ADVANCED EQUITY AND TRUSTS

University of London LLM

The course is led by:

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ADVANCED EQUITY AND TRUSTS LAW

Introduction
This course intends to focus on aspects of equity and trusts in two specific contexts: commerce and the home. It will advance novel conceptual approaches to two significant arenas in which equitable doctrines like the trust are deployed. In the context of commercial activity the course will consider the manner in which discretionary equitable doctrines are avoided but also the significant role which the law of trusts plays nevertheless in commercial and financial activity. In the context of the home to consider the various legal norms which coalesce in the treatment of the home: whether in equitable estoppel, trusts implied by law, family law, human rights law and housing law.

Teaching
Organised over three terms, 2 hours per week, comprising a lecture in the first week followed, generally, by a seminar in the following week as a cycle. See, however, the three introductory topics which are dealt with differently.

Examination / assessment
Examination will be by one open-book examination which will ask students to attempt three questions in three hours.

Textbooks
It is suggested that you acquire a textbook and you may find it useful to acquire a cases and materials book, particularly if you have not studied English law before.

Recommended general text:-
*****Alastair Hudson: *Equity and Trusts* (4th ed.: Cavendish Publishing 2005).

Other textbooks:-
Hanbury and Martin: *Modern Equity* (17th ed., by Dr J. Martin: Sweet & Maxwell 2005).
Parker and Mellows: *The Modern Law of Trusts* (8th ed., by A.J. Oakley: Sweet & Maxwell 2003).
Pettit: *Equity and the Law of Trusts* (10th ed.: OUP 2005).

Introductory reading
*****Hudson, *Understanding Equity and Trusts* ((2nd ed, Cavendish, 2004) this book will be particularly useful for students who have not studied trusts law before.

Cases and materials books which may be of use or save time in the library:-
Maudsley and Burn: *Trusts and Trustees: Cases and Materials* (6th ed.: Butterworths 2002).
Hayton and Marshall: *Cases and Commentary on the Law of Trusts* (12th ed., by D. Hayton and C. Mitchell: Sweet & Maxwell 2005).
Moffat: *Trusts Law: Text and Materials* (4th ed.: reprinted CUP 2005).

Practitioners' texts
*Thomas and Hudson, *The Law of Trusts* (1st ed., Oxford University Press, 2004, 1,907pp): the newest practitioner text in England which not only considers the basic principles of trusts law but also puts them in the context of particular uses of trusts in practice.
Underhill and Hayton, *Law Relating to Trusts and Trustees* (16th ed., by D. Hayton: Butterworths 2002).
Lewin on Trusts (17th ed., by Mowbray, et al: Sweet & Maxwell, 2000).

Syllabus

Aims and objectives

This course considers the topic of Equity & Trusts in two ways: first, it considers the practical application of trusts law principles to commercial and non-commercial contexts; second, it considers the intellectual issues which are bound up with equity and with trusts law. This course considers issues such as the place of equity within legal theory, the nature of property in law, the inter-action of commercial law and trusts law, the stuttering development of unjust enrichment, and the particular context of the home as considered by equity, trusts law, family law and legal theory.

Course outline

Topic 1*****.	Core principles of equity and the law of trusts
Topic 2*****.	Foundational techniques of express trusts (1 & 2)
Topic 3*****.	Themes in equity & trusts
Topic 4.	Obligations of trustees (i): control of trustees & breach of trust
Topic 5.	Obligations of trustees (ii): investment of trusts
Topic 6.	Equity and commerce (1): suspicion of equity, taking security & contract
Topic 7.	Equity and commerce (2): finance, trusts and the local authority swaps cases
Topic 8.	Constructive trusts (i): secret profits and bribes
Topic 9.	Constructive trusts (ii): fraud, contract and confidentiality
Topic 10.	Breach of trust (i): dishonest assistance and knowing receipt
Topic 11.	Breach of trust (ii): tracing
Topic 12.	Trusts of homes (i): English trusts law approaches
Topic 13.	Trusts of homes (ii): Commonwealth and remedial approaches
Topic 14.	Trusts of homes (iii): Other perspectives on rights in the home
{Topic 15.	Equitable remedies and the nature for equity}

*****Due to the nature of the LLM – and the movement of people through various courses until the group eventually settles down – these initial topics will be covered for one week only principally in the form of lectures. These topics are intended (a) to introduce people who have not studied trusts before to the core principles, as well as refreshing the memories of those who have studied trusts before, and (b) to introduce students to some of the key intellectual debates which will form the subject matter of the course. Each of these sessions will have space for discussion.

Thereafter, each topic will be covered by a lecture in the first week followed by a seminar on the same topic in the second week.

Timetable for the course

This course outline sets out the sequence of lectures in this topic. Students should be warned, however, that it is susceptible to minor change as the year progresses. It also contains lecture notes and the outline questions for seminars.

Week: w/c	*Topic:* **lecture** / *seminar*
2 / 10	Core principles of equity and the law of trusts
9 / 10	Foundational techniques of express trusts (1)
16 / 10	Foundational techniques of express trusts (2)
23 / 10	Themes in equity and trusts
30 / 10	Obligations of trustees (i): control of trustees & breach of trust
6 / 11	***No class this week***
13 / 11	*Obligations of trustees (i): control of trustees & breach of trust*
20 / 11	Obligations of trustees (ii): investment of trusts
27 / 11	*Obligations of trustees (ii): investment of trusts*
4 / 12	Equity and commerce (1): suspicion of equity, taking security & contract
11 / 12 Term End	*Equity and commerce (1): suspicion of equity, taking security & contract*
8 / 1	Equity and commerce (2): finance, trusts and the local authority swaps cases
15 / 1	*Equity and commerce (2): finance, trusts and the local authority swaps cases*
22 / 1	Constructive trusts (i): secret profits and bribes
29 / 1	***No class this week***
5 / 2	*Constructive trusts (i): secret profits and bribes*
12 / 2	Constructive trusts (ii): fraud, contract and confidentiality
19 / 2	*Constructive trusts (ii): fraud, contract and confidentiality*
26 / 2	Breach of trust (i): dishonest assistance and knowing receipt
5 / 3	*Breach of trust (i): dishonest assistance and knowing receipt*
12 / 3	Breach of trust (ii): tracing
19 / 3	*Breach of trust (ii): tracing*
26 / 3 Term End	Trusts of homes (i): English trusts law approaches
30 / 4	*Trusts of homes (i): English trusts law approaches*
7 / 5	Trusts of homes (ii): Other perspectives on rights in the home
14 / 5	*Trusts of homes (ii): Other perspectives on rights in the home*
21 / 5	

TOPIC 1. THE FOUNDATIONS OF EQUITY AND THE LAW OF TRUSTS

Aim: *This topic is concerned to introduce students to the core principles which underpin equity in general terms and the law of trusts in particular. The difficulty with beginning this LLM course is that there are usually two types of student: those who studied trusts law at undergraduate level and those who never studied trusts law at all before. Therefore, the first three topics of this course aim to teach the basics to novices and to serve as a refresher course for the initiated.*

LECTURE MATERIALS

(A) The nature of equity

Reading: ***Hudson*****, section 1.1**

1) Philosophical ideas of equity

The following ideas come from Aristotle's *Ethics*, and should be understood as considering the difference between common law and equity:

> *"For equity, though superior to justice, is still just … justice and equity coincide, and although both are good, equity is superior. What causes the difficulty is the fact that equity is just, but not what is legally just: it is a rectification of legal justice."*

So it is that equity provides for a better form of justice than the common law because it provides for a more specific judgment as to right and wrong in individual cases which rectifies any errors of fairness which the common law would otherwise have made:

> "*The explanation of this is that all law is universal, and there are some things about which it is not possible to pronounce rightly in general terms; therefore in cases where it is necessary to make a general pronouncement, but impossible to do so rightly, the law takes account of the majority of cases, though not unaware that in this way errors are made. … So when the law states a general rule, and a case arises under this that is exceptional, then it is right, where the legislator owing to the generality of his language has erred in not covering that case, to correct the omission by a ruling such as the legislator himself would have given if he had been present there, and as he would have enacted if he had been aware of the circumstances.*"

Thus, equity exists to rectify what would otherwise be errors in the application of the common law to factual situations in which the judges who developed common law principles or the legislators who passed statutes could not have intended.

2) Early case law on the role of equity

Earl of Oxford's Case (1615) 1 Ch Rep 1, *per* Lord Ellesmere:

> "*the office of the Chancellor is to correct men's consciences for frauds, breach of trusts, wrongs and oppressions … and to soften and mollify the extremity of the law*"

Lord Dudley v Lady Dudley (1705) Prec Ch 241, 244, *per* Lord Cowper:

> "*Now equity is no part of the law, but a moral virtue, which qualifies, moderates, and reforms the rigour, hardness, and edge of the law, and is an universal truth; it does also assist the law where it is defective and weak in the constitution (which is the life of the law) and defends the law from crafty evasions, delusions, and new subtleties, invested and contrived to evade and delude the common law, whereby such as have undoubted right are made remediless: and this is the office of equity, to support and protect the common law from shifts and crafty contrivances against the justice of the law. Equity therefore does not destroy the law, nor create it, but assist it.*"

3) The fusion of common law and equity

Judicature Act 1873

4) The structure of English private law

Reading: ***Hudson*, section 1.2**

- Common law and equity were always distinct: the courts of common law were in Westminster Hall at one time, the courts of equity were in Lincoln's Inn Hall.
- For a good illustration of the difficulties caused by this distinction see Charles Dickens's *Bleak House*.
- Judicature Act 1873 merged the two streams of courts, however the *intellectual* distinction between common law and equity remains very important.

Common law	**Equity**
Examples of claims:	
Breach of contract	Breach of trust
Negligence	Tracing property
Fraud	Claiming property on insolvency
Examples of remedies available:	
Damages	Compensation
Common law tracing	Equitable tracing
Money had and received	Specific performance
	Injunction
	Rescission
	Rectification
	Imposition of constructive trust
	Imposition of resulting trust
	Subrogation
	Account

(B) The structure of the trust relationship.

Reading: ***Hudson*, sections 2.1 and 2.2**

> '*The essence of a trust is the imposition of an equitable obligation on a person who is the legal owner of property (a trustee) which requires that person to act in good conscience when dealing with that property in favour of any person (the beneficiary) who has a beneficial interest recognised by equity in the property. The trustee is said to "hold the property on trust" for the beneficiary. There are four significant elements to the trust: that it is equitable, that it provides the beneficiary with rights in property, that it also imposes obligations on the trustee, and that those obligations are fiduciary in nature.*'

- Thomas and Hudson, *The Law of Trusts*

> '*A trust is an equitable obligation, binding a person (called a trustee) to deal with property owned by him (called trust property, being distinguished from his private property) for the benefit of persons (called beneficiaries or, in old cases, cestuis que trust), of whom he may himself be one, and any one of whom may enforce the obligation [or for a charitable purpose, which may be enforced at the instance of the Attorney-General, or for some other purpose permitted by law though unenforceable]*.'

- Underhill and Hayton, *The Law of Trusts and Trustees*, as amended by Pettit

(C) Classification of trusts.

Reading: ***Hudson*, section 2.2**

The four types of trust
1. Express trusts
2. Resulting trusts
3. Constructive trusts
4. (Implied trusts)

Section 53(2) Law of Property Act 1925 refers to "implied, resulting and constructive trusts".

Westdeutsche Landesbank v. Islington [1996] 1 AC 669, *per* Lord Browne-Wilkinson:-

> "*(i) Equity operates on the conscience of the owner of the legal interest. In the case of a trust, the conscience of the legal owner requires him to carry out the purposes for which the property was vested in him (express or implied trust) or which the law imposes on him by reason of his unconscionable conduct (constructive trust).*"

(D) The means by which the different forms of trusts come into existence.

Reading: ***Hudson*, section 2.2**

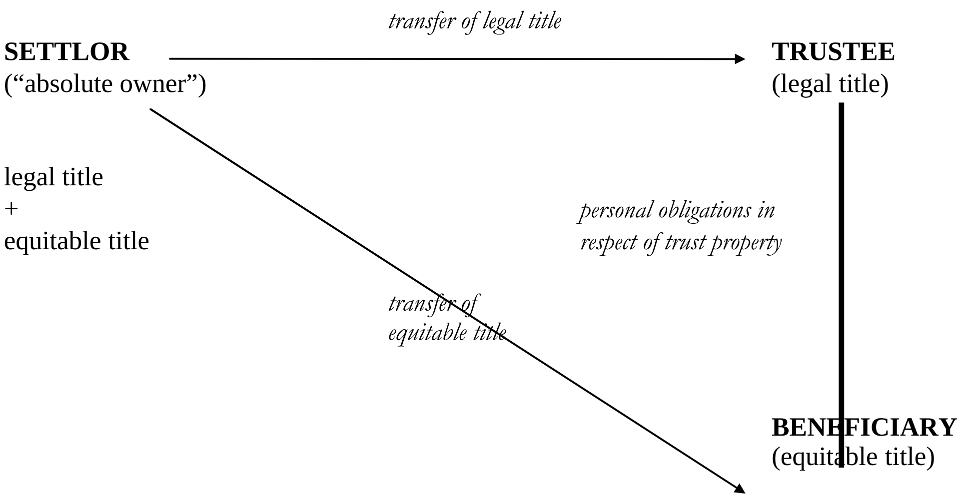
The three forms of trust come into existence in the following ways:

> '*A trust comes into existence either by virtue of having been established expressly by a person (the settlor) who was the absolute owner of property before the creation of the trust (an express trust); or by virtue of some action of the settlor which the court interprets to have been sufficient to create a trust but which the settlor himself did not know was a trust (an implied trust); or by operation of law either to resolve some dispute as to ownership of property where the creation of an express trust has failed (an automatic resulting trust) or to recognise the proprietary rights of one who has contributed to the purchase price of property (a purchase price resulting trust); or by operation of law to prevent the legal owner of property from seeking unconscionably to deny the rights of those who have equitable interests in that property (a constructive trust).*'
>
> - Thomas and Hudson, *The Law of Trusts*

(E) The rudiments of express trusts.

Reading: ***Hudson*, section 2.3**

An express trust can be understood as follows, comprising the "magic triangle" of <u>settlor</u>, <u>trustee</u> and <u>beneficiary</u>. The core of the "trust" is the inter-action of personal rights and claims between these persons in relation to the trust property. It is therefore vital to distinguish between "in personam" and "in rem" rights.



(F) The concept of fiduciary responsibility.

Reading: ***Hudson*, section 2.3.3; and the essay comprising chapter 14.**

A trustee is an example of a fiduciary, so it is important to understand what the concept of fiduciary responsibility entails.

> '*A fiduciary is someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence. The distinguishing obligation of a fiduciary is the obligation of loyalty. The principal is entitled to the single-minded loyalty of his fiduciary. The core liability has several facets. A fiduciary must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and his interest may conflict; he may not act for his own benefit or the benefit of a third person without the informed consent of his principal. This is not intended to be an exhaustive list, but it is sufficient to indicate the nature of fiduciary obligations. They are the defining characteristics of the fiduciary.*'
>
> - *Bristol and West Building Society v Mothew* [1998] Ch 1 at 18, *per* Millett LJ

> "*A person will be a fiduciary in his relationship with another when and in so far as that other is entitled to expect that he will act in that other's interests or (as in a partnership) in their joint interests, to the exclusion of his own several interest.*"
>
> Paul Finn, "Fiduciary Law and the Modern Commercial World", in *Commercial Aspects of Trusts and Fiduciary Relationships* (ed. McKendrick, 1992), p. 9.

See also: Finn, Fiduciary Obligations (1977);
Finn, "The Fiduciary Principle", in *Equity, Fiduciaries and Trusts* (ed. T.G. Youdan, 1989);
A.J. Oakley, *Constructive Trusts* (1997), Ch. 3; and
A.J. Oakley (ed.), *Trends in Contemporary Trust Law* (1996).

(G) The benefits of trusts

Reading: **Hudson*, section 2.5***

A framework for understanding change in the law of trusts: three conceptions of the trust - moralistic, individual property, capital management: see Cotterrell, "*Trusting in Law*" (1993) 46 CLP 75, 86-90.

(H) The core principles of equity

Reading: ***Hudson*, section 1.4**

The thirteen propositions set out below are culled, as a list, primarily from *Snell's Equity*, (31st ed., 2004) by McGhee, 27.

- Equity will not suffer a wrong to be without a remedy
- Equity follows the law
- Where there is equal equity, the law shall prevail
- Where the equities are equal, the first in time shall prevail
- He who seeks equity must do equity
- He who comes to equity must come with clean hands
- Delay defeats equities
- Equality is equity
- Equity looks to the intent rather than to the form
- Equity looks on that as done that which ought to have been done
- Equity imputes an intention to fulfil an obligation
- Equity acts *in personam*

Hudson adds to that list three further principles:-

- Equity will not permit statute or common law to be used as an engine of fraud (e.g.: *Rochefoucauld v. Boustead*);
- Equity will not permit a person who is trustee of property to take benefit from that property *qua* trustee (e.g.: *Westdeutsche Landesbank*);
- Equity abhors a vacuum (e.g.: *Vandervell v. IRC*).

(I) Fundamental principles of trusts: the obligations of trustees and the rights of beneficiaries

Reading: **Hudson, section 2.4**

***Westdeutsche Landesbank v. Islington* [1996] 2 All E.R. 961, 988. [1996] AC 669
**Saunders v Vautier* (1841) – the rights of the beneficiary

Lord Browne-Wilkinson in *Westdeutsche Landesbank v. Islington* [1996] 2 All E.R. 961, 988 sought to set out the framework upon which the trust operates:-

> "**THE RELEVANT PRINCIPLES OF TRUST LAW:**
>
> (i) Equity operates on the conscience of the owner of the legal interest. In the case of a trust, the conscience of the legal owner requires him to carry out the purposes for which the property was vested in him (express or implied trust) or which the law imposes on him by reason of his unconscionable conduct (constructive trust).
>
> '(ii) Since the equitable jurisdiction to enforce trusts depends upon the conscience of the holder of the legal interest being affected, he cannot be a trustee of the property if and so long as he is ignorant of the facts alleged to affect his conscience …
>
> '(iii) In order to establish a trust there must be identifiable trust property …
>
> '(iv) Once a trust is established, as from the date of its establishment the beneficiary has, in equity, a proprietary interest in the trust property, which proprietary interest will be enforceable in equity against any subsequent holder of the property (whether the original property or substituted property into which it can be traced) other than a purchaser for value of the legal interest without notice."

TOPIC 2. FOUNDATIONAL TECHNIQUES OF EXPRESS TRUSTS (1)

Aim: *The purpose of this topic is to consider some of the core principles underpinning express trusts law – the area which is most commonly met in practice (before litigation to recover property begins …) – and to introduce novice students to these core ideas. However, this is not simply an undergraduate lecture. Rather, the intellectual goal here is to present some of these well-known cases on the constitution of express trusts as being* a set of techniques *which are used by practitioners to develop the forms of trust and "property management vehicles" which their clients need. The textbook considers this set of techniques in* Hudson, Equity & Trusts, *Chapter 7*. *It is not expected that we will cover all of this material in detail.*

LECTURE MATERIALS

Lecture plan

A set of techniques
- Avoiding mandatory rules
- Controlling who has rights and who does not
- Retaining flexibility
- The line between trust and contract, proprietary and personal rights
- Regulatory avoidance

Areas covered
- Certainty of intention
- Certainty of subject matter
- Certainty of objects
- The beneficiary principle
- Dispositions of equitable interests
- Covenants to settle property

The need for the three certainties

Reading: ***Hudson*, sections 3.1 and 3.2**

"...first...the words must be imperative...; secondly...the subject must be certain...; and thirdly...the object must be as certain as the subject"
(*per* Lord Eldon in *Wright v. Atkyns* (1823) Turn. & R. 143, 157).

(A) Certainty of Intention.

Reading: ***Hudson*, section 2.6, and especially 3.3**

(1) Intention to create a trust inferred from the circumstances

Paul v Constance [1977] 1 W.L.R. 527
Re Kayford [1975] 1 WLR 279

(2) Sham trusts and trusts intended to defraud creditors

Midland Bank plc v. Wyatt [1995] 1 F.L.R. 696 (*sham trusts*).

(B) Certainty of Subject Matter.

Reading: ***Hudson*, section 3.4**

Overall Point: Trusts are part of the law of property (as well containing equitable obligations on the trustees too) and therefore it is essential that the trust property be segregated from all other property.

(1) The traditional principle – the trust fund must be separately identifiable

Palmer v Simmonds (1854) 2 Drew. 221 ("*bulk of my... residuary estate*").
Sprange v. Barnard (1789) 2 Bro. C.C. 585 ("*remaining part of what is left, that he does not want for his own wants and use to be divided...*").
**Re London Wine Co. (Shippers) Ltd.* (1986) Palmer's Co. Cas. 121 (*wine bottles to be held on trust not separated from other bottles*).
**MacJordan Construction Ltd v Brookmount Erostin Ltd* [1992] BCLC 350
***Re Goldcorp* [1995] 1 A.C. 74 (*necessity of segregating trust property - bullion "ex bulk"*)
Westdeutsche Landesbank v Islington [1996] AC 669

(2) A different principle for intangible or for fungible property?

***Hunter v. Moss* [1994] 1 W.L.R. 452 (*identification of shares - the nature of intangible property*).
**Re Harvard Securities* [1997] 2 BCLC 369
But see **MacJordan Construction Ltd v Brookmount Erostin Ltd* [1992] BCLC 350
Cf. the law of insolvency generally and the need for clear secured rights.

(3) A different approach in commercial law

Sale of Goods Act 1979, s 20A – tenants in common of the combined fund
Sale of Goods (Amendment) Act 1995
Cf. the law on tracing later in the course

(4) Floating charges (not trusts)

Clough Mill v Martin [1984] 3 All ER 982

(5) A note on the nature of property in trusts law

Reading: ***Hudson*, section 31.1**
Re Goldcorp [1995] 1 A.C. 74 – *the identity of the property is paramount*
Attorney-General for Hong Kong v. Reid [1994] 1 AC 324, [1993] 3 WLR 1143 – *the morality of the situation is paramount*
Don King Productions v. Warren [1998] 2 All E.R. 608
See Grantham, 'Doctrinal bases for the recognition of proprietary rights' (1996) OJLS 561.

(C) Certainty of Objects.

Reading: ***Hudson*, section 3.5**

Overall point: there are different analyses of ostensibly similar fiduciary obligations over property. Also there are a number of ways of avoiding those rules of formality by structuring the material differently.

1) Introduction

Morice v. Bishop of Durham (1804) 9 Ves. Jr. 399 (affd. (1805) 10 Ves. Jr. 522): *there must be some person in whose favour the court can decree performance.*

**Re Hay's Settlement Trusts* [1982] 1 W.L.R. 202: for the most useful summary of these principles and of the various forms of power.

2) Distinguishing between types of power and of trust

- The distinction between "powers" and "trusts": permissive and obligatory
- Fixed trusts and bare trusts obligations
- Discretionary trusts, (once known as "powers in the nature of a trust")
- Fiduciary powers: powers of appointment and powers of advancement
- Personal, non-fiduciary powers

Cf. The nature of beneficial entitlements (cf. mere powers) in general and of corresponding trustees' duties.

3) Certainty rules for personal powers.

Re Hay's Settlement Trusts [1982] 1 W.L.R. 202

4) Certainty rules for mere (fiduciary) powers.

Re Gestetner Settlement [1953] Ch. 673 (the old, strict approach).
Re Gulbenkian's Settlement [1970] A.C. 508: *the "any given postulant test"; aka the "is or is not test".*

5) Certainty rules for discretionary trusts.

McPhail v. Doulton [1971] A.C. 424 (*can it be said with certainty that any given individual is or is not a member of the class?*)

6) Certainty rules for fixed trusts (e. g. fixed shares within a class).

I.R.C. v. Broadway Cottages Trust [1955] Ch. 20.

7) Mechanisms for eluding the "any given postulant test" (1): conceptual and evidential certainty.

(*Re Allen* [1953] Ch 810)
Re Baden's Deed Trusts (No 2) [1973] Ch. 9.
Re Barlow [1979] 1 WLR 278

8) Mechanisms for eluding the "any given postulant test" (2): use of an expert.

Re Tuck's ST [1978] 2 WLR 411

9) Mechanisms for eluding the "any given postulant test" (3): let the trustees do whatever they want .

(a) Trustees' opinion decisive
Re Coxen [1948] Ch 747 (*trustees' opinion may not replace certainty by itself*)
Re Jones [1953] Ch 125 (*ditto*)

(b) Wide powers
Re Manisty's Settlement [1974] Ch. 17 (*granting wide powers – e.g. "trustees may give to anyone in the world except x" – may be certain if clear who excluded*).
Blausten v IRC [1972] Ch 256 (*if class so wide that it is not really a class at all – e.g. everyone in the world – then uncertain*)

10) The nature of powers of appointment

*Thomas and Hudson, Chapters 11 and 20
Underhill & Hayton 93-98, 518-519, 631-633

(D) The nature of the beneficiary's rights in the trust fund

Reading: ***Hudson*, section 4.1**

**Saunders v Vautier* (1841) 4 Beav 115
Re Bowes [1896] 1 Ch 507
In re Holt's Settlement [1969] 1 Ch 100, 111, *per* Megarry J: '*If under a trust every possible beneficiary was under no disability and concurred in the re-arrangement or termination of the trusts, then under the doctrine in* Saunders v Vautier *those beneficiaries could dispose of the trust property as they thought fit; for in*

equity the property was theirs. Yet if any beneficiary was an infant, or an unborn or unascertained person, it was held that the court had no general inherent or other jurisdiction to concur in any such arrangement on behalf of that beneficiary.'

Gartside v IRC [1968] AC 553 – *when does object of discretionary trust have a proprietary right?*

(E) The beneficiary principle.

Reading: ***Hudson*, section 4.2**

Overall point: the mandatory rule that there must be some person in whose favour the trust is enforced has spawned a number of imaginative, analytical attempts to circumvent that rule. This topic will be considered in detail in Topic 6.

1) The general principle

Morice v. Bishop of Durham (1804) 9 Ves. 399; (1805) 10 Ves 522.
"*There can be no trust, over the exercise of which this court will not assume control ..If there be a clear trust, but for uncertain objects, the property... is undisposed of... Every...[non-charitable] trust must have a definite object. There must be somebody in whose favour the court can decree performance*" (*per* Lord Grant M.R.).
Bowman v Secular Society Ltd [1917] AC 406

2) The strict, traditional principle

Leahy v. Att.-Gen. for New South Wales [1959] A.C. 457 (*trust for 'such order of nuns' as trustees shall select*) – *this case is considered in detail below.*
Re Grant's WT [1979] 3 All ER 359 (*gift "for the benefit of the HQ of the Chertsey CLP" = void purpose trust; see below*).

3) Interpreting what is ostensibly a purpose trust as being a trust for the benefit of persons

Re Denley's Trust Deed [1969] l Ch. 373 (*trust "directly or indirectly for the benefit of individuals" = people trust and therefore valid*.)

4) Interpret the power to be something other than a trust

i) Transfer interpreted to be a gift

Re Lipinski's W.T. [1976] Ch. 235 – gift ("*a clear distinction between …a purpose … clearly intended for the benefit of ascertained or ascertainable beneficiaries …, and the case where no beneficiary at all is intended … or where the beneficiaries are unascertainable"*)

ii) Use of the principle in *Saunders v Vautier*

Re Bowes [1896] 1 Ch 507 – (*use of Saunders v Vautier to allow human beneficiaries to displace settlor's stated intention*)
Re Nelson [1928] Ch 920 *"the principle in Saunders v Vautier is that where there is what amounts to an absolute gift, it cannot be fettered by prescribing a mode of enjoyment"*

(F) Conceptual issues with property held for unincorporated associations.

Reading: ***Hudson*, section 4.3**

If there has been a transfer made for the benefit of an association and/or its members, then these are the analytical possibilities of that transfer. You should consider the facts of each transfer and decide which you consider to be the most appropriate analysis of the facts in front of you.

- Valid "people" trust: a transfer to the individual members of the association for their benefit personally – *Re Denley*
- Valid gift: outright transfer / assignment / gift to the members individually to use the capital how they see fit – *Re Lipinski*

- Void "purpose" trust: a transfer for present and future members of the association – *Leahy v Att-Gen NSW*
- Void "purpose" trust by way of endowment: a transfer to the trustees or other officers of the association to hold as an endowment – *Leahy v Att- Gen NSW*; *Re Grant's WT*
- Contract law: a transfer to the existing members beneficially as an accretion to the association's funds - *Re Recher* [1972] Ch. 526
- Contract law: a transfer to the officers with a mandate to use it for particular purposes - *Conservative Association v Burrell* [1982] 1 W.L.R. 522, per Brightman LJ
- Contract law: winding up an association should be conducted in accordance with the contract / constitution in place between the members - *Re Bucks Constabulary Fund (No 2)* [1979] 1W.L.R. 936 (displacing *Re West Sussex Constabulary's Widows, Children and Benevolent (1930) Fund Trust* [1971] Ch. 1 based on resulting trust)

(G) Is the beneficiary principle justifiable?

Overall point: would the removal of the beneficiary principle aid international trusts law practice? this topic will be considered in Topic 6 in detail.

Reading: ***Hudson*, paras 4.2.8 and 21.2.3**
Langbein, "The contractarian basis of the law of trusts" (1995) 105 *Yale Law Journal* 625.
Hayton, "Developing the obligation characteristic of the trust" (2001) 117 LQR 96.
Hudson, section 21.2

TOPIC 3. FOUNDATIONAL TECHNIQUES OF EXPRESS TRUSTS (2)

This material follows on from the previous lecture …

(H) Dispositions of equitable interests.

General reading for this topic: ***Hudson*, section 5.7**

Overall point: the creativity of trusts lawyers is endless and a variety of means of structuring transactions can be used to circumvent a mandatory rule of trusts law.

Statutory material

Law of Property Act 1925, s. 53 (1) (c): "*A disposition of an equitable interest or trust subsisting at the time of the disposition, must be in writing signed by the person disposing of the same, or by his agent*..."

1) Declarations of trust may sometimes amount to dispositions of an equitable interest and so be caught by s. 53 (1) (c)

Reading: ***Hudson*, section 5.7.1 and esp. 5.7.2**

Grey v. I.R.C. [1960] A.C. 1 (*direction to trustee by beneficiary constituting disposition of equitable interest*).

2) Direction to transfer legal estate (carrying with it the equitable interest) is not a disposition under s. 53 (1) (c)

Reading: ***Hudson*, sections 5.7.3 and 5.7.4**

Vandervell v. I.R.C. [1967] 2 A.C. 291.

3) Structures falling outside s 53(1)(c)

a) Sub-trusts not a disposition of the equitable interest if some rights retained

Reading: *Hudson*, section 5.7.6

Re Lashmar (1891) 1 Ch 258

Grainge v Wilberforce (1889) 5 TLR 436

b) Declaration of a new trust, rather than disposition of equitable interest

Reading: *Hudson*, section 5.7.7

Cohen Moore v. IRC [1933] All E.R. 950

c) Contract transfers equitable interest automatically

Reading: *Hudson*, section 5.7.8

Oughtred v. I.R.C. [1960] A.C. 206.

Chinn v. Collins [1981] A.C. 533

Neville v. Wilson [1996] 3 All E.R. 171.

Cf. *Jerome v Kelly* [2004] 2 All ER 835, [2004] UKHL 25 (*Hudson*, para 12.6.2)

d) Transfers in (c) understood to take effect by constructive trust

Reading: *Hudson*, section 5.7.9

Neville v. Wilson [1996] 3 All E.R. 171.

Cf. *Jerome v Kelly* [2004] 2 All ER 835, [2004] UKHL 25 (*Hudson*, para 12.6.2)

e) Were *Grey* and *Vandervell* correctly decided?

Reading: *Hudson*, section 5.7.5

Green, (1984) 47 MLR 388.

(I) The proper constitution of trusts & the problem of incompletely constituted trusts.

General reading: ***Hudson*, sections 5.3, 5.4 and 5.6**

Overall Point: Equitable doctrines and considerations, like *Re Rose* and *Rochefoucauld*, may trump clear rules of formality so as to achieve fairness.

1) Methods for the proper constitution of a trust

Reading: *Hudson*, section 5.3

Milroy v. Lord (1862) 4 De G. F. & J. 264, *per* Turner LJ (*there is no equity to perfect an imperfect gift*):

> *'... in order to render a voluntary settlement valid and effectual, the settlor must have done everything which, according to the nature of the property comprised in the settlement, was necessary to be done in order to transfer the property [to the trustee] and render the settlement binding upon him. He may, of course, do this by actually transferring the property to the persons for whom he intends to provide, and the provision will then be effectual and it will be equally effectual if he transfers the property to a trustee for the purposes of the settlement, or declares that he himself holds it in trust for those purposes … but in order to render the settlement binding, one or other of these modes must, as I understand the law of this court, be resorted to, for there is no equity in this court to perfect an imperfect gift.'*

2) … except where transferor has does everything necessary for him to do to effect the transfer

Reading: *Hudson*, section 5.4.3

Re Rose [1952] Ch. 499 (*ineffective transfer of legal title to shares but equitable title held to pass because inequitable for transferor to seek to renege on the transfer*).

3) Resulting, implied and constructive trusts require no formalities for their creation

General reading: ***Hudson*, section 5.2**

LPA 1925, s. 53 (2)

Hodgson v. Marks [1971] Ch. 892 - resulting trust.

4) Statute may not be used as an engine of fraud

General reading: ***Hudson*, section 5.2**

Rochefoucauld v. Boustead [1897] 1 Ch. 196.

Bannister v. Bannister [1948] 2 All E.R. 133

Lyus v. Prowsa [1982] 1 W.L.R. 1044.

(J) Covenants and promises to create a settlement.

Overall Point: Even if property law will not provide a remedy, contract law may provide a personal claim.

Reading: ***Hudson*, section 5.6**

1) Can the intended beneficiaries enforce the settlor's promise?

a) A settlement cannot be unmade once it has been made

Reading: *Hudson*, section 5.6.1

Paul v. Paul (1882) 20 Ch. D. 742

b) Mere promise unenforceable if beneficiary gave no consideration:

Reading: *Hudson*, section 5.4.2

'equity will not assist a volunteer'/ 'equity will not perfect an imperfect gift'.

Re Brook's ST [1939] 1 Ch 993

Re Ralli's WT [1964] 1 Ch 288

c) But enforceable by someone who has given consideration for the promise at common law or is within marriage consideration...

Reading: *Hudson*, section 5.6.1

Pullan v. Koe [1913] 1 Ch. 9 (widow and children within marriage consideration).

d) ... or by someone who is a party to the settlor's binding covenant to create the trust.

Reading: *Hudson*, section 5.6.1
Cannon v. Hartley [1949] Ch. 213 (volunteer able to enforce as party to covenant under seal).

2) Trustee not permitted to enforce the promise?

Reading: ***Hudson*, section 5.6.2** "Trustee not permitted to enforce the promise"

a) Should common law rights to enforce a binding promise/agreement be exercised against the spirit of the maxim 'equity will not assist a volunteer'?
**Re Cook's S.T.* [1965] Ch. 902 (trustees cannot be required to enforce).

b) The law of contract
Contract (Rights of Third Parties) Act 1999

3) A trust of the promise itself – a means of validating this promise through trusts law

Reading: ***Hudson*, section 5.6.2** "A trust of the promise itself"

(a) the settlor's binding promise as 'property' held on trust by the intended trustee(s): a 'trust of the benefit of the covenant'.
Fletcher v. Fletcher (1844) 4 Hare 67.

(b) modern cases on whether contracts can themselves form the subject matter of a trust, even if those contracts are unassignable
Don King Productions v. Warren [1998] 2 All E.R. 608; affirmed [1999] 2 All E.R. 218

TOPIC 4. THEMES IN EQUITY AND TRUSTS

Aim: *The aim of this seminar is to summarise at the outset some of the key thematic and intellectual questions which this course will seek to address and which will be assessed ultimately in the form of essays (as opposed to much of this course which focuses otherwise on problem-solving).*

LECTURE MATERIALS

A. Definition

1. What is meant by "conscience"?
2. Where is the line between personal and proprietary rights?

B. Equity in commercial law

1. If the central philosophy of commercial law is certainty, how does equity interact with commercial law?
2. Commercial law uses equitable doctrines like floating charges, trusts and tracing to take security and to recover property.
3. Commercial law is nevertheless suspicious of judicial discretion as exercised through equity: why?
4. How does the law relating to ownership of the home differ from trusts used in commercial contexts? Will this lead to a schism in trusts law?
5. How does financial regulation correlate with the ordinary law of trust – see, for example, regulation of pensions, regulation of unit trusts, and FSA regulation of trustees trading as authorised persons.

C. The demands of international trusts law practice

1. Can trusts be better understood on the basis of contractual models: e.g. exclusion of liability of trustees?
2. Is the beneficiary principle necessary, or would international trusts law fare better by using protectors and other devices?
3. Is the trust part of property law or of the law of obligations?
4. Do these mooted developments qualify the notion of fiduciary liability?

D. Competing models to the conscience-based model

1. Is unjust enrichment a better model for equitable doctrines like resulting trust and constructive trust than conscience-based models?
2. Is there a coherent basis for constructive trusts?

3. Do equitable doctrines protect pre-existing property rights or grant new property rights?
4. Can property law be based on moral or ethical grounds, or can it only be responsive?
5. Is the trust a part of property law or of obligations?

E. Jurisprudential questions about equity

1. Is conscience a subjective or an objective construct?
2. Is equity built on natural law or on positive law?
3. Do judges in courts of equity have strong or weak discretion?
4. How does equity differ from human rights law in the protection of the individual?
5. Do all legal systems have some informal type of equity?
6. Is equity a necessary recognition of chaos in natural life?

TOPIC 4. OBLIGATIONS OF TRUSTEES (1): CONTROL OF TRUSTEES AND BREACH OF TRUST

LECTURE MATERIALS

(A) The trustees' duties in outline.

1) The core trustees' duties

This chapter of the course considers a selection of the key duties of trustees. Hudson, 2005, chapter 8 considers 13 general duties, as well as the procedures for the appointment and removal of trustees:

(1) The duties on acceptance of office relating to the need to familiarise oneself with the terms, conditions and history of the management of the trust.
(2) The duty to obey the terms of the trust unless directed to do otherwise by the court.
(3) The duty to safeguard the trust assets, including duties to maintain the trust property, as well as to ensure that it is applied in accordance with the directions set out in the trust instrument.
(4) The duty to act even-handedly between beneficiaries, which means that the trustees are required to act impartially between beneficiaries and to avoid conflicts of interest.
(5) The duty to act with reasonable care, meaning generally a duty to act as though a prudent person of business acting on behalf of someone for whom one feels morally bound to provide.
(6) Duties in relation to trust expenses.
(7) The duties of investment, requiring prudence and the acquisition of the highest possible rate of return in the context.
(8) The duty to distribute the trust property correctly.
(9) The duty to avoid conflicts of interest, not to earn unauthorised profits from the fiduciary office, not to deal on one's own behalf with trust property on pain of such transactions being voidable, and the obligation to deal fairly with the trust property.
(10) The duty to preserve the confidence of the beneficiaries, especially in relation to Chinese wall arrangements.
(11) The duty to act gratuitously, without any right to payment not permitted by the trust instrument or by the general law.
(12) The duty to account and to provide information.
(13) The duty to take into account relevant considerations and to overlook irrelevant considerations, failure to do so may lead to the court setting aside an exercise of the trustees' powers.

There are other duties considered in ***Hudson***, section 8.1 and in chapter 9 (relating specifically to investment of the trust property); and there are also general powers for trustees considered in ***Hudson***, chapter 10. We will be focusing only on those duties with emboldened numbers.

2) Key concepts in the obligations of trustees

i) The requirement of good conscience

Reading: ***Hudson*, para 8.2.4**

Westdeutsche Landesbank v Islington [1996] AC 669.

ii) The general duty of care and prudence

Reading: ***Hudson*, para 8.3.5**

(a) Under case law:-

Speight v Gaunt (1883) 9 App Cas 1

Learoyd v Whiteley (1887) 12 App Cas 727

(b) Under statute:-

Trustee Act 2000, s.1:

"(1) Whenever the duty under this subsection applies to a trustee, he must exercise such care and skill as is reasonable in the circumstances, having regard, in particular –

(a) to any special knowledge or experience that he has or holds himself out as having, and

(b) if he acts as trustee in the course of a business or profession, to any special knowledge or experience that it is reasonable to expect of a person acting in the course of that kind of business or profession."

iii) Duties to act jointly

Luke v South Kensington Hotel (1879) 11 Ch D 121 – *ordinarily trustees must act jointly*

Trustee Act 2000, s.11 – *the trust instrument may permit some other arrangement*

Consterdine v Consterdine – (1862) 31 Beav 330 – *or the nature of the trust property may require separate holding.*

Brice v Stokes (1805) 11 Ves 319 – *trustee need not be liable for breach of duty which was the fault of another trustee.*

Re Munton [1927] 1 Ch 262 – *ditto.*

See generally "Breach of Trust", the next topic.

iv) Liability for breach of trust

Target Holdings v Redfern [1996] 1 AC 421

This topic is considered in detail in the next chapter of these Course Documents.

(B) Fiduciary responsibility of trustees.

Reading: ***Hudson*, section 8.6**

1) What it means to be a fiduciary

White v Jones [1995] 2 AC 207 at 271, *per* Lord Browne-Wilkinson:

'*The paradigm of the circumstances in which equity will find a fiduciary relationship is where one party, A, has assumed to act in relation to the property or affairs of another, B*'.

Bristol and West Building Society v Mothew [1998] Ch 1 at 18, *per* Millett LJ:

'*A fiduciary is someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence. The distinguishing obligation of a fiduciary is the obligation of loyalty. The principal is entitled to the single-minded loyalty of his fiduciary. The core liability has several facets. A fiduciary must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and his interest may conflict; he may not act for his own benefit or the benefit of a third person without the informed consent of his principal. This is not intended to be an exhaustive list, but it is sufficient to indicate the nature of fiduciary obligations. They are the defining characteristics of the fiduciary.*'

2) Conflicts of interest not permissible

Reading: ***Hudson*, para 8.3.9**

(i) The general principle against secret profits and conflicts of interest in general terms

[Considered in detail in relation to "Constructive Trusts" later in the course.]

Keech v Sandford (1726) Sel Cas Ch 61

**Boardman v. Phipps* [1967] 2 AC 46 – see Topic 8.

(ii) The self-dealing principle

Ex parte Lacey (1802) 6 Ves 625 (*any transaction in which the trustee has a personal interest is voidable at the instance of the beneficiary*)

Holder v Holder [1968] Ch 353 (*the court may not inquire into the trustee's intentions*)

(iii) The fair-dealing principle

Tito v Waddell (No 2) [1977] 3 All ER 129, *per* Megarry V-C:

"... if a trustee purchases the beneficial interest of any of his beneficiaries, the transaction is not voidable ex debito justitiae, but can be set aside unless the trustee can show that he has taken advantage of his position and has made full disclosure to the beneficiary, and that the transaction is fair and honest."

3) Duty of impartiality

`Reading:` ***Hudson*****, section 8.3.4**

Re Barton's Trust (1868) LR 5 Eq 238 (*life tenant entitled to the income generated by the fund, provided that there is no unauthorised discrimination in favour of the life tenant as against other beneficiaries*)

**Cowan v Scargill* [1985] Ch 270, 286, *per* Megarry V-C:

> *'It is the duty of trustees to exercise their powers in the best interest of the present and future beneficiaries of the trust, holding the scales impartially between the different classes of beneficiaries.'*

**Nestlé v National Westminster Bank* (1988) [2000] WTLR 795, 802, Hoffmann J:

> *'A trustee must act fairly in making investment decisions which may have different consequences for differing classes of beneficiaries. … The trustees have a wide discretion. They are, for example, entitled to take into account the income needs of the tenant for life or the fact that the tenant for life was a person known to the settlor and a primary object of the trust whereas the remainderman is a remoter relative or stranger. Of course, these cannot be allowed to become the overriding considerations but the concept of fairness between classes of beneficiaries does not require them to be excluded. It would be an inhuman rule which required trustees to adhere to some mechanical rule for preserving the real value of capital when the tenant for life was the testator's widow who had fallen upon hard times and the remainderman was young and well-off.'*

Nestlé v National Westminster Bank plc (1988) [1993] 1 WLR 1260, CA (*deciding between life tenants and remainder beneficiaries*)

4) Validity of exclusion clauses

`Reading:` ***Hudson*****, section 8.5**

Armitage v. Nurse [1998] Ch 241, *per* Millett LJ:

> *'[T]here is an irreducible core of obligations owed by the trustees to the beneficiaries and enforceable by them which is fundamental to the concept of a trust. If the beneficiaries have no rights enforceable against the trustees there are no trusts. But I do not accept the further submission that there core obligations include the duties of skill and care, prudence and diligence. The duty of trustees to perform the trusts honestly and in good faith for the benefit of the beneficiaries is the minimum necessary to give substance to the trusts, but in my opinion it is sufficient ... a trustee who relied on the presence of a trustee exemption clause to justify what he proposed to do would thereby lose its protection: he would be acting recklessly in the proper sense of the term.'*

Walker v Stones [2001] QB 902

(C) Trustees taking into account irrelevant considerations, etc.

`Reading:` ***Hudson*****, section 8.3.13**

1) The basis of the principle in *Hastings-Bass*

(i) The original, negative form of the principle

Re Hastings-Bass [1975] Ch 25, 40, *per* Buckley LJ

> '*… a trustee is given a discretion as to some matter under which he acts in good faith, the court should not interfere with his action notwithstanding that it does not have the full effect which he intended, unless (1) what he had achieved is unauthorised by the power conferred upon him, or (2) it is clear that he would not have acted as he did (a) had he not taken into account considerations which he should not have taken into account, or (b) had he not failed to take into account considerations which he ought to have taken into account.*'

(ii) The positive form of the principle

Mettoy Pensions Trustees v Evans [1990] 1 WLR 1587, 1624, per Warner J

> '*If, as I believe, the reason for the application of the principle is the failure by the trustees to take into account considerations which they ought to have taken into account, it cannot matter whether that failure is due to their having overlooked (or to their legal advisers having overlooked) some relevant rule of law or limit on their discretion, or is due to some other cause. … [I]t is not enough that it should be shown that the trustees did not have a proper understanding of the effect of their act. It must also be clear that, had they had a proper understanding of it, they would not have acted as they did.*'

Burrell v Burrell [2005] EWHC 245, [15], *per* Mann J

(iii) The requirement for a breach of trust

Abacus Trust Company (Isle of Man) v Barr [2003] 2 WLR 1362, [23] *per* Lightman J

> '*In my view it is not sufficient to bring the rule into play that the trustee made a mistake or by reason of ignorance or a mistake did not take into account a relevant consideration or took into account an irrelevant consideration. What has to be established is that the trustee in making his decision has … failed to consider what he was under a duty to consider. If the trustee has, in accordance with his duty, identified the relevant considerations and used all proper care and diligence in obtaining the relevant information and advice relating to those considerations, the trustee can be in no breach of duty and its decision cannot be impugned merely because in fact that information turns out to be partial or incorrect. … [T]he rule does not afford the right to the trustee or any beneficiary to have a decision declared invalid because a trustee's decision was in some way mistaken or has unforeseen and unpalatable consequences.*'

Burrell v Burrell [2005] EWHC 245, [22], *per* Mann J (*the principle could be invoked in either case because there had been a breach of duty*.)
Gallaher v Gallaher [2004] EWHC 42, [2005] All ER (D) 177, [162] *et seq.*, *per* Etherton J (*point raised but not disposed of because not necessary on the facts.*)

(iv) The *Abacus v Barr* version of the test

a) That there might have been a different decision reached

Abacus Trust Co (Isle of Man) v Barr [2003] 2 WLR 1362, 1369, *per* Lightman J

> '*[This principle] does not require that the relevant consideration unconsidered by the trustee should make a fundamental difference between the facts as perceived by the trustee and the facts as they should have been perceived and actually were. All that is required in this regard is that the unconsidered relevant consideration would or might have affected the trustee's decision, and in a case such as the present that the trustee would or might have made a different appointment or no appointment at all.*'

Lightman J suggested four pre-requisites

> *(1) whether or not the trustee's actions were sufficiently fundamental;*
> *(2) whether the trustee had failed to consider something which she was duty-bound to consider and failed to act with sufficient diligence in identifying that necessary information;*
> *(3) whether the trustee was at fault for failing to give effect to the settlor's objectives; and*
> *(4) whether the exercise of the power was void or voidable.*

b) Does this test set the barrier too low?

[2003] PCB 173 (E Nugee)
(2003) Trust Law Int 114 (B Green)

Thomas and Hudson, *The Law of Trusts*, 2004, 385 *et seq*

c) Is the test based on whether the trustees "would have" or whether they "might have" reached a different decision if they had proceeded properly?

Re Hastings-Bass [1975] Ch 25 (*would have*)
Stannard v Fisons Pension Trust Ltd [1991] PLR 224 (*might have*)
Hearn v Younger [2002] WTLR 1317, 1338, [86], *per* Etherton J (*(a) trustees have failed to take into account a material consideration and (b) that consideration might have materially affected their decision*)
Hunter v Senate Support Services Ltd [2004] EWHC 1085: (*might have is objective, whereas would have is subjective*).

(v) Examples of considerations taken into account or not taken into account

Stannard v Fisons Pension Trust Ltd [1991] PLR 224 (*failure to take an up-to-date valuation of assets held in a pension fund before transferring assets between funds*)
Green v Cobham [2002] STC 820 (*failing to take into account the fiscal consequences of a decision & considerations in relation to a single beneficiary may differ from the considerations applicable in relation to a power over a large class of potential beneficiaries*)
Burrell v Burrell [2005] EWHC 245 (*failing to take into account the fiscal consequences of a decision: inheritance tax*)
Abacus Trust Company (Isle of Man) v Barr [2003] 2 WLR 1362 (*failing to take the settlor's wishes into account correctly*)

2) The remedy: set aside of the trustees' decision

(i) The traditional remedy

**Re Hastings-Bass* [1975] Ch 25
Scott v National Trust [1998] 2 All ER 705
Edge v Pensions Ombudsman [2000] Ch 602.

(ii) Exercisable of the power voidable but not void

AMP v Barker [2001] PLR 77, *per* Lawrence Collins J
Hearn v Younger [2002] WTLR 1317, 1338, [90], *per* Etherton J
**Abacus Trust Company (Isle of Man) v Barr* [2003] 2 WLR 1362, [28]-[33], *per* Lightman J
Hunter v Senate Support Services Ltd [2004] EWHC 1085.

(iii) Validation if effect of exercise of power substantively similar

Re Vestey's Settlement [1951] Ch 209, 221, *per* Lord Evershed MR

(iv) Alternative understanding as an excessive exercise of a power

Thomas and Hudson, *The Law of Trusts*, 2004, 388, para 11.55 *et seq*
Bestrustees v Stuart [2001] PLR 283 (*prospective alterations only permitted, alteration in fact purportedly retrospective too: invalid only to extent excessive*)
Mettoy Pension Trustees Ltd v Evans [1990] 1 WLR 1587 (*considered*)
Burrell v Burrell [2005] EWHC 245, [25], *per* Mann J (*considered*)

(D) Trustee's duty to provide information and to account to the beneficiaries.

Reading: ***Hudson*, section 8.4**

1) No general obligation for the trustees to give full information to anyone who considers themselves entitled to an equitable interest under the trust

***O'Rourke v Derbyshire* [1920] AC 581 – *right to information only if proprietary right*
**Re Londonderry* [1965] Ch 918 – *no obligation to give reasons for decisions nor to disclose confidential information*
Hawkesley v May [1956] 1 QB 304 – *duty only to inform sui juris beneficiaries of the existence of the trust*
Tito v Waddell (No 2) [1977] Ch 106, 242 – *no duty to explain terms of trust to beneficiaries*

2) The traditional English view: information only for those with proprietary rights

O'Rourke v Derbyshire [1920] AC 581, 626, *per* Lord Wrenbury

> *[A beneficiary] is entitled to see all the trust documents because they are trust documents and because he is a beneficiary. They are in a sense his own. Action or no action, he is entitled to access to them. This has nothing to do with discovery. The right to discovery is a right to see someone else' document. A proprietary right is a right to access to documents which are your own. … A beneficiary has a right of access to the documents which he desires to inspect upon what has been called in the judgments in this case a proprietary right. The beneficiary is entitled to see all trust documents, because they are trust documents, and because he is a beneficiary. They are, in this sense, his own.*

Cf. e.g. *Gartside v IRC* [1968] AC 553 – *when does object of discretionary trust have proprietary right?*

3) The new approach

***Schmidt v Rosewood Trust Ltd* [2003] 2 WLR 1442, 1463, *per* Lord Walker

> *… no beneficiary … has any entitlement as of right to disclosure of anything which can plausibly be described as a trust document. Especially when there are issues as to personal or commercial confidentiality, the court may have to balance the competing interests of different beneficiaries, the trustees themselves, and third parties. Disclosure may have to be limited and safeguards may have to be put in place.*

4) Traditional applications of the new approach

Crowe v Stevedoring Employees Retirement Fund [2003] PLR 343
Foreman v Kingstone [2004] 1 NZLR 841

5) No obligation to give reasons for decision

Re Londonderry [1965] Ch 918 (*management information to be given, exercise of discretions not*)
Re Beloved Wilkes Charity (1851) 3 Mac & G 440
Klug v Klug [1918] 2 Ch 67

6) Confidential information

Re Londonderry [1965] Ch 918
(*Lemos v Coutts & Co* (1992) Cayman Islands ILR 460)
***Schmidt v Rosewood Trust Ltd* [2003] 2 WLR 1442

7) Duty to render accounts

Hudson, para 8.4.8

(E) Judicial control of trustees' actions.

Reading: ***Hudson*, section 8.6.2**

1) Basis for judicial review of trustees' actions

Re Beloved Wilkes's Charity (1851) 3 Mac & G 440, 448, per Lord Truro:

> *… the duty of supervision on the part of the Court will thus be confined to the question of the honesty, integrity, and fairness with which the deliberation has been conducted, and will not be extended to the accuracy of the conclusion arrived at, except in particular cases.*

2) Discretionary trust: no interference if exercise of power in good faith

Gisborne v Gisborne (1877) 2 App Cas 300, 305, *per* Lord Cairns
Re Schneider (1906) 22 TLR 223, 226, *per* Warrington J

3) Review where exercise of power not in best interests of beneficiary

Tabor v Brooks (1878) 10 Ch D 273, *per* Malins V-C.
Cf. *Re Schneider* (1906) 22 TLR 223.

4) Where the exercise of the power relates to the rights of children

Re Hodges (1878) 7 Ch D 754 (*capriciously in excess of powers*)
Tabor v Brooks (1878) 10 Ch D 273 (*ditto*).
Klug v Klug [1918] 2 Ch 67 (*improper reasons*)

5) The form of behaviour justifying judicial review

Turner v Turner (1978) 122 SJ 696 (*failure to examine trust instrument*)
Re Chapman (1895) 72 LT 66 (*acting vexatiously*)
**Mettoy Pensions Fund* [1990] 1 WLR 1587, *per* Warner J (*review only if exercise of power performed capriciously or outside the scope of the trust – fiduciary power more reviewable than personal power, infra*)
Stannard v Fisons [1992] IRLR 27 (*trustees must consider all appropriate information, including actuarial information where necessary to reach an appropriate decision in relation to a pension fund*)

6) Absolute versus permissive powers

**Breadner v Granville-Grossman* [2001] Ch 523 (*permissively drafted power led to validation of exercise even though exercise on date other than that specified in trust instrument*)
Maybe absolute powers cannot be interfered with by the court. E.g. a personal power might be non-justiciable if it is provided that the power-holder "may do whatever she pleases"; however, a fiduciary power may not be exercised capriciously even if it is worded equally broadly: see e.g. *Re Hay's ST* [1981] 3 All ER 786, [1982] 1 WLR 202

SEMINAR MATERIALS

1. What role does the law of fiduciaries play within common law legal systems?

2. Tariq was trustee of a family trust. The terms of his powers were that he could invest only in the shares of companies quoted on the FTSE-100. Tariq decided to invest in a private company not quoted on the FTSE-100 which made investments only in Fairtrade business enterprises in Africa. Tariq's reasons for doing this were that:

(a) the beneficiaries were all committed Christians belonging to a sect which did not believe in investing solely for profit without also seeking to do good; and

(b) Tariq had read an article in *Investor's Chronicle* which stated that this private company earned profits which outstripped the FTSE-100.

Advise Tariq now that the company has made a loss.

3. What are the advantages for a beneficiary under a trust if a trust structure is used for investment purposes rather than an ordinary contract with an investment fund manager?

4. Lawrence was trustee of a family trust with a power to invest in any property he considered appropriate. Lawrence was a solicitor in a small provincial practice in Essex, albeit with no investment experience. The trust document provided that Lawrence's liability for breach of trust was excluded completely unless he had acted "fraudulently or recklessly". After a good lunch and two bottles of wine with a stockbroker friend, Lawrence agreed to invest two-thirds of the trust fund on his friend's recommendation. He signed the papers while drinking his first cognac. The stockbroker had ten year's experience in the markets. The fund made a loss. Advise the beneficiaries.

5. Would your answer to **4.** differ if you knew that

(a) the investment made a profit, albeit a profit which was 30% lower than the market average; or that

(b) it was common practice for such trustees to hand over the running of their funds to stockbrokers in this fashion?

6. Jocasta was trustee of a family trust. She decided to sell a number of artworks which were owned by the trust and to invest the sale proceeds in new dot.com companies which were publicly quoted on the Stock Exchange's Alternative Investment Market. [The Alternative Investment Market specialises in quotations of new companies which are marketed to the public and regulated (albeit more lightly than the Official List on the Stock Exchange).]

Jocasta had no investment experience but she had read in a number of journals that successful dot.com companies would outperform the relevant art markets by 200% over two years. The trust is now faced with a sizeable tax bill which Jocasta had not anticipated.

Jocasta could not find buyers for the artworks at the prices she had been quoted by independent art dealers, and so she bought the artworks with her own money. She paid 90% of the market value of the artworks, which was 10% more than any other potential buyer had offered. The trust's investments are now worth 50% less than the original investment.

In advising the beneficiaries what to do next, how would your advice be shaped by the following information:

(a) Jocasta had acted on the understanding that her principal obligation was to provide income for the life tenants under the trust;

(b) Jocasta had received advice that the trust would not face a tax bill for the sale of the property;

(c) Jocasta would have made those investments even if she had realised that the tax bill would accrue to the trust;

(d) Jocasta was only permitted by the terms of the trust to invest in companies quoted on the FTSE-100?

7. Why should access to information from trustees be restricted only to claimants who can demonstrate that they have some proprietary right in the trust property?

TOPIC 5. OBLIGATIONS OF TRUSTEES (2): INVESTMENT OF TRUSTS

LECTURE MATERIALS

(A) The investment of trusts.

General Reading for this section: ***Hudson*, chapter 9**

1) The power of investment under TA 2000

Section 3(1) of the Trustee Act 2000 provides

> '*Subject to the provisions of this Part, a trustee may make any kind of investment that he could make if he were absolutely entitled to the assets of the trust.*'

Section 6(1) of the Trustee Act 2000 provides that the general investment power is:

> '*(a) in addition to powers conferred on trustees otherwise than by [the Act], but*
> *(b) subject to any restriction or exclusion imposed by the trust instrument or by any enactment or any provision of subordinate legislation.*'

2) Statutory duty of care

Trustee Act 2000, s.1

> '*(1) Whenever the duty under this subsection applied to a trustee, he must exercise such care and skill as is reasonable in the circumstances, having regard in particular –*
>
> *(a) to any special knowledge or experience that he has or holds himself out as having, and*
>
> *(b) if he acts as trustee in the course of a business or profession, to any special knowledge or experience that it is reasonable to expect of a person acting in the course of that kind of business or profession.*
>
> *(2) In this Act the duty under subsection (1) is called "the duty of care".*'

3) Standard investment criteria.

Trustee Act 2000, s.4.

4) The duty to take advice

Trustee Act 2000, s.5(1): trustees are under a positive obligation to take professional advice on the investments which they propose to make on behalf of the trust. This advice must be taken before the exercise of any investment power. Once the advice has been obtained, the trustees are required to consider it and its bearing on the manner in which their investment power should be exercised. The trustees are not obliged to follow the advice which they receive, provided that they have considered it appropriately.

Cowan v Scargill [1985] Ch 270, 289, *per* Megarry V-C:

> '*Although a trustee who takes advice on investments is not bound to accept and act on that advice, he is not entitled to reject it merely because he sincerely disagrees with it, unless in addition he is acting as an ordinary prudent man would act.*'

4) General duties regarding protection and investment of trust assets on the case law.

(i) Seek the highest available return

**Cowan v. Scargill* [1985] 2 Ch. 270, 286-287, *per* Megarry V-C.

'When the purpose of the trust is to provide financial benefits for the beneficiaries, as is usually the case, the best interests of the beneficiaries are normally their best financial interests. The power must be exercised so as to yield the best return for the beneficiaries, judged in relation to the risks of the investments in question; and the prospects for the yield of income and capital appreciation both have to be considered in judging the return from the investment.'

- To require the trustees simply to seek the most profitable investment no matter what the risk?
- To select that investment which offered the highest available yield entirely in accordance with the investment criteria which the Trustee Act 2000 requires the trustees to have created for the trust?
- To ignore non-financial considerations, such as ethics, *Cowan v Scargill*?

<u>(ii) Act as though a prudent person of business investing on behalf of someone for whom one feels morally bound to provide</u>

Learoyd v Whiteley (1887) 12 App. Cas. 727 (HL) (the 'prudent businessman').
Bartlett v. Barclays Bank Trust Co Ltd. [1980] Ch 515
Nestle v. National Westminster Bank plc [1993] 1 W.L.R. 1260.
Cowan v. Scargill [1985] 2 Ch. 270, 289, *per* Megarry V-C:

'[the trustee's obligation is to] take such care as an ordinary prudent man would take if he were minded to make an investment for the benefit of other people for whom he feels morally bound to provide. This duty includes the duty to seek advice on matters which the trustee does not understand, such as the making of investments, and, on receiving that advice, to act with the same degree of prudence. Although a trustee who takes advice on investments is not bound to accept and act on that advice, he is not entitled to reject it merely because he sincerely disagrees with it, unless in addition he is acting as an ordinary prudent man would act.'

(B) The basis of liability for breach of trust.

General Reading for this topic: ***Hudson*, chapter 18.**

This section on Breach of Trust focuses on the leading decision, Target Holdings, and two issues specifically:- (1) in what circumstances a loss can be remedied by a claim based on breach of trust, and (2) at what level should the loss be valued? This topic follows on from the material in the last chapter of these Course Documents relating to the duties of trustees.

Reading: ***Hudson*, section 18.2**

<u>1) The old cases</u>

Re Massingberd's Settlement (1890) 63 LT 296
Re Dawson [1966] 2 NSWR 211, NSW SC
Holder v. Holder [1968] Ch 353, [1968] 1 All ER 665, [1968] 2 WLR 237

<u>2) The modern law</u>

***Target Holdings v. Redferns* [1996] 1 AC 421, [1995] 3 All ER 785 HL
Clough v Bond (1838) 3 My & C 490.
Bristol & West Building Society v. Mothew [1996] 4 All ER 698
Swindle v. Harrison [1997] 4 All ER 705, CA

2 arguments put forward by Target:-

(A) T is *now* entitled to have the 'fund' restored on a restitutionary basis
(B) immediately the moneys were paid way there was an *immediate* loss to trust fund and this should be made good.

Per Lord Browne-Wilkinson in *Target Holdings*:- '… *in my judgement it is important, if the trust is not to be rendered commercially useless, to distinguish between the basic principles of trust law and those specialist rules* *developed in relation to traditional trusts which are applicable only to such trusts and the rationale of which has no application to trust of quite a different kind.'*

3) Loss as the foundation for the claim

Target Holdings v. Redferns [1996] 1 AC 421
Re Massingberd's Settlement (1890) 63 LT 296

4) Loss in relation to investment

Nestle v National Westminster Bank plc (No 2)[1993] 1 WLR 1260, [1994] 1 All ER 118

(C) Remedies for breach of trust.

Reading: ***Hudson*, section 18.3**

***Target Holdings v. Redferns* [1996] 1 AC 421, [1995] 3 All ER 785 HL *per* Lord Browne-Wilkinson:-
'*Courts of Equity did not award damages but, acting in personam, ordered the defaulting trustee to restore the trust estate. If specific restitution of the trust property is not possible, the liability of the trustee is to pay sufficient compensation to the trust estate to put it back to what it would have been had the breach not been committed. Even if the immediate cause of the loss is the dishonesty or failure of a third party, the trustee is liable to make good that loss to the trust estate if, but for the breach, such loss would not have occurred. Thus the common law rules of remoteness of damage and causation do not apply. However, there does have to be some causal connection between the breach of trust and the loss to the trust estate for which compensation is recoverable, viz the fact that the loss would not have occurred but for the breach.*'

There are therefore three forms of remedy here:

- proprietary obligation,
- obligation to restore trust fund,
- compensation.

(D) Defences to breach of trust.

Reading: ***Hudson*, section 18.4**

1) Lack of a causal link between breach and loss
Target Holdings v. Redferns [1996] 1 AC 421

2) Breach committed by another trustee
Townley v Sherborne (1633) Bridg 35; (1633) W & TLC 577.
Brice v Stokes (1805) 11 Ves Jr 319

3) Failure by beneficiary to alleviate loss
Nacional del Cobre de Chile v Sogemin Metals Ltd [1997] 1 WLR 1396

4) Release
Lyall v Edwards (1861) 6 H & N 337; (1861) 158 ER 139
BCCI v Ali [2000] 3 All ER 51

5) Trustee exemption clause
Armitage v Nurse [1998] Ch 241
Bogg v Raper (1998) *The Times*, 12 April
Wight v Olswang [2000] WTLR 783
Walker v Stones [2001] QB 902

6) Excuses for breach of trust

Trustee Act 1925, s.61: "*If it appears to the court that a trustee … is or may be personally liable for any breach of trust … but has acted honestly and reasonably, and ought fairly to be excused for the breach of trust and for omitting to obtain the directions of the court in the matter in which he committed such breach, then the court may relieve him either wholly or partly from personal liability for the same.*"
Chapman v Browne [1902] 1 Ch 785
Re Evans (Deceased) [1999] 2 All ER 777

7) Action not in connection with fiduciary duties
Ward v Brunt [2000] WTLR 731
Galmerrow Securities Ltd v National Westminster Bank plc [2002] WTLR 125

8) Concurrence by beneficiary
Re Pauling's Settlement Trusts [1962] 1 WLR 86, at 108, *per* Wilberforce J.

General reading
Hudson, *Equity & Trusts*, Ch. 9 "Investment of Trusts"
Thomas and Hudson, *The Law of Trusts*, Ch. 52 "Investment of private trusts", extract provided in reading materials.

SEMINAR MATERIALS

These seminar materials are different from other materials on this course. Because this area crosses disciplinary boundaries, these materials contain a brief text to guide your study, together with "learning activities" (as the teaching jargon calls them) to help you through the issues, and four questions for us to consider in detail in the seminar.

1. INTRODUCTION: HOW INVESTMENT TRUSTS WORK

Specific reading
Hudson, *Equity & Trusts*, section 9.1
Thomas and Hudson, *The Law of Trusts*, chapter 52 (extract provided in reading pack)

One the key commercial uses of the trust is as a means of investment. This topic includes not only principles of traditional trusts law but also principles of financial regulation which are applied specifically to professional trustees selling investments to the public and to particular types of trust such as pension funds and unit trusts. As a student of this topic you are therefore required to understand how investment professional use trusts and to differentiate between the means by which the law governing investment trusts differs from ordinary trusts law.

The structure of an investment trust

A trust is a flexible means of managing property, whether that property has been settled by one settlor or by a number of settlors. There are usually a number of investors involved in an investment trust with each of those investors being a settlor of that trust: each investor is a settlor because it is these investors who provide the trust property. Unlike an ordinary trust, the investors provide different amounts of property at different times: this is because, in the marketplace, new customers join the investment trust from time-to-time.

The trustee is the person who has invented the trust – deciding on the amount of money which it hopes to raise from the public, deciding on the types of investment which the trust will make, and then advertising those products to ordinary investors. The trustee will usually be a financial institution or a bank which will manage a large number of trusts simultaneously: each trust will be aimed at a different market sector (whether people wishing to make ethical investments, people wishing to invest only in pharmaceutical companies, people wishing to invest only in oil companies, and so on).

Between the trustee and the investors will be a contract: it is this contract which sets out the rights of the investors and the obligations of the trustee in relation to the investment of the money invested and in relation to the calculation and payment of profits. The investor, however, also acquire the right of beneficiaries under the trust structure. It is this trust structure which was intended originally to provide investors with protection against the trustee – over time, however, public policy came to believe that more stringent forms of protection by financial services regulation and often ombudsmen were also required.

What is meant by an "investment trust"

We will use the term "investment trust" to cover any trust which is created solely for the purposes of making an investment, or which has as one of its purposes the making of investment. As we go through our analysis of this area we will distinguish between various types of investment trust. We will distinguish between investment trusts which are ordinary private trusts but which have as one of their purposes the investment of the trust property, and investment trusts which are marketed by professional trustees to induce members of the public to invest money with them. Ordinary private trusts have a traditional understanding of the trustee as a fiduciary whereas trusts marketed by professional trustees are clearly intended to make a profit for the trustee and consequently contain an in-built conflict of interest between the trustee's personal profits and the beneficiaries' interests.

Among these professionally marketed trusts there are specific models of trust such as pension funds and unit trusts which have their own statutory codes governing them. The existence of these statutory codes make these trusts different from ordinary trusts precisely because Parliament has thought it necessary to treat them separately. You should seek to understand why these distinctions have been made and what the differences are.

Some key distinctions between investment trusts law and traditional trusts law

- Investment trusts have a specific statutory code (in the Trustee Act 2000) governing all trust investment which was intended (a) to modernise the law by giving trustees greater freedom, (b) to act as a supplement to any specific powers which may have been included in the trust instrument, and (c) to encourage the greater use of trusts.

- Some particular types of investment trust have their own statutory codes instead of the Trustee Act 2000. This reflects the understanding that the traditional case law dealing with the investment of ordinary trusts is insufficient to provide adequate redress for beneficiaries because there are often too many beneficiaries to organise the commencement of litigation.

- Some investment trusts such as pension funds and unit trusts have specific statutory codes, distinct from all other trusts, as a reflection of (a) the lack of expertise of ordinary investors compared to professional trustees in making trust investment, and (b) the social importance of these forms of trusts requiring government action to ensure that the public is being protected from any possibility of profiteering by professional trustees.

- The Financial Services and Markets Act 2000 provides a code for the regulation of investment activity throughout the UK in part by creating the Financial Services Authority. The Financial Services Authority in turn has the power to create regulations as to the manner in which trustees can be authorised to sell investments to the public.

2. THE MANAGEMENT OF INVESTMENT ACTIVITY

Specific reading
Hudson, *Equity & Trusts*, sections 9.4 and 9.5
Thomas and Hudson, *The Law of Trusts*, paragraph 52-15 (extract provided in reading pack)

Standard investment criteria

The following explanation of the standard investment criteria is set out in *Thomas and Hudson's Law of Trusts*, para 52-49:

> The Trustee Act 2000 requires that the trustees have regard to something described in the statute as the 'standard investment criteria'[1] when exercising their investment powers. Further, the trustees are required to review the trust's investments 'from time-to-time' and consider whether or not those investments should be varied in the light of the standard investment criteria.[2] Consideration of these standard investment criteria apply whether the trustees are making new investments or considering their existing investments.[3] The two 'standard investment criteria' encompass both the need to make 'suitable' investments and the need to maintain a diverse portfolio of investments to spread the fund's investment risk. Section 4(3) of the Trustee Act 2000 provides that the standard investment criteria are:
>
>> '(a) the suitability to the trust of investments of the same kind as any particular investment proposed to be made or retained and of that particular investment as an investment of that kind, and
>> (b) the need for diversification of investments of the trust, in so far as is appropriate to the circumstances of the trust.'[4]
>
> The expression 'suitability'[5] is one familiar to investment regulation specialists[6] which requires that, in general terms, investment managers are required to consider whether or not the risk associated with a given investment is appropriate for the client proposing to make that investment. In line with the FSA Conduct of Business regulations,[7] a regulated service provider is required to allocate each client to a regulatory category in accordance with their knowledge of financial investments. The conduct of business regulations do not set out a specific definition of what will or will not be suitable in any particular context but rather provide that the steps which are required of any service provider:
>
>> '… will vary greatly, depending on the needs and priorities of the private customer, the type of investment or service being offered, and the nature of the relationship between the firm and the private customer and, in particular, whether the firm is giving a personal recommendation or acting as a discretionary investment manager.'[8]
>
> Having categorised each client in this manner, the service provider is then required to treat them in a manner which is suitable to their expertise and also to ensure that the investments sold to them are suitable for their purposes.

Therefore we can see that, while the trustees have the powers of the absolute owner when making investments, nevertheless the trustees are obliged to consider their approach to making investments in advance. For example, non-professional trustees of a family trust would probably wish to take fewer risks than professional trustees of a large pension fund who

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[1] Trustee Act 2000, s 4(1).
[2] Trustee Act 2000, s 4(2).
[3] Trustee Act 2000, s 4(2).
[4] Trustee Act 2000, s 4(3).
[5] This term is considered in detail at para 54-03.
[6] See the discussion of suitability in AS Hudson, *Swaps, Restitution and Trusts* (Sweet & Maxwell, 1999) 192; AS Hudson, *The Law on Financial Derivatives* (3rd edn, Sweet & Maxwell, 2002) 275, 527. See also, for example, the old Securities and Investment Board Rulebook, Ch III, Part 2; Securities and Futures Authority Rulebook, as supplemented from time-to-time, Rule 5.31; New York Stock Exchange 'Know Your Customer Rule', CCH NYSE Guide, s 2152 (Art III, s 2).
[7] See the discussion at para 47-26.
[8] FSA, *Conduct of Business Rules*, para 5.3.4.

are obliged to make profits as large as possible for the benefit of the pensioners. The principal significance of the standard investment criteria provision is that trustees are not entirely free to do whatever they want but rather that they must be able to justify their decisions. This is more akin to the general law of trusts in which the holder of a fiduciary power is obliged to review and to be able to justify any exercise of that power: *Re Hay's Settlement Trusts* [1981] 3 All ER 786.

The general principles under the case law

> ***Specific reading***
> Thomas and Hudson, *The Law of Trusts*, paragraph 52-23 et seq (extract provided in reading pack)
> You should also read the cases mentioned in the text to follow because they are the leading cases in this area.

Whereas the Trustee Act 2000 was concerned with the trustee's duty to act with reasonable care in the subjective context of that trustee's special knowledge and experience, the case law has advanced a more objective standard orientated around the need to take caution, to protect the trust fund and (latterly) to act in accordance with market practice. The trustee's general duties of investment under the case law can be summarised in the following three core principles:

- the duty to act prudently and safely;[9]
- the duty to act fairly between beneficiaries;[10] and
- the duty to do the best for the beneficiaries financially.[11]

There has always been a conflict between these three principles because the first two principles require the trustees to take care, whereas the third principle suggests that the trustee must take risks in order to make sufficient profits.

3. Principles of the law of finance

Section learning outcomes
By the end of this chapter you should be able to compare the obligations imposed on "authorised persons" by the Financial Services and Markets Act 2000 and by the general law of trusts.

> ***General reading***
> Hudson, *Equity & Trusts*, section 9.8
> Thomas and Hudson, *The Law of Trusts*, para 47-06 et seq in reading pack

The regulation of trustees under the Financial Services and Markets Act 2000

The Financial Services and Markets Act 2000 (referred to here as "FSMA 2000") requires that investments can only be sold be people who have been authorised to do so. To conduct such business – referred to as "regulated activity" – without authorisation is a criminal offence (FSMA 2000, s 19). Once a person has been authorised, he falls within the regulatory regime of the Financial Services Authority ("FSA").

Trustees will be regulated under FSMA 2000 by the FSA in circumstances in which they are conducting "regulated activities"[12] (considered by Thomas and Hudson's *The Law of Trusts* at

[9] *Learoyd v Whiteley* (1887) 12 App Cas 727.
[10] *Bartlett v Barclays Bank* [1980] Ch 515.
[11] *Cowan v Scargill* [1984] 3 WLR 501.
[12] Financial Services and Markets Act 2000, s 22(2), giving effect to s 22(1) by way of Sch 2.

para 47-18) of a specified kind[13] and always providing that they do so “by way of business”.[14] The meaning of the term “business” is discussed in the reading at para 47-07 and the following provisions: the legislation does not provide a definition of that term but rather leaves it deliberately broad.

Learning activity

Consider whether or not the following trustees will require authorisation:

(a) Gigantic Trustee Ltd which employs one hundred fund managers and which advertises mutual fund products to the general public, managing a thousand funds in total;

(b) Arthur Mullard, brother and executor to a testator, George Mullard, who left £25,000 to be held on trust by Arthur for George’s two infant children. Arthur is a plumber by trade.

(c) Stephen Johnson, an accountant, has acted as trustee for twelve of his total of one hundred and fifty clients. For those twelve clients for whom he has acted as trustee, Stephen’s duties involved finding independent financial advisors to suggest portfolio investments and then maintaining his clients’ tax and accounting affairs in relation to those investments. Stephen spends about two days in every month on these clients’ investment portfolios. The average size of the investment funds is £400,000.

Feedback

(a) Gigantic is clearly involved in the business of managing investment trusts and will therefore be involved in regulated activities under FSMA 2000.

(b) Arthur is not involved in a business: the funds under his control are small, he is trustee of only one trust, and he claims to have no professional expertise.

(c) This is the most difficult category. Stephen is a professional person who spends a little less than 10% of his time organising the investment portfolios of a little less than 10% of his clients. Stephen’s role, however, is limited to finding investment advisors – it would be important to know whether Stephen simply processes this advice or whether Stephen himself gives advice (even commenting on the professional advice received) such that he could be seen to conducting the business of advising on investment activity (as opposed merely to acting as nominee for the trusts at issue). The size of the funds is large but no more than the value of a modest detached house or central London flat and therefore there is nothing so large as to require that this necessarily be considered to be a business.

Conduct of business regulation

Specific reading

Hudson, *Equity & Trusts*, section 9.8.3

One very important aspect of financial regulation is the means by which business between financial institution and client will be conducted. The purpose of this regulation is to ensure that clients are treated equitably by financial institutions, particularly given that financial institutions will have a conflict of interest (whether or not acting as a trustee) in that they want to make money from their clients when their clients may simply be trying to provide for their old age by means of a pension. That a financial institution wishes to make profits from a client need not be problematic if that client is also a financial institution, but it will be problematic if the client is an elderly pensioner dealing with her life’s savings (see e.g. *Bankers Trust v Dharmala* [1996] CLC 518). Therefore, the root of conduct of business regulation is the requirement that any authorised person under FSMA 2000 must demonstrate that it has identified the level of expertise of its clients and in consequence that it has dealt suitably with that client.

[13] That is, those listed in Financial Services and Markets Act 2000, Sch 2, as considered below.

[14] Financial Services and Markets Act 2000, s 22(1).

The general requirement which underpins the Conduct of Business code is that when the seller communicates information to a customer, it must do so in a way which is "clear, fair and not misleading".[15]

Suitability in the conduct of business

The test adopted throughout chapter 5 of the FSA's Conduct of Business regulation is that the seller must have taken "reasonable steps" in relation to its treatment of that client. An example would be the manner in which its officers induce clients to enter into particular transactions and any survey of the type of financial instrument which is sold to that particular client.[16] The type of reasonable steps which will be suitable are not susceptible of general definition but rather …

> "… will vary greatly, depending on the needs and priorities of the private customer, the type of investment or service being offered, and the nature of the relationship between the firm and the private customer and, in particular, whether the firm is giving a personal recommendation or acting as a discretionary investment manager."[17]

In so doing the firm is required to ensure that the financial instrument itself is the most suitable of that type of product for the purpose, as well as that the means by which that financial instrument is sold is also suitable in that context.

Limitation of liability

The principles relating to the trustees' ability to exclude or limit their liability by contract were considered in Topic 4. In relation to trustees who are regulated by the FSA there are regulations as to the conduct of investment business which prevent the regulated (or, authorised) person from relying on contractual provisions which are inappropriate for that type of customer, as described under the conduct of business regulations.

Such contractual exclusion clauses are also subject to the Unfair Contract Terms Act 1977 ("UCTA"). One important example of such limitations are those of trustees in the business of selling their services as investment managers seeking to rely on their standard documentation, particularly when dealing with inexpert customers.

The control of misfeasance by financial regulation

> ***Specific reading***
> Hudson, *Equity & Trusts*, section 9.8.4

There are particular forms of regulation which deal with various aspects of financial activity, as follows:

> **Money laundering:** The regulation of banks with a view to combating money laundering has long been a feature of international financial regulation but has been given new impetus by concerns about international terrorism. In England and Wales the Proceeds of Crime Act 2002 seeks to make provision for the treatment of the proceeds of criminal activity and the Terrorism Act 2000 makes provision for the treatment of funds which it is suspected will be applied for the purposes of terrorism. There are also the Money Laundering Regulations 1993 at the European Union level. The regulations require that authorised persons, including regulated trustees, conduct due diligence as to their clients' identity and the source of their funds. Bound up with this is the need to report suspicious transactions, to train staff

[15] COB, 2.1.3.
[16] COB, 5.1.11, 5.1.13.
[17] COB, 5.3.4.

appropriately and to keep records appropriately.[18] The details of these criminal statutes and of the appropriate financial regulation are beyond the scope of this work.[19]

Market abuse: The market abuse code is concerned primarily with behaviour which would be regarded by "a regular user of that market" as a failure "to observe the standard of behaviour reasonably expected of a person in … their position in relation to the market".[20] The behaviour in question relates to information which would not be available to the market generally, which would be likely to give a misleading impression to a client and which would be likely to distort the market. There is also a criminal offence of knowingly or recklessly making misleading statements is contained in section 397 of FSMA 2000.

Insider dealing: The legislative code on insider dealing was established under Part V of the Criminal Justice Act 1993 and is intended to deal with any situation in which a market participant abuses price sensitive information which he acquires when acting as an insider when dealing in price-affected securities.[21] Further to the enactment of the Financial Services and Markets Act 2000 ("FSMA 2000"), the Financial Services Authority has the power to prosecute any allegations of insider dealing.[22]

Learning activity

What are the principal effects of financial regulation on the principles of general trusts law?

Feedback

The principal distinctions are as follows:

- Conduct of business regulation qualifies the situation in which professional trustees will be seeking to earn profit from their relationship with their clients.
- However, conduct of business regulation does not equate to fiduciary obligations: trustees may still make profits from clients under financial regulation, whereas ordinary trusts law prohibits *unauthorised* profits.
- Financial regulation is concerned with ensuring the proper functioning of financial markets, whereas trusts law is concerned exclusively with the protection of the rights of beneficiaries.
- Much of that financial regulation is concerned with the imposition of criminal penalties on certain kinds of activity, and not simply with the civil liability of trustees and others for making profits from their customers.
- Trustees conducting regulated activity under FMSA 2000 will need to observe the requirements of financial regulation as well as the obligations placed on them by the trust instrument and general trusts law.
- The requirements of financial regulation will be a guide to the liability of trustees under trusts law in that a trustee who can show that he has observed the requirements of such regulation will probably be able to demonstrate that he has not acted unconscionably, in general terms, in relation to the investment of a trust. See, for example, *Nestle v National Westminster Bank plc*, considered in the previous chapter.

Sample examination question

How do the principles of financial regulation qualify the general law of trusts relating to the obligations of trustees under the general law of trusts?

[18] See W Blair, A Allison, G Morton, P Richards-Carpenter, G Walker, N Walmsley, *Banking and Financial Services Regulation* (3rd edn, Butterworths, 2003) 282.
[19] The reader is referred to the work cited in the previous footnote.
[20] Financial Services and Markets Act 2000, s 118(3).
[21] Criminal Justice Act 1993, s 52.
[22] Financial Services and Markets Act 2000, s 402.

4. Issues with portfolio investment strategies

General reading
Hudson, *Equity & Trusts*, sections 9.4, 9.5 and 9.9

The meaning of portfolio investment and risk management

Much of this Topic has already been concerned with portfolio management and risk management. The key points are as follows:

- Standard market practice is concerned with spreading risk by acquiring a large number of investments so that a loss on any one investment will be evened out by the performance of the other investments.
- This process of spreading risks is known as "portfolio investment". If a trustee does not use portfolio investment then it will be presumed (an assertion which may be rebutted) that that trustee is not acting in accordance with the normal standards expected of an expert trustee.
- The watch word of investment professionals is risk: the greater the risk, the greater the return which is required by those investment professionals to make the investment worthwhile. Consequently, if a trustee is expected to generate a high return (*Cowan v Scargill*), then that trustee will have to take a high risk. However, if a trustee acts imprudently then he may be sued for generating a loss. This is a difficult position for a trustee: you must take risk to make profit, but if your risk makes a loss then you may be liable for breach of trust. A trustee must bear these two apparently contradictory issues in mind at once.

Liability for breach of trust for a loss

Specific reading
Hudson, *Equity & Trusts*, section 9.9

We considered liability for breach of trust in detail in Topic 4 of this Study Guide. You should refer back to that material. The key points were as follows. The leading case of *Target Holdings v Redferns* (1996) required that:

- There be some causal connection between any loss suffered by the beneficiaries and a breach of trust by the trustees.
- The loss is the loss actually suffered by beneficiaries provable at trial.
- The remedies available to the beneficiaries are (a) specific restitution of any property taken from the trust, (b) restoration of the cash value of the trust fund, or (c) equitable compensation for any further loss suffered by the trust.

In relation specifically to breach of trust for investment of the trust fund:

- The trustees must have committed a breach of trust – it is not sufficient that the trust have suffered a loss because its investments have become worth less than once they were: rather, the loss must have been caused by a breach of trust.
- There are difficulties in establishing whether a failure to make a large enough profit can be considered to be a loss.
- Often, attempting to prove that a trustee has committed a breach of trust is an attempt to prove that that trustee has failed to live up to a standard of trusteeship drawn from the case law, such as a failure to be sufficiently prudent or to make a sufficiently large return, as opposed to identifying a technical breach of the trust instrument. A trustee can escape liability for breach of trust in relation to a loss by demonstrating that it was standard market practice to follow the type of investment strategy which the trustee followed: *Nestle v National Westminster Bank plc.*

- Therefore it may be possible to sue a trustee for realising an inadequate profit, but only if the trustee has acted otherwise than in accordance with standard market practice.

Questions to be considered in class

Question 1.

Consider the following situations and decide whether or not you think that the trustees ought to be liable for breach of trust. Each trust requires that the trustees hold most of the trust's investments in electronics companies, but that the trustees ensure a suitable range of other investments too. Each trust began with GB£500,000.

(a) The trustees acquired shares in a range of investments in the two hundred leading electronics companies, and held one-third of the fund in other forms of company. Due to the global economy all electronics companies suffered a small reduction in profits. The value of the trust fell by £10,000.

(b) The trustees only bought shares in Microsoft and one-third of the fund was used to acquire shares in other forms of company. Meanwhile, shares in Apple doubled in value due the sales of the new I-pod machines, whereas Microsoft's share value remained the same.

(c) The trustees invested 95% of the fund in the two hundred leading electronics company shares and only 5% of the fund in other forms of companies. Due to global economic pressures the value of electronics company shares fell by 25%, whereas the average share price in other markets rose by 25%.

Question 2

Consider the three problems which you have just analysed and read *Thomas and Hudson*, para 52-17 and the following sections through to para 52-21: what difference would it make to these problems if you knew that the trustees were investment specialists or that the trustees were inexpert friends of the settlor?

Question 3

A trust instrument was silent as to the obligations of the trustees. The trustees held £100,000 on trust for infant children of a testator. The trust was the children's sole source of income. The trustees were made up of two people: Alan worked for a firm of stockbrokers as a solicitor and Brian was a plumber. Alan and Brian took advice from Colin who worked as a stockbroker at Alan's firm: Colin advised the division of the trust fund between a large number of different investments. Alan and Brian were concerned, however, that Colin's suggestions required investment in companies of which neither trustee had never heard and which they therefore considered to be unnecessarily risky. Consequently Alan and Brian decided to invest £90,000 in Microsoft shares because they considered Microsoft to be a safe bet. The remaining £10,000 they invested in a biotechnology company, X Ltd, which Colin had rated highly. Subsequently, Microsoft have under-performed other companies in the electronics sector by making only a slight profit and X Ltd has gone into bankruptcy.

Question 4.

Albert is a trustee of the Taylor family trust. The trust fund is made up of £100,000 and is held on trust for Mr Taylor's wife and children under the terms of Mr Taylor's will. Mr Taylor died six months ago. Albert has been presented with the following advice by a stockbroker:

> "Invest in ABC Ltd if you want an investment which will generate profits of 2% but which is unlikely to suffer any losses; invest in DEF Ltd if you want to generate medium level profits of 5% with double the risk of the first investment; invest in GHI Ltd if you want to make a likely return of 15% but with the real risk that the company might go into bankruptcy. DEF and GHI work in the same industry."

Albert invested 70% of the fund in GHI Ltd and 30% of the fund in DEF Ltd. DEF made only 4% profits, whereas GHI has gone into bankruptcy.

Advise the beneficiaries.

TOPIC 6. EQUITY AND COMMERCE (1): SUSPICION OF EQUITY, TAKING SECURITY & CONTRACT

Aim: *to consider issues of retention of title in commercial transactions. In particular the nature of the Quistclose trust as a resulting trust, as an express trust, or as a contractual rule.*

LECTURE MATERIALS

Commercial uses of the trust

(A) Commercial law suspicion of equitable doctrine

Reading: ***Hudson*, section 21.2**

1) Keeping equity out of commercial transactions
Reading: ***Hudson*, section 21.2.1**
The Afovos [1980] 2 Lloyd's Rep. 469
Scandinavian Trading v. Flota Ecuatoriana [1983] 2 WLR 248, 257, *per* Goff LJ
Westdeutsche Landesbank v. Islington [1996] AC 669

2) Developing the commercial trust
Reading: ***Hudson*, section 21.2.2**
Target Holdings v. Redferns (1996)
Cf. *Stent v. Baillie* 2 P. Wms. 217, 24 E.R. 596

3) The inter-action between trusts law and contract law
Reading: ***Hudson*, section 21.2.3**
See below.

4) Exclusion of trustees' liability through contract
Reading: ***Hudson*, section 21.2.4**
See Topic 4 materials.

5) International trusts law services
Reading: ***Hudson*, paras 4.2.8** and **21.2.5** *"Offshore trusts services"*

(B) Commercial law compared to trusts law in relation to certainty of subject matter

Certainty of subject matter was considered in Topic 2.

1) Certainty of subject matter
Reading: ***Hudson*, section 3.4**
Re Goldcorp [1995] 1 A.C. 74

2) The nemo dat principle
Reading: ***Hudson*, section 21.4**
Factors Act 1889
Lickbarrow v. Mason (1787)
Cundy v. Lindsay (1878)
Rainbow v. Hawkins (1904)
Jerome v. Bentley & Co. (1952)
Bishopsgate Motor Finance Corporation Ltd v. Transport Brakes Ltd (1949)
Central Newbury Car Auctions Ltd v. Unity Finance Ltd (1957)

Eastern Distributors Ltd v. Goldring (1957)

3) Certainty of subject matter in commercial law
Reading: ***Hudson*, section 3.4.3 *"the approach in commercial law"*, and 21.5**
Sale of Goods (Amendment) Act 1995

(C) Taking security in loan contracts

1) Retention of title
Reading: ***Hudson*, para 22.2.1**
Aluminium Industrie Vassen v. Romalpa Aluminium [1976] 1 Lloyd's Rep 443, [1976] 1 WLR 676

2) Floating charges
Reading: ***Hudson*, section 23.1**
Re Yorkshire Woolcombers Association Ltd [1903] 2 Ch 284, 295, *per* Romer LJ
Illingworth v Houldsworth [1904] AC 355, 358, *per* Lord Macnaghten
Clough Mill v. Martin [1984] 3 All ER 982; [1985] 1 WLR 111

3) *Quistclose* trusts
See next heading

4) Guarantee

5) Purely personal rights

6) Letter of comfort

(D) *Quistclose* trusts

Reading: ***Hudson*, section 11.3, and chapter 22 generally.**

1. The core principle … a resultant trust or a form of express trust? …
Hassall v. Smither (1806) 12 Ves. 119.
Re Rogers (1891) 8 Morr 243, 248, *per* Lindley LJ (*must be a resulting trust to prevent trustee from taking benefit from property*)
Barclays Bank v. Quistclose [1970] AC 567; [1968] 3 All ER 651; [1968] 3 WLR 1097
Re EVTR Ltd. [1987] B.C.L.C. 647.
Twinsectra Ltd v. Yardley [1999] Lloyd's Rep. Bank 438, Court of Appeal.

2. … or a constructive trust? …
Carreras Rothmans v. Freeman Mathews Treasure Ltd [1985] 1 Ch 207
cf. Westdeutsche Landesbank [1996] 1 AC 669

3. … or retention of title by lender.
Worthington, *Proprietary Interests in Commercial Transactions*, 43-71
**Twinsectra Ltd v. Yardley* [2002] 2 All E.R. 377, at 398, House of Lords, *per* Lord Millett: '… *the Quistclose trust is a simple, commercial arrangement akin … to a retention of title clause (though with a different object) which enables the borrower to have recourse to the lender's money for a particular purpose without entrenching on the lender's property rights more than necessary to enable the purpose to be achieved. The money remains the property of the lender unless and until it is applied in accordance with his directions, and in so far as it is not so applied it must be returned to him. I am disposed, perhaps predisposed, to think that this is the only analysis which is consistent both with orthodox trust law and with commercial reality.*'
Re Margaretta Ltd [2005] All ER (D) 262, *per* Deputy Judge Crystal QC (*following the above*)
Cf. Chambers, *Resulting Trusts*, 68-91

See also:-
(1985) 101 L.Q.R. 269 (P. Millett);
(1991) 107 L.Q.R. 608 (C. Rickett); and
C. Rickett in *Equity, Fiduciaries and Trusts* (ed. D. Waters, 1993).
Swadling, et al, *Quistclose Trusts* (Hart, 2004)

(E) The nature of the beneficiary's rights in the trust fund

Reading: ***Hudson*, section 4.1**

**Saunders v Vautier* (1841) 4 Beav 115
Re Bowes [1896] 1 Ch 507
Re Smith [1928] Ch 915 (*could compel transfer to beneficiaries even where two classes of beneficiaries under discretionary trusts*)
In re Holt's Settlement [1969] 1 Ch 100, 111, *per* Megarry J: '*If under a trust every possible beneficiary was under no disability and concurred in the re-arrangement or termination of the trusts, then under the doctrine in* Saunders v Vautier *those beneficiaries could dispose of the trust property as they thought fit; for in equity the property was theirs. Yet if any beneficiary was an infant, or an unborn or unascertained person, it was held that the court had no general inherent or other jurisdiction to concur in any such arrangement on behalf of that beneficiary.*'

(F) The beneficiary principle.

Reading: ***Hudson*, section 4.2**

1) The traditional beneficiary principle

Morice v. Bishop of Durham (1804) 9 Ves. 399; (1805) 10 Ves 522.
Bowman v Secular Society Ltd [1917] AC 406
Re Astor's S.T. [1952] Ch. 534
Leahy v. Att.-Gen. for New South Wales [1959] A.C. 457
Re Grant's WT [1979] 3 All ER 359
Re Denley's Trust Deed [1969] l Ch. 373
Re Lipinski's W.T. [1976] Ch. 235

2) Arguments as to the future of the beneficiary principle in international trusts law

Langbein, "The contractarian basis of the law of trusts" (1995) 105 *Yale Law Journal* 625.
J Penner, 'Exemptions' in P Birks ed, *Breach of Trust* (Hart Publishing, 2002) 241.
D Hayton, "The irreducible core content of trusteeship" in A Oakley (ed) *Trends in Contemporary Trusts Law* (OUP, 1996) 47
D Hayton, "Developing the obligation characteristic of the trust" (2001) 117 LQR 96
Hudson, *Equity & Trusts*, section 21.2

SEMINAR MATERIALS

(A) TAKING SECURITY IN LOAN CONTRACTS

General reading
Hudson, *Equity & Trusts*, ch. 22.

Introduction

By "take security" we mean the ways in which a commercial person will seek to protect himself from any action or omission of any other party to that transaction. The events against which the commercial person may want protection range from some other party's failure to make a payment or to perform some act required by a contract right through to the other party going bankrupt or being legally prevented from performing the contract in some other way. Commercial people therefore rely on their legal advisors to devise the means by which they can acquire some protection. That protection can take many forms. This particular chapter is concerned with taking security specifically in relation to loan contracts. Later chapters will consider other contexts in which security is taken.

Some of the various possible methods of taking security

A commercial person may take security in many different ways. The objective is always to ensure that the commercial person receives some rights or property which will provide adequate recompense to him if another party to a contract fails to perform its obligations for whatever reason. Suppose, for example, that a clothing manufacturer has entered into a contract to acquire cotton because he has a contract to supply a given number of shirts by a given date. In such a situation the clothing manufacturer's greatest fear will be that the cotton supplier fails to make delivery of the appropriate amount of cotton on the specified date. An appropriate means of taking security would be to withhold payment for the cotton until the goods have been delivered.

To look at the same facts from another perspective, the person supplying the cotton bears the risk that the clothing manufacturer may fail to pay for the cotton once it has been delivered. Therefore, the cotton supplier may take one of a number of routes. He may stipulate in the contract that he remains the absolute owner of the cotton until payment is made. Alternatively, he may have greater need of the money than simply to have a consignment of cotton on his hands which he might not be able to sell quickly to another buyer. Consequently the cotton supplier may require that the purchase price be paid to an independent trustee before the cotton is even shipped so that if the buyer fails to make payment then the money will be deemed to be held on trust for the cotton supplier.

In this chapter we will consider taking security in relation to ordinary loan contracts. The money lender, usually a bank, will be concerned that the borrower will fail to make repayment of the loan capital and that the borrower will fail to make payments of interest when due. The lender will therefore wish to find some way in which the borrower's use of the loan moneys is restricted or in which the repayment of the loan is assured.

(B) THE USE OF TRUSTS TO TAKE SECURITY

Specific Reading
Hudson, *Equity & Trusts*, section 2.5, 21.1.

Two general circumstances in which trusts are used to take security

Trusts provide an excellent means of taking security in commercial transactions, if structured correctly. The situations in which trusts are used to take security are twofold.

(1) First, in transactions in which some identified property is being used as part of the transaction. For example a transaction in which a specific machine is being used to manufacture goods. In such a situation, the owner of the machine will be concerned to ensure that his ownership of the machine is protected even if the transaction fails or one or other the

participants goes into bankruptcy. If the machine were purchased by the contracting parties in equal shares solely for the purposes of their transaction, then the question of the ownership of that machine would be more problematic. A trust would identify the rights of the various parties. Importantly there will also be the goods manufactured as part of the transaction: before those goods are sold there will be a question as to who owns them. Suppose, for example, that one of the contracting parties went bankrupt before all of the goods had been sold, then the bankrupt party's creditors would wish to know which goods were part of the bankrupt person's estate and thus capable of being used to pay off his creditors.

(2) The second situation would be that in which there may not be any property used as part of the transaction. Nevertheless, each contracting party may be nervous as to whether or not the other party will perform its part of the contract. Therefore, the first contracting party may ask the second party to provide some property – whether money or some other thing – in which the first party can take absolute title if the second party fails to perform. Suppose a situation in which the parties have entered into a contract whereby the first party agrees to build a house for the second party. The construction process is expected to take one year. The builder will clearly be concerned that the second party will not pay after the builder has bought materials and paid people to put them together. Therefore, one of the ways in which the builder may seek protection is to require the second party to pay a quarter of the total construction price into a bank account every three months so that it can be held on trust by the bank as trustee for the benefit of the builder, provided that the builder builds the house properly.

The chief advantage of the trust is its flexibility. To continue with the example of the house construction contract: the second party may want protection against the possibility that the builder might fail to build the house properly. Therefore, the terms of the trust might be drafted so that the money held on trust is held for the benefit of the second party if the builder does not have his work certified by a surveyor as being of the appropriate standard. However, if the builder does perform the work properly then the money is to be held by the trustee to the builder's order.

Thus both parties to the transaction acquire protection under the same trust structure. This is the secret of the trust: it permits more than one person to have rights in the same item of property at the same time. Among the people with rights in the property is the trustee. The trustee has legal title in the property which enables the trustee to pay the money in and out of the bank account and to advance it to whichever party is entitled to it ultimately.

Other means of taking security

Specific reading
Hudson, *Equity & Trusts*, section 23.1.

There are a range of other mechanisms for taking security other than the trust. This section lists them but most of them are considered in more detail in later chapters as indicated below:

- Mortgage
- Fixed charge
- Floating charge
- Pledge
- Retention of title
- Contract of guarantee

The contract of guarantee is not considered elsewhere in this course because it is not a proprietary form of security. A "proprietary form of security" means a form of security in which some identified or identifiable property can be seized by the secured party if the other party fails to perform some relevant contractual obligation. This course focuses on proprietary structures in the form of trusts but also considers mortgages, charges, pledges and retention of title as forms of proprietary security: we are thus able to compare these other forms of proprietary security with the trust and so able better to understand the nature of the trust.

All of those forms of security listed above are comprised of common law and equitable mechanisms. There are others not on the list which are typically included in commercial contracts themselves and form common law mechanisms but we will not consider them here. For present purposes we should distinguish between the contract of guarantee – which is not a proprietary form of security – and the other techniques on the list. A contract of guarantee provides that X will make a payment to Z if Y does not perform his contractual obligations to Z in full. Importantly, the main contract is between Y and Z and X is not a party to it: rather, X is guaranteeing that Z will suffer no loss from any failure by Y to perform the terms of that main contract. Z is the party acquiring security in these circumstances but, importantly, Z acquires no right to any identified property under the guarantee. Rather, Z has a merely personal right against X to recover the amount calculated by reference to the guarantee. Significantly, then X has a right to a calculable amount of money but not to any specific fund of money: therefore if X went into insolvency, Z would be an unsecured creditor because no specific fund of money is set aside for his benefit. It would only be if a specific fund of money were segregated from all other funds of money that there could be a trust over any such money and only then could Z be a secured creditor.

Specific reading

AS Hudson, *The Law on Financial Derivatives*, (Sweet & Maxwell, 2002) Ch 11, extract in your bundle of materials, relating specifically to taking security discusses the differences between the various techniques considered here.

Learning activities

1. In what circumstances would a contracting party be content with a contract of guarantee as opposed to a trust?
2. Jed and Josh entered into a contract under which Jed agreed to provide computer chips to Josh so that Josh could use them in the manufacture of computers. Josh was not obliged to pay for the computer chips until the computers had been sold. The contract provided that "the computer chips shall be held by Josh for Jed's benefit until such time as the computer in which any individual chip is incorporated has been sold". What manner of right does Jed have to the computer chips before they are sold? How could this provision be better drafted to achieve that same goal?

Feedback

1. A person would be content with a contract of guarantee if that person had a long history of transacting with the other party or if the party providing the guarantee was known to have a good credit rating: in such circumstances it would be satisfactory to know that the person providing the guarantee was likely to make payment in the event that the contract was not properly performed.
2. It appears that the parties' intentions would be best described as an intention to create a trust over the computer chips such that if Josh failed to perform, then Jed would have an equitable interest in the computer chips. What this provision does not consider, however, is who owns the computers into which the chips had been incorporated. The provision could be better

drafted to make it clear that all computers into which the chips have been incorporated are to be held on trust for Jed and also that any chips which have not yet been incorporated into the computers are also held on trust for Jed. As the provision is currently drafted it would be possible to interpret it as meaning that Jed has a floating charge over the stock of computers of a value equal to the amount owed to Jed by Josh from time-to-time. Floating charges are considered in detail in chapter 6.

The Particular Context of Taking Security in Loan Contracts

In a loan contract, the lender ordinarily enters into a contract with the borrower such that the borrower receives absolute title in the loan moneys. The borrower is therefore entitled to use the money as his own money, provided that there are no contractual terms to the contrary. The borrower's obligations are to repay the capital amount of the loan and to pay interest on the loan as provided in the contract. Loan contracts, particularly corporate loans, contain a range of "covenants". Loan covenants provide that the borrower will be obliged to repay the entire amount of the loan, including interest, at an earlier date than the ordinary effluxion of the loan period if the borrower contravenes the terms of the covenant. An example of such a covenant might be that the borrower would be in default under the loan if the borrower breached the terms of any other loan contract with any other lender. Such covenants give the lender protection against the risk that the borrower might be unable to repay the loan at some point in the future. A well-drafted loan contract will protect the lender against such risks in advance of the risk coming to pass.

The material in this chapter considers another way in which lenders take protection against such risks. It is common for guarantees to be taken from third parties whom the lender considers to be reliable, but *Quistclose* trusts offer a different form of protection as part of a loan contract.

(C) *QUISTCLOSE* TRUSTS

Specific reading
Hudson, *Equity & Trusts*, section 22.3

The nature of a *Quistclose* trust

A *Quistclose* trust is a term in a loan contract which provides that the borrower can only use the loan moneys for a specific purpose with the result that, if the loan moneys are used for another purpose, then rights to the loan moneys revert to the lender. The reason for this provision being known as a "trust" is that the borrower retains the legal title in the loan moneys but the equitable interest is said to be held by the lender.

In the case of *Barclays Bank v Quistclose* [1970] AC 567 Quistclose lent money to a company, Rolls Razor Ltd, so that that company could pay a dividend to a group of its shareholders. Rolls Razor Ltd subsequently went into insolvency having misapplied the money in discharging its overdraft with Barclays Bank. Barclays Bank argued that the money which Rolls Razor Ltd had borrowed from Quistclose should be set off against the company's overdraft with Barclays Bank. It was held by the House of Lords that the loan money, held separately in a share dividend bank account, should be treated as having been held on resulting trust for the lender. The House of Lords held unanimously that the money in the share dividend account was held on trust for the lender on the basis that the specified purpose of the loan – to pay the dividend – had not been performed.

Problems with the nature of the *Quistclose* trust

The structure of a Quistclose loan contract

What is complex about this form of trust is that it is unclear precisely how the lender's rights arise. This problem causes a lot of difficulty in theory but, it is suggested, in practice the source of the lender's rights will be best explained by the precise terms of the loan contract. In theory it is not clear whether the lender has rights in the loan moneys throughout the life of the contract, or whether the lender has rights in the loan moneys which are held in suspense in some way during the life of the contract, or whether the lender's rights arise for the first time when the borrower uses the money for an unspecified purpose.

The time sequence operates as follows:

Day 1: Loan contract entered into between lender and borrower, including a provision that the borrower use the money only for a specific purpose.	**Day 2**: Loan moneys transferred at common law to borrower.	**Day 3**: Borrower breaches the term in the loan contract by using the money for an unspecified purpose.	**Day 4**: Lender seeks to recover the loan moneys as a result of the breach of the term in the loan contract.

The question is therefore as follows. Does the lender retain some equitable interest in the loan moneys from Day 1, or are all rights given up on Day 2 with the transfer of the loan moneys, or does the lender acquire rights in the money on Day 3? For there to have been a trust it cannot be that the lender acquires rights in the loan moneys only on Day 4 because that would be to make the trust remedial, something which is not possible at English law (as decided in *Westdeutsche Landesbank v Islington* (1996)).

The explanation given in the Quistclose case itself

Lord Wilberforce held that the *Quistclose* trust operated as a resulting trust. That is, his lordship held that whereas the money had passed from the lender to the borrower under the loan contract, the breach of the loan contract meant that the equitable interest in the moneys passed back to the lender on resulting trust. Lord Wilberforce considered that there was a primary trust under which the borrower was empowered to use the money for the specified contractual purposes. His lordship further considered that there was a secondary trust which came into existence once the contractual provision governing the use of the loan moneys had been breached. This secondary trust gave effect to the resulting trust.

However, as is considered in relation to *Twinsectra* trusts in the next section, this secondary trust could also be explained as being a provision in an express trust which is only called into operation if the terms of the loan contract are broken.

(D) *TWINSECTRA* TRUSTS – ANOTHER VIEW OF *QUISTCLOSE* TRUSTS

The case of *Twinsectra v Yardley* [2002] 2 All ER 377 contained a dissenting speech by Lord Millett which suggested another approach to *Quistclose* trusts. In the *Twinsectra* case itself moneys had been lent to a borrower with conditions as to how the property could be used. Lord Millett was the only member of the House of Lords to consider the importance of *Quistclose* trusts in this context because the remainder of their lordships were appraised of the question whether or not a solicitor who had become involved in the transaction had assisted in a breach of trust: therefore, it is possible that Lord Millett's views were obiter dictum in any event.

Lord Millett suggested that the lender could be considered to have retained some form of right in the loan moneys throughout the life of the transaction. The breach of contract caused those rights to crystallise. Therefore, the *Quistclose* trust did not arise by means of a resulting trust but rather resulted from some form of express trust under which the lender's rights had existed throughout the life of the transaction.

Lord Millett considered the nature of the *Quistclose* trust as being akin to a retention of title clause, as considered in chapter 7. His Lordship explained his view that a *Quistclose* trust operated in the following manner ([2002] 2 All 377, 398-399):

> '…the *Quistclose* trust is a simple, commercial arrangement akin … to a retention of title clause (though with a different object) which enables the borrower to have recourse to the lender's money for a particular purpose without entrenching on the lender's property rights more than necessary to enable the purpose to be achieved. The money remains the property of the lender unless and until it is applied in accordance with his directions, and in so far as it is not so applied it must be returned to him. I am disposed, perhaps predisposed, to think that this is the only analysis which is consistent both with orthodox trust law and with commercial reality.'

The lender could therefore be taken to retain the equitable interest in loan moneys throughout the life of the contract. One problem with this approach is that the expression "the money remains the property of the lender" might suggest that the loan moneys remain absolutely the property of the lender. If that were true, then the borrower would not be able to spend the loan moneys as is the purpose of the loan contract. The least satisfactory analysis of a *Quistclose* trust would be that the lender retains absolute title in the money because that would deny the existence of a trust. A better reading of this expression is that it is the equitable interest in the money which remains vested in the lender, except that the borrower must nevertheless still have the power to spend the money for the purpose identified in the loan contract. Consequently, the lender's equitable interest must be capable of being defeated by the borrower's proper use of the money.

Objections to this approach are considered in the next section.

The terms of the loan contract govern the Quistclose arrangement

The principal weakness in Lord Millett's approach is that it purports to give a universal answer to the nature of all *Quistclose* trusts whereas, in truth, the nature of such trusts will depend upon the terms of the loan contracts which give rise to them. The precise nature of any given *Quistclose* arrangement will depend upon the structure of the loan agreement which the parties have effected. The loan contract itself may provide that the loan moneys are to be held on express trust by a third party so that the trustee is only empowered to use the moneys for the contractually-specified purpose: this structure would be used if the lender did not trust the borrower at all and would be unusual. It might be that the lender would act as trustee and make payment directly to the intended recipient on behalf of the borrower. This would clearly be an express trust and would go beyond the *Twinsectra* explanation. It would also be possible to construct this mechanism without using a trust at all and simply provide that the lender has a contractual obligation to make a transfer.

What is not considered in the decided cases is the following problem: if the loan moneys have been misapplied and paid to some person who was not meant to receive them, how is it possible to impose a trust over them? If the money has been passed into a general bank account then the money will be unidentifiable. It would not be possible to impose a resulting trust over those moneys nor to impose an express trust over those moneys in its ordinary terms. The key feature of the *Quistclose* trust is that it gives the lender the potential to trace after the lost moneys and to recover them or their equivalent in one of the ways considered in chapter 10 *Recovery of property in relation to terminated transactions*.

A more traditional explanation

There have been explanations of the *Quistclose* trust as being based on general equitable principles of conscience and not therefore based on any particular category of trust. This approach has been stated in *Carreras Rothmans Ltd v Freeman Mathews Treasure Ltd* [1985] Ch 207, 222 in the following terms:

> "… equity fastens of the conscience of the person who receives from another property transferred for a specific purpose only and not therefore for the recipient's own purposes, so that such person will not be permitted to treat the property as his own or to use it for other than the stated purpose."

Learning activity

How should a *Quistclose* trust be best understood?

Feedback

This chapter has considered this question in detail. You should attempt to consider the arguments in favour of the *Quistclose* trust as being (1) a resulting trust composed of primary and secondary trusts; (2) a form of express trust with a power to use the loan moneys; (3) a hybrid trust and retention of title clause as in *Twinsectra*; (4) any one of the preceding analyses dependent on the terms of the loan contract.

(E) THE CONTENTION THAT TRUSTS ARE CONTRACTS

The contractarian position as part of commercial people's attitude to trusts

This part of this course is concerned with commercial uses of trusts. We have considered the proposition that commercial people valued certainty and therefore that commercial people were suspicious of discretionary equitable remedies. We have doubted whether or not the law on express trusts was in fact as discretionary as that discussion might have suggested.

The contractarian position has been most clearly set out by Prof Langbein of Yale University. In considering the contractarian position relating to trusts we return to the notion that commercial people might feel more comfortable with the terms of their carefully drafted contracts than with equitable doctrines such as the trust. The contractarian position suggests the following:

- Most trusts are created between settlors and professional people who are appointed to act as trustees. It is said that those professional trustees will insist on their liabilities being limited by contract or by terms inserted in the trust instrument (as considered in section 2.8 of this Study Guide) and therefore it is said that the obligations of trustees should be interpreted in accordance with the law of contract rather than the law of trusts

- It is thought by commercial people that the law of contract prioritises freedom of contract and therefore that the courts would be less likely to interfere with the parties' agreed contractual position. By contrast, it is suspected that trusts law, operating on the basis of the vague notion of conscience, may interfere with the parties' contractual intentions.
- More generally it is suggested that the obligations of trustees are becoming less concerned with conscience and more concerned with the interpretation of the contracts entered into between settlor and trustees. In particular, it is suggested that rather than trustees being subject to general fiduciary duties those trustees instead have their duties described and limited by contracts. In effect, the general law of trusts as considered in Chapter 2 of this Study Guide can be limited by the contract agreed between the parties.
- It is also argued that there are obligations created between trustee and beneficiary (primarily to ensure that the trustee obeys the terms of the trust) and that in consequence the trust ought to be thought of as being based on those obligations, akin to a contract, rather than on principles of property law.

Essential reading

Hudson, *Equity & Trusts*, section 21.2
Langbein, "The contractarian basis of the law of trusts" (1995) 105 *Yale Law Journal* 625.

Further reading

J Penner, 'Exemptions' in P Birks ed, *Breach of Trust* (Hart Publishing, 2002) 241. This essay suggests that the trust should be considered to be comprised solely of personal obligations and not of proprietary obligations.

Arguments against the contractarian position

There are a number of arguments against the contractarian position.

- Under traditional trusts law, the contractarian position is simply wrong: we are considering whether it might be a useful basis for reform. The reasons for saying that it is doctrinally incorrect are as follows.
- Trusts and contracts are very different institutions. Principally, the difference centres on the fact that all trusts impose fiduciary duties on trustees, whereas ordinary contracts do not (with the exception of contracts of agency and of partnership).
- Trusts involve the management of property by one person occupying a fiduciary office on behalf of another person who has equitable proprietary interests in that property, whereas contracts do not.
- It is not true that all trusts involve a contract between trustee and settlor. The exceptions include –
    - Constructive and resulting trusts which are imposed by operation of law.
    - Express trusts which are implied by the courts in circumstances in which the owner of property's intentions are deemed to be to create a trust: *Paul v Constance* [1977] 1 WLR 527
- There is an irreducible core of trusteeship which cannot be reduced, even by contract. This proposition is complex because not all commentators agree with it, we will discuss it in Part 3 of this course.
- As to the argument that trusts should be considered to be based merely on obligations, it is suggested that this argument is wrong. As Lord Browne-Wilkinson held in *Westdeutsche Landesbank v Islington*, and as has been held

in all other trusts law cases down the ages, there must be some property which is to be held on trust or else there is nothing over which the trust can take effect. Without property, there is no trust. Therefore, the trust is a creature of equity, of property law and also of equitable obligations: but it cannot be reduced to any one of these issues alone.

Essential reading

Hudson, as before.

D Hayton, "The irreducible core content of trusteeship" in A Oakley (ed) *Trends in Contemporary Trusts Law* (OUP, 1996) 47.

To understand these arguments more closely, we need to return to an analysis of exactly what sort of right the beneficiary is said to have in the trust fund and then the extent of the trustees' obligations.

(F) THE USE OF A PROTECTOR

There are arguments that the position of beneficiary could be replaced with a functionary, called a protector, who would represent the interests of beneficiaries in a trust fund without the need for there to be any identified beneficiaries. In considering this issue we will begin with a resume of the English law position before considering the protector.

The nature of the beneficiary's rights in the trust fund

The beneficiary principle requires that there must be some person in whose favour the court will decree performance. In England, the position is that the beneficiary has a proprietary right in the trust fund itself, whereas in most states in the USA it is thought that the settlor's wishes are to be observed, in a discretionary or protective trust the beneficiary will have no proprietary right. On this topic see section 2.4 of this Study Guide.

What this means is the following. If the beneficiary has proprietary interests in the trust fund, then the beneficiary can assert rights of ownership. The principle in *Saunders v Vautier* (1841) 4 Beav 115 provides that if all of the beneficiaries acting unanimously decide to do so, then they can direct the trustees how to deal with the trust property even if that is in contravention of the terms of the trust as set out by the settlor. (For a discussion of this principle see Hudson, *Equity & Trusts*, section 4.2. As you will see in that discussion there are a number of cases in which the beneficiaries have effective re-written the trust by taking control of the trust property.)

By contrast, most states in the USA take a contrary position and refuse to allow the beneficiaries to alter the settlor's wishes by taking possession of the property. It is possible to mimic this effect in practice in English law if the beneficiaries are only provided to be beneficiaries with contingent interests in the event that the trustees choose to exercise some discretion in their favour. If a beneficiary has only a contingent right then, if the trust is properly drafted, it can be made impossible for the beneficiary ever to acquire a vested interest in the trust property. (On this specific point, see Hudson, *Equity & Trusts*, section 4.2.3) Alternatively, the settlor could make herself one of the trustees or one of the beneficiaries so as to prevent the necessary unanimity ever being achieved among the beneficiaries to trigger the *Saunders v Vautier* power.

It is a central plank of English trusts law, however, that the beneficiaries have a property right in the trust fund. By extension, as considered in Chapter 2 of this Study Guide in relation to the beneficiary principle, there can only be a valid trust if there is some identifiable beneficiary. That point was made by Lord Grant MR in *Morice v. Bishop of Durham* (1804) 9 Ves. 399; (1805) 10 Ves 522 in the following terms:

> 'There can be no trust, over the exercise of which this court will not assume control … If there be a clear trust, but for uncertain objects, the property … is undisposed of … . Every … trust must have a definite object. There must be somebody in whose favour the court can decree performance.'

With those principles in mind, we will move in the next section to consider the way in which trusts practitioners are seeking to negotiate the obstacles put in their way by the beneficiary principle.

Essential reading
Hudson, *Equity & Trusts*, section 21.2.3.

The possible role for a protector

When selling financial services to wealthy clients, it would be preferable for the service provider and for the investor if there were no tax to pay. In consequence, many of these service providers organise their trusts in jurisdictions in which there is little or no tax to pay, so that the investors can try to avoid paying tax in their home jurisdictions. However, the revenue authorities in their home jurisdictions will frequently attempt to levy tax on any investment profits generated even by these overseas trusts structures. Therefore, the investors (and the service providers who wish to sell trusts investments to them) would prefer to conceal their investment in any overseas trust (whether lawfully or unlawfully). To conceal an investment lawfully, the investor would wish to be entitled to receive a return on their investment under contract but not to be identified as having an proprietary right in the profits which the trust makes until it can be organised to extract her profits in such a way that no tax is payable on them.

The key, then, is the attempt to create a trust without the beneficiary needing to have any proprietary interest under it. This is, as considered in the preceding section, impossible under English law because of the beneficiary principle.

The argument in favour of a protector, then, is aimed at the purpose of the beneficiary principle: that there must be some person in whose favour the court can decree performance and that there cannot be trusts for abstract purposes without any benefit for identifiable people. It is argued that the purpose of this principle is that there must be someone who can bring matters before a court in the event that the trustees are thought to have breached their duties.

Therefore, it has been suggested that some third party could be appointed to act as protector. The protector need not be a beneficiary but rather would be disinterested and would be empowered to take the trustees to court if the trustees were thought to have breached their obligations. Thus, it is argued, the purpose of the beneficiary principle will be achieved because there is someone in relation to whom the court can decree performance. Therefore, there would be no need for any investor to have the proprietary rights of a beneficiary: instead, they could have merely contractual rights to be paid their part of the profits.

Many jurisdictions have enacted trusts statutes to recognise trusts in which the beneficiaries do not have proprietary rights. However, if English law does not recognise those trusts then the UK Inland Revenue would still tax the investors as though they did have the proprietary rights of beneficiaries or as if they were still the absolute owners of the investment property.

Essential reading

Hudson, *Equity & Trusts*, section 21.2.3.

D Hayton, "Developing the obligation characteristic of the trust" (2001) 117 LQR 96.

Learning activity

1. Having read Professor Hayton's article, are you convinced that the English courts *could* replace the rights of beneficiaries with the post of protector?
2. On a subtly different basis, are you convinced that English law *should* create the role of protector?

Feedback

1. It is possible that English law could change – after all, the House of Lords can reverse any earlier precedent. This would require a complete alteration of the rights of the beneficiary under an English trust – therefore, you should be careful before expressing support for this proposition without accounting for the fundamental changes that would be necessary.
2. On the second question, one should consider *why* this change is being suggested. The principal reason is that rich clients want to avoid payment of tax (albeit possibly lawfully) in their home jurisdictions. There is therefore a moral question as to whether or not one ought to pay tax in common with all other citizens, or whether it is permissible to avoid one's own obligations. Further, however, it is possible that the investors may be criminals or terrorists who are seeking to use the anonymity promised by such trust funds to conceal their money and other property from regulators and governments. In the current world climate concerning terrorism, this advocacy of the legalisation of secret funds seems to be difficult to support.

(G) ASSET PARTITIONING

Asset partitioning is a means by which trusts can be used to divide the ownership of property between different funds. At a simple level a trust divides ownership in all cases between legal title and equitable title. It is possible to create as many trusts as one wishes without needing to go through that sort of formality which is necessary to create and operate a company. Therefore, one person can divide her various assets between different trusts – established in different jurisdictions if necessary – and so spread the liability to tax across them. Assets can be held on trust for a range of different beneficiaries, including children who will probably have no other income for tax purposes and who may therefore pay tax only at the lower rate.

Alternatively, if there are a number of contributors of property to a single trust fund then it is possible to pool all of their contributions to create a larger fund which is able to generate larger profits across a larger portfolio of investments than a small fund would be able to do.

Background, non-essential reading

There is little reading for this area as it relates to legal practice. The following books and essays reflect that practice.

J Glasson (ed), *The International Trust* (London: Jordans, 2003) generally.

D Hayton (ed), *Extending the Boundaries of Trusts Law and Other Ring-fenced Funds* (Hague: Kluwer International, 2002) generally.

J Glasson, "Asset protection trusts" in GW Thomas and AS Hudson (eds), *The Law of Trusts* (Oxford University Press, 2004) chapter 38.

(H) THE LIMITATION OF TRUSTEES' OBLIGATIONS BY EXCLUSION CLAUSE

The general issue concerning trustees' obligations

There is a broad point as to whether or not trusts are capable of being considered to be merely contracts relating to the possibility of excluding the liability of trustees for breach of trust by means of contract. It is the case that recent English decisions have held that trustees are entitled to limit their liabilities by contract or other exemption of liability provision (*Armitage v Nurse* (1998)). Nevertheless, trustees bear fiduciary obligations of the kind considered throughout this book which are not created by ordinary contracts (although contracts of agency and partnership do create such rights). Consequently, there is a clear distinction between contracts on the one hand and trusts on the other. Furthermore, it is not true that there are always contracts between settlors and trustees. Constructive and resulting trusts are not predicated on any contract between settlor and trustee, but rather on the control of the trustees' conscience. Similarly, express trusts of the kind found in *Paul v Constance* (1977) in which the courts infer the existence of the trust from the circumstances necessarily do not require any contract in place between the parties: rather the trust arises on the basis of conscience and the parties' intentions as to the treatment of the property at issue. Such limitations of liability are usually thought of as being part of the trust instrument even though the contractarians prefer to think of them as being contracts.

For commercial people it is reassuring to think of trusts as being an extension of the contractual principles which are familiar to them. There are forms of trusts such as unit trusts which seem to combine contractual and trusts law principles in investment contexts, and therefore there is a tendency to want to collapse those principles into one another. However, it is very important that the trust is recognised as being something distinct from contract precisely because the law of trusts deals with a number of significant parts of our non-commercial life in which the principles of the law of contract have no place, including the allocation of rights in the home and the administration of will trusts. To deal with such non-commercial situations with commercial law principles would mean that inappropriate rules would be used to resolve disputes, for example, in familial situations. Furthermore, it is difficult to see why commercial people should have their own transactions subject to entirely different laws from those which apply to ordinary people. Why should those who have the resources to hire expensive legal representation be subject to less onerous legal codes than the rest of the population, and why should professional trustees be entitled to limit their own liabilities when non-professional trustees would not know to create such exemption clauses and so to limit their liabilities? This is one of the key challenges facing the modern law of trusts.

The core content of trusteeship

Another interesting question, considered above, is "what does it mean to be a trustee?" It may be surprising to learn that there is no single, statutory or even case law list of the duties which a trustee owes and the rights which a trustee has. Rather, the writers of the textbooks on trusts law have attempted to create lists or categorisations of the many duties which trustees bear. (You are referred, for example, to Hudson, *Equity & Trusts*, chapter 8 for just such a discussion.)

The suggestion that trustees can limit their liabilities by contract is then an important one and it creates the following debate.

- On the one hand, it might be said that no trustee should be bound to any liabilities which she has not voluntarily accepted. Therefore, if the trustee has created a contract with the settlor which specifies those things for which she does not agree to be liable, having the settlor's agreement, then there is no reason to hold the trustee liable for anything which that contract intends to exclude.

- Alternatively, it could be argued that because trusts are based on the good conscience of the trustee, then trustees ought not to be permitted to refuse liability for any action or omission which calls their good conscience into question.
- The law of trusts has generally not upheld a contract which excludes liability for dishonesty or fraud. To do so would, it is suggested, destroy the notion of the trust being based on good conscience if trustees were permitted to act dishonestly. However, the law of trusts has upheld a contract which limits the trustees' liability for gross negligence because that is not said to go to their good conscience but rather only calls into question their competence.

Learning activity

1. Which point of view in this debate convinces you more?
2. If you agree that the current law is correct in principle, does your opinion differ when you learn that it is only professionally qualified trustees who would generally know to have carefully drafted limitations on their obligations contained in a contract, whereas trustees who are not professionals are less likely to know to protect themselves in this way, with the result that professional trustees are more likely to escape liability for causing a loss to a trust when that is part of their business whereas a trustee acting without any claim to expertise is likely to face that liability?

Questions to be considered in class

(A) Suspicion of equity

1. In what ways do commercial lawyers conceive of property rights different from more doctrinaire property lawyers?

2. Should the law create its own, internal categories (e.g. trusts law, contract law, tort law, etc) or should the law reflect its subject matter (international commercial activity, domestic home ownership, etc.)?

3. Should there be a distinction between commercial trusts principles and non-commercial trusts principles?

(B) *Quistclose* trusts

1. How should a Quistclose trust be categorised within the lexicon of trusts?

2. What is the best explanation of the nature of the Quistclose trust?

3. Ted borrowed money from Profit Bank to fund the construction of a new factory for his shoe manufacturing business. The loan contract provided that the money could be used only for the construction of the factory. Nevertheless Ted used the money to pay off his overdraft so that the bank with whom he held his business's current account would not increase the rate of interest payable on his borrowing. Consider the effect of the following, hypothetical provisions in the contract:
   a. "Profit Bank shall remain the absolute owner of the loan moneys until the construction of the factory is complete";
   b. "The loan moneys shall be absolutely the property of the borrower (Ted) provided that Ted shall use them to build the factory as aforesaid, and if Ted shall use any of

these moneys for any other purpose then the whole of the equitable interest in the loan moneys shall revert to the lender";

c. "The loan moneys shall be held by the borrower (Ted) so that Ted shall use them to build the factory as aforesaid, and if Ted shall use any of these moneys for any other purpose then the whole of the equitable interest in the loan moneys shall be considered to be the property of the lender".

Consider which analysis of these provisions is most appropriate.

(C) International trusts law: the beneficiary principle and the contractarian analysis of trusts

1. Should the beneficiary principle be retained in English trusts law or should protectors be introduced?

2. "To make trusts relevant to commercial transactions it would be better to understand them as being based on principles of contract rather than on principles of equity." Discuss.

3. "For those who suggest that the law of trusts should permit greater privacy for investors, there remains the problem that their intentions cut against the grain of modern political priorities to fight terrorism and organised crime in part by preventing such people from being able to hide their money from sight." Discuss.

Trusts in Commercial Contexts: some issues

Getting beyond the "certainty point" …

The central issue for this course is how the trust adapts to commercial use. The judges always return to the question of whether or not there is sufficient certainty in the application of trusts to commercial contexts. In effect, this juxtaposes the historical heritage of the trust as a part of Equity – that is, a means of acting *in personam* against the conscience of the defendant – with some supposedly contradictory notion of iron-clad commercial good sense and pragmatism.

There is, almost at the level of cliché, a fear amongst commercial people of equitable remedies and/or trusts because they are discretionary and therefore considered to be dangerous. But this question of uncertainty, as we have discussed, is almost only a part of the question. The broader question is also as to the *intellectual roots* of the trust: that is, from where do these ideas of trust and of equity come? Some would place the roots of these questions in natural law theory, in a moral base to society and in sociology; others would see the trust as being a feature of history; others would see the trust as needing to fulfil some analytically precise purpose. By engaging with these ideas we move beyond simply the notion of the "certainty" point. Each approach to the roots of the trust is outlined in turn.

(1) The *moral* approaches would focus on the conscience of the legal owner of property – e.g. *Westdeutsche Landesbank v Islington*, *per* Lord Browne-Wilkinson. Many of the commercial issues about how property rights are to be imposed in such transactions melt away if the trust is seen as a flexible device used to police the conscience of the trustee. If we were to jump ahead to that part of the course concerned with trusts over the family home then perhaps we would think of such moral ideas as being more fitting whereas commercial lawyers – e.g. Goode, *Commercial Law in the Next Millennium* – are suspicious of anything not based on the (supposed) certainties of contract. See the section on contract below.

(2) The *historical* approaches would point to the development of ideas like resulting trust – quite rightly – as having emerged as a question of historical fact from the practices of settlors seeking to avoid their creditors or, more usually, seeking to keep their property out of family settlements or dower arrangements by passing to that property to another person – that other person then holding the property on resulting trust for the settlor (cf. *Tribe v Tribe*, *Tinsley v Milligan*). The presumptions of resulting trust arose because judges saw these arrangements so often that when property was transferred in such circumstances they presumed a resulting trust was intended: except in the case of transfers to wives or to children. Commercial lawyers then feel free to adopt and to adapt these notions in modern commercial contexts, inter alia, by relying on the fact that their historical roots are no longer of sufficient significance. See below the discussion of revocable trusts.

(3) The *analytical* approaches become most critical when talking of constructive trusts and resulting trusts. We can identify Prof. Birks as a key proponent of this approach: in effect, it is said that no proprietary right should be recognised or awarded unless there is some evident proprietary base and some analytical reason for making that award. Constructive trusts in particular are criticised by this approach because they are considered not to arise on any analytical basis – in effect, this view is antithetical to the purely moral approach outlined above because that view does not necessarily have such an analytical base.

So, how do these approaches matter to commercial uses of trusts? The key is to consider the manner in which commerce uses the trust. In effect there are two main purposes: taking title in commercial transactions and asset management. We have considered taking title in some detail – *Quistclose* trusts, retention of title / *Romalpa* clauses, and so forth. Asset management is worth some further consideration in what follows, relating primarily to tax planning.

When is a trust not a trust?

This question might seem a little bizarre but it is at the heart of current debates among those lawyers who use trusts for tax management and other forms of asset management. A key article in this area is Prof. Hayton's "The Irreducible Core Content of Trusteeship" (copy provided). Prof. Hayton seeks to identify those things without which there cannot be said to be anything which we would describe as a trust. The importance of these debates will emerge in the sections to follow.

Do trusts give proprietary rights or purely contractual rights?

The answer to this question for an English trusts lawyer is obvious: the trust grants equitable proprietary rights to the beneficiary. The rule in *Saunders v Vautier* is key in this context. However, in the USA for example, that rule is generally not followed: in the USA the settlor's wishes are followed strictly and the beneficiaries do not have the power to unpick the trust, unless that power is expressly granted to them in the trust itself. This raises the question: does the beneficiary have a proprietary right – or indeed any meaningful right – if that trust is revocable (see next section)?

Prof Langbein from Yale argues that in this context we should think of the trust as creating only contractual rights – that is, based on the contract between settlor and trustee governing the trust and not on any proprietary right of the beneficiary in the trust fund and against the trustee for proper management of the trust (copy hopefully attached). This is deeply heretical to many English trusts lawyers because it negates the whole, long-understood purpose of the trust to vest some property right in the beneficiary. To some commercial lawyers, this recognition of a contractual base for the trust accords more closely with their desire to use trusts within broader contractual contexts: whether in an underlying commercial contract, or simply in an investment or other contract between a settlor and a professional trustee. This contractual model of trust compares closely with civil code models of the trust (and questions of patrimony) – although some e.g. Italian lawyers suggest that pre-Napoleon the trust was recognised by these jurisdictions in any event. Cf. unit trusts.

Revocable trusts

In the USA it is rare to make testamentary trusts: instead inter vivos trusts are usually created such that the settlor disposes of assets in his/her lifetime with a power to revoke the trust if s/he changes his/her mind. Therefore, the trust is held in effect for the settlor for life and to the named beneficiaries / legatees on death in remainder. In England, it is common for discretionary trusts to be used so that the trustees have the discretion to pass property to the settlor *qua beneficiary* rather than use a testamentary structure. Cf. purpose trusts.

An answer … or just another question?

The trouble is that this contractual / revocable approach is to adapt the trust solely for commercial use and to forget that the trust is still used in relation to domestic, non-commercial situations. So, that brings us to another crunch question: should we develop different trust norms for commercial contexts which mirror the law of contract, or should we insist on one law of trusts founded on the proprietary rights of the beneficiary?

TOPIC 7. EQUITY AND COMMERCE (2): FINANCE, TRUSTS AND THE LOCAL AUTHORITY SWAPS CASES

***Aim**: to consider the nature of trusts implied by law, especially in the commercial context in the wake of the decision of the House of Lords in Westdeutsche Landesbank; considering the work of Birks and Chambers on restitution and the resulting trust, and Oakley and Elias on our understanding the constructive trust; and the role of "conscience" in commercial transactions.*

LECTURE MATERIALS

The local authority swaps cases

- How does equity inter-act with commercial practice?
- What is an interest rate swap contract and what was the property involved?
- What was decided in *Westdeutsche Landesbank v Islington*?
- The background arguments (i): the argument based on restitution of unjust enrichment
- The background arguments (ii): the trust based on conscience – but whose conscience?
- How can good title be retained in such contracts post-*Westdeutsche*?

Background reading

Hudson, *The Law on Financial Derivatives* (3rd ed, 2002; 4th ed, 2006: Sweet & Maxwell), chapter 9, "Termination of Financial Derivatives Contracts". For the history of the transactions, see p.379 *et seq*.

1) The source of the litigation

Hazell v Hammersmith & Fulham [1992] 2 AC 1
Kleinwort Benson v Sandwell [1994] 4 All ER 890, joined with …
Westdeutsche Landesbank v Islington [1994] 4 All ER 890, Hobhouse J, CA; [1996] AC 669
Kleinwort Benson v South Tyneside MBC [1994] 4 All ER 972, Hobhouse J
Morgan Grenfell v Welwyn Hatfield DC [1995] 1 All ER 1
Kleinwort Benson v Birmingham CC [1996] 4 All ER 733, CA

2) The leading case: *Westdeutsche Landesbank v Islington* [1996] AC 669

a. Proprietary right – trust implied by law
   (i) resulting trust
   (ii) constructive trust
b. Tracing title
c. Compound interest
d. Void and illegal transactions
   Tinsley v Milligan [1994] 1 AC 340
   Tribe v Tribe [1995] 4 All ER 236
e. Commercial expectations
f. Mistake
   Kleinwort Benson v Lincoln CC [1998] 4 All ER 513

3) The academic commentary

a. Traditional trusts law
   Swadling, 'A New Role for Resulting Trusts?', (1996) 16 L.S. 110
   Hudson, *Swaps, restitution and trusts* (Sweet & Maxwell, 1999)

Finn, "Fiduciary Law in the Modern Commercial World" in McKendrick, *Commercial Aspects of Trusts and Fiduciary Obligations* (Oxford, 1992)
Worthington, *Proprietary Interests in Commercial Transactions* (Oxford, 1996), esp. addendum.

b. Restitution of unjust enrichment

Birks, *Introduction to the Law of Restitution*, (Oxford, 1989)
Birks, 'Restitution and Resulting Trusts', in *Equity: Contemporary Legal Developments*, 1992, ed. Goldstein, Jerusalem, 335
Birks, 'Trusts raised to avoid unjust enrichment: the *Westdeutsche* Case' [1996] R.L.R. 3
Chambers, *Resulting Trusts*, (Oxford, 1997)
Chambers, "Restitution, Trusts and Compound Interest", (1996) 20 Mel. U.L. Rev. 848

c. Generally

Birks, ed., *Lessons of the Swaps Cases* (Mansfield Press, 2000)

Unit trusts

- How does equity inter-act with commercial practice?
- The bi-cameral fiduciary structure
- Regulation by the Financial Services Authority
- What rights does the investor / beneficiary have?
- Are unit trusts really trusts or really based on principles of contract?
- *See generally the text on Unit Trusts on the pages following.*

SEMINAR MATERIALS

These seminar materials fall into two parts. First, some materials specifically on Unit Trusts, given the dearth of ordinary textbook consideration of these funds and, secondly, the questions which are to be focused on in particular in the seminar.

UNIT TRUSTS

1 INTRODUCTION

The general law of trusts imposes duties on trustees and through the beneficiary principle requires that there be beneficiaries who can enforce the trustees' obligations through the courts. Therefore, the ordinary law of trusts requires that the beneficiaries are sufficiently well-informed or are sufficiently wealthy or are sufficiently motivated to bring the trustees to court. If no-one brought the trustees to court then, theoretically, the trustees would not be obliged to perform their duties appropriately.

By contrast there are specific types of trust which are not simply governed by the general law of trusts but rather which are also governed by specific statutes and by formal regulation. The underlying purpose of this chapter, then, is to consider how such trusts are treated differently by this combination of trusts law and the law of finance. To do this we will focus primarily on the unit trust, a good example of a trust which is governed by financial regulation while also being commercial. From time to time we will also consider other types of financial trust where appropriate.

Chapter learning outcomes
To explain the nature of the unit trust as a trust but also as a means of providing a mutual investment fund structure governed by financial services regulation. The underlying purpose, then, is to

differentiate between unit trusts governed by financial regulation and ordinary trusts which function solely on the basis of the general law of trusts. We shall consider the fundamentals of the unit trust, the nature of the unit trust as a trust, the obligations of the scheme manager, and the rights of the participants.

Essential reading

Hudson, *Equity & Trusts*, chapter 24. This chapter covers all of the material in this chapter. You will be referred to specific parts of that chapter through this topic where appropriate.

General reading

Hudson, *The Law on Investment Entities* (Sweet & Maxwell, 2000), chapters 7, 9. This book deals with investment in general terms.

Legislation

Financial Services and Markets Act 2000 ("FSMA"), s.237, et seq.

2 THE COMMERCIAL NATURE OF UNIT TRUSTS: THE UCITS DIRECTIVE

The fiduciary structure in a unit trust

A unit trust is a form of trust which has existed broadly in its present form since the 19th century. The purpose of the unit trust is to raise money from the public and to invest that money for the purposes identified in the unit trust's prospectus. The interesting feature about the unit trust, and one which became an important part of early financial regulation, is that it has two different types of fiduciary. The unit trust is marketed by someone whom we shall refer to as the "scheme manager". The scheme manager is a financial institution which is authorised by the Financial Services Authority to sell unit trust investments to the public. It is the scheme manager who creates the scheme and who manages all of the unit trust's investment decisions. The other fiduciary is referred to simply as the "trustee" but this trustee's role is the safekeeping of the unit trust's property. The trustee effects investments on behalf of the unit trust at the scheme manager's instruction. In this way it is expected that both fiduciaries can watch over one another and so ensure that there is no breach of duty by the other party.

The commercial structure of a unit trust

The investors enter into a contract with the scheme manager to the effect that the scheme manager will invest their money for the purposes set out in the scheme's documentation. The true purpose of the investors is receive the commercial return generated by their investment in the unit trust. The investors (known as "participants") receive units, which are broadly equivalent to shares in an ordinary company in that the investor receives a number in proportion to the size of their investment in the unit trust. The investors are then permitted to redeem their units (that is, to cash them in) at any time they wish. As is considered below, this raises the question whether it is most appropriate to think of unit trusts as being trusts in the ordinary sense, or whether they should be considered to be commercial contracts in which the parties are solely concerned with the financial return which the participants receive from the scheme manager.

The fundamentals of the legal treatment of the unit trust

The unit trust is a form of collective investment scheme organised under the Undertaking for Collective Investment in Transferable Securities ("UCITS") Directive [O.J. 1985, L375/3]. The purpose of the UCITS directive was to "co-ordinate" the various legal codes and legal models which existed in member states dealing with investment in common "with a view to approximating the conditions of competition between those undertakings at Community level, while at the same time ensuring more effective and more uniform protection for unit holders", to make it easier for schemes to operate in different member states within the EU and thus to facilitate the creation of a "European capital market" [as set out in the Preamble to the UCITS Directive]. The focus of the directive is on open-ended investment vehicles which raise capital by promoting themselves to the public in the EU [UCITS Directive, art 2(1)].

Collective investment schemes are expressed in s 235(1) FSMA 2000 to comprise: “any arrangements with respect to property of any description … the purpose or effect of which is … to participate in or receive profits or income …”.

The unit trust is a trust [Financial Services and Markets Act 2000, s 237]. However, the most important element of this trust relationship from a commercial stand-point is the ‘unit’ in which the participant acquires rights. The approach of the case law has been to identify the rights of the participant in those units: that is a form of chose in action against the manager and the trustee of the unit trust. Unlike beneficiaries under an ordinary trust, therefore, the common understanding of the rights of the participant was that they were not rights attaching to the scheme property. Now s 237(1) of the Financial Services and Markets Act 2000 which makes the nature of the legal nature of the unit trust quite clear when it provides that the term

> “… ‘unit trust scheme’ means a collective investment scheme under which the property is held on trust for the participants.”

The question which remains outstanding is what was meant by the term “property” under the 2000 Act in forming the trust fund. It is not clear whether this refers to the scheme’s investment property or simply to the chose in action created between the participant and the scheme manager by their initial contract of investment. The scheme manager acquires securities to be held on the terms of the unit trust. The manager is required to ensure that a broad portfolio of investments is maintained in the scheme. Rather than allow the investments acquired to be limited to a small range of securities, there is an obligation on the managers to acquire a range of investments which spreads the risk of the scheme. The securities acquired then form a single unit. The investors are expressed to be the beneficiaries under the trust deed. However, their rights are strictly to a *pro rata* share of the dividends, interest or other income generated by the portfolio of securities which make up the unit.

General reading

Hudson, *Equity & Trusts*, section 24.1.

3 THE OBLIGATIONS OF THE SCHEME MANAGER AND OF THE TRUSTEE

The obligations and powers of the scheme manager and of the unit trustee are considered in the material from Thomas and Hudson’s *The Law of Trusts* provided with your Study Pack appended to this Study Guide. Significantly, scheme managers in a unit trust are not permitted to exclude their liabilities by contract unlike ordinary trustees. Any such provision of a trust deed which provides for the exclusion of the scheme manager’s liabilities is simply void (FSMA 2000, s 253).

Learning activities

1. How do we define the “unit trustee”?
2. Is the manager a trustee?

Feedback

1. The unit trustee is probably a custodian trustee in that he appears to have little fiduciary responsibility beyond ensuring the safekeeping of the scheme property.
2. The manager is, it is suggested, a trustee because the scheme manager is responsible for the investment of the trust property – a duty which is characteristic of a trustee – without any possible suggestion that it is a power which has been delegated from some other fiduciary. This issue is considered in detail in Hudson, *Equity & Trusts*, section 24.3.4.

Background reading

Hudson, *Equity & Trusts*, 3rd edn, chapter 24 “Unit Trusts”.

4 THE RIGHTS OF THE PARTICIPANTS

Section 243(10) of the 2000 Act provides for the nature of the participants in a unit trust in the following terms:

> 'The participants must be entitled to have their units redeemed in accordance with the scheme at a price related to the net value of the property to which the units relate and determined in accordance with the scheme.'

Further:

> 'But a scheme shall be treated as complying with this subsection if it requires the manager to ensure that a participant is able to sell his units on an investment exchange at a price not significantly different from that mentioned in this subsection.' [s 243(11)]

Therefore, the central right of the participant is that of redemption. Without redemption of the unit, and payment out of the value of the unit, the unit trust would be commercially useless. The commercial purpose of the unit trust is the ability of the participant to redeem her units by ensuring that she is entitled to sell them for their market value at any given time.

There are, however, no obligations owed between participants to a unit trust: *Smith v. Anderson* (1879) 15 Ch D 247. That means the participants are not deemed to be partners and therefore do not owe any obligations to one another to keep their money in the unit trust or to behave in the best interests of anyone other than themselves.

Learning activities

1. What is the nature of participant's rights?
2. How do the participants inter-act?

Feedback

The rights of participants are considered in detail in the pack of materials included with your Study Pack.

5 THE NATURE OF UNIT TRUSTS AS TRUSTS

Under s 237(1) of the Financial Services and Markets Act 2000 provides that the term '"unit trust scheme" means a collective investment scheme under which the property is held on trust for the participants.' Therefore, there is no doubt that, since the 2000 Act was passed, the unit trust is a trust.

Learning activities

1. Are unit trusts better considered to be trusts or merely contracts?
2. It is incontrovertible that unit trusts are trusts since the enactment of the FSMA 2000 but what is the significance of describing them as being trusts?

Feedback

1. While there is some attraction to the idea that the participants are only interested in their commercial return, it is nevertheless the case that unit trusts are defined as being trusts by FSMA 2000.
2. The significance of describing the unit trust as being a trust can be summarised as follows:
   - A trust imposes fiduciary obligations on its trustee, and the scheme manager in this context, whereas a mere contract would not do so.
   - The imposition of fiduciary responsibilities gives the participants a range of remedies in equity (such as breach of trust, equitable compensation and equitable tracing) in the event that the scheme manager or trustee breaches their obligations, when compared to liabilities under contract.
   - In the event that there is a breach of the terms of the unit trust, the participants do have proprietary rights in the scheme property as opposed merely to personal rights against the scheme manager and the trustee.
   - You might also consider the discussion in Chapter 3 of this Study Guide relating to the contractarian basis of trusts.

6 REGULATION OF COLLECTIVE INVESTMENT SCHEMES BY THE FINANCIAL SERVICES AUTHORITY

The outline of financial services regulation in the UK

The significance of unit trusts and other trust structures through which investments are sold in the United Kingdom are regulated by the Financial Services Authority under FSMA 2000.

Any person who carries on a regulated activity in the United Kingdom is required to obtain authorisation to do so from the FSA [FSMA 2000, s 19]. Therefore, one is not entitled to carry on investment activity as a business without authorisation [FSMA 2000, s 19], nor is one entitled to advertise the sale of any investment without FSA authorisation [FSMA 2000, s 21], nor is one entitled (in effect) to do any preparatory act connected with engaging in investment activity [FSMA 2000, s 26]. The penalties for acting without authorisation vary from the unenforceability of any agreements formed by an unauthorised person [FSMA 2000, s 26] to criminal penalties for the breach of the code prohibiting financial promotion and advertisement [FSMA 2000, ss 21, 23].

Trustees will be regulated under FSMA 2000 by the FSA in circumstances in which they are conducting "regulated activities" [FSMA 2000, s 22] of a specified kind [FSMA 2000, Sch 2] and always providing that they do so "by way of business" [FSMA 2000, s 22]. The next section considers those investment activities which constitute "regulated activities", whereas this section considers what is meant by carrying on investment "by way of business".

The FSMA 2000 provides for overtly political and macro-economic objectives relating to the manner in which the FSA exercises its regulatory powers. In short, the new regulatory body is charged with the preservation of the integrity of financial markets in the UK, the education of investors and the place of the UK within the global economy, as well as the oversight of the operations of market participants which characterised the previous legislative code. The FSA not only centralises the power of a number of previously distinct regulatory bodies but it also grants that body a quasi-judicial function in relation to market abuse and overtly macro-economic objectives in the way in which those powers are exercised.

The FSA's general duties are the promulgation of "market confidence, public awareness, the protection of consumers, and the reduction of financial crime" [FSMA 2000, s 2(2)]. The second principle relates to the "protection of consumers" [FSMA 2000, s 5(1)]. The definition given that objective is the provision of "the appropriate degree of protection for consumers". This standard of appropriateness includes consideration of -

> "(a)… the different degrees of *risk* involved in different kinds of investment or other transaction;
> (b) the differing degrees of *experience and expertise* that different consumers may have in relation to different kinds of regulated activity;
> (c) the needs that consumers may have for advice and accurate information; and
> (d) the general principle that consumers should *take responsibility* for their decisions." [FSMA 2000, s 5(2)]

Conduct of Business Rules

The FSA's conduct of business rules prioritise the need for the sellers of financial products – that is, those who are authorised under the Act to do so – to categorise their customers according to the level of their expertise [FSA Rulebook, *Conduct of Business Sourcebook* ("COB"), generally]. Consequently, the manner in which business is done and the type of business which can be done with inexpert customers differs from that which can be done with more expert customers. Customers are divided between three categories: market counterparties, intermediate customers and private customers. In effect, the seller of financial products is required to maintain the suitability of both the means by which the product is sold and the nature of the product itself. The rules themselves are contained in the FSA's *Conduct of Business Sourcebook*. There is a different code for business done with customers and business done with market professionals, the latter is contained in the Inter-Professionals Conduct code which is supplemental to the main code on conduct of business. The general requirement which underpins the Conduct of Business code is that when the seller communicates information to a customer, it must do so in a way which is "clear, fair and not misleading" [COB, 2.1.3]. The regulations provide that the seller must have regard to the level of knowledge which the buyer has of the transaction at issue when making written or oral communications [COB, 2.1.4]. Further, the seller must ensure that its officers do not take any inducements or "soft commissions" in effecting transactions [COB, 2.2.3].

The seller must provide a private customer with its terms of business before any designated business is conducted, whereas intermediate customers must only be so informed within a reasonable period of the beginning of designated business being conducted [COB, 4.2.5]. Those terms of business should include mention of the commencement of the terms of business, the applicable regulator, the investment objectives, any restrictions on the relevant designated business, which services will be provided, how payment for services will be effected, disclosure of any polarisation, whether the seller is to act as investment manager, any conflicts of interest, and whether or not the client has a right to withdraw [COB, 4.2.15].

The philosophy underpinning the FSA's *Conduct of Business* regulations is that the treatment of the client, the investments and financial products which are sold to that client, and the manner in which business is conducted with that client must all be suitable for that context. The test adopted throughout chapter 5 of COB is that the seller must have taken "reasonable steps" – the expression adopted by the caselaw for example in relation to the enforcement of domestic mortgages against co-habitees of the mortgagor [*Barclays Bank v. O'Brien* [1994] A.C. 180] – in relation to its treatment of that client. An example would be the manner in which its officers induce clients to enter into particular transactions [COB, 5.1.11, 5.1.13]. The type of reasonable steps which will be suitable are not susceptible of general definition but rather:

> "will vary greatly, depending on the needs and priorities of the private customer, the type of investment or service being offered, and the nature of the relationship between the firm and the private customer and, in particular, whether the firm is giving a personal recommendation or acting as a discretionary investment manager." [COB, 5.3.4]

In so doing the firm is required to ensure that the product is the most suitable of that type of product for the purpose [COB, 5.3.6(1)], although another product would not be more suitable simply because it would be available at a lower price [COB, 5.3.7].

Learning activity

How does the COB requirement that the scheme manager must distinguish between different classes of customer differ from the manner in which general trusts law considers beneficiaries?

Feedback

General trusts law always seeks to protect the beneficiary in all circumstances whereas the COB is sensitive to context. The concern with reference to COB Regulation is (a) to ensure that firms act with integrity and accepts that the beneficiaries may suffer loss provided that the firm providing services to the beneficiaries has acted with integrity and (b) to assuage governmental concern about integrity of the marketplace. General trusts law is concerned only to deal with disputes between litigants, principally by means of providing beneficiaries with a remedy in any circumstance in which they suffer a loss due to their trustees' behaviour, and not to ensure the management of an entire marketplace.

Market abuse

The code on "market abuse" expands the powers of the Financial Services Authority to prosecute those market participants – whether authorised or unauthorised under the legislation – outside the ambit of the ordinary criminal law for misfeasance in financial dealings. The importance of this regime is that it carries punitive penalties but that it does not replicate all of the protections and rights which are characteristic of the criminal law. Its legislative purpose was to make successful prosecutions for market abuse easier to obtain than had been the case under the pre-existing criminal law.

The market abuse regime relates to "qualifying investments" traded on LIFFE, the London Stock Exchange and other markets [FSMA, s.118(1)] where the behaviour in question would be regarded by "a regular user of that market" as a failure "to observe the standard of behaviour reasonably expected of a person in … their position in relation to the market" [FSMA, s.118(3)]. A "regular user" is someone who is a "reasonable person who regularly deals on that market in investments of the kind in question"; the term "regular user" appears frequently in this code [FSMA, s.118(10)]. More specifically, the behaviour in question must exhibit three further features. First, it must be based on information which is "not generally available to those using the market" but which would be considered by a "regular user" of the market to be "relevant" to entering into transactions on that market. Second, it must be "likely to give a regular user of the market a false or misleading impression" as to the supply of, demand for and value of the investments in question. Third, the behaviour must of a kind that would be "likely … to distort the market" in question [FSMA, s.118(2)].

Financial promotion

The financial promotion code provides that no person shall "in the course of business, communicate an invitation or inducement to engage in investment activity" [FSMA, s.21(1)]. This general prohibition is then hedged in with exceptions where the communication is made by an authorised person or is an authorised communication. Further exceptions are provided for by Treasury regulation. Breach of this central prohibition on financial promotion constitutes an offence; although it is a defence to that offence for the accused to show that he took "all reasonable precautions and exercised all due diligence to avoid committing the offence" [FSMA, s.23]. Any agreement entered into by an authorised person in contravention of the general prohibition on inviting or inducing another person to engage in investment activity under s.21(1) of FSMA 2000 will be "unenforceable against the other party" [FSMA, s.26(1)].

Learning activity

How do these quasi-criminal law rules differ from general trusts law?

Feedback

- The quasi-criminal law rules in financial regulation are sensitive to context in that they require the beneficiaries to be informed as to the risks associated with their investment and do not simply rely on the trustees to demonstrate the utmost loyalty to the beneficiaries.
- Thus, financial regulation is concerned to see that the trustees have acted properly in the manner expected by good market practice, whereas general trusts law is concerned to remedy any losses which the beneficiaries suffer as a result of some misfeasance by the trustees.
- Under financial regulation it is those regulations which set out the detail of the trustees' duties; whereas under general trusts law it is the trust instrument which sets out the trustees' duties.
- Financial regulation operates akin to criminal law in that the FSA can punish the trustees if they breach financial regulatory principles, whereas trusts law is concerned only with providing compensation for losses and not with punishing the trustees.

7 EUROBOND TRUSTEES AND REGULATORY SUPERVISION

In relation to Eurobond issues which are listed on the London Stock Exchange (as most large issues in the UK markets are) there is a requirement that the issue be conducted through a trustee who is appointed so as to ensure that the bond issue is conducted properly. A Eurobond is a means by which a company borrows money from large numbers of investors in the bond markets. The issuer issues a prospectus which explains the reason why it is seeking to borrow money and which promises investors the rate of interest which it will pay in return for the loan and the terms on which those interest payments will be made. In return the investor acquires a number of bonds which depends on the size of the investment made (similar, in that sense, to acquire shares in a company). The bond can be sold to other investors later on, particularly if the bonds become more valuable due to changes in other financial markets or the performance of the issuing company.

The bond issue is conducted through a trustee whereby the bonds are issued to the trustee and held on trust by the trustee for the investors, although the interest paid on the bonds and the money payable on the sale of any bond are paid directly to the investors and not to the trustee. The structure of the Eurobond is considered in Hudson, *Equity & Trusts*, section 22.5.2 but what remains unclear is precisely what property is held on trust. The trustee is, in truth, a form of policeman whose job is to ensure that the issuer of the bond and the banks who advise that issuer all perform their roles properly. The trustee therefore appears to be in a similar role to the protector which was considered in Chapter 3 of this Study Guide.

The central issue for our purposes, then, is the difference between this form of trustee and the ordinary trustees which we have considered so far. These trustees are really a regulatory tool to ensure that the bond issuer acts properly under the terms of the bond. Their regulatory role could be said to have diminished given that the issue of bonds generally is overseen by the FSA under the FSA's formal listing rules (dealing with admission to the London Stock Exchange) and general financial regulation governing the manner in which securities such as bond are sold.

Essential reading

Hudson, *Equity & Trusts*, section 22.5

Background reading

Thomas and Hudson, *The Law of Trusts*, chapter 50.

8 DEBENTURE TRUSTEES AND REGULATORY SUPERVISION

In relation to the issue of debentures – that is, loan stock, bonds in general terms, certificates of deposits and other instruments creating or acknowledging indebtedness – a trustee is used in the same manner as for the Eurobond trustee in the preceding section.

Essential reading

Hudson, *Equity & Trusts*, section 22.6

Learning activities relating to sections 7 and 8

3. How does the law of finance supplement the general law of trusts?
4. Why does public policy take the view that the general law of trusts is insufficient in relation to investment activity?

Feedback

The assumption made in relation to unit trusts and Eurobond or debenture trustees is that the general law of trusts will be inadequate to protect the interests of investors. The ordinary law of trusts requires that beneficiaries take their trustees to court. To do so will be expensive and will require that the beneficiaries are sufficiently well-informed to know that there has been a breach. More significantly perhaps there will usually be a large number of investors involved in one of these trusts and therefore organising all of the beneficiaries will be a difficult task. More practically, with the large amounts of money involved in these trusts, it is feared that the losses may be too substantial to be recompensed and too easily put beyond the reach of the beneficiaries: therefore, public policy dictates that there must be a financial regulator who keeps a closer watch on financial services providers in an attempt to ensure the proper management of the investment funds market.

Useful further reading

Sin, *The Legal Nature of the Unit Trust* (Clarendon Press, 1997), chapter 1
Thomas and Hudson, *The Law of Trusts* (OUP, 2004), chapter 50

Questions to be considered in class

(A) The local authority swaps cases

1. Evaluate the changes which Lord Browne-Wilkinson has wrought on equity in cases as diverse as Westdeutsche, Tinsley, and Barclays v. O'Brien. Is the trust merely an extension of equity's more general control of the conscience of the defendant, or is it more akin to a contract between trustee and settlor?

2. How did the local authority swaps cases arise? In future cases, how should parties to such contracts avoid the results of that litigation?

3. What are the lessons of the swaps cases for the legal system?

4. Does the principle of restitution of unjust enrichment offer a preferable method of understanding the legal analysis of these issues?

(B) Unit trusts

1. If it is argued that commercial transactions should receive different treatment from non-commercial situations, then what is it exactly about commercial activities which deserves this treatment?

2. One argument for commercial transactions receiving different treatment might be that commerce is important to the economy of every nation: however, would it be desirable for any economy to permit unconscionable conduct without given the victims of that conduct a chance to seek legal redress for any loss that they suffer?

3. What sort of mandatory rules – that is, rules like the criminal law which can never be allowed to be broken – should a legal system promote to control commercial activity?

4. Unit trusts, and indeed all forms of trust, are better considered to be a form of contract effected between scheme manager and participant than as creating any form of property right in favour of the participant. Discuss.

TOPIC 8. CONSTRUCTIVE TRUSTS (I): SECRET PROFITS AND BRIBES

LECTURE MATERIALS

1) The general principle: constructive trusts at large

Reading: ***Hudson*, sections 12.2**

The English model 'institutional constructive trust' will protect existing rights in proprietary by means of imposition of a trust. By definition, these are rights which would not be protected by common law remedies.

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

2) Fiduciary making unauthorised profits

Reading: ***Hudson*, sections 12.5**

(a) The basis of liability: avoidance of conflicts of interest

Keech v. Sandford (1726) 2 Eq Cas Abr 741, *per* Lord King LC:

> "*This may seem hard, that the trustee is the only person of all mankind who might not have [the trust property]: but it is very proper that rule should be strictly pursued, and not in the least relaxed; for it is very obvious what would be the consequence of letting trustees have the lease …*"

Bray v Ford [1896] AC 44, [1895-99] All ER Rep 1009, 1011, *per* Lord Herschell:

> "*It is an inflexible rule of the court of equity that a person in a fiduciary position … is not, unless otherwise expressly provided [in the terms of the that person's fiduciary duties], entitled to make a profit; he is not allowed to put himself in a position where his interest and duty conflict. It does not appear to me that this rule is, as had been said, founded upon principles of morality. I regard it rather as based on the consideration that, human nature being what it is, there is danger, in such circumstances, of the person holding a fiduciary position being swayed by interest rather than by duty, and thus prejudicing those whom he was bound to protect. It has, therefore, been deemed expedient to law down this positive rule.*"

See, e.g. Parker LJ in *Bhullar v Bhullar* [2003] 2 BCLC 241, para [17] *referring to the "ethic" in these cases*.

(b) The leading case

***Boardman v. Phipps* [1967] 2 AC 46

(c) The defence of authorisation and the issue as to who may authorise secret profits

Regal v Gulliver [1942] 1 All ER 378 (*directors may not authorise other directors*)
**Queensland Mines v. Hudson* (1978) 18 ALR 1; (1979) 42 MLR 771
**Industrial Development Consultants v Cooley* [1972] 2 All ER 162
Equiticorp Industries Group Ltd v The Crown [1998] 2 NZLR 485 (*only shareholders may authorise*)
Q: All of these cases relate to companies, only *Boardman v Phipps* does not: so, in what way does authorisation fall to be obtained in relation to trusts as opposed to corporate situations as in the corporate opportunity doctrine considered next?

3) The corporate opportunity doctrine

(a) Authorisation predicated on appropriate disclosure

Regal v Gulliver [1942] 1 All ER 378 (*directors may not authorise other directors*)
**Queensland Mines v. Hudson* (1978) 18 ALR 1; (1979) 42 MLR 771

(b) Where there was no maturing business opportunity

Island Export Finance Ltd v Umunna [1986] BCC 460
Balston v Headline Filters Ltd [1990] FSR 385

(c) Where there is an opportunity and insufficient disclosure is made

**Industrial Development Consultants v Cooley* [1972] 2 All ER 162
Crown Dilmun v Sutton [2004] 1 BCLC 468

(d) Equitable compensation

Boardman v. Phipps [1967] 2 AC 46
Guinness v. Saunders [1988] 2 All ER 940

4) Profits from bribes

Reading: ***Hudson*, para 12.4.1**

(a) The leading case: constructive trust over property acquired with the bribes; plus personal liability if value of property falls

***Att-Gen for Hong Kong v. Reid* [1994] 1 All ER 1, 4-5; [1994] AC 324, 330; [1993] 3 WLR, *per* Lord Templeman:-

"*A bribe is a gift accepted by a fiduciary as an inducement to him to betray his trust. A secret benefit, which may or may not constitute a bribe is a benefit which the fiduciary derives from trust property or obtains from knowledge which he acquires in the course of acting as a fiduciary. A fiduciary is not always accountable for a secret benefit but he is undoubtedly accountable for a secret benefit which consists of a bribe. In addition a person who provides the bribe and the fiduciary who accepts the bribe may each be guilty of a criminal offence. In the present case the first respondent was clearly guilty of a criminal offence. / Bribery is an evil practice which threatens the foundations of any civilised society. In particular bribery of policemen and prosecutors brings the administration of justice into disrepute. Where bribes are accepted by a trustees, servant, agent or other fiduciary, loss and damage are caused to the beneficiaries, master or principal whose interests have been betrayed. The amount of loss or damage resulting from the acceptance of a bribe may or may not be quantifiable. In the present case the amount of harm caused to the administration of justice in Hong Kong by the first respondent in return for bribes cannot be quantified.*"

(b) Who will be a fiduciary in these circumstances?

Reading v Att-Gen [1951] 1 All ER 617
Brinks v Abu-Saleh (No 3) [1996] CLC 133
Brown v. Bennett [1999] B.C.C. 525
Petrotrade Inc v Smith [2000] 1 Lloyd's Rep 486 (*no fiduciary office, no constructive trust*)

(c) Applications of the *Reid* principle

Mercedes Benz AG v Leiduck [1996] AC 284, 300 (*in relation to interim relief*)

Ocular Sciences Ltd v Aspect Vision Care Ltd [1997] RPC 289
Fyffes Group Ltd v Templeman [2000] 2 Lloyd's Rep 643 (*where this case was obiter*)
Dubai Aluminium Company Ltd v Alawi [2002] EWHC 2051
**Tesco Stores v Pook* [2003] EWHC 823
**Daraydan Holdings Ltd v Solland International* [2004] EWHC 622, [2004] 3 WLR 1106, [2005] Ch 1

(d) Alternative approaches not following *Reid*
nb: *Lister v. Stubbs* (1890) 45 ChD 1 [now over-ruled by *Reid*]
Halifax Building Society v Thomas [1996] Ch 217, 229 (*applying Lister v Stubbs*)
A-G v Blake [1997] Ch 84, 96, *per* Sir Richard Scott V-C

SEMINAR MATERIALS

Question 1

Consider the following factual scenarios and decide whether or not a constructive trust would be appropriate.

(1) On Monday, Sven posted a cheque for £10,000 to Ivan to buy an valuable oil painting. By mistake, Sven wrote another cheque for £10,000 the following day to pay for the same painting. On Tuesday, Ivan paid both cheques into his bank account. On Thursday, Sven telephoned Ivan to tell Ivan of the mistake.

(2) Would your answer to (1) differ if you knew that Ivan went bankrupt on Wednesday?

Question 2

Consider the following factual scenarios and decide whether or not a constructive trust would be appropriate.

(1) On Monday, Trevor posted a cheque for £1,000 to Bernard to buy an antique clock. By mistake, Trevor wrote another cheque for £1,000 the following day to pay for the same clock.

(2) On Tuesday, Bernard's assistant paid both cheques into Bernard's bank account. On Thursday, Trevor telephoned Bernard to tell Bernard of the mistake.

(3) Would your answer to (1) differ if you knew that Bernard went bankrupt on Wednesday?

Question 3

Arthur was managing-director of Ethanol Ltd, a private company. Ethanol Ltd specialised in research and development in relation to pharmaceutical products used in human healthcare. In January 2002 Arthur learned that there were opportunities using the connections which he had built up while employed by Ethanol Ltd which could develop new opportunities in relation to agricultural chemicals, a business in which Ethanol Ltd had never previously been involved. Arthur decided that the in-fighting within the company was so intense that he would like to sell his shares in Ethanol and pursue this new opportunity on his own account. He disclosed his plan to his wife, Eve, who was also a director of Ethanol Ltd.

Ethanol Ltd typically expected to earn a profit in the third year of a new product line of about £1 million, with start-up costs of about £3 million. It was expected that the agricultural chemicals venture would involve start-up costs of about £6 million. One advisor suggested that the agricultural chemicals venture would generate profits of about £750,000 in the third year, whereas another advisor suggested profits could be as high as £2 million.

Arthur decided to make a presentation to Ethanol's board of directors about the information he had received. Arthur wrote a memorandum to Joan, Ethanol's finance director, explaining that he considered the second estimate to be unrealistic whereas the first advisor was well-known to Arthur.

Joan asked why only one profit estimate was being included in the presentation to the board of directors. Arthur reminded her that he was managing director and that in any event it would be his presentation and not hers. To reassure her that she was valuable, Arthur procured a one-off cash bonus of £40,000 to be paid by Ethanol to Joan.

The board of directors was therefore presented with the first estimate of profits of £750,000 but was also presented with the estimate of start-up costs of £6 million. The board's unanimous decision was that "no matter what the level of profit which might be earned, the company could not reasonably countenance start-up costs of £6 million". Arthur therefore sought confirmation from the board that the company would not pursue this opportunity and further that Arthur should consider himself free to resign and pursue it himself: the board agreed unanimously to Arthur's request.

Joan invested her bonus in Arthur's new company and earned profits of a further £30,000. Joan spent £10,000 of the money on a round-the-world cruise, the rest of the money remains in her deposit account. Arthur earned personal profits of £100,000 from the new venture in 2005; Eve earned £60,000 personal profits in 2005.

Advise Ethanol Ltd.

Topic 9. Constructive trusts (II): fraud, contract and confidentiality

Lecture Materials

1) Profits from unlawful killing

Reading: ***Hudson*****, para 12.4.2**

In the estate of Crippen [1911] P 108
Re K (deceased) [1986] Fam 180

2) Profits from theft

Reading: ***Hudson*****, para 12.4.3**

Attorney-General's Ref (No 1 of 1985) [1986] QB 491; Theft Act 1968, s.5(3)
Westdeutsche Landesbank v Islington [1996] 1 AC 669
Cf. *Att-Gen for Hong Kong v. Reid* [1994] 1 All ER 1
Box, Brown & Jacobs v Barclays Bank [1998] Lloyd's Rep Bank 185, 200, *per* Ferris J (*thief does not ordinarily acquire property rights*)
Shalson v Russo [2003] EWHC 1637, [110], *per* Rimer J (*ditto*)
Cf. Proceeds of Crime Act 2002, s.6 (*Assets Recovery Agency*)

3) Profits from fraud

Reading: ***Hudson*****, para 12.4.4**

(a) Ordinarily property acquired by fraud will be held on constructive trust

Westdeutsche Landesbank v Islington [1996] 1 AC 669, 716, *per* Lord Browne-Wilkinson:

> "*when property is obtained by fraud, equity places a constructive trust on the fraudulent recipient*".

Paragon Finance v Thackerar [1999] 1 All ER 400, 408, per Millett LJ:

> "*Equity has always given relief against fraud by making any person sufficiently implicated in the fraud accountable in equity. In such a case he is traditionally though I think unfortunately described as a constructive trustee and said to be "liable to account as constructive trustee.*"

Twinsectra v Yardley [2000] WTLR 527, 567 (*applying Westdeutsche*).
Collings v Lee (2001) 82 P&CR 27
JJ Harrison (Properties) Ltd v Harrison [2002] 1 BCLC 162, [2001] WTLR 1327
Niru Battery Manufacturing Co v Milestone Trading Ltd [2002] EWHC 1425, [2002] All ER (Comm) 705, 722, *per* Moore-Bick J (*applying Westdeutsche*).

(b) Property acquired by fraudulent misrepresentation not held on constructive trust

Daly v Sydney Stock Exchange Ltd (1986) 160 CLR 371, 387
**Lonrho v Al Fayed (No 2)* [1992] 1 WLR 1; [1991] 4 All ER 961, *per* Millett J:

> '*A contract obtained by fraudulent misrepresentation is voidable, not void, even in equity. The representee may elect to avoid it, but until he does so, the representor is not a constructive trustee of the property transferred pursuant to the contract, and no fiduciary relationship exists between him and the*

representee. It may well be that if the representee elects to avoid the contract and set aside a transfer of property made pursuant to it, the beneficial interest in the property will be treated as having remained vested in him throughout, at least to the extent necessary to support any tracing claim.'

Halifax Buildings Society v Thomas [1996] Ch 217
Re Ciro Citterio Menswear plc (in administration) [2002] 2 All ER 717

Cf. *Sinclair Investment Holdings SA v Versailles Trade Finance Ltd* [2004] All ER (D) 158 and *Shalson v Russo* [2003] EWHC 1637, para [106] for considerations of the conflict positions.

4) Chinese walls and confidential information

Reading: ***Hudson*, para 12.5.6**

**Bolkiah v. KPMG* [1999] 1 All ER 517 (HL)
Marks & Spencer plc v Freshfield Bruckhaus Deringer [2004] 3 All ER 773
Galmerrow Securities Ltd v National Westminster Bank plc [2002] WTLR 125 (*attribution of liability from individual to company*)

5) Constructive trust, commercial arrangements and contract

(a) Contract to stay out of the market & joint ventures

Reading: ***Hudson*, para 12.3.2 & 12.3.3**

Chattock v Miller (1878) 8 Ch D 177 (*agreement not to bid at auction = equity over property acquired*)
Pallant v Morgan [1952] 2 All ER 951 (*contract to stay out of market = constructive trust*)
Banner Homes Group plc v. Luff Development Ltd [2000] Ch 372 (*negotiation for joint venture led to constructive trust*)
London and Regional Investments Ltd v TBI plc [2002] EWCA Civ 355, [2002] All ER (D) 369 (*agreement was "subject to contract" and therefore not a contract*)
Kilcarne Holdings Ltd v Targetfellow (Birmingham) Ltd [2004] EWC 2547 (*express provision that no contract at all until negotiations complete: expressed to be "draft only"*)

(b) Contract for the sale of property

Reading: ***Hudson*, para 12.6.2**

**Lysaght v Edwards* (1876) 2 Ch D 499 (*contract for sale of land*)
Lloyds Bank v Carrick [1996] 4 All ER 630 (*assumption of constructive trust*)
Neville v Wilson [1997] Ch 144 (*ditto, personalty*)
Shaw v Foster (1872) LR 5 HL 321 (*any fiduciary obligations are limited: trustee may protect own position*)
Chang v Registrar of Titles (1976) 137 CLR 177 (*doubts Lysaght because purchase may not be completed but constructive trust may nevertheless seem to bite*)
***Jerome v Kelly* [2004] 2 All ER 835, [2004] UKHL 25 (*may be merely a trustee sub modo*)

(c) Statute may not be used as an engine of fraud

Reading: ***Hudson*, para 12.3.4**

**Rochefoucauld v Boustead* [1897] 1 Ch 196
***Paragon Finance plc v. Thakerar & Co* [1999] 1 All E.R. 400 (*the equity in Rochefoucauld is a constructive trust*)

6) Is the doctrine of constructive trust coherent?

Consider the various competing forms of constructive trust we have encountered:-

- *Westdeutsche Landesbank v Islington* – based on conscience
- *Att-Gen Hong Kong v Reid* – based on (i) equity looks upon as done that which ought to have been done (ii) the evil practice of accepting bribes and (iii) may lead to a personal liability over and above the proprietary liability
- *Boardman v Phipps* – avoidance of conflicts of interest
- *Lloyds Bank v Rosset* – common intention by agreement or by understanding
- *Neville v Wilson* / *Jerome v Kelly* – contract transfers equitable interest by constructive trust although nature of obligations take effect sub modo
- *Rochefoucauld v Boustead* – based on avoidance of fraud
- *Royal Brunei Airlines v Tan* – a personal liability to account (see next section)

Given that these forms of constructive trust arise on different bases, is the doctrine coherent? If not, does it matter?

SEMINAR MATERIALS

1. Does the doctrine of constructive trust frustrate or support commercial activity?

2. Why is confidentiality such a central concept in fiduciary law and how does one construct an effective Chinese wall in practice?

3. Is the imposition of a constructive trust in relation to cases of theft really appropriate?

4. Why should fraudulent misrepresentation be treated differently in relation to the imposition of constructive trusts from other forms of unconscionable activity?

5. Do constructive trusts in commercial contexts arise on the basis of general equitable principle (i.e. to prevent unconscionable behaviour in a natural law sense) or on the basis of strict adherence to precedent (i.e. in a positive law sense)?

6. (i) Is the doctrine of constructive trust coherent? (ii) Does it matter if it is not?

TOPIC 10. BREACH OF TRUST (I): DISHONEST ASSISTANCE AND KNOWING RECEIPT

Aim: *to consider the nature of breach of trust and the range of people who may become responsible for a breach of trust: in particular, to unearth the reasons behind this approach.*

LECTURE MATERIALS

STRANGERS TO THE TRUST

A "stranger" in this context is someone who is not a trustee of that trust.

1. Introduction.

Reading: ***Hudson*****, section 20.1**

You should read first the introduction to chapter 20 to understand the background to these claims. The remedy is personal liability to account as a constructive trustee on the basis of being a dishonest assistant to a breach of trust or being a recipient of property knowing of a breach of trust.

2. Dishonest Assistance

Reading: ***Hudson*****, section 20.2**

a). The basis for the action

Lord Selborne LC in *Barnes v. Addy* ((1874) 9 Ch. App. 244, 251-252):-

> "*… strangers are not to be made constructive trustees merely because they act as the agents of trustees in transactions within their legal powers, transactions, perhaps, of which a Court of Equity may disapprove, unless those agents receive and become chargeable with some part of the trust property, or unless they assist with knowledge in a dishonest and fraudulent design on the part of the trustee …*"

Agip Africa v. Jackson [1990] Ch 265
*******Royal Brunei Airlines v. Tan* [1995] 3 WLR 64; [1995] 3 All ER 97

b). The objective test for dishonesty

*******Royal Brunei Airlines v. Tan* [1995] 3 WLR 64; [1995] 3 All ER 97, *per* Lord Nicholls:

> "*… acting dishonestly, or with a lack of probity, which is synonymous, means simply not acting as an honest person would in the circumstance. This is an objective standard. ... All investment involves risk. Imprudence is not dishonesty, although imprudence may be carried recklessly to lengths which call into question the honesty of the person making the decision. This is especially so if the transaction serves another purpose in which that person has an interest of his own.*"

Smith New Court v. Scrimgeour Vickers [1997] A.C. 254
Twinsectra Ltd v. Yardley [1999] Lloyd's Rep. Bank 438, Court of Appeal

c). An alternative test for dishonesty based on subjectivity

R v. Sinclair [1968] 3 All ER 241, applied in *Baden Delvaux v. Societe Generale* [1992] 4 All ER 161, 234
R v. Ghosh [1982] QB 1053, applied in *R v. Clowes* [1994] 2 All ER 316
*******Twinsectra Ltd v. Yardley* [2002] 2 All E.R. 377, 387, *per* Lord Hutton:

> "*There is, in my opinion, a further consideration [than deciding whether the test is one of knowledge or dishonesty as set out by Lord Nicholls] which supports the view that for liability as an accessory to arise*

the defendant must himself appreciate that what he was doing was dishonest by the standards of honest and reasonable men. A finding by the judge that a defendant has been dishonest is a grave finding, and it is particularly grave against a professional man, such as a solicitor. Notwithstanding that the issue arises in equity law [sic] and not in a criminal context, I think that it would be less than just for the law to permit a finding that a defendant had been 'dishonest' in assisting in a breach of trust where he knew of the facts which created the trust and its breach but had not been aware that what he was doing would be regarded by honest men as being dishonest."

Manolakaki v Constantinides [2004] EWHC 749, [167], *per* Peter Smith J

Cf. *Royal Brunei Airlines v. Tan* [1995] 3 WLR 64; [1995] 3 All ER 97, *per* Lord Nicholls:

"*… subjective characteristics of dishonesty do not mean that individuals are free to set their own standards of honesty in particular circumstances. The standard of what constitutes honest conduct is not subjective. Honesty is not an optional scale, with higher or lower values according to the moral standards of each individual. If a person knowingly appropriates another's property, he will not escape a finding of dishonesty simply because he sees nothing wrong in such behaviour.*"

Cf. *Walker v Stones* [2000] 4 All ER 412, 444, *per* Sir Christopher Slade:

"*A person may in some cases act dishonestly, according to the ordinary use of language, even though he genuinely believes that his action is morally justified. The penniless thief, for example, who picks the pocket of the multi-millionaire is dishonest even though he genuinely considers the theft is morally justified as a fair redistribution of wealth and that he is not therefore being dishonest.*"

d). Applications of the objective test

Corporacion Nacional Del Cobre De Chile v. Sogemin Metals [1997] 1 WLR 1396
Twinsectra Ltd v. Yardley [1999] Lloyd's Rep. Bank 438
Grupo Toras v. Al-Sabah [1999] C.L.C. 1469
Wolfgang Herbert Heinl v. Jyske Bank [1999] Lloyd's Rep. Bank 511
Tayeb v HSBC Bank plc [2004] 4 All ER 1024
***Dubai Aluminium v Salaam* [2002] 3 WLR 1913

e). Dishonesty and risk

Royal Brunei Airlines v. Tan [1995] 2 AC 378, 387, *per* Lord Nicholls

"*All investment involves risk. Imprudence is not dishonesty, although imprudence may be carried recklessly to lengths which call into question the honesty of the person making the decision. This is especially so if the transaction serves another purpose in which that person has an interest of his own.*"

3. Knowing Receipt

Reading: ***Hudson*, section 20.3**

a). The basis of liability for knowing receipt

Re Diplock [1948] Ch 465, 478-479
Re Montagu's Settlements [1987] Ch 264
Agip v. Jackson [1990] Ch 265, 286, *per* Millett J.; CA [1991] Ch 547
**El Ajou v. Dollar Land Holdings* [1994] 2 All ER 685
Meridian Global Funds v. Securities Commission [1995] 3 All ER 918

b). What type of knowledge?

**Baden v. Societe Generale* (1983) [1993] 1 W.L.R. 509 *per* Peter Gibson J, the five types of knowledge:

(1) actual knowledge;
(2) wilfully shutting one's eyes to the obvious;
(3) wilfully and recklessly failing to make inquiries which an honest person would have made;

(4) knowledge of circumstances which would indicate the facts to an honest and reasonable man;
(5) knowledge of circumstances which would put an honest and reasonable man on inquiry.

**Re Montagu's Settlements* [1987] Ch 264 (*only first three categories of knowledge; forgetfulness*)
**Polly Peck v. Nadir* [1992] 4 All ER 769, [1993] BCLC 187
El Ajou v. Dollar Land Holdings [1994] 2 All ER 685
Macmillan Inc. v. Bishopsgate Investment Trust [1995] 1 WLR 978, 1000, 1014; [1995] 3 All ER 747, 769, 783.

c). Changing the test (i): dishonesty

Twinsectra Ltd v. Yardley [1999] Lloyd's Rep. Bank 438, Court of Appeal
Bank of America v. Kevin Peter Arnell [1999] Lloyd's Rep. Bank 399
Grupo Toras v. Al-Sabah [1999] C.L.C. 1469
Ali v Al-Basri [2004] EWHC 2608, [195] (*dishonesty is likely to suggest knowledge and so attract liability*)
Cf. Niru Battery Manufacturing Co v Milestone Trading Ltd [2004] 2 WLR 1415, [188], *per* Sedley LJ (*dishonesty not a requirement of liability*)

d). Changing the test (ii): unconscionability

Houghton v. Fayers [2000] 1 BCLC 571
**BCCI v Akindele* [2000] 4 All ER 221
Criterion Properties plc v Stratford UK Properties LLC [2003] 2 BCLC 129, [38] (*expresses preference for flexibility of a test of conscionability*)
Niru Battery Manufacturing Co v Milestone Trading Ltd [2004] 2 WLR 1415, [188], *per* Sedley LJ
Citadel General Assurance v. Lloyds Bank Canada [1997] 3 SCR 805, 152 DLR (4th) 385
Cf. Crown Dilmun v Sutton [2004] EWHC 52 (Ch), [23] (*criticises looseness of conscionability test*)

Academic commentary:-
Birks [1993] LMCLQ 318;
Gardner (1996) 112 LQR 56
Millett, "Restitution and Constructive Trusts" (1998) 114 L.Q.R. 399: arguing for replacing constructive trusteeship by restitution. Also (1998) 114 LQR 214.
Fox, "Constructive Notice and Knowing Receipt: an Economic Analysis" [1998] C.L.J. 391: considering what form of "notice" is required in knowing receipt.
Smith, "Constructive trusts and constructive trustees" [1999] C.L.J. 294.

4. Liability to account in corporate contexts.

Reading: ***Hudson*, section 20.5**

If an individual is dishonest or has knowledge, then the claimant can claim against that individual. However, if that individual is employed by a company, then there is a question as to whether or not that company can also be said to have been dishonest or to have had knowledge so that the claimant could claim against the company instead.

a) Controlling mind test

Tesco v Nattrass [1972] AC 153
Royal Brunei Airlines v. Tan [1995] 2 AC 378
Crown Dilmun v Sutton [2004] EWHC 52 (Ch), [23] (*controlling mind test*)

b) Liability of employee

Royal Brunei Airlines v. Tan [1995] 2 AC 378
Brown v Bennett [1999] 1 BCLC 649 (*assisting a director*)
Standard Chartered Bank v Pakistan National Shipping Corp [2003] 1 AC 959

c) Risk in commercial transactions

Royal Brunei Airlines v. Tan [1995] 2 AC 378

> "*All investment involves risk. Imprudence is not dishonesty, although imprudence may be carried recklessly to lengths which call into question the honesty of the person making the decision. This is especially so if the transaction serves another purpose in which that person has an interest of his own. … [Where a person] takes a risk that a clearly unauthorised transaction will not cause loss ... If the risk materialises and causes loss, those who knowingly took the risk will be accountable accordingly.*"

Catch-22: *Tayeb v HSBC Bank plc* [2004] 4 All ER 1024 (*bank may breach contract if it refuses to accept payment*)
Cf. Criminal Justice Act 1988, s.93A (*bank may commit offence to accept payment from suspicious client*)

d) Standard commercial conduct in the context in that market

**Cowan de Groot Properties Ltd v Eagle Trust plc* [1992] 4 All ER 700, 761, *per* Knox J (*a person guilty of "commercial unacceptable conduct in the particular context" is likely to be held to have been dishonest*)
**Polly Peck v Nadir (No 2)* [1992] 4 All ER 769 (*liability of financial advisors dependent on context and whether they ought to have been suspicious*)
**Royal Brunei Airlines v. Tan* [1995] 2 AC 378
Heinl v Jyske Bank (Gibraltar) Ltd [1999] Lloyd's Rep Bank 511, at 535, *per* Colman J (*contravention of financial regulation*)
Bank of Scotland v A Ltd [2001] 3 All ER 58 (*contravention of financial regulation*)
**Sphere Drake Insurance Ltd v Euro International Underwriting Ltd* [2003] EWHC 1636 (Comm) (*taking unacceptable risk in contravention of conduct of business regulation = dishonesty*).
Tayeb v HSBC Bank plc [2004] 4 All ER 1024 (*contravention of financial regulation*)
**Manolakaki v Constantinides* [2004] EWHC 749 (*clear dishonesty where contravention of financial regulation, backdating of documents and including untrue statements in documents; absence of personal profit would militate against finding of dishonesty*)
E.g. Financial Services and Markets Act 2000 – FSA Conduct of Business Rules: Hudson, 20.5.2

SEMINAR MATERIALS

Question 1

Monster Bank employs 100 traders who are divided into four equal teams specialising in one of bonds, shares, derivatives or commodities trading. Monster Bank is regulated by the Financial Services Authority in the UK.

Sullivan is a trader and board director of Monster Bank specialising in share trading. Sullivan advised one client, the trustees of the Davidson family trust to invest in a new company which was proposing to sell one product in the UK: a drug to fight obesity. The Davidson family trust comprised £10 million and the Davidson family home in Shropshire, a 10 bedroom house in 30 acres of land worth £4 million. Sullivan advised an investment of £5 million in the drug company.

Sullivan dealt on behalf of a second client who sought to invest in any shares quoted in the UK. The size of this client's investment varied between £5 million and £100 million. Sullivan conducted no detailed research into this client and discouraged his fellow directors from doing so because of the size of this client's investment. Sullivan heard a rumour that this client was involved in terrorist finance but he took no further action.

Sullivan told his assistant, Malone, to falsify the records as to the accounts to which the moneys relating to this second client had been paid. Malone was aged 25, and had worked as a junior assistant at Monster Bank for three years. Malone knew nothing of the rumours about this second client. It transpired that this second client had in fact obtained all of this money by stealing from UK pension funds under his control.

All of these moneys were paid into bank accounts owned by Monster Bank.

Advise Monster Bank, Sullivan and Malone in relation to these facts.

Question 2

Shady was a solicitor retained by a private family trust to advise their trustees on investment policy and other matters. The trustees were all non-professionals and tended to do whatever Shady told them. The trust fund consisted of £100,000 in cash in October 1999. The trust document provided that the trust fund was to be "invested only in a very safe bank account at a reasonable rate of interest or in very safe financial investments".

The trustees had never asked Shady for proper accounts for any of these investments. Shady decided to exploit the trust by making some risky financial investments and then keeping back any profits for himself.

On 1st November 1999, Shady decided to deal with a young stockbroker called Tragic with whom Shady already had £10,000 of Shady's own money invested. Tragic worked for an investment bank called Bull Markets. Tragic had been experiencing difficulty with his "High Risk Fund" and so needed new clients quickly. This fund was advertised by Bull Markets as offering "high risk products for thrill-seeking clients who want to make big money".

Tragic offered Shady personally a guaranteed return of £1,000 annually on Shady's pre-existing investment if Shady invested the whole of the family trust fund in the High Risk Fund. Shady agreed. Shady told Tragic that this investment would be valid under the terms of the trust. The trust fund money was paid into one of Bull Markets' accounts as part of their usual market practice and kept under their control throughout the life of the investment.

Tragic decided that all of the funds under his control should be invested in a new company which intended to sell high quality sand products to Egyptian hotel chains. Tragic knew this venture was being managed by someone who had had a conviction for armed robbery. The company went insolvent when the former armed robber absconded with the money.

> ***(i)*** *Advise the beneficiaries of the family trust as to their rights against Shady, Tragic and Bull Markets.*
> ***(ii)*** *Would it change your advice if you knew that (a) Tragic was one of 1,000 traders employed by Bull Markets, or (b) Tragic was one of only 5 traders employed by Bull Markets?*
> ***(iii)*** *Would it change your advice if you knew that (a) the High Risk Fund contained £100 million or (b) that it contained only £1 million?*

Question 3

How can the law account for the distinct approaches to property rights in *Re Goldcorp* and in *Att-Gen Hong Kong v. Reid*? Must property be tangible and certain, or is equity concerned merely to focus on the conscience of the defendant and thus leave the question of certainty of property in the background?

Question 4

In what circumstances are constructive trusts concerned only to impose rights over property, and in what circumstances are they really concerned with imposing remedies when there has been a wrong committed (more like the law of torts)?

TOPIC 11. BREACH OF TRUST (II): TRACING

Aim: *to consider the complexities of the law of tracing and to consider the innovative thinking in this area in relation to the banking law and commercial treatment of tracing.*

General Reading on this topic: ***Hudson*, chapter 19**

LECTURE MATERIALS

A. THE PROCESS OF TRACING, AND *THEN* CLAIMING

Reading: ***Hudson*, section 19.1**

***Boscawen v. Bajwa* [1995] 4 All ER 769 - *tracing is the process of identification, the appropriate claim is something else.*
Westdeutsche Landesbank v. Islington LBC [1996] AC 669, [1996] 2 All ER 961 - *equitable proprietary rights are based on 'conscience + knowledge'.*

B. COMMON LAW TRACING

Reading: ***Hudson*, section 19.2**

Lipkin Gorman v. Karpnale [1991] 3 WLR 10, [1992] 4 All ER 512, [1991] 2 AC 548 - *can trace at common law into bank accounts where money identifiable.*
Agip Africa v. Jackson [1991] Ch 547, [1991] 3 WLR 116; [1992] 4 All ER 451 - *common law tracing only possible in clean, physical substitutions.*
**FC Jones & Sons v. Jones* [1996] 3 WLR 703; [1996] 4 All ER 721 - *common law tracing operates into substitutions.*
Millett, 'Tracing the Proceeds of Fraud' (1991) 107 LQR 71.

C. EQUITABLE TRACING

Reading: ***Hudson*, sections 19.3 and 19.4**

1. <u>Need for prior equitable interest / proprietary base</u>
Reading: ***Hudson*, para 19.3.2**
Re Diplock [1948] Ch 465 - *fiduciary relationship required to base equitable proprietary claim.*
Chase Manhattan Bank NA v. Israel-British Bank (London) Ltd [1981] Ch 105; [1980] 2 WLR 202; [1979] 3 All ER 1025 - *mistake grounds a 'proprietary tracing claim'*.
Agip Africa v. Jackson [1991] Ch 547, [1991] 3 WLR 116; [1992] 4 All ER 451 - *fiduciary relationship / equitable interest a pre-requisite for equitable tracing.*
***Boscawen v. Bajwa* [1995] 4 All ER 769 - *fiduciary relationship / equitable interest a pre-requisite for equitable tracing.*
**Westdeutsche Landesbank v. Islington LBC* [1996] AC 669, [1996] 2 All ER 961 - *semble, 'conscience + knowledge' is enough, no expressed need for prior interest.*

2. <u>Mixture of trust money with trustee's own money</u>
Reading: ***Hudson*, para 19.4.1**

a) <u>Honest trustee approach</u>
**Re Hallett's Estate* (1880) 13 ChD. 695 - *presumption of trustee honesty.*

b) <u>Beneficiary election approach</u>

Re Oatway [1903] 2 Ch. 356 - *beneficiary election*.

c) Other approaches
Roscoe v. Winder [1915] 1 Ch 62
Re Tilley W.T. [1967] Ch. 1179

d) The modern approach – a question of property law, not justice nor unjust enrichment
***Foskett v. McKeown* [2000] 3 All E.R. 97 - *fraudster mixing innocent volunteers' money with own money; disapproving Hallett in part, now there is no restriction to a lien.*

3. Mixture of two trust funds or with innocent volunteer's money
Reading: ***Hudson*, paras 19.4.2 and 19.4.3**

a) The traditional rule
**Clayton's Case* (1816) 1 Mer 572 - *first in, first out w.r.t current accounts*
Re Diplock, supra - '*Where an innocent volunteer (as distinct from a purchaser for value without notice) mixes 'money' of his own with 'money' which in equity belongs to another person, or is found in possession of such a mixture, although that other person cannot claim a charge on the mass superior to the claim of the volunteer, he is entitled, nevertheless, to a charge ranking pari passu with the claim of the volunteer … Such a person is not in conscience bound to give precedence to the equitable owner of the other of the two funds*.' [1948] Ch 465, 524.

b) The retreat from *Clayton's Case*
Re Ontario Securities Commission (1985) 30 DLR (4d) 30 - *proportionate share*.
Re Registered Securities [1991] 1 NZLR 545
***Barlow Clowes International v. Vaughan* [1992] 4 All ER 22, [1992] BCLC 910; noted Birks [1993] LMCLQ 218 - *rolling charge*.
***Russell-Cooke Trust Co v Prentis* [2003] 2 All ER 478
Commerzbank AG v IMB Morgan plc [2004] EWHC 2771

c) Tracing into pension fund rights
Clark v Cutland [2003] 4 All ER 733, [2003] EWCA Civ 810
Cf. Foskett v McKeown [2000] 3 All ER 97

4. Loss of right to trace
Reading: ***Hudson*, para 19.5.5**
Roscoe v. Winder [1915] 1 Ch. 62 - cannot claim more than lowest intermediate balance.
**Bishopsgate Investment Management v. Homan* [1995] Ch 211

5. Theft
Reading: ***Hudson*, section 19.5.7**
Bishopsgate v. Maxwell [1993] Ch 1, 70 - stolen money can be traced in equity
Westdeutsche Landesbank v. Islington (*supra*) L. B-W: '*I agree that stolen monies are traceable in equity*.'

D. CLAIMING: TRUSTS AND REMEDIES

Reading: ***Hudson*, section 19.5**

1. Introduction to tracing remedies – charge, lien or constructive trust?
Reading: ***Hudson*, para 19.5.1 and 19.5.2**

2. Charges, liens and proportionate shares
Reading: ***Hudson*, paras 19.5.1 and 19.5.3**
Re Tilley [1967] Ch 1178
Paul Davies Pty Ltd v. Davies [1983] 1 NSWLR 440
Re Ontario Securities Commission (1985) 30 DLR (4d) 30 - proportionate share.

**Barlow Clowes International v. Vaughan* [1992] 4 All ER 22, [1992] BCLC 910 - rolling charge approach.

3. Constructive trusts in relation to tracing: is unconscionability necessary?

Reading: ***Hudson*, para 19.5.2**

***Westdeutsche Landesbank v Islington* [1996] AC 669

Re Diplock [1948] Ch 465

Cf. *Chase Manhattan v Israel-British Bank* [1981] Ch 105

Cf. *Attorney-General for Hong Kong v Reid* [1994] 1 AC 324

**Foskett v McKeown* [2001] AC 102

Allen v Rea Brothers Trustees Ltd [2002] EWCA Civ 85

4. Subrogation

Reading: ***Hudson*, para 19.5.4**

Boscawen v. Bajwa [1995] 4 All ER 769

Wenlock v. River Dee Co. (1887) 19 QBD 155

5. Swollen assets theory

Reading: ***Hudson*, para 19.5.6**

Space Investments Ltd v. Canadian Bank [1986] 3 All ER 75, 76-77; [1986] 1 WLR 1072, 1074 - *per* Lord Templeman:-

'*In these circumstances it is impossible for the beneficiaries interested in trust money misappropriated from their trust to trace their money to any particular asset belonging to the trustee bank. But equity allows the beneficiaries, or a new trustee appointed in place of an insolvent bank trustee … to trace the trust money to all the assets of the bank and to recover the trust money by the exercise of an equitable charge over all the assets of the bank … that equitable charge secures for the beneficiaries and the trust priority over the claims of customers … and … all other unsecured creditors.*'

Bishopsgate Investment Management v. Homan [1995] Ch 211, [1995] 1 All ER 347, [1994] 3 WLR 1270 - not possible where overdrawn account.

6. A note on resulting trust

El Ajou v. Dollar Land Holdings [1994] 2 All ER 685 - trust here is probably resulting

Cf. Birks and restitution of unjust enrichment

Westdeutsche Landesbank v Islington [1996] AC 669

E. DEFENCES

Reading: ***Hudson*, section 19.6**

1. Change of Position

Reading: ***Hudson*, para 19.6.1**

a) The test for change of position

***Lipkin Gorman v. Karpnale*, supra; per Lord Goff:- '*Where an innocent defendant's position is so changed that he will suffer an injustice if called upon to repay or to repay in full, the injustice of requiring him so to repay outweighs the injustice of denying the plaintiff restitution.*'

b) Bad faith as a barrier to change of position

**Niru Battery Manufacturing Co and anor v Milestone Trading Ltd and ors* [2003] EWCA Civ 1446

Maersk Air Ltd v Expeditors International (UK) Ltd [2003] 1 Lloyd's Rep 491

c) Activity which will constitute a change of position

**Philip Collins Ltd v Davis* [2000] 3 All ER 808

**Scottish Equitable plc v. Derby* [2001] 3 All ER 818

Barros v MacDaniels Ltd [2004] 3 All ER 299, [2004] EWHC 1188

Campden Hill Ltd v Chakrani [2005] EWHC 911

d) When must the change of position have taken place?

South Tyneside MBC v Svenska International plc [1995] 1 All ER 545
Pearce v Lloyds Bank plc [2001] EWCA Civ 1097
**Dextra Bank and Trust Co v Bank of Jamaica* [2002] 1 All ER (Comm) 193

e) Is change of position now equitable as opposed to restitutionary?

Niru Battery Manufacturing Co and anor v Milestone Trading Ltd and ors [2003] EWCA Civ 1446

2. Is change of position now to be understood in terms of estoppel by representation?

Reading: ***Hudson*, para 19.6.2**
(*Jorden v Money* (1854) V HLC 185, 10 ER 868)
(*Avon CC v Howlett* [1983] 1 WLR 605)
**National Westminster Bank plc v Somer International* [2002] QB 1286, CA.
Niru Battery Manufacturing Co and anor v Milestone Trading Ltd and ors [2003] EWCA Civ 1446

3. Bona fide purchaser for value without notice of the defendant's rights

Reading: ***Hudson*, para 19.6.4**
**Westdeutsche Landesbank v Islington* [1996] AC 669

Specific reading:

- Smith, *The Law of Tracing* (Oxford, 1997)
- Millett, 'Tracing the proceeds of fraud' (1991) 107 LQR 71
- Birks, 'Necessity of Unitary Law of Tracing' in *Making Commercial Law*, ed. Cranston (Oxford, 1997), 239.
- Birks, *Introduction to the Law of Restitution*, (Oxford, 1989)
- Birks, 'Trusts raised to avoid unjust enrichment: the *Westdeutsche* Case' [1996] R.L.R. 3
- Birks 'Mixing and Tracing: Property and Restitution' (1992) 45 CLP 69;
- Birks 'Overview: Tracing, Claiming and Defences' in Birks, *Laundering and Tracing* (1995) 289-322
- Hayton, 'Equity's Identification Rules' also in Birks, *Laundering and Tracing* (1995).
- Oakley, 'The Prerequisites of an Equitable Tracing Claim' (1975) 28 *CLP* 64
- Pearce, 'A Tracing Paper' (1976) 40 *Conv*. 277.

SEMINAR MATERIALS

Question 1

Bingo was a well-established stockbroker and investment advisor to the Taylor family trust. He gave advice the trustees to invest in the following terms: at that time, the trust fund was worth a total of £500,000. The trustees were not professional investors and so took Bingo's advice. The trust expressly prohibited investment in shares in private, "Ltd" companies.

Bingo was a substantial shareholder in Whizz Ltd. In 1996 Bingo advised that the total trust fund (£500,000) be invested in Whizz Ltd. Bingo knew that Whizz Ltd was about to enter into a risky business venture at that time in an area in which Whizz Ltd had no experience. Margaret, the managing director and controlling mind of Whizz Ltd, had asked Bingo to look into raising money for this business venture. When Bingo procured £500,000 from the Taylor family trust and presented the payment to Whizz Ltd, Margaret asked: 'where did you manage to find such a large investment?' Bingo replied, cryptically: 'Ask me no questions, and I will tell you no lies.' Margaret said nothing more.

The £500,000 was then used in the following four ways:-

(i) First, £150,000 was placed in a current bank account No. 100. That account went overdrawn in 1997; the money was used to pay off the mortgage on the company headquarters. There was £80,000 in the account by April 1998.

(ii) Second, £50,000 was placed in current bank account No. 200 in July 1997. Account No. 200 already contained £10,000. Out of account No. 200, £20,000 was spent on a lavish Christmas party for clients. No further amounts have been paid out of the account no. 200 since then.

(iii) Third, £275,000 was used to purchase machinery which the company has kept.

(iv) Fourth, £25,000 was used to buy operating equipment and donated to a medical charity.

Advise Tick and Tock generally.

Question 2

Badman was appointed as managing-director of a small trading company, Trade Ltd, which was taken over as part of large corporate restructuring. The company had three bank accounts which fell under Badman's control. Badman could not resist the temptation to misuse the money held in the accounts.

From bank account #001 Badman took £50,000 which he used to invest in Dotcom plc shares. Those investments realised profits of £20,000. All of the money was paid into a bank account contained no other moneys.

From bank account #002 Badman took £30,000 which he paid into an account in which he held £20,000 on trust for the Taylor family trust. On 2nd January there was therefore £50,000 in this account. On 3rd January, Badman bought £20,000 worth of Whizz plc shares which tripled in value. On 4th January, Badman bought £30,000 worth of Duff plc shares which fell in value to £5,000.

From bank account #003 Badman took £60,000 which he paid into a bank account which he held on trust for the Johnson family trust. That account previously held £3,000. The beneficiaries of the Johnson family trust learned of the additional £60,000 which had been paid into their account and so they exercised their rights to terminate the trust. Badman wrote a letter to the beneficiaries asserting that the money had come "from a lawful source". The beneficiaries decided to spend £40,000 on refurbishing milking machinery at the family farm. The remaining £23,000 remains in the account.

Advise Trade Ltd.

Question 3

Does the remedial use of the constructive trust in relation to tracing claims depend upon there being some unconscionable act, or is equitable tracing based on a different principle? Discuss.

Question 4

Should the two forms of tracing be fused and subjected to a principle of unjust enrichment? Discuss.

Question 5

Albert is trustee of a family trust. The beneficiaries are Tommy and Tammy, Albert's nephew and niece. The trust fund is made up of a single bank account containing £100,000. It was the sole term of the trust that Albert should use the money only to invest in government bonds. Albert is a retired schoolteacher. One day he had lunch with two old friends, Badman and Crafty.

Badman is a stockbroker. He convinced Albert to pay £50,000 of the trust fund to him so that Badman could add that money to a company, which was wholly-owned by Badman, which would invest in a new venture in the former Soviet state of Turkmenistan which was to manufacture tractors. Badman paid £40,000 into the investment fund. The tractor factory failed within six months of its establishment because it had no buyers for its tractors.

Badman kept the remaining £10,000 as an "investment management fee". He paid the £10,000 into bank account number #100 in which he already had £5,000 of his own money. Badman then paid £7,500 to acquire a small sculpture which transpired to be an original Rodin piece worth £500,000. He used the remaining £7,500 to place a bet on England winning the World Cup in 1998 (they did not, so the bet was lost).

Crafty advised Albert to use the other half of the trust fund to buy shares from Crafty. The shares were in a private company which Crafty knew intended only to try to sell umbrellas to people in the Sahara desert, and so was doomed to bankruptcy. Crafty did not tell Albert this.

Advise Tommy and Tammy, now that Albert has died penniless.

Question 6

Louse was trustee of a family trust. The terms of the trust permitted him to invest the trust fund in the shares of "established companies which are quoted on the FTSE-100". Louse had become friends with Venal, a stockbroker, who was trying to find investors for a new company called Useless Cars Ltd (which would not be quoted on the Stock Exchange) which was to manufacture saloon cars.

Venal promised Louse one of company's cars worth £20,000 if Louse invested the whole of the trust fund in Useless Cars Ltd and also a cash payment of £10,000. Louse did invest the entire fund as Venal had suggested in January 2000.

The cars were faulty and their value fell to £7,000. The company went into insolvency in June 2000 and their shares were worthless. The trust fund therefore held a worthless investment.

Louse kept the car. On 1st February 2000, Louse paid the £10,000 into a bank account in which he already held £5,000 which he held on trust for his mother. On 2nd February Louse used £4,000 to buy Whizz plc shares - which have trebled in value. On 3rd February, Louse bought £2,000 to buy Dotcom plc shares which have doubled in value. On 4th February, Louse used the remaining £9,000 to invest in a Formula 3 racing car which promptly caught fire and is now worthless.

Advise the beneficiaries of the family trust.

TOPIC 12. TRUSTS OF HOMES (I): ENGLISH TRUST LAW APPROACHES

Aim: *in general terms this half of the course aims to consider the innovative thinking in relation to trusts of the home, estoppel, undue influence in relation to mortgages and unjust enrichment. It also seeks to consider the different norms of family law and of social justice in this context. This session aims to unpack the various threads in the basic English law.*

LECTURE MATERIALS

Trusts of homes – the core concepts

- The social context of trusts of homes
- Resulting trusts
- Common intention constructive trusts
- The unsatisfactory nature of the *Rosset* test
- The balance sheet approach
- The family assets approach

General Reading for this topic: ***Hudson*, chapter 15**

The area of trusts of land, specifically in relation to family homes, is particularly vexed. The following lectures will consider the manner in which Equity allocates rights in the home and will also consider the theoretical bases on which that allocation takes place. Any categorisation of the possible claims in this area will be controversial - the lay-out is therefore one possible way of categorising this subject.

A. THE POSITION UNDER ENGLISH LAW

Trusts of Land and Appointment of Trustees Act 1996
s.37 Matrimonial Property and Proceedings Act 1970

1. Express trust of land

Reading: ***Hudson*, section 15.2**
Goodman v. Gallant [1986] FLR 106

2. Contribution to purchase price - resulting trusts

Reading: ***Hudson*, section 15.3**
Dyer v Dyer (1788) 2 Cox Eq Cas 92
Pettit v. Pettit [1970] 1 AC 777
**Gissing v. Gissing* [1971] AC 886; [1970] 3 WLR 255
Tinsley v Milligan [1994] 1 AC 340
Cf: *Westdeutsche Landesbank v. Islington L.B.C.* [1996] AC 669
Curley v Parkes [2004] All ER (D) 344 (*resulting trust cannot be altered after purchase*)

3. Acquisition of equitable interest otherwise than by contribution to purchase price - constructive trusts

Reading: ***Hudson*, para 15.4.1**
Gissing v. Gissing, op cit.
**Cowcher v. Cowcher* [1972] 1 All ER 948-951, 954-5
Burns v. Burns [1984] Ch 317, [1984] 1 All ER 244, [1984] 2 WLR 582; M&B235
Grant v. Edwards [1986] Ch 639; H&M 516; M&B 240

4. Common intention constructive trust

Reading: ***Hudson*, section 15.4**
Mee, *The Proprietary Rights of Co-habitees* (Hart, 1999).

4.1 The core test …

***Lloyds Bank v. Rosset* [1990] 1 All ER 1111, [1990] 2 WLR 867
Burns v. Burns [1984] Ch 317, [1984] 1 All ER 244, [1984] 2 WLR 582
Ivin v. Blake (1994) 67 P&CR 263

4.1.1 the requirement of detriment

Grant v. Edwards [1986] Ch 639
Lloyds Bank v. Rosset [1990] 1 All ER 1111, [1990] 2 WLR 867
Chan Pu Chan v Leung Kam Ho [2003] 1 FLR 23 (*working in defendant's business acquires right in property*)

4.1.2 the meaning of "detriment"

Grant v. Edwards [1986] Ch 639
Coombes v. Smith [1986] 1 WLR 808

4.1.3 the meaning and nature of "common intention"

Gissing v. Gissing [1971] AC 886; [1970] 3 WLR 255
**Lloyds Bank v. Rosset* [1990] 1 All ER 1111, [1990] 2 WLR 867
Ungarian v Lesnoff [1990] Ch 206 (*where no intention that a person acquires an interest, there will not be a common intention*)
**McHardy v Warren* [1994] 2 FLR 338 (*transmission of intention to subsequent purchases*)
Drake v Whipp [1996] 1 FLR 826 (*contribution of one-fifth of purchase price may acquire one-half interest if that was deemed to be the common intention*)
Churchill v Roach [2004] 3 FCR 744 (*the courts will not make up an intention where none exists*)
Koulias v Makris [2005] All ER (D) 352 (*ditto*)
See below for Commonwealth criticism of this principle

4.1.4 "interest consensus" and "money consensus"

**Cowcher v. Cowcher* [1972] 1 All ER 948-951, 954-5
Midland Bank v. Cooke [1995] 4 All ER 562

4.2 Application of that test: what is the nature of the constructive trust now?

Huntingford v. Hobbs [1993] 1 FLR 936
Midland Bank v. Cooke [1995] 4 All ER 562

4.3 … and its remedial, as opposed to institutional, potential

*Hayton [1990] Conv. 370; [1993] LQR 485
Oakley *Constructive Trusts* (Sweet & Maxwell, 1997), 64-84
cf. Hudson, *Swaps, restitution and trusts* (1999), ch.12 - a place for common intention in commercial transactions?

5. Identifying an equitable interest: three alternative approaches.

5.1 The "balance sheet" approach

Reading: ***Hudson,*** **section 15.5**
Bernard v. Josephs [1982] Ch 391
***Springette v. Dafoe* (1992) HLR 552; [1992] 2 FLR 388
***Huntingford v. Hobbs* [1993] 1 FLR 936

5.2 The "family assets" approach
Reading: ***Hudson,*** **section 15.6**
**Hammond v. Mitchell* [1991] 1 WLR 1127 (*this case is well worth a read!*)
***Midland Bank v. Cooke* [1995] 4 All ER 562 (*undertake a survey of the entire course of dealing*)

5.3 The "unconscionability" approach
Reading: ***Hudson,*** **section 15.8**
**Jennings v Rice* [2002] EWCA Civ 159, [2003] 1 P&CR 100
Oxley v Hiscock [2004] 2 FLR 669, [2004] Fam Law 569
**Cox v Jones* [2004] 3 FCR 693, [2004] EWHC 1486 (*this case is well worth a read!*)
Cf. Australia

5.4 What can be included: deposits, discounts and washing-up
5.4.1 Long-term relationships
**Springette v. Dafoe* (1992) HLR 552; [1992] 2 FLR 388
**Midland Bank v. Cooke* [1995] 4 All ER 562

5.4.2 Wedding gifts
McHardy v. Warren [1994] 2 FLR 338
**Midland Bank v. Cooke* [1995] 4 All ER 562

5.4.3 Discounts on the purchase price
Springette v. Dafoe (1992) HLR 552; [1992] 2 FLR 388
Evans v Hayward [1995] 2 FLR 511 (*negotiating reduction in price does not acquire right in property*)
Cox v Jones [2004] 3 FCR 693 (*obtaining reduction in price can be taken into account*)

5.4.4 Conservatories and building work
**Huntingford v. Hobbs* [1993] 1 FLR 936;

5.5 Can these various approaches be reconciled?
Reading: ***Hudson,*** **section 15.10**
Thompson, 'Constructive trusts, estoppel and the family home', (2005) *Conv* …?
Gardner (2004) 120 LQR 541.
Oxley v Hiscock [2004] 2 FLR 669, [2004] Fam Law 569

Specific reading:-
Mee, *The Proprietary Rights of Co-habitees* (Hart, 1999).

SEMINAR MATERIALS

1. Is the attempt in *Oxley v Hiscock* to reconcile all of the decided English cases on trusts of homes a valid exercise?

2. Given the seeming strictness of the decision in *Rosset*, is it possible for the parties to change the nature of their respective rights after the acquisition of the property?

3. In 1990, Gerald and Daphne were a married couple who had decided to move away from London. Daphne's mother Thelma was growing old and so all three of them decided to live together in a bigger house in the country.

All three of them decided to buy a house in the Essex countryside for £120,000. The Essex house was bought with £100,000 provided by way of mortgage in the names of Gerald and Daphne. As a pensioner Thelma was entitled to a £20,000 relocation grant on giving up her council flat: this also went towards to acquisition of the Essex house.

From 1990, Thelma required daily medical attention at the Essex house. Gerald and Daphne both worked as teachers and both earned £1,000 per month. The mortgage cost £600 per month and Thelma's daily care cost £600 per month. It was decided after a family meeting that Gerald would pay for the mortgage and Daphne would pay for the medical costs.

In 1990, before completing the purchase of the Essex house, Gerald had promised Thelma that she could live there for the rest of her life. Meanwhile Thelma looked after all the housework, looked after her two grandchildren, and in 1995 used all her savings of £3,000 to repair the basement after a freak flood.

In 2000 Gerald and Daphne have realised that they can no longer cope with Thelma and so have decided that she must be relocated to a full-time old persons' nursing home for which Thelma will be required to pay.

Advise Thelma

4. George and Miriam bought a house in 2000 for £300,000 immediately after their marriage. The deposit on the house was paid for by means of a wedding gift of £30,000. The wedding gift had been made to the couple jointly by George's parents. The remaining £270,000 was provided by way of a mortgage with Profit Bank which was taken out in George's sole name.

The house was bought from Anthea, a childhood friend of Miriam. Miriam was able to negotiate a reduction on the purchase price of £20,000 because of her friendship with Miriam.

In 2001 Miriam paid for a refit of the bathroom which cost £15,000. Otherwise George worked full-time as an accountant, earning about £3,000 per month after tax; Miriam had a job as a part-time secretary in a local school, earning about £750 per month after tax. Both parties paid their wages into a joint current bank account. The mortgage interest repayments and all other household expenses were paid out of this account.

The couple's marriage was in difficulties in 2002. They separated for a month before they were reconciled. Miriam asked what stake she had in their home. George said that "this is as much your home as mine". Nothing further was said. The couple had twin children in 2003.

Now in 2005, the couple are unable to make the mortgage repayments. Profit Bank is seeking a sale of the house under the mortgage contract.

Advise George and Miriam.

TOPIC 13. TRUSTS OF HOMES (II): COMMONWEALTH AND REMEDIAL APPROACHES

Aim: *The Commonwealth jurisdictions have taken a different approach since the decision in Gissing. The common intention constructive trust approach in Rosset has not found favour generally. Each jurisdiction has developed its own approach.*

LECTURE MATERIALS

A. PROPRIETARY ESTOPPEL.

Reading: ***Hudson,*** **sections 13.3 and 15.7.**
See generally:
Cooke, *The Modern Law of Estoppel* (OUP)
Pawlowski, *The Doctrine of Proprietary Estoppel* (Sweet & Maxwell)
Wilken and Villiers *Waiver, Variation and Estoppel* (Wiley).

There is an extended and detailed discussion of the doctrine of equitable estoppel generally in ***Hudson***, Chapter 13 which goes into greater detail on the cases relating to this topic than the material in chapter 15 which considers many of those cases more briefly and only in the sense that they relate to trusts of homes.

1. Establishing the estoppel

1.1 The nature of the test: representation, reliance and detriment
*Re Basham [1987] 1 All ER 405, [1986] 1 WLR 1498
cf. *Coombes v. Smith* [1986] 1 WLR 808

1.2 The representation can be formulated over time, it need not be a single representation
Re Basham [1987] 1 All ER 405, [1986] 1 WLR 1498
**Gillett v. Holt* [2000] 2 All ER 289
**Jennings v Rice* [2002] EWCA Civ 159, [2003] 1 P&CR 100
**Lissimore v Downing* [2003] 2 FLR 308

1.3 Irrevocability of assurances
A-G Hong Kong v. Humphreys Estate (Queen's Gardens) Ltd [1987] AC 114, PC
**Gillett v. Holt* [2000] 2 All ER 289, CA
Thompson [1998] Conv. 210; Swadling [1998] RLR 220; cf. Dixon [1999] Conv. 46.

2. Identifying the appropriate remedy

2.1 A remedial approach - (i) "minimum equity necessary"
Crabb v Arun DC [1976] Ch 179
**Pascoe v. Turner* [1979] 2 All ER 945
Re Basham [1987] 1 All ER 405, [1986] 1 WLR 1498

2.2 A remedial approach - (ii) proprietary claim but personal remedy
**Baker v. Baker* [1993] 25 HLR 408
**Wayling v. Jones* (1995) 69 P&CR 170
Campbell v Griffin [2001] EWCA Civ 990, [2001] WTLR 981
**Jennings v Rice* [2002] EWCA Civ 159, [2003] 1 P&CR 100
(*Cobbe v Yeoman's Row Management Ltd* [2005] All ER (D) 406)

2.3 The avoidance of detriment …

Lim v. Ang [1992] 1 WLR 113
Walton Stores v. Maher (1988) 62 ALJR 110
Lloyds Bank v. Rosset, *supra*, *op cit.*

2.4 … or the enforcement of promises / representations …
**Pascoe v. Turner* [1979] 2 All ER 945

2.5 … or to avoid unconscionability?
Taylor Fashions Ltd v Liverpool Victoria Trustees Co Ltd [1982] QB 133, 151.
Jennings v Rice [2002] EWCA Civ 159, [2003] 1 P&CR 100

3. The nature of proprietary estoppel: fusion with constructive trust?
Hayton [1990] Conv. 370; [1993] LQR 485
Ferguson (1993) 109 LQR 114
Stokes v. Anderson [1991] 1 FLR 391; H&M 527
**Yaxley v. Gotts* [2000] 1 All E.R. 711 (c.i.ct. and p.e. 'almost indistinguishable'!)

B. THE COMMONWEALTH CASES

The Commonwealth jurisdictions have taken a different approach since the decision in *Gissing*. The common intention constructive trust approach in *Rosset* has not found favour generally. Each jurisdiction has developed its own approach.

Reading: ***Hudson,*** **section 15.9.**

1. Unjust enrichment - Canada

Pettkus v. Becker (1980) 117 DLR (3rd) 257
Sorochan v. Sorochan (1986) 29 DLR (4th) 1
Peter v. Beblow (1993) 101 DLR (4th) 621, 642-653

2. Unconscionability - Australia

Austin v. Keele (1987) 61 ALJR 605, 610 (PC)
Baumgartner v. Baumgartner [1988] Conv. 259, (1988) 62 ALJR 29, 164 CLR 137
Walton Stores v. Maher (1988) 62 AJLR 110; 164 CLR 387
Commonwealth of Australia v. Verwayen (1990) 64 ALJR 540, 546; 170 CLR 394, 411-412

3. Reasonable expectations and fairness - New Zealand

Gillies v. Keogh [1989] 2 NZLR 327
Phillips v. Phillips (1993) 3 NZLR 159, 167-171

SEMINAR MATERIALS

Suggestion on how to go about answering questions on trusts of homes:

The suggested outline for answering problems on this topic is to follow this structure:

1. apply the test in *Lloyds Bank v Rosset* literally and consider who wins and who loses;
2. apply the balance sheet / resulting trusts cases and see if the result is any different from 1;
3. apply the family assets cases and see if the result is any different from 1 or 2;
4. apply the unconscionability cases and see if the result is any different from 1, 2 or 3;
5. apply the doctrine of proprietary estoppel and see if the results are different from the above;

6. consider how any theoretical approaches would impact on the facts of the problem.

The suggested outline for essays is a matter for you. You could (i) create your own set of facts and through your essay reflect on how the different case law models would produce different results (perhaps by changing the facts of your own hypothetical example for emphasis) or (ii) consider some of the ideas set out in section (c) immediately below.

1. Why have the Commonwealth jurisdictions diverged from English law?

2. What drives each approach in each jurisdiction?

3. How would the problem questions in the previous seminars by addressed by other jurisdictions?

4. Consider the problem questions from the previous seminar in the light of the material in this seminar.

Topic 14. Trusts of homes (iii): Other perspectives on rights in the home

Aim: *to consider the weight of material covered in previous topics in the light of the norms of family law and the need to achieve social justice generally.*

Lecture Materials

Ideas about trusts of homes

There is a large literature on this topic. You could refer generally to Hudson (ed), *New Perspectives on Property Law Human Rights and the Home* (Cavendish, 2004) and in particular to the following essays:

- Alastair Hudson, "Equity, individualisation and social justice: towards a new law of the home", p.1-36
- Rebecca Probert, "Family law and property law: competing spheres in the regulation of the family home", p.37-52
- Anne Barlow, "Rights in the family home – time for a conceptual revolution", p.53-78
- Simone Wong, "Rethinking *Rosset* from a human rights perspective", p.79-98.

The footnotes to these essays contain an extensive bibliography of recent articles and books on this topic and are an excellent source of further reading. Choose the themes which interest you most.

a) Conflation or separation?

Reading: ***Hudson*, section 15.10**

b) Social justice and trusts of homes

Reading: ***Hudson*, section 17.5**

c) Human rights and trusts of homes

Reading: ***Hudson*, sections 17.4**

d) Family law and the law of the home

Reading: ***Hudson*, sections 17.4**

Proprietary estoppel

- Open-ended discretion
- Reversal of detriment or achievement of expectation?
- The nature of the remedy – a flexible form of justice?
- How many forms of estoppel – does this matter?

Human rights law

- The sources of human rights law
- The right to possessions
- The right to a family life
- The inter-action of equity and human rights: principles without principle?

Social justice

- Creating a model of social justice
- Rights to property
- Deserts founding entitlement to property
- Needs for property
- Contracting family law, property law, and welfare law

General reading:

Hudson, *Equity and Trusts*, 4th ed., (London: Cavendish, 2005) chapters 15 through 17.

Specific reading:-

O'Donovan, *Family Law Matters* (Pluto Press)
Douzinas, *The End of Human Rights* (Hart, 2000).
Ferguson (1993) 109 LQR 114
Hayton [1990] Conv. 370; [1993] LQR 485
Miller, *Social justice* (Oxford University Press)
Wong (1998) *Legal studies*

SEMINAR MATERIALS

1. 'Equity's treatment of the acquisition of rights in the home depends primarily on contradictory understandings of the law of trusts. The approaches that would be possible based on equitable estoppel and human rights law disclose radically different attitudes to this area of the law.' Discuss.

2. 'A philosophical understanding of social justice, when applied to the various ways in which law deals with the home, demonstrates that there are many radically different philosophies in operation in the decided cases.' Discuss.

3. Does proprietary estoppel create brand new proprietary rights, or does it merely confirm the existence of rights which existed previously? Indeed, does proprietary estoppel necessarily create a proprietary right at all, given the decision in *Baker*?

4. 'The English courts' approach to trusts of homes is merely the search for the "phantom of common intention". A better approach would be to identify the detriment suffered by the plaintiff and make awards on that basis alone.' Discuss

5. Hoe useful is a model of social justice to explain the various approaches to the legal treatment of rights in the family home?

6. How might human rights law develop the law in this area? Does it offer a standard around which other areas of law can coalesce?

7. Tom and Meg were an unmarried couple who had lived together since 1990 in a large detached house in Surbiton, held in their joint names. Tom and Meg had run an e-mail marriage-bureau business jointly since 1990. Meg was responsible for the creative side of the business, whereas Tom typically took charge of the financial and business related matters. All of the business profits were paid into a joint bank account with Profit Bank. The couple were well-known to Profit Bank as a result.

In 1998, Tom decided to leave Meg and move to Brazil. Therefore, Tom needed some money quickly. Tom told Meg that he had decided to enter into a business venture on his own, selling used cars. Meg was initially supportive of his plan. Tom arranged for a second mortgage over the Surbiton house for £50,000 with Profit Bank. Meg had been told the amount of the loan would only be £10,000.

The mortgagee insisted that Meg must sign the mortgage. Tom had told the mortgagee that Meg would be a co-partner in the used car business. The mortgagee nevertheless insisted that Meg must receive independent legal advice. Tom suggested that the mortgagee and Meg should all use Tom's childhood friend and solicitor, Flashman. The mortgagee agreed to this arrangement because they had used Flashman before.

Flashman knew that Tom was planning to leave Meg and to abscond with the money but did not tell Meg this. Flashman met Meg at the Surbiton house and advised her to sign the mortgage. Meg had developed great reservations about the used car venture. After Flashman left, Tom flew into a rage and threatened to leave her if she did not sign the agreement. Meg signed the agreement and a certificate stating that she had received independent advice.

Tom has now fled to Brazil with the money. The mortgagee is seeking to exercise its power to sell the house.

Advise Meg as to her rights against the mortgagee.

Topic 15. Equitable Remedies and the Nature of Equity

Aim: *the aim of this final section is to draw together the various themes in this area of equity and of the law: to try to place the idea of equity within the broader context of social theory, and so forth.*

Lecture Materials

A. Remedy (i): Undue influence

- The doctrine of notice as a central tenet of the old English equity
- The roots of undue influence in constructive fraud
- *Barclays Bank v O'Brien*
- *Royal Bank of Scotland v Etridge (No.2)*
- How proprietary rights can metamorphose into merely personal rights

1. Doctrine of notice

Reading: **Hudson, *Equity and Trusts*, section 29.1**
Hunt v Luck [1902] 1 Ch 428
Midland Bank Trust Co Ltd v Green [1981] 2 WLR 28
Henning v Bristol & West BS [1985] 1 WLR 778
Kingsnorth Finance v Tizard [1986] 2 All ER 54
Abbey National v Cann [1991] 1 AC 56

2. Undue influence and misrepresentation

Reading: **Hudson, *Equity and Trusts*, sections 29.2 - 29.4**

2.1 the scope of equity
National Westminster Bank v. Morgan [1985] AC 686
Bank of Credit and Commerce International SA v. Aboody [1992] 4 All ER 955
***Barclays Bank v. O'Brien* [1994] 1 AC 180
***CIBC Mortgages v. Pitt* [1994] 1 AC 200
***Royal Bank of Scotland v. Etridge* [2001] 3 WLR 1021 HL

2.2 the need for manifest disadvantage
**CIBC Mortgages v. Pitt* [1994] 1 AC 200
Mahoney v. Purnell [1996] 3 All ER 61 - *manifest disadvantage is obligatory*
Credit Lyonnais Bank Nederland NV v. Burch [1997] 1 All ER 144
**Barclays Bank v. Coleman* [2000] 1 All ER 385 - *claimant must show manifest disadvantage*

2.3 "reasonable steps" - the bank's duty to give, or to procure, advice
**Barclays Bank v. O'Brien* [1994] 1 AC 180
**Massey v. Midland Bank* [1995] 1 All E.R. 929
Midland Bank v. Serter [1995] 1 All E.R. 929
Bank of Boroda v. Reyerel [1995] 2 F.L.R. 376
**Banco Exterior Internacional v. Mann* [1995] 1 All ER 936

2.4 discharge of the bank's duty
Cheese v. Thomas [1994] 1 All ER 35, at 39 per Nicholls V-C
**Barclays Bank v. Coleman* [2000] 1 All ER 385 - *a certificate is enough*

National Westminster Bank v. Kostopoulos [2000] 1 F.L.R. 815 - *not sufficient for bank to leave it to husband to explain the transaction, unless the wife also received independent legal advice*

2.5 the liability of solicitors giving advice

**Halifax Mortgage Services Ltd. v. Stepsky* [1996] Ch. 1; [1995] 4 All ER 656
Banco Exterior International SA v. Thomas [1997] 1 WLR 221; [1997] 1 All ER 46
Barclays Bank v. Thomson [1997] 4 All E.R. 816
Dunbar Bank plc v. Nadeem and another [1998] 3 All E.R. 876
**Barclays Bank v. Coleman* [2000] 1 All ER 385 - *liability via legal executive*

2.6 remedy - setting the mortgage aside

**TSB Bank v. Camfield* [1995] 1 All ER 951
**Castle Phillips Finance v. Piddington* [1995] 70 P&CR 592
Allied Irish Bank v. Byrne [1995] 1 F.C.R. 430
cf: *Equity Home Loans v. Prestidge* [1992] 1 All ER 909

2.7 remedy - a discretionary element

**Midland Bank v. Greene* [1994] 2 FLR 827 - *not in toto where some benefit to P*
Dunbar Bank plc v. Nadeem [1997] 1 All ER 253 - *equitable relief "on terms"*

2.8 burden of proof

Barclays Bank v. Boulter (1999) The Times, 21 October, *"she who alleges must prove", reversing Court of Appeal*

Commentary: Lawson [1995] CLJ 280; Mee [1995] CLJ 536; Bigwood (1996) 16 OJLS 503; Proksch [1996] RLR 71; Chen-Wishart [1997] CLJ 60; Boyd & Hudson 'Setting Mortgages Aside' (1995/96) 6 KCLJ; Oakley *Constructive Trusts* (Sweet & Maxwell, 1997) 35-46; see generally Rose, ed., *Restitution and Banking Law* (Oxford: Mansfield Press, 1998).

3. Equitable relief in relation to mortgages

Quennell v. Maltby [1979] 1 All ER 568

B. Remedy (ii): Injunctions

- Permanent and interim injunctions
- Supreme Court Act 1981, s.37 – "*where just and convenient to do so*"
- Strong and weak discretion

1. Awarding damages in lieu of an injunction

Shelfer v City of London Electric Lighting Co [1895] 1 Ch 287
Jaggard v Sawyer [1995] 1 WLR 269, [1995] 2 All ER 189

2. Interim injunctions

American Cyanamid v Ethicon [1975] AC 396, [1975] 1 All ER 504
Cambridge Nutrition Ltd v British Broadcasting Association [1990] 3 All ER 523
Series 5 Software v Clarke [1996] 1 All ER 853

C. The relevance of the core principles of equity

- Traditionally …equity acts *in personam*: e.g. *Leahy v. Att-Gen NSW* - strict interpretation
- New developments …*Target Holdings* - the role of commerce / *Westdeutsche Landesbank* – conscience
- The development of "equitable wrongs"?
- What is "property"?
- Value judgement – "conscience"

D. The nature of property in trusts law

- *Hudson*, Chapter 31
- *Re Goldcorp*
- *Att-Gen for Hong Kong v Reid*
- Four senses of property rights
    - Rights in a thing
    - Rights against people
    - Transferable personal claims (quasi-property rights)
    - Control over property

E. The nature of restitution of unjust enrichment

- The three elements: an enrichment … which is unjust … is to be restored (i.e. restitution)
  'The proof that resulting trusts are restitutionary makes it unnecessary to ask whether they respond to unjust enrichment. If they reverse unjust enrichments, those enrichments are unjust.' (Birks, Introduction to the Law of Restitution (Oxford, 1989), 19, supra)
- Value judgement - "unjust"

F. Equity and social justice: a force for the humane response of the legal system

- *Hudson*, Chapter 32, esp section 32.2.
- How to think of the individual within law?
- Equity and human rights law: two codes of thought with similar goals?
- Equity only in commercial cases, what about housing law, etc.?
- From psychology to law: common law / equity – ego / id?
- Equity as a "world idea" (trust / waqf), or simply as a product of English history?
- Embracing chaos …

Victorian ordering of the subject:-
Snell's Equity
Broader reading:-
Aristotle, *Ethics* – in relation to "equity"
Douzinas, *The end of human rights* (Hart, 2000)
Giddens, "Risk and responsibility" [1999] 62 MLR 1

Seminar Materials

Discussion points

1. What is equity for?
2. Is equity a part of natural law or a part of positive law?