the settlor would like set aside due to his mistakenly failing to taken account of a relevant consideration when entering into the transaction augmenting the trust fund: *Smithson v Hamilton* at [81] [90] and [97].

(7) It is most important to note that setting aside for mistake is no longer restricted to an individual's "mistake as to the effect of the transaction itself and not merely as to its consequences or the advantage to be gained by entering into it" (per Millett J in *Gibbon v Mitchell*<sup>32</sup>) but is available to a donor "showing that he was under some mistake of so serious

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<sup>29</sup> *Connolly v Bellway Homes Ltd* [2007] EWHC 895(Ch) at [107-109], *Allnutt v Wilding* [2007] EWCA Civ 412, [2007] WTLR 942 at [18-21] per Mummery LJ

<sup>30</sup> *Allnutt* [2006] EWHC 1905 (Ch), [2006] WTLR 1317 at [25-26] per Rimer J (as he then was), plus in CA at [26-27] per Carnwath LJ

<sup>31</sup> [2005] EWHC 245 (Ch)

<sup>32</sup> [1990] 1 WLR 1304 at 1309

a character as to render it unjust on the part of the donee to retain the property” per Lindley LJ in *Ogilvie v Littleboy*<sup>33</sup>, endorsed on appeal<sup>34</sup> by Lord Halsbury and applied in *Ogden v Trustees of the RHS Griffiths 2003 Settlement*<sup>35</sup> and *Clarkson v Barclays Private Bank & Trust (Isle of Man) Ltd*<sup>36</sup>. These cases indicate that a mistake is regarded as sufficiently serious if it is a causative mistake so the donor would not have made the gift but for his mistake.

This provides support for the view that Lloyd LJ was right in *Sieff v Fox* to reject the view of Lightman J in *Re Barr’s ST*<sup>37</sup> that *H-B* only applied where it was a breach of the trustee’s duties that led him to ignore a relevant consideration or to act upon an irrelevant consideration. Thus *H-B* is also available where the trustee acted properly in trying to identify the relevant consideration but was led astray by a representation of the settlor or of professional tax advisers and so made a discretionary distribution that he would not have made but for an innocent mistake caused by others misleading him when duly performing his duties.

## **B. How does *H-B* work: void or voidable decisions and ouster of *H-B*?**

### **(1) Void or voidable decisions?**

Older case law indicates that the application of *H-B* leads to the trustee’s impeached exercise of a discretionary equitable power being declared to be void ab initio<sup>38</sup>. The basis for this seems to be that the trustee can only fairly exercise his *fiduciary* distributive powers if he is adequately accurately informed of the relevant considerations, so that if not so informed the exercise of the power is unauthorised and void, just like the exercise of a power of advancement for the benefit of B is void if not for B’s benefit.

Clearly, it would give the court greater flexibility in trying to restrict the potential ambit of *H-B* if application of *H-B* led to the trustee’s exercise of discretion being voidable and so subject to

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<sup>33</sup> (1897) 13 TLR 399

<sup>34</sup> (1899) 15 TLR 294

<sup>35</sup> [2008] 2 All ER 654

<sup>36</sup> [2007] WTLR 1703

<sup>37</sup> [2003] Ch 409

<sup>38</sup> See *AMP(UK) Ltd v Barker*[2001] WTLR 1265 at [90] and *Sieff v Fox* [2005] 1 WLR 3811at [81]

discretionary bars on the granting of such relief, as Lightman J was prepared to hold in *Re Barr's ST*<sup>39</sup>, though Lloyd LJ<sup>40</sup> doubted whether this was open to Lightman J, and the New South Wales Supreme Court<sup>41</sup> has followed Lloyd LJ's view.

So far, the matter has only been considered in the High Court. However, there is much to be said for treating the mistakes of trustees as voidable like the mistakes of individuals, so that there is a level playing field for taxation of individuals and taxation of individuals with interests under trusts. It is noteworthy that in *Barrow v Isaacs*<sup>42</sup> where a tenant had sub-let the premises, mistakenly forgetting to ask for his landlord's consent as required under the lease, and the landlord sought to forfeit the lease, the Court of Appeal accepted that there had been a mistake but in the exercise of its equitable discretion would not relieve the tenant "from a forfeiture incurred by his own gross carelessness." It would be sensible for gross carelessness of a trustee in implementing a tax avoidance scheme devised by a Queen's Counsel to prevent relief being granted to the trustee under the *H-B* principle.<sup>43</sup>

Alternatively, one could take advantage of the fact that the Court of Appeal in *Edge v PO*<sup>44</sup> brought out an analogy between judicial review principles for impeaching the exercise of a discretion and trust law principles for impeaching the exercise of a trustee's equitable discretions. In the judicial review context (concerned like *H-B* with the process by which decisions were reached) in *London & Clydesdale Estates Ltd v Aberdeen DC* Lord Hailsham stated<sup>45</sup>:

"though language like 'mandatory', 'directory', 'void', 'voidable', 'nullity' and so forth may be helpful in argument, it may be misleading in effect if relied on to show that the courts, in deciding upon the consequences of a defect in the exercise of a power, are necessarily bound to fit the facts of a particular case and a developing chain of events into rigid legal categories or to stretch or cramp them on a bed of Procrustes invented by lawyers for the purposes of convenient exposition."

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<sup>39</sup> [2003] Ch 409 at [3], [33]

<sup>40</sup> *Sieff* at [81]

<sup>41</sup> *Sinclair v Moss* [2006] VSC 130 at [84]

<sup>42</sup> [1891] 1 QB 417

<sup>43</sup> See *Abacus Trust Co (Isle of Man) Ltd v NSPCC* [2001] WTLR 953, [2001] STC 1344

<sup>44</sup> [2000] Ch 602

<sup>45</sup> [1980] 1 WLR 182 at 190 endorsed by Lord Woolf in *R v Sec of State for Home Dept* [2000] 1 WLR 354 at [32]

Developing a similar flexible approach to the impugned exercise by trustees of their equitable powers would help curb the excessive potential of *H-B* and would be consistent with the flexibility accorded by *Schmidt v Rosewood Trust Ltd*<sup>46</sup> to the issue of the locus standi of the objects of discretionary powers or trusts to obtain information from the trustees and see documents in their possession. Otherwise, to restrict the unfortunate effects of a void exercise of an equitable power, just as pleas of acquiescence or laches can bar the claim of a beneficiary under an express trust<sup>47</sup>, so they should be able to bar *H-B* claims. However, as will be seen at **5A** below, if the beneficiary retains the transferred property the defence of change of position is unavailable against a proprietary claim to recover the property, so that the innocent recipient of the property can only obtain an equitable allowance for any work done that improved the retained property eg where he received a dilapidated cottage that was trust property. Where money was received and invested wisely, the better view (as will also be seen at **5A** below) is that the traced investments innocently bought for himself can only be recovered from an innocent volunteer on the basis of an unjust enrichment claim that is inherently subject to the defence of change of position reducing the enrichment. On the other view that a vindicatory proprietary claim lies against the traced property, the innocent recipient can claim an allowance for his investment skills.

## (2) Ouster of *H-B*?

Trust law gives effect to whatever a settlor intends<sup>48</sup> so long as his intentions are certain and workable and not illegal nor contrary to public policy eg Perpetuities & Accumulations Act 1964. It is presumed that a settlor expects his trustees to act fairly and honestly in disinterested but adequately informed fashion, so as to further the best interests of the beneficiaries, and not to act irrationally or capriciously in a manner perverse to the settlor's purposes when conferring extensive powers upon his trustees. However, the settlor can expressly or by necessary implication authorise his trustees to exercise their powers despite any conflicts of interest – or to exercise their equitable powers to benefit the Primary Discretionary Beneficiary without any need at all to consider the interests of any other person capable of benefiting under the trust.

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<sup>46</sup> [2003] 2 AC 709

<sup>47</sup> *Re Cross* (1880) 20 Ch D 109 at 121, CA

<sup>48</sup> *Burgess v Wheate* (1759) 1 Eden 177 at 195, *Citibank v MBIA Assurance* [2007] EWCA Civ 11 at [82]

Similarly, there is no reason why the settlor should not be able effectively to state “The honest exercise by my Trustees from time to time of any equitable power to distribute any part of the Trust Fund to anyone capable of benefiting hereunder or to add any person to membership of such class or to subtract any person from such class or to bring forward the termination of the Trust Period shall be valid, even if they would not have so acted but for ignoring a relevant consideration or taking account of an irrelevant consideration.”

The settlor may wish to do this, so that there can be no attempts by disgruntled beneficiaries to attack distributions to favoured beneficiaries, while the trustees may wish for protection where they make distributions to beneficiaries resident in foreign countries where it would be difficult, if not impossible, to sue such beneficiaries to recover money distributed to them.

#### **4. Utilising foreign trust laws: avoiding the pitfalls**

##### **Why use a foreign trust law?**

The point of using a foreign trust law is to escape from perceived deficiencies in the local trust law that prevents the settlor from achieving his goals. Such deficiencies in English domestic law include:

- (a) an accumulation period of 21 years or the settlor’s life;
- (b) a perpetuity period of 80 years or royal lives plus 21 years;
- (c) trusts being terminable by all beneficiaries under *Saunders v Vautier*;
- (d) no possibility of non-charitable purpose trusts, except in three testamentary instances when the duration is restricted by the rule against inalienability<sup>49</sup>.

What then is the reaction of English private international law to a trust governed by a foreign trust law that does not have such deficiencies? A more liberal reaction can be expected in the private international law of jurisdictions not having one or more of such deficiencies.

##### **Problem of uncertainties of local private international law**

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<sup>49</sup> See Underhill & Hayton, *Law of Trusts & Trustees 17<sup>th</sup> ed* paras 8.176 et seq

At one extreme (“Scenario 1”) *all* the elements of a trust are English except for the express choice of “Trustopian” trust law and, perhaps, of a licensed Trustopian trustee. At the other extreme (“Scenario 2”) *all* the elements of a trust are Trustopian, except for purchased English assets which could be owned by a Trustopian company, owned by the Trustopian trustee which had established the company shortly after the Trustopian settlor had established the trust.

An English court will be able to invoke Art. 18 of The Hague Trusts Convention only if it decides that application of the Convention’s provisions requiring recognition of the trust “would be manifestly incompatible with public policy”.

Courts in other jurisdictions that have implemented the Convention will also be able to invoke Article 13 affording an opportunity to refuse to recognise a trust “the significant elements of which except for the choice of the applicable law, the place of administration and the habitual residence of the trustee, are more closely connected with states which do not have the institution of the trust or the category of trust involved”.

Courts in other jurisdictions that have not implemented the Convention will, it seems, have a similar opportunity under their own rules of private international law.

Scenario (1): English trust except for Trustopian applicable law (& perhaps trustee)

Due to the different specialist backgrounds and personalities of the Chancery judges, it is uncertain how strict or liberal an approach will be taken by a judge in Scenario 1 when faced with the following points:

- (a) the UK Government has accepted the Law Commission Report with a draft Bill proposing a period of 125 years for both the perpetuity and the accumulation period, and has accepted that Scotland and many Crown Dependencies and British Overseas Territories can have longer periods or none at all;

- (b) Article 8(2)(f) Trusts Convention provides for the applicable law<sup>50</sup> to govern “restrictions [presumably “if any” e.g. charitable trusts] upon the duration of the trust and upon the power to accumulate the income of the trust”;
- (c) trustees can own an underlying investment company and be validly empowered to accumulate income within it; indeed, the company could have power to create a trust and the rule against accumulations does not apply to a corporate settlor<sup>51</sup>;
- (d) Article 8(2)(h) provides for the applicable law<sup>52</sup> of the trust to govern “termination of the trust” eg under *Saunders v Vautier*;  
although
- (e) an allegedly essential attribute of equitable ownership of English assets is the *Saunders v Vautier* right to call for legal title to be transferred to the equitable owner(s); and
- (f) non-charitable purpose trusts cannot exist (though, perhaps, an appellate court could uphold such an English trust enforceable by an enforcer, having an administratively workable purpose and restricted to the duration of a royal lives plus 21 years period<sup>53</sup>);  
while,  
query how restrictive an approach a judge should take, once appreciating that there is, anyhow, much scope for an English settlor to avoid the scope of the English domestic rules by using a foreign trust law with the foreign trustees owning a foreign underlying company to hold English assets: “Scenario (3)” below.

Scenario (2): Trustopian trust except for underlying English assets

In the case of this fully Trustopian case (subject to none of the English deficiencies) where the trustee’s Trustopian company has purchased English assets, it will be possible to use the company to carry out pure purposes or to accumulate income (as also possible with an English trust operating via an underlying English company), but what about

- (i.) income of the company passing to the trustee for a lengthy or indefinite perpetuity and accumulation period;

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<sup>50</sup> Accepted by Lawrence Collins J in *Tod v Barton* [2002] WTLR 469 at [37-38]

<sup>51</sup> *Re Dodwell & Co Ltd’s Trust Deed* [1979] Ch 301

<sup>52</sup> See penultimate footnote

<sup>53</sup> See Underhill & Hayton paras 8.157 et seq

- (ii.) the initial validity of a non-charitable purpose trust, especially if not limited to an English perpetuity period, and
- (iii.) the *Saunders v Vautier* rights of the beneficiaries collectively to terminate the trust and obtain legal title to the shares in the underlying company?

Over 100 years ago, the Court of Appeal<sup>54</sup> accepted that, though a life interest under an English trust cannot be inalienable, an alimentary life interest under a Scots trust can be inalienable, so that its alienation to a London mortgagee as security for a loan was void. The fact that a rule of foreign trust law is fundamentally different from a rule of English trust law – especially when specifically catered for under Article 8 eg paras (f) and (h) - is not of itself a reason to find it contrary to English public policy. Just think of what fundamentally different rules non-trust jurisdictions are being expected to recognise without this being manifestly incompatible with their public policy.

- (i.) Perhaps some jurisdictions may regard a non-charitable trust of unlimited duration as a totally new category of trust (within Article 13), while England could, perhaps, regard such a trust as manifestly incompatible with English public policy (Art 18). However, a period of up to 150 years should be acceptable, going beyond current English law and the Law Commission’s proposals only as a matter of degree, but well within Article 8(2)(f)<sup>55</sup>.
- (ii.) Where there is a workable non-charitable purpose trust capable of being enforced by an office-holder known as an enforcer for a duration not exceeding royal lives plus 21 years or a longer period accepted under (i), it seems very likely that the English court will enforce this obligation so that there is a valid trust<sup>56</sup>.
- (iii.) Many foreign trust laws provide no *Saunders v Vautier* rights to terminate a trust so long as a material purpose of the settlor remains to be fulfilled; moreover, accepting the validity of non-charitable purpose trusts permits trusts which no-one can terminate till the purpose has been fulfilled.

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<sup>54</sup> *Re Fitzgerald* [1904] 1 Ch 573

<sup>55</sup> See Lewin at 11-65 and Underhill & Hayton at 102.205

<sup>56</sup> See Lewin at 11-84 and Underhill & Hayton at 102.208. But note the forum’s sovereign ability to characterise issues differently from that under the applicable trust law eg three special cases in D Hayton “Major Trends in the Trust World Part I” [2007] Private CB Jan/Feb 39 at 48-50, Underhill & Hayton 102.209 – 102.210

## **Overcoming the uncertainties by a grafting process**

### Scenario (3): Wholly Trustopian trust except for English settlor who later grafts on non-Trustopian elements

The English , 'S', transfers the equivalent of, say £20,000, in Trustopian money to a Trustopian trustee of a trust expressly governed by Trustopian law with a Trustopian charity (perhaps founded by the settlor) as the initial sole beneficiary for a period of royal lives plus 21 years (playing safe, when such period is surely long enough in practice in the vast majority of cases).

S, while alive and of full capacity, has non-beneficial personal powers (subject only to the fraud on a power doctrine):

- to replace the charity with a non-charitable or charitable purpose from time to time,
- to appoint any relatives of S's grandfather (and any persons nominated by any of them) to become beneficiaries or objects of the trustee's discretionary fiduciary powers over income and capital,
- to remove any person or purpose from being capable of benefiting.

Thereafter the trustee has such powers (with any fiduciary or merely personal obligations attached to them spelled out).

The net income of money in Trustopian Bank is paid to the Trustopian charity in the first year plus, say, the equivalent of £2,000 of capital pursuant to a power in that behalf; then the trustee, pursuant to a power in this behalf, incorporates a Trustopian company to which the equivalent of £15,000 trust money is transferred, which is then used to purchase £15 million worth of assets from the settlor, being the traceable product of the Trustopian money owned by the Trustopian company owned by the Trustopian trustee. The charity is then replaced by a non-charitable purpose, while individuals are appointed to a class of objects of a discretionary power over income and capital.

Here there is a valid Trustopian trust of Trustopian assets for a Trustopian beneficiary with valid Trustopian powers. Once a valid trust always a valid trust: it should be irrelevant to the validity

of a trust that from time to time there is a change in the beneficiaries or their country of residence or a change of investments changing the lex situs of underlying assets owned by the underlying Trustopian company.

Thus it is possible to utilise a Trustopian trust structure to avoid perceived domestic English trust law deficiencies, but playing safe with a royal lives perpetuity clause. However, one could draft the trust so that it would be necessary under the English “wait & see” rule to see if the trust happened to terminate by achieving its ends before expiry of a royal lives perpetuity clause, so that only if this did not happen would it then fall to a 22<sup>nd</sup> century judge to decide whether the trust then became void for perpetuity under Article 18 or continued as a valid trust.

#### Variant with Trustopian settlor-protector

For an even stronger Trustopian connection, a Trustopian could be the settlor of the Trustopian trust of assets worth £20,000 for a Trustopian charity and also the “protector” with a non-beneficial personal power to replace the charity with a non-charitable purpose, to add beneficiaries or purposes and subtract beneficiaries or purposes, while having the beneficial personal power to replace himself as protector for a fee to be paid by the new protector.

The Englishman owning assets worth £15 million pays £25,000 to the settlor-protector to become the new protector and then sells those assets to the Trustopian trustee for £15,000.

## **5. The extent of proprietary and personal remedies against innocent wrongful recipients of trust property**

### **A. Proprietary Remedies**

#### Introduction

If a claim concerns “*trust property*” located in countries recognising beneficiaries as having equitable proprietary interests, the property can be recovered in rem (in specie) from a transferee who had received ownership of the property from the trustee unless the transferee is

- (i) a bona fide purchaser of the legal interest in the property without “*notice*” of the trust  
or

- (ii) protected by special legislation (e.g. giving a purchaser with notice good title to land if paying the purchase price to two trustees or a trust corporation) or
- (iii) perhaps, able to make out to some extent the defence of change of position.

“Notice” covers actual or “constructive” notice of the transferee or the transferee’s agent. “Constructive” notice is notice of those matters that would have come to the knowledge of the transferee or his agent if such inquiries and inspections had been made as ought reasonably to have been made by him.

“Trust property” covers the traceable product of trust property e.g. a valuable house or painting bought by D with £1 million of trust money wrongfully given to D by the trustee. Where D receives money which he spends on improving his own property eg re-wiring his house and installing central heating, there will be a lien over the property for the amount of money with interest unless D is an innocent volunteer when the court will not impose a lien if this would be unfair or inequitable<sup>57</sup>.

#### Availability of change of position defence

Case law is awaited to clarify the availability of the defence of change of position that, to a greater or lesser extent, can undermine the claim that the defendant has been unjustly enriched at the claimant’s expense.

Where an innocent donee, D, still retains the actual received property he must return that property due to the impact of property law rules<sup>58</sup>. The defence of change of position is only available where there is an unjust enrichment claim and not where the claim is a simple proprietary claim<sup>59</sup>, though in such a case D can obtain an equitable allowance for any work done that improved the asset<sup>60</sup>, eg if he received a dilapidated cottage that he modernised.

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<sup>57</sup> *Foskett v McKeown* [2001] 1 AC 102 at 109 per Lord Browne-Wilkinson, citing *Re Diplock* [1948] Ch 465 at 548

<sup>58</sup> *Foskett v McKeown* [2001] 1 AC 102. T privately took out life assurance policy and declared trust of it for DD. Later he wrongfully paid 4<sup>th</sup> & 5<sup>th</sup> annual premiums with money from trust of which he was trustee. He then died. The trust beneficiaries successfully claimed entitlement to two fifths of the policy (and thus of its proceeds on maturity) as their property.

<sup>59</sup> See *Foskett v McKeown* at 108-109 per Lord Browne-Wilkinson and at 129 and 130 per Lord Millett (as explained by him in S Degeling & J Edelman, *Equity in Commercial Law*, Lawbook Co Sydney 2005 pp 325 and 326 in Chap 12 “Proprietary Restitution”

<sup>60</sup> See Lord Millett in Degeling & Edelman above at p318

One needs to distinguish the case where D had sold the property and used the proceeds to buy a traceable asset (not considered in *Foskett*) from the case of a trustee who had done the same. On accepting office as trustee, a trustee binds himself to act in his beneficiaries' best interests and to hold the trust property and the traceable product thereof on trust for the beneficiaries. Thus he is not allowed to deny this if the beneficiaries make the proprietary claim that the traceable product in his ownership is their trust property<sup>61</sup>.

However, D had not so bound himself when innocently receiving the property and then selling it to purchase new property for himself. Surely the beneficiaries cannot simply claim that D's newly purchased property is irrebuttably *their* trust property. Thus, D's proprietary liability to return the traceable asset needs to be based upon him otherwise being unjustly enriched at the claimant's expense<sup>62</sup>. This affords D scope to prove that he has not been unjustly enriched at all or only partially so enriched because his position has changed either due to his own acts or due to external factors, eg he spent £50,000 on a round-the-world-holiday with his wife to mark their wedding anniversary, or on shares that are now worthless or on jewellery stolen when uninsured.

### Cross-border tracing

Of course, proprietary claims via the tracing process cannot be made in respect of property located in a jurisdiction without a concept of equitable ownership. However, it seems clear that if T holds State A property on trust for beneficiaries with an equitable interest in property, and under State A's evidential tracing rules the property can be traced into State B and State C, neither of which knows of equitable ownership, before the property is traced back into State A in T's ownership, then the beneficiaries can recover that property from T, T not being allowed to deny this as a substitutive performance of his duties e.g. if T sells property in State A for \$1 million which he uses to purchase shares in State B, before selling them for £2 million Euros to buy shares in State C, before selling them for £3 million Euros used to buy a house in State A. The position should be no different if the property were traced not to State A but to State E if the

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<sup>61</sup> *Foskett v McKeown* [2001] 1 AC 102

<sup>62</sup> See Hayton & Marshall, *Commentary & Cases on Law of Trusts* (12<sup>th</sup> ed 2005) paras 12-108 to 12-117, Underhill & Hayton, *Law of Trusts & Trustees* 17<sup>th</sup> ed 92.5-92.10, but see *Lewin on Trusts* 18<sup>th</sup> ed, 41.57

latter had equitable proprietary interests and tracing rules permitting this, and T was amenable to its jurisdiction. Case law is awaited to confirm this<sup>63</sup>.

However, if T in the above example had used 1 million Euros of trust money to buy jewellery in State B which he gave to X in State C under the law of which X received a good title, could the jewellery be traced and recovered? Not if X were resident in State C (or B) and so was sued there, where X would be held to have a good title<sup>64</sup> (subject, perhaps, only to an in personam ad rem claim if X was a party to T's fraud). However, if X became resident in State A and was sued there (or took the jewellery to State E and this afforded jurisdiction to the courts of State E), there could be no question of the beneficiaries having an equitable proprietary interest binding X as a mere volunteer; though, it seems that if X had been a party to T's fraud, the courts (on the basis Equity acts in personam on persons' consciences<sup>65</sup>) could make not just an in personam compensatory award but an in personam ad rem order for the transfer of the jewellery to the trustee who had replaced T on trust for the beneficiaries.

## **B. Personal (or monetary) remedies**

### "Innocent" Recipients

To the extent that proprietary remedies are not available, it is clear that Equity provides a personal monetary remedy against a wrongful recipient of trust property if he is not an "innocent" recipient.

A recipient will not be "innocent" if he deals with the property inconsistently with the trust with actual knowledge or "blind-eye" knowledge of this. The latter requires<sup>66</sup>

- (i.) a suspicion that certain facts may exist, but this must be more than an untargeted or speculative suspicion, and

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<sup>63</sup> Note *El Ajou v Dollar Land Holdings plc* [1994] 2 All ER 685, CA where fiduciary assets could be traced through foreign civil law systems to England to a 40% stake in a property development so as to establish the amount of personal liability of a recipient of such stake who was a purchaser with notice of the breach of a fiduciary duty

<sup>64</sup> See Lord Hoffmann in *Tripole Trading Ltd v Prosperfield Ventures Ltd* (2006) 9 HKCFAR 1 at [86]

<sup>65</sup> *El Ajou v Dollar Land Holdings Ltd* (above). If the foreign *lex situs* conferred a valid title on X and did not make X liable to an *in personam ad rem* liability, it seems that State A or E would respect this as a matter of comity: *Masri v Consolidated Contractors International Co* [2008] EWCA Civ 303 at [47] and [59]

<sup>66</sup> *Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd (The Sea Star)* [2003] 1 AC 469 at [112], [116]

- (ii.) a decision to refrain from making inquiries for fear of learning the truth of those facts.

The Court of Appeal has held<sup>67</sup> that a defendant will be personally liable to account in equity whenever his “state of knowledge is such as to make it *unconscionable* for him to retain the benefit of the receipt”. This can cover the case where the defendant had knowledge of circumstances which would make an honest and reasonable man suspicious enough not to proceed without further inquiries even though the defendant states that he was not suspicious. The defendant can either be disbelieved or not be allowed to rely on his moral obtuseness to excuse his failure to recognise suspicious circumstances that would have been apparent to an ordinary honest person applying the standards of such person<sup>68</sup>. His conduct has to be wrongful in Equity’s eyes.

#### Is an innocent recipient personally liable in equity without any fault?

Equity’s traditional position, exemplified in 20<sup>th</sup> century case law, is that no personal (as opposed to proprietary) remedy is available against an innocent wrongful recipient of trust property<sup>69</sup>: after all, there is no fault on his part and Equity only operates against a bad conscience<sup>70</sup>.

However, common lawyers, like Professor Birks<sup>71</sup> and Professor Burrows<sup>72</sup> concerned with developing a law of restitution or of unjust enrichment have encouraged Equity lawyers<sup>73</sup> to

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<sup>67</sup> *BCCI (Overseas) Ltd v Akindele* [2001] Ch 437 at 455, accepted as current law in *City Index Ltd v Gawlor* [2007] EWCA Civ 1382 at [8] and [31(iv)]

<sup>68</sup> See *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* [2007] HCA 22 at [177] and *Barlow Clowes International Ltd v Eurotrust International Ltd* [2005] UKPC 37, [2006] 1 WLR 1476

<sup>69</sup> The *Re Diplock* [1948] Ch 465 affd [1951] AC 251 personal claim of a deceased’s unpaid or underpaid creditor or legatee or next-of-kin, who has exhausted his remedy against the PR, to recover compensation from an overpaid beneficiary or a stranger, can be explained as restricted to administration of deceaseds’ estates due to its historical derivation from the strict rules of the ecclesiastical courts. Since *Kleinwort Benson Ltd v Lincoln CC* [1999] 2 AC 349 notwithstanding a mistake of law, a PR or a trustee himself can sue the overpaid or wrongly paid recipient.

<sup>70</sup> See *BCCI* above

<sup>71</sup> “Misdirected Funds: Restitution from the Recipient” [1989] LMCLQ 296, though also see his Chapter “Receipt” in Birks & Pretto, *Breach of Trust* Oxford 2002, 213 at 223

<sup>72</sup> “We do this at Common Law but That in Equity”, (2002) 22 Ox JLS 1

<sup>73</sup> Lord Nicholls in “Knowing Receipt” in Cornish et al (eds) *Restitution: Past, Present and Future* (1998) at 238 and in *Criterion Properties plc v Stratford UK Properties* [2004] 1 WLR 1846 at [4]; Lord Millett in *Twinsectra Ltd v Yardley* [2002] 2 AC 164 at [105] and in *Dubai Aluminium Co Ltd v Salaam* [2003] 2 AC 366 at [87]; Lord Walker “Dishonesty and Unconscionable Conduct in Commercial Life” (2005) Sydney LR 187

consider harmonising the liability of innocent recipients in equity with that of the liability for unjust enrichment of innocent recipients of money at common law.

At law, there is a strict *proprietary* liability to return land to its owner, a strict *personal* liability to pay compensation for conversion of chattels<sup>74</sup> and a strict *personal* liability under an action for money had and received to pay compensation to the extent unjustly enriched by such receipt<sup>75</sup>. In equity, there is a broader strict proprietary liability to return trust property or its traceable product to the beneficiaries or to trustees for them, unless the defendant proves he was a bona fide purchaser for value of a legal interest without notice. If the defendant is an innocent donee of trust property but no longer has any traceable trust property, should he also be strictly personally liable in equity to pay compensation for his unjust enrichment as at common law if he had innocently received money?

It is noteworthy that the settlor in transferring his property to a trustee has chosen to confer legal title and the right to possession, with corresponding rights of disposition and management obligations, upon a trustee able to deal with third parties in situations where they may justifiably be ignorant of any beneficiaries, so putting the interests of any beneficiaries at risk. There arose Equity's traditional requirement for a third party's conscience to be affected before his personal liability can be established at the behest of a beneficiary, so that an "innocent" recipient should not be made personally liable if a proprietary remedy is unavailable (e.g. because the traceable property had been dissipated so as to be untraceable).

After all, a claimant beneficiary under a trust can make the trustee, T, strictly liable to provide the necessary restorative compensation for the breach of trust of distributing trust property to a non-beneficiary, whether T acted dishonestly or due to an innocent mistake. Why should the beneficiary also be able to make similarly strictly liable an innocent donee of the legal interest, carrying possession or the right to possession of the property, when the beneficiary had no such legal interest or possessory rights, his primary rights being to make T account for his

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<sup>74</sup> See further P Birks (ed) *English Private Law*, Oxford 2000, paras 14.314 et seq and Torts (Interference with Goods) Act 1977

<sup>75</sup> *Lipkin Gorman v Karpnale plc* [1991] 2AC 548

trusteeship?<sup>76</sup> For a donee to be made similarly accountable for trust property his conscience needs to be affected by some knowledge of the trust<sup>77</sup>.

It is significant that possession and the right to possession, as interests in the physical integrity of assets, are at the core of legal ownership of land and chattels, so meriting strict liability protection in their own right, irrespective of any fault on the part of a defendant transferee of such ownership. Legal ownership of choses in action carries no such possessory rights and so, according to a recent House of Lords decision<sup>78</sup>, merits no such strict liability by an extension of the tort of conversion beyond chattels to choses in action, especially when considering the practical implications in these days of electronic transfers of an ever-widening range of choses.

It follows that Equity ought not to create a strict personal liability to protect equitable interests carrying no physical possessory rights but founded upon the trustee's obligations to his beneficiaries<sup>79</sup>, especially when an ever-increasing range of fiduciary obligations gives rise to equitable interests<sup>80</sup>. Nourse LJ has indicated that such an extension, making it easy to bring a claim that places recipients of trust or other fiduciary property on the back foot, having to make full disclosure and having to prove an innocent change of position or a bona fide purchaser defence, would encourage a multitude of claims and be "commercially unworkable"<sup>81</sup>.

#### Can an innocent recipient be personally liable at common law without fault?

In the case of a trustee mistakenly paying out trust money, whether the mistake is one of fact or law, the trustee can bring a common law action for money had and received against the wrongly paid or overpaid beneficiary or a stranger<sup>82</sup>. This is a strict liability for unjust enrichment, though a defendant can plead a change of position to reduce or negative any claimed enrichment<sup>83</sup>. However, if the trustee paid the money out deliberately to achieve his dishonest purpose then his

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<sup>76</sup> See L Smith "Unjust enrichment, property and the structure of trusts" (2000) 116 LQR 412

<sup>77</sup> See S Worthington, *Equity*, 2<sup>nd</sup> ed 2006, Oxford pp179-189

<sup>78</sup> *Douglas v Hello! Ltd* [2007] UKHL 21

<sup>79</sup> In the rare case where a beneficiary has possession eg of a trust painting, he can bring a common law action eg for conversion: *MCC Proceeds Inc v Lehmann Bros* [1998] 4 All ER 675,CA

<sup>80</sup> See view of High Court of Australia in *Farah* above, discussed by D Hayton (2007) 21 Trust LI 55

<sup>81</sup> In *BCCI* (above) at 456, Ward & Sedley LJJ concurring, but see fn 87 below

<sup>82</sup> *Re Mason* [1928] Ch 385 at 391-392 (affd [1929 Ch 1]), *Ministry of Health v Simpson* [1951] AC 251 at 274

<sup>83</sup> *Lipkin Gorman v Karpnale plc* [1991] 2 AC 548

intention to pay is not vitiated in any way, so that neither he nor a successor trustee nor any beneficiary can bring a common law action against the payee<sup>84</sup>.

In the case of a trustee mistakenly transferring chattels, title will normally pass to the transferee (except in the extremely rare case of a fundamental mistake as to identity<sup>85</sup>): the trustee will not be able to sue in conversion, though he will be able to set aside a transfer if “showing that he was under a mistake of so serious a character as to render it unjust on the part of the donee to retain the property.”<sup>86</sup> This latter equitable remedy will also be available for mistaken transfers of choses in action.

If the trustee, whether the transferor-trustee or his replacement<sup>87</sup>, exercises these above rights to augment the trust fund, the beneficiaries will benefit.

If the trustee, in breach of trust, refuses to exercise these rights then a beneficiary can, in his own name “in right of the trust and in room of the trustee”<sup>88</sup>, in special circumstances<sup>89</sup> bring a derivative action against the defendant transferee, joining the trustee as co-defendant and also the other beneficiaries, if not represented by him under CPR 19. The trust fund will then be augmented, exploiting the common law money had and received action where appropriate<sup>90</sup>.

## **6. Limitation Act protection of dishonest accessories in a breach of fiduciary duty**

By the English Limitation Act 1980 s. 21 (reproduced in other jurisdictions)

“(1) No period of limitation prescribed by this Act shall apply to an action by a beneficiary under a trust, being an action.

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<sup>84</sup> See S Worthington, *Equity*, 2<sup>nd</sup> ed 2006, OUP pp 276-277, *Re Clapham* [2006] WTLR 203 at [76]-[77]

<sup>85</sup> Eg *Cundy v Lindsay* (1878) App Cas 459

<sup>86</sup> See *Ogden v Trustees of RHS Griffiths Settlement* [2008] EWHC 118 Ch, discussed in 3A(7) above

<sup>87</sup> *Young v Murphy* [1996] 1 VR 279, CA of Victoria

<sup>88</sup> *Parker-Tweedale v Dunbar Bank plc* [1991] Ch 12 at 19-20; *Re Mason* [1929] 1 Ch 385 at 391-392

<sup>89</sup> *Roberts v Gill* [2008] EWCA Civ 803

<sup>90</sup> Banks and companies, whose officers in breach of fiduciary duty pay the former’s money to a stranger, will rely upon *Lipkin Gorman v Karpnale plc* [1991] 2 AC 548 to sue the stranger for money had & received and not bother with an equitable knowing receipt claim eg *State Bank of NSW v Swiss Bank* (1995) 39 NSWLR 350, *Spangaro v Corporate Investment Australia Funds Ltd* [2003] FCA 1025 (2003) 47 ACSR 285, *Att-Gen of Zambia v Meer Care & Desai* [2008] EWCA Civ 754 at [64]

- (a) in respect of any fraud or fraudulent breach of trust to which the trustee was a party or privy; or
- (b) to recover from the 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...
- (3) Subject to the preceding provisions of this section, an action by a beneficiary to recover trust property or in respect of any breach of trust, not being an action for which a period of limitation is prescribed by any other provision of this Act, shall not be brought after the expiration of six years from the date on which the right of action accrued.”

*Paragon Finance v Thakerar*<sup>91</sup> establishes two categories of trustees or fiduciaries:

- (i.) persons who are trustees or fiduciaries (like company directors<sup>92</sup>) established as such *before* the events complained of; and
- (ii.) persons who become treated as constructive trustees *because* of the events complained of.

Speaking of a category (ii) person Lord Millett in obiter dicta in *Dubai Aluminum Company Limited v Salaam*<sup>93</sup> states

“He is not in fact a trustee at all, even though he may be liable to account as if he were. He never claims to assume the position of trustee on behalf of others, and he may be liable without ever receiving or handling the trust property. If he receives the trust property at all he receives it adversely to the claimant and by an unlawful transaction which is impugned by the claimant. He is not a fiduciary or subject to fiduciary obligations [viz a category (i) fiduciary] and he could plead the Limitation Acts as a defence in the claim.”

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<sup>91</sup> [1999] 1 All ER 400, CA

<sup>92</sup> *JJ Harrison (Properties) Limited v Harrison* [2002] 1 BCLC 162

<sup>93</sup> [2003] 2 AC 366 at [141]

Hence in *Cattley v Pollard*<sup>94</sup> a Deputy High Court Judge held that s. 21 (1)(a) did not apply to oust the six years period in s. 21 (3), there being no reason to distinguish between an action for damages for fraud at common law and its counterpart in equity based on the same facts merely because equity employs the formula of constructive trusteeship to justify the exercise of the equitable jurisdiction.

Surprisingly, in obiter dicta in *Statek Corporation v Alford*<sup>95</sup> Evans-Lombe J refused to follow *Cattley v Pollard*. He considered that a principled system of limitation would treat a claim against an accessory barred only when the claim against the principal was barred, and by virtue of s. 21 (1)(a) no period of limitation applies to an action “in respect of any fraud or fraudulent breach of trust to which the trustee was a party or privy”, which could be broadly construed as extending to actions against dishonest trustees/fiduciaries and their dishonest accessories.

In my view it is better to restrict s. 21 (1)(a) to actions only against dishonest category (i) trustees or fiduciaries, as was the case in *Attorney General of Zambia v Meer Care & Desai*<sup>96</sup>, the Attorney General not contesting this, being happy to rely upon s. 32 of the Limitation Act 1980:

“(1) where in the case of any action for which a period of limitation is prescribed by the Act either

(a) the action is based upon the fraud of the defendant; or

(b) any relevant fact to the plaintiff’s right of action has been deliberately concealed from him by the defendant;

the period of limitation shall not begin to run until the plaintiff has discovered the fraud, concealment or mistake (as the case may be) or could with reasonable diligence have discovered it.”

This will often afford leeway to claimants against dishonest defendants who normally try to cover up their dishonesty.

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<sup>94</sup> [2007] 3 WLR 317, [2007] WTLR 245, followed by Hong Kong Court of Appeal in *Peconic Industrial Development Co. v Lan Kwok Fai Appeal* Nos 245, 247, 248 of 2006, 18 Dec 2007

<sup>95</sup> [2008] EWHC (Ch) 32 at [125]

<sup>96</sup> [2007] EWHC 952 (Ch) at [375]. On appeal the defendants were cleared of dishonesty: [2008] EWCA Civ 875.