

The Abuse of the Trust (or: “Going Behind the Trust Form”)

The South African Experience with Some Comparative Perspectives

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I. Introduction

Sometime during 1994 a trust was created with a certain Mr. Badenhorst, a successful farmer near a small South African town, as one of its trustees. At the time he was happily married. The marriage between Mr. Badenhorst and his wife was out of community of property, meaning that each one of the parties to the marriage had an own separate estate (or “patrimony”). The

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Literature cited in *abbreviated form*: *Alexandra Braun*, Trusts in the Draft Common Frame of Reference, The Best Solution for Europe?: Cambridge L.J 70 (2011) 327–352; *Edwin Cameron/Marius J. de Waal/Basil Wunsh/Peter Solomon/Ellison Kahn*, Honoré’s South African Law of Trusts⁵ (2002); *Alastair Hudson*, Equity and Trusts⁶ (2010).

reason for the establishment of the trust, as he explained it to his wife, was to protect them against their creditors and to avoid inheritance tax. In the course of time, many of the assets acquired by Mr. Badenhorst in his private capacity were transferred to the trust.

Unfortunately, the marriage did not last. Divorce proceedings were commenced and eventually a court granted a divorce order. One of the questions at the divorce proceedings – and the only one relevant for this contribution – concerned the assets which could be taken into account for the purposes of a redistribution of assets between the parties under s. 7(3) of the Divorce Act 70 of 1979. Mr. Badenhorst’s wife argued that the trust assets should be included in this redistribution exercise. He strenuously opposed such a course of action.

This may appear to be a simple question, but its answer has implications for the integrity of the trust institution itself and for the law of trusts in general. In *Badenhorst v. Badenhorst*,¹ that I will discuss, together with a number of related cases, in greater detail below,² the Court gave an answer which meant that the trust in question was effectively ignored. Put differently, the Court “went behind the trust form” and did exactly what Mr. Badenhorst’s wife asked of it, namely take the trust assets into account for purposes of the redistribution of assets.

This phenomenon of a court being willing to “go behind the trust form” is relatively new in the context of South African trust law. It has been described in other ways, for instance that a court can “disregard the veneer of the trust”; or “disregard the trust”; or treat the trust as the “alter ego” of one or more of the trustees; or even “pierce the veil of the trust”. Occasionally, and in my view incorrectly, the trust in question is also referred to as a “sham”.³ But, regardless of the language used, it remains a radical action for a court in the sense that it runs counter to one of the fundamental principles of the law of trusts. This principle, to which I will return in greater detail,⁴ is that the trust estate (also referred to as the trust “patrimony” or trust “fund”) is distinct or separate from the private estate of the trustee.

In this contribution I will discuss the phenomenon, with South African trust law as my point of departure. My focus will primarily be the following two questions: First, when will a court be willing to “go behind the trust form” and ignore the trust for a particular purpose? And, secondly, what will be the consequences of such an action?

However, the issue goes further than South African law. It is safe to say that there is, at the very least, a growing interest in the development of what

¹ *Badenhorst v. Badenhorst* 2006 (2) SA 255 (SCA).

² See *infra* III.2.

³ See *infra* II.

⁴ See *infra* III.1.

one may perhaps call a “continental European trust law”.⁵ One can see this at the level of individual states,⁶ but also at the general European level, with the publication in 1999 of the Principles of European Trust Law,⁷ and in 2009 of Book X of the Draft Common Frame of Reference (the DCFR);⁸ the latter of which has introduced a general model for a civil law trust.⁹ South Africa has a developed trust law, with a trust institution the architecture of which is fully compatible with civilian principles. The South African experience with regard to the phenomenon described here may therefore offer useful lessons to a (developing) continental European trust law.

The English law trust always provides a rich source for comparison in the trust context.¹⁰ In this contribution, I will refer to English trust law in order to illustrate that the phenomenon at issue here should be distinguished from the so-called “sham” trust issue.¹¹ I will argue that the “sham” trust issue is one that plays itself out in quite a different context, and that it is important from both a theoretical and a practical perspective to keep the two issues apart. In order to illustrate the importance of the distinction between these two issues, it will, in fact, be necessary to deal with the “sham” issue first.

II. The “sham” trust issue

1. General: “simulation” or “sham” in South African law

There is a long line of South African cases in which the courts were confronted with the question whether the parties to an agreement had the intention to enter into that agreement in the form alleged by them, or

⁵ This says nothing new, but for some references see e.g. *Braun* 345; *Eric Dirix/Vincent Sagaert*, *Trusts in European Civil Law, On Building Bridges and Trojan Horses*, in: *Essays in Honour of CG van der Merwe* (2011) 275–292 (277); *Michele Graziadei/Ugo Mattei/Lionel Smith*, *Commercial Trusts in European Private Law, The Interest and Scope of the Inquiry*, in: *Commercial Trusts in European Private Law*, ed. by *Graziadei/Mattei/Smith* (2005) 3–10; *David Hayton*, *The Developing European Dimension of Trust Law: King’s College L.J* 10 (1999)48–70.

⁶ See previous note.

⁷ *Principles of European Trust Law*, ed. by *David J. Hayton/Sebastian C. J.J. Kortmann/Hendrik L. E. Verhagen* (1999).

⁸ *Principles, Definitions and Model Rules of European Private Law: Draft Common Frame of Reference (DCFR) – Outline edition*, ed. by *Christian von Bar/Eric Clive/Hans Schulte-Nölke* (2009).

⁹ Previous note. The development of a European trust law as such is not the focus of this contribution, but I will use a few examples from that context in order to illustrate the importance of fundamental trust law principles for the problem at issue here: see *infra* III. 1.

¹⁰ See in general *Marius J. de Waal*, *The Core Elements of the Trust: Aspects of the English, Scottish and South African Trusts Compared: S. Afr L.J* 117 (2000)548–571 (569–570).

¹¹ See *infra* II.

whether they used that particular agreement as a disguise for something quite different. I will not discuss these cases in any depth or, indeed, analyse the particular issue as such. My intention is rather to draw attention to the general “simulation” or “sham” issue, and to show that it constitutes an issue which is quite different from the one described above with reference to the *Badenhorst* case.¹²

As a general illustration, it may be helpful to use one of the latest South African cases in which this issue arose – not only because it is in many ways a typical case, but also because it contains an overview of some of the other leading authorities on the point. This is the case of *Commissioner for the South African Revenue Service v. NWK Ltd.*¹³ and it concerned a tax matter. The facts were quite complicated, but for present purposes it is not necessary to relate them in any great detail. NWK (the respondent, a public company) claimed deductions from income tax in respect of interest paid on a loan made to it by another company. These deductions were allowed. However, in 2003 the Commissioner for the South African Revenue Service (the appellant) issued new assessments which disallowed these deductions and imposed additional tax. NWK appealed to the Tax Court against the revised assessments and its appeal was upheld. The case under discussion is the Commissioner’s appeal to the Supreme Court of Appeal¹⁴ against this decision of the Tax Court.

On appeal, the Commissioner argued that the loan in question was “simulated”, in that it had to be viewed in the light of a series of agreements which were “devised to increase the ostensible amount lent, so that deductions of interest on a greater amount could be claimed”.¹⁵ In other words, the intention was to gain a tax advantage rather than really to borrow the sum of money in question.¹⁶ NWK, on the other hand, argued that there was an “honest intention” to execute the agreements “in accordance with their tenor” and that the claims for deductions were therefore valid.¹⁷

The Supreme Court of Appeal’s point of departure was that the “mere production of agreements does not prove that the parties genuinely intended them to have the effect they appear to have”.¹⁸ The question is rather whether the parties to an agreement actually intended that the agreement would have effect *inter partes* “according to its tenor” (or form); if not, effect must be

¹² See *supra* I.

¹³ *Commissioner for the South African Revenue Service v. NWK Ltd.* 2011 (2) SA 67 (SCA).

¹⁴ South Africa’s highest court in non-constitutional matters.

¹⁵ *Commissioner for the South African Revenue Service v. NWK Ltd.* (*supra* n. 13) para 3.

¹⁶ See also *Commissioner for the South African Revenue Service v. NWK Ltd.* (*supra* n. 13) para 38.

¹⁷ *Commissioner for the South African Revenue Service v. NWK Ltd.* (*supra* n. 13) para 3.

¹⁸ *Commissioner for the South African Revenue Service v. NWK Ltd.* (*supra* n. 13) para 40.

given to “what the transaction really is”.¹⁹ But how can this question be answered?

Here, the Court sought guidance from a number of leading cases on this issue that have been reported over the years. In these cases, the courts have invoked two principles which appear to be finely balanced, but not in conflict.²⁰ One is that there is nothing wrong in arranging one’s affairs so as to avoid some or other liability or to gain some or other advantage.²¹ The other is that a court “will not be deceived by the form of a transaction: it will rend aside the veil in which the transaction is wrapped and examine its true nature and substance”.²² One of the classic formulations of these principles in South African law is that of Innes J. A. in the old case of *Zandberg v. Van Zyl*²³ which, because it eloquently expresses some of the points I regard as important for this contribution, is worth quoting in full here:²⁴

“Now, as a general rule, the parties to a contract express themselves in language calculated without subterfuge or concealment to embody the agreement at which they have arrived. They intend the contract to be exactly what it purports; and the shape which it assumes is what they meant it should have. Not infrequently, however (either to secure some advantage which otherwise the law would not give, or to escape some disability which otherwise the law would impose), the parties to a transaction endeavour to conceal its real character. They call it by a name, or give it a shape, intended not to express but to disguise its true nature. And when a Court is asked to decide any rights under such an agreement, it can only do so by giving effect to what the transaction really is; not what in form it purports to be.”

According to the judge all of this can be summarised in the maxim *plus valet quod agitur quam quod simulate concipitur*:²⁵ The challenge is consequently to establish the “real intention” of the parties, which differs from the “simulated intention”.²⁶ In each case this is a question of fact, the correct answer to which cannot be based on any general rule.²⁷

¹⁹ *Erf 3183/1 Ladysmith (Pty.) Ltd. v. Commissioner for Inland Revenue* 1996 (3) SA 942 (A) (953A-F) to which the Court (supra n. 13) refers in para 40.

²⁰ See *Commissioner for the South African Revenue Service v. NWK Ltd.* (supra n. 13) para 42.

²¹ *Commissioner for the South African Revenue Service v. NWK Ltd.* (supra n. 13) para 42.

²² Wessels A. C. J in *Kilburn v. Estate Kilburn* 1931 AD 501 (507), as cited by Hefer J. A. in *Erf 3183/1 Ladysmith (Pty.) Ltd. v. Commissioner for Inland Revenue* (supra n. 19) 951C-D: see para 42.

²³ *Zandberg v. Van Zyl* 1910 AD 302.

²⁴ *Zandberg v. Van Zyl* (previous note) 309.

²⁵ “The real intention carries more weight than a fraudulent formulation (or pretence)”: Victor G. Hiemstra/Henri L. Gonin, *Trilingual Legal Dictionary*³ (1992).

²⁶ *Zandberg v. Van Zyl* (supra n. 23) 309.

²⁷ *Zandberg v. Van Zyl* (supra n. 23) 309.

However, this remains a very difficult challenge. In the *NWK* case the Court pointed to a certain divergence in case law regarding the application of the two principles mentioned above, especially in that the cases “do not consistently approach what is really meant by a party’s intention in concluding a contract – what purpose he or she seeks to achieve”.²⁸ This is probably why the Court was unwilling to accept that the test to identify a “simulation” should simply be whether the parties had the intention to give effect to the agreement in accordance with its terms. In the Court’s view, the test should go further and require “an examination of the commercial sense of the transaction: of its real substance and purpose”.²⁹ Therefore, the Court concluded, if the purpose of a contract is only to achieve an object which allows for the evasion of tax or of a peremptory law, it will be regarded as simulated.³⁰ Also, the mere fact that the parties do perform in accordance with the contract is not an indication that it is not a simulation – the “charade” of performance may only be meant to give “credence” to the simulation.³¹

In the context of the facts of the *NWK* case, the central question for the Court was therefore what the “real purpose” of the loan was – whether it had commercial substance or made business sense.³² In other words, did the loan have any purpose or commercial sense other than creating a tax advantage to *NWK*?³³ In answering this question the Court identified several “inexplicable aspects”³⁴ regarding the series of contracts between the parties.³⁵ It also analysed other contracts concluded between the parties pursuant to the loan contract;³⁶ the motive for any possible deception;³⁷ and the credibility of one of the key witnesses for *NWK*.³⁸ Based on all these factors, the Court’s conclusion was that there was indeed no “real and

²⁸ *Commissioner for the South African Revenue Service v. NWK Ltd.* (supra n. 13) para 45. In this regard the Court referred to diverging approaches followed in the following cases: *Commissioner of Customs and Excise v. Randles, Brothers & Hudson Ltd.* 1941 AD 369; *Vasco Dry Cleaners v. Twycross* 1979 (1) SA 603 (A); *Skjelbreds Rederi A/S v. Hartless (Pty.) Ltd.* 1982 (2) SA 710 (A); *Hippo Quarries (Tvl.) (Pty.) (Ltd.) v. Eardley* 1992 (1) SA 867 (A) and *Commissioner for Inland Revenue v. Conhage (Pty.) Ltd. (Formerly Tyxon [Pty.] Ltd.)* 1999 (4) SA 1149 (SCA).

²⁹ *Commissioner for the South African Revenue Service v. NWK Ltd.* (supra n. 13) para 55.

³⁰ *Commissioner for the South African Revenue Service v. NWK Ltd.* (supra n. 13) para 55.

³¹ *Commissioner for the South African Revenue Service v. NWK Ltd.* (supra n. 13) para 55.

³² *Commissioner for the South African Revenue Service v. NWK Ltd.* (supra n. 13) para 57.

³³ *Commissioner for the South African Revenue Service v. NWK Ltd.* (supra n. 13) para 58.

³⁴ *Commissioner for the South African Revenue Service v. NWK Ltd.* (supra n. 13) para 58.

³⁵ *Commissioner for the South African Revenue Service v. NWK Ltd.* (supra n. 13), see, especially, paras 59–72.

³⁶ *Commissioner for the South African Revenue Service v. NWK Ltd.* (supra n. 13) paras 73–78.

³⁷ *Commissioner for the South African Revenue Service v. NWK Ltd.* (supra n. 13) paras 79–80.

³⁸ *Commissioner for the South African Revenue Service v. NWK Ltd.* (supra n. 13) paras 81–83.

sensible commercial purpose” in the contract.³⁹ It was “dressed up” (in other words, simulated) as an obligation to pay interest in order to obtain the right to claim a tax deduction.⁴⁰ The Commissioner’s appeal was consequently successful.

2. What is a “sham” trust?

Against this background a more pertinent question now arises: what is a sham trust? Surprisingly little has been said on this particular question in South African law⁴¹ and, because of the specific focus of this contribution, it is not necessary to deal with it in any great detail. In the light of the general discussion of the simulation or sham issue above, it is in any event not too difficult to venture an answer. But first it is important to determine the correct context within which the question should be asked. In my view the question whether or not a trust is a sham has everything to do with the requirements for the creation of a valid trust. In South African law these requirements are now firmly settled and they are the following:⁴² (1) the founder (also referred to as the “settlor” [in English law] or “truster” [in Scots law and the DCFR]) must intend to create a trust; (2) the founder’s intention must be expressed in a mode appropriate to create an obligation (such as a valid contract or will); (3) the trust property must be defined with reasonable certainty; (4) the trust object (which can be either personal or impersonal) must be defined with reasonable certainty; and (5) the trust object must be lawful. If one or more of these requirements are not met, then no trust is established.

Particularly relevant for present purposes is the first requirement mentioned: the founder must have the *intention* to create a trust.⁴³ If this intention is lacking, or the real intention is to create something different, no trust comes into existence. It is exactly here where jurisprudence on the simulation or sham issue becomes relevant. In the language of *Zandberg*, one has to establish whether the founder intended the trust to be exactly what it

³⁹ *Commissioner for the South African Revenue Service v. NWK Ltd.* (supra n. 13) para 86.

⁴⁰ *Commissioner for the South African Revenue Service v. NWK Ltd.* (supra n. 13) para 87.

⁴¹ But see *Rowan Bell Stafford*, A Legal-Comparative Study of the Interpretation and Application of the Doctrines of the Sham and the Alter-Ego in the Context of South African Trust Law, *The Dangers of Translocating Company Law Principles into Trust Law* (2010) (LLM thesis, Rhodes University) where the issue is investigated from a somewhat different angle.

⁴² See *Cameron/De Waal/Wunsh/Solomon/Kahn* 117.

⁴³ In South African law an *inter vivos* trust is created by contract and the intention to create a trust must consequently be shared by the founder and the prospective trustee: see *Cameron/De Waal/Wunsh/Solomon/Kahn* 119. However, unless the context requires otherwise, the emphasis here will only be on the intention of the founder.

purports to be; whether the shape which it assumes is what he meant it should have.⁴⁴ Or has the founder given it the name or shape of a trust, not with the intention to express its true nature, but to disguise it?⁴⁵ In the South African context it is possible, for example, that the founder did not intend to create a trust, but rather a *modus, a fideicommissum*, an agency or a partnership.⁴⁶ It is also possible that there could have been no intention on the part of the founder to create any particular legal institution, but only to use the name or the shape of the trust institution to gain some or other advantage. In especially the latter instance, it may properly be said that the “trust” in question is a sham – in the sense that no trust has come into existence. Then a court will – again in the language of *Zandberg* – give effect to what the “transaction” really is, not what in form it purports to be.⁴⁷ In order to do this, the challenge will be to determine the “real intention” of the founder, as opposed to the “simulated intention”.⁴⁸ As indicated, this will always be a question of fact, and the application of general rules will be of little assistance.⁴⁹ Of course, the new test formulated in the *NWK* case might be of assistance here – an examination, namely, of “the commercial sense of the transaction: of its real substance and purpose”.⁵⁰ However, it should be kept in mind that *NWK* concerned a tax matter and that the test might be especially useful in that context.

This brings us back to the *Badenhorst* case with which the discussion commenced.⁵¹ It will be recalled that there the essential question was whether the Court could “go behind the trust form” in that instance (or “ignore the trust”) in order to determine the scope of Mr. Badenhorst’s assets for the purposes of a redistribution order in divorce proceedings. But before one can speak of something like “going behind the trust form” or “ignoring the trust” for a particular purpose, it is, to my mind, clear that one must be satisfied that a valid trust has been created in the first place. In the light of this, the trust in *Badenhorst* was not a sham trust at all. If it were, the question whether the Court could “go behind” the trust or “ignore” it would obviously have been inappropriate and unnecessary. On the contrary, a perusal of that case shows that the Court’s premise throughout was that a valid trust did exist.⁵² Moreover, nowhere in the case did the Court use the

⁴⁴ See supra II. 1. the quotation from *Zandberg v. Van Zyl* (supra n. 23) 309.

⁴⁵ *Zandberg v. Van Zyl* (supra n. 23) 309.

⁴⁶ For a discussion of the differences between these legal institutions and a trust, see *Cameron/De Waal/Wunsh/Solomon/Kahn* 32 ff.

⁴⁷ See supra II. 1. the quotation from *Zandberg v. Van Zyl* (supra n. 23) 309.

⁴⁸ See supra II. 1.

⁴⁹ Previous note.

⁵⁰ *Commissioner for the South African Revenue Service v. NWK Ltd.* (supra n. 13) para 55.

⁵¹ See supra I.

⁵² See e.g. the Court’s references to the creation of the trust in paras 1 and 4(d) as well as the references throughout the case to the “trust assets” or “assets of the trust”.

term “sham” in its discussion of the trust. In her evidence in the earlier case (from which this one was an appeal) Ms. Badenhorst did suggest that the trust was a “sham”.⁵³ However, the Court’s ultimate finding in that case effectively entailed a rejection of this suggestion.⁵⁴ Indeed, as I will illustrate in my discussion of this and other related cases,⁵⁵ sham terminology was – rightly in my view – never used in this particular context. However, the same cannot be said about all academic commentary on the case. For example, in an article titled “Sham Trusts”, Joffe analyses *Badenhorst* and concludes that the Court found that the trust in question “was a sham”.⁵⁶ I suggest that this amounts to an unfortunate distortion of the real issue in that case. Its classification as a sham issue is not only theoretically unsound, but could also lead to the posing of the wrong questions, and the consequent proposal of the wrong solutions.⁵⁷

3. “Sham” trusts in English law

Compared with South African law, English law possesses a much richer judicial and academic literature on the sham issue – also in the context of trust law. An extensive analysis of this literature is neither possible nor necessary here. However, in it one does find support for the approach to the sham trust issue proposed in the South African context above.

First, it appears that English and South African law share an understanding of the basic sham idea. For English law, Hudson defines a sham as “a scheme of action or a pattern of documentation which seeks to create the impression that the state of affairs is one thing when in fact it is something else”.⁵⁸ For this definition, he draws on one of the leading English cases on the issue, namely *Snook v. London and West Riding Investments Ltd.*⁵⁹ In *Snook*, Diplock L. J. held that a sham constitutes “acts done or documents executed by the parties to the ‘sham’ which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create”.⁶⁰ Conaglen points out that this statement has indeed acquired “canonical” status, having been cited and adopted as an authoritative statement of the sham doctrine in common law jurisdictions

⁵³ See *Badenhorst v. Badenhorst* (supra n. 1) para 23.

⁵⁴ See *Badenhorst v. Badenhorst* (supra n. 1) e.g. para 28.

⁵⁵ See infra III.

⁵⁶ *Harry Joffe, ‘Sham’ Trusts: De Rebus* (January/February 2007) 25–26 (26).

⁵⁷ See infra IV.

⁵⁸ *Hudson* 956. See also *Philip H. Pettit, Equity and the Law of Trusts*¹¹ (2009) 239–240.

⁵⁹ *Snook v. London and West Riding Investments Ltd.* [1967] 2 QB 786.

⁶⁰ *Snook v. London and West Riding Investments Ltd.* (previous note) 802.

around the world.⁶¹ The analogy with the South African position as set out above⁶² is also obvious.

Secondly, in English books on the law of trusts, the issue of sham trusts is consistently dealt with in the context of the requirements for the creation of a valid express⁶³ trust.⁶⁴ English law requires three forms of certainty for this act of creation: (1) certainty of intention; (2) certainty of subject matter (that is, regarding the subject matter of the trust fund); and (3) certainty of object (that is, regarding who the beneficiaries are).⁶⁵ As is the case in South African law,⁶⁶ the first requirement is the decisive one for the issue of sham trusts.⁶⁷ If the founder's intention⁶⁸ is not to create a trust, but something else, no trust will come into existence.⁶⁹ Alternatively, the founder may wish to create the impression that a trust has been created in order to use it as a device to achieve a particular purpose – such as to deceive potential creditors. The latter scenario would be one in which the trust may properly be referred to as just a sham or a “pretence”⁷⁰ and, once again, no trust will come into existence.⁷¹ Here, according to Moffat, there will be no certainty of intention, but rather a “sham intention”.⁷²

⁶¹ *Matthew Conaglen*, *Sham Trusts*: Cambridge L.J. 67 (2008) 176–207 (177).

⁶² See supra II. 1.

⁶³ The term “express” trust is used here to distinguish trusts created by an act of the parties from trusts arising by operation of law, such as constructive and resulting trusts. The latter types of trust fall outside the scope of this discussion.

⁶⁴ See e.g. *Hudson* 77 ff.; *John Mowbray/Lynton Tucker/Nicholas le Poidevin/Edwin Simpson/James Brightwell*, *Lewin on Trusts*¹⁸ (2008) 83 ff.; *Graham Moffat (with Gerry Bean/Rebecca Probert)*, *Trusts Law: Text and Materials*⁵ (2009) 160 ff.; *Graham J. Virgo/Edward H. Burn*, *Maudsley and Burn's Trusts and Trustees: Cases and Materials*⁷ (2008) 80 ff.

⁶⁵ *Hudson* 77. See also *Mowbray/Tucker/Le Poidevin/Simpson/Brightwell* 83 ff.; *Moffat* 121 ff.; *Virgo/Burn* 75 ff. (all previous note).

⁶⁶ See supra II. 2.

⁶⁷ However, the argument has been advanced that the sham doctrine should not be treated as merely a part of trust law's principle regarding certainty of intention: see *Conaglen* (supra n. 61) 184–185.

⁶⁸ Note again (see also supra n. 43) that here I make reference only to the intention of the founder. But it has been argued convincingly in the context of the sham trust issue in English law that the sham intention must be shared by all the parties involved – in other words, that there must be a “commonality of intention”: see *Conaglen* (supra n. 61) 187–192.

⁶⁹ This happened in the case of *Clough Mill v. Martin* [1984] 3 All ER 982 where the court concluded that the intention was not to create a trust, but rather a “charge over property”: see *Hudson* 88–89.

⁷⁰ See *Mowbray/Tucker/Le Poidevin/Simpson/Brightwell* 92 and *Virgo/Burn* 80 (both supra n. 64) for the use of this term. The latter authors (at 80) also speak of the importance to determine whether there was an intention to create a “genuine trust”.

⁷¹ This happened in the case of *Midland Bank v. Wyatt* [1995] 1 F.L.R. 697 where the court concluded that the trust set up by Mr. Wyatt was a sham with the sole purpose of attempting to put property out of the reach of his creditors: see *Hudson* 90 and 488–489.

⁷² *Moffat* (supra n. 64) 164.

III. The issue of “going behind the trust form”

1. Separation between trust assets and a trustee’s private assets

A comparative analysis of the civilian or mixed legal systems in which the trust has been received (and this is also true of South Africa, a prime example of a mixed legal system) clearly shows that the acceptance of the concept of two separate estates (or patrimonies) is absolutely vital.⁷³ This means that there is a separation between the assets which the trustee owns in his official capacity as trustee (the “trust assets”) and the assets which the trustee owns in his private or personal capacity (the “private assets”). Put simply, there are two estates: a trust estate and a private estate. Apart from anything else, this concept of two estates explains why civilian or mixed legal systems can accommodate the trust without also having to accept the dichotomy in common law systems of “legal ownership” (of the trustee) and “beneficial (or equitable) ownership” of the trust beneficiary.⁷⁴

It is important to note that the concept of separate estates is also central to the structure of the trust as envisaged in the DCFR.⁷⁵ There it is formulated as follows:⁷⁶

“A trust takes effect in accordance with the rules in Chapter 10 ... with the effect that the trust fund is to be regarded as a patrimony distinct from the personal patrimony of the trustee and any other patrimonies vested in or managed by the trustee.”

This concept is also confirmed explicitly in the Principles of European Trust Law⁷⁷ and the Hague Convention on the Law Applicable to Trusts and on their Recognition (1985),⁷⁸ and it features strongly in many of the trust-like arrangements in continental Europe.⁷⁹

⁷³ For a general overview of (and further references to) the trust in civilian and mixed jurisdictions, see *De Waal* (supra n. 10) 548–571; *id.*, In Search of a Model for the Introduction of the Trust into a Civilian Context: Stellenbosch L. Rev. 12 (2001) 63–85; *George L. Gretton*, Trusts without Equity: Int. Comp. L.Q. 49 (2000) 599–620; *Kenneth G. C. Reid*, National Report for Scotland, in: Principles of European Trust Law (supra n. 7) 67–84; *id.*, Patrimony not Equity, The Trust in Scotland: European Review of Private Law (Eur. Rev. Priv. L.) 8 (2000) 427–437; *Hendrik L. E. Verhagen*, Trusts in the Civil Law: Making Use of the Experience of “Mixed” Jurisdictions: *ibid.* 477–498.

⁷⁴ See in general and for further references *Braun* 345–346 and also the authorities quoted in the previous note.

⁷⁵ However, McFarlane adds the qualification that Book X does not “take as its starting point the idea that the trust *depends* on a trustee’s simultaneous holding of separate patrimonies” (my emphasis): see *Ben McFarlane*, An English Perspective, Two Cheers for Book X: Edinburgh L. Rev. 15 (2011) 471–474 (472). See also *Braun* 341 where she elaborates on this aspect.

⁷⁶ Art. X.-1:202(1).

⁷⁷ Art. 1(1).

⁷⁸ Art. 2 lit. a.

⁷⁹ See e.g. the examples from Belgian law provided by *Dirix/Sagaert* (supra n. 5) 279–282.

In the civilian trust model, the trust beneficiary does not have a form of ownership (“beneficial [or equitable] ownership”) as does his common law counterpart – at most he has a personal right against the trustee.⁸⁰ The concept of the separation of estates is therefore important, above all, for the protection of the trust beneficiary. This is also recognised and confirmed in the DCFR:⁸¹

“In particular ... the personal creditors of the trustee may not have recourse to the trust fund, whether by execution or by means of insolvency proceedings; the trust fund is not subject to rules allocating property rights on the basis of matrimonial or family relationships; ...”

The implication is quite clear: trust property cannot be “the object of rights of a creditor of the trustee or of his successors and cannot be subject to rules allocating property rights on the basis of matrimonial or family relationships”.⁸² In other words, the DCFR makes provision for the “ring-fencing” of trust assets.⁸³ The true function of the concept of separate estates (or a “segregated fund”) – in distinction with common law systems’ concept of a split ownership – is very well explained by Hayton:⁸⁴

“However, there is no need for a modern trust law to perpetuate the historical distinction between the legal ownership of trustees and the equitable ownership of beneficiaries. The economic value vested in beneficiaries does not require them to have equitable proprietary interests in the trust property, as evident, for example, in the case of Scots, Liechtenstein, Indian, South African, Japanese and Sri Lankan trusts. The crucial core of the trust concept is that the value of the beneficiaries’ interests survives the insolvency, death or divorce of the trustee-owner-manager of the trust property considered as a segregated fund available only for the beneficiaries ...”

These authors also explain (at 290–291) the significance of the principle in the context of the French *fiducie*, introduced in 2007. Regarding the latter, see also *Jan Szemjonneck*, *Die fiducie im französischen Code civil*: Zeitschrift für Europäisches Privatrecht (ZEUP) 18 (2010) 562–587 (576–577). Regarding Italian law, see *Aldo Berlinguer*, *The Italian Road to Trusts*: Eur. Rev. Priv. L. 15 (2007) 533–553 (who at 538 states that “the segregation of the property and rights in the assets of the trustee is contrary to the general principle of the liability of the debtor” in Art. 2740 of the Italian Civil Code); *Alexandra Braun*, *An Italian Perspective*: Edinburgh L. Rev. 15 (2011) 475–479 (pointing out at 478 that Italian courts have held that the segregation of trust assets in the context of the *trust interno* is indeed not in conflict with the unitary concept of ownership in Art. 2740); and *Maurizio Lupoi*, *Trusts, A Comparative Study* (2000) 377–384. Writing with specific reference to Dutch law, also Van Erp has expressed the concern that, if Book X were to be followed on this issue, “the doctrine of unity of patrimony would be abandoned”: see *Sjef van Erp*, *A Dutch Perspective*: Edinburgh L. Rev. 15 (2011) 479–482 (477–478).

⁸⁰ See in general the authorities referred to supra n. 73.

⁸¹ Book X Art. 1:202(2). See also Art. 1 (3) of the Principles of European Trust Law.

⁸² *Dirix/Sagaert* (supra n. 5) 287. See also *Braun* 333.

⁸³ *Dirix/Sagaert* (supra n. 5) 287. See also *Braun* 333.

⁸⁴ *Hayton* (supra n. 5) 51 (and also at 57, 65 and 68).

The concept of two estates (or patrimonies) is therefore not only important from a dogmatic or theoretical perspective, but also from a practical one. However, it is exactly in the practical context where a danger lurks. This is that the founder of a trust can also be a trustee in that same trust and, especially, that the trustee can also be a beneficiary. In developed trust law systems this is so trite a statement of the law that no authority needs to be cited, but it is instructive to note that it is also specifically acknowledged in both the DCFR⁸⁵ and the Hague Convention.⁸⁶ This notion of a trustee of a trust also being a beneficiary of that trust – in combination with the possibility that the particular trustee may also be the founder – also provides an explanation for why things went awry in some of the South African cases discussed in the next section. Note, however, that the trustee also being the founder and/or a beneficiary is not a prerequisite in this scenario. In *Badenhorst* – to name but one example – the trustee (Mr. Badenhorst) was neither the founder nor a beneficiary of the trust. As I will illustrate,⁸⁷ the conduct of the trustee in the administration of the trust lies at the heart of the matter.

2. The trust in practice: the possibility of breaching the separation

As explained above,⁸⁸ the issue which had to be decided in *Badenhorst*⁸⁹ was whether, when making a redistribution order in terms of the South African Divorce Act, the assets of an *inter vivos* discretionary trust created during the marriage of the parties could be taken into account.⁹⁰ As indicated, the Court decided that this could indeed be done. Why did it reach this conclusion?

As its point of departure, the Court confirmed the basic concept of a separation between the trust estate (or trust assets) and the trustee's private estate (or private assets).⁹¹ However, the Court qualified this by stating that “the mere fact” of this separation did not “per se” mean that trust assets cannot be taken into account for the purposes of the redistribution order.⁹² But before it can be included, there has to be evidence that the party in question “controlled the trust and but for the trust would have acquired and

⁸⁵ See Book X Art. 1:203(5). See also *Braun* 332.

⁸⁶ See Art. 2 which states that “the fact that the trustee may himself have rights as a beneficiary, [is] not necessarily inconsistent with the existence of a trust”.

⁸⁷ See *infra* III. 3.

⁸⁸ See *supra* I.

⁸⁹ *Badenhorst v. Badenhorst* (*supra* n. 1).

⁹⁰ *Badenhorst v. Badenhorst* (*supra* n. 1) para 1.

⁹¹ See *Badenhorst v. Badenhorst* (*supra* n. 1) para 9 and *supra* III. 1.

⁹² *Badenhorst v. Badenhorst* (*supra* n. 1) para 9.

owned the [trust] assets in his own name”.⁹³ This control must be “de facto” and not necessarily “de iure”, as determined by taking into consideration both the terms of the particular trust deed and evidence of how the practical affairs of the trust were conducted during the marriage.⁹⁴

An analysis of both of these dimensions left the court with no doubt that Mr. Badenhorst did in fact control the trust assets. In terms of the trust deed, he was one of only two trustees (the other one was his brother); the trustees could determine the date of the vesting of rights in the beneficiaries; he could discharge his co-trustee and appoint someone else in his place; he and his co-trustee had an unfettered discretion to do with trust assets and income as they saw fit; and he could be compensated for his duties as trustee, thereby ensuring an income stream for himself (should he wish to make use of it).⁹⁵ Regarding the running of the practical affairs of the trust (or the administration of the trust), it transpired that Mr. Badenhorst seldom consulted or sought the approval of his co-trustee; he was in “full control” of the trust; and he paid “scant regard” to the difference between trust assets and his own assets (of which the Court gave several practical examples).⁹⁶ On this point the Court therefore concluded that, “but for the trust, ownership in all the assets would have vested in the respondent”.⁹⁷ It was thus a “classic instance” of a case where the trustee had full control of the trust assets and in fact used the trust “as a vehicle for his business activities”.⁹⁸ This conclusion provided the basis on which the Court could order that the trust assets could be “added to” Mr. Badenhorst’s private assets for the purposes of the redistribution order.⁹⁹

Badenhorst was decided in the context of matrimonial property law. However, very much the same pattern has also played itself out also in other contexts – notably in insolvency and more general commercial ones. A typical example of an insolvency case is that of *Nedbank Ltd. v. Thorpe*.¹⁰⁰ This case concerned an application for an order provisionally sequestering the estate of Mr. Thorpe (the respondent). The bank (the applicant) alleged that Mr. Thorpe had established various family trusts (of which he was both a trustee and a beneficiary), which he effectively used to “insulate his wealth from creditors and thereby to frustrate the efforts of his creditors to recover

⁹³ *Badenhorst v. Badenhorst* (supra n. 1) para 9.

⁹⁴ *Badenhorst v. Badenhorst* (supra n. 1) para 9.

⁹⁵ *Badenhorst v. Badenhorst* (supra n. 1) para 10.

⁹⁶ *Badenhorst v. Badenhorst* (supra n. 1) para 11.

⁹⁷ *Badenhorst v. Badenhorst* (supra n. 1) para 11.

⁹⁸ *Badenhorst v. Badenhorst* (supra n. 1) para 10.

⁹⁹ *Badenhorst v. Badenhorst* (supra n. 1) para 13. For other cases decided in the context of matrimonial property law see e.g. *Jordaan v. Jordaan* 2001 (3) SA 288 (C); *Brunette v. Brunette* 2009 (5) SA 81 (SECLD).

¹⁰⁰ *Nedbank Ltd. v. Thorpe* [2008] JOL 22675 (N).

debts owed to them”.¹⁰¹ The bank accordingly submitted that, if his estate were sequestrated, it would become possible to investigate his business affairs and to locate trust assets that in reality belonged to him in his private capacity.¹⁰² Based on an analysis of the facts of the case, the Court concluded that there was indeed a “strong suspicion” that Mr. Thorpe was simply conducting his personal business through the trust.¹⁰³ It consequently granted the provisional sequestration order. In the follow-up case, where the granting of a final sequestration order was considered, the issue of the true status of the trust and its assets was once again central.¹⁰⁴ Here the Court conducted a more thorough investigation into the trust and its affairs, and it emphasised the following aspects regarding Mr. Thorpe’s relationship with the trust:¹⁰⁵ the trust deed provided that he could not be removed as trustee;¹⁰⁶ it was “apparent” that he controlled the trust and access to the funds held by the trust;¹⁰⁷ in a tax return his income was declared as “trustee remuneration”;¹⁰⁸ and the trust income allowed him to enjoy “an affluent lifestyle”.¹⁰⁹ It was therefore probable that “the true and complete control of the trusts” vested in Mr. Thorpe.¹¹⁰ Moreover, there was enough evidence that he utilised the trusts to receive income generated by his various activities and to “insulate his wealth and assets” from his creditors.¹¹¹ The Court thus clearly foresaw the possibility of going behind the trusts, with the result that trusts assets could eventually be used to satisfy Mr. Thorpe’s private creditors.¹¹² It consequently granted the final sequestration order.

¹⁰¹ *Nedbank Ltd. v. Thorpe* (previous note) para 4.

¹⁰² *Nedbank Ltd. v. Thorpe* (supra n. 100) para 5.

¹⁰³ *Nedbank Ltd. v. Thorpe* (supra n. 100) para 49.

¹⁰⁴ *Nedbank Ltd. v. Thorpe* [2009] ZAKZPHC 44 (unreported, accessible at <<http://www.saflii.org/za/cases/ZAKZPHC/2009/44.html>>).

¹⁰⁵ Note the focus, as in *Badenhorst*, on both the terms of the trust deed and the practical running of the affairs of the trust.

¹⁰⁶ *Nedbank Ltd. v. Thorpe* (supra n. 104) para 17.

¹⁰⁷ *Nedbank Ltd. v. Thorpe* (supra n. 104) para 18.

¹⁰⁸ *Nedbank Ltd. v. Thorpe* (supra n. 104) para 23.

¹⁰⁹ *Nedbank Ltd. v. Thorpe* (supra n. 104) para 24.

¹¹⁰ *Nedbank Ltd. v. Thorpe* (supra n. 104) para 27.

¹¹¹ *Nedbank Ltd. v. Thorpe* (supra n. 104) para 27.

¹¹² *Nedbank Ltd. v. Thorpe* (supra n. 104) para 28. Such an order was in fact granted in the more recent case of *First Rand Limited Trading as First National Bank v. Britz* [2011] ZAGPPHC 119 (unreported, accessible at <<http://www.saflii.org/za/cases/ZAGPPHC/2011/119.html>>). Here, the one trustee was the founder of the trusts in question and both he and his co-trustee were also beneficiaries of the trusts. In terms of the trust deeds they also had wide powers, e.g. to remove and appoint trustees and to deal with trust assets in their sole discretion. The Court also found that, in practice, these trustees possessed, utilised and derived the full benefit from the trust assets “on day-to-day basis” (see para 24). The Court thus came to the conclusion that the trusts were the “alter egos” of the trustees and that the trusts were not “actually separate” from them (see para 26).

In the last category of cases which I want to refer to briefly, the respective courts did consider going behind the trusts in question. However, on the facts of the cases they eventually decided against such a step. In these cases the focus rather fell on the way the trustees conducted the affairs of the trusts, with a particular emphasis on their non-compliance with the provisions of the trust deeds and their non-fulfilment of their fiduciary duties as trustees. The relevant cases are *Land and Agricultural Bank of South Africa v. Parker*¹¹³ (undoubtedly the leading case regarding the topic of this contribution) and *Van der Merwe NO and Others v. Hydraberg Hydraulics CC*.¹¹⁴ The facts of both cases are somewhat complicated, but it is not necessary to give a detailed exposition here. Suffice it to say that, in essence, both cases concerned the validity of legal acts performed by the trustees of the respective trusts. In *Parker* (apart from loan agreements purporting to bind the trust) it was a petition for leave to appeal against an order sequestering the trust, and in *Van der Merwe* a contract for the sale of land. In both cases it was held that these acts were invalid because the trustees had acted in contravention of basic trust law principles (especially that trustees must act jointly) as well as central provisions of the respective trust deeds. This failure of the trustees takes on special significance in light of the fact that, in both cases, the trustees in question were also trust beneficiaries. In both cases the Courts were highly critical of the conduct of the trustees and considered going behind the trusts as a possible option. However, in neither of the cases did this actually happen: in *Parker* because a less drastic solution was available, and in *Van der Merwe* because the Court felt itself restrained by legislation pertaining to the sale of land. But this did not at all soften the distaste with which the conduct of the trustees in both cases was regarded. In *Van der Merwe*, for example, Binns-Ward J. expressed it in the following terms:¹¹⁵

“The facts of the current matter afford a classic example of an abuse of the trust form flowing directly from the conduct by Clarke and Bosman [two of the three trustees] in respect of the ownership of the fixed property, with no distinction between their responsibilities as trustees and their expectations as beneficiaries. They treat the property as their own, and invoke the existence of the trust only when it suits them.”

This statement accurately encapsulates much of what has gone wrong in all the cases mentioned above: the breach of the separation between trust assets and private assets; no distinction being made between duties as trustee and expectations as beneficiary; and, in general, the “abuse” of the trust institution. This idea of the “abuse” of the trust is an important one which I will explore in greater detail in the next section.

¹¹³ *Land and Agricultural Bank of South Africa v. Parker* 2005 (2) SA 77 (SCA).

¹¹⁴ *Van der Merwe NO and Others v. Hydraberg Hydraulics CC* 2010 (5) SA 555 (WCC).

¹¹⁵ *Van der Merwe NO and Others v. Hydraberg Hydraulics CC* (previous note) para 39.

3. The explanation: the “abuse” of the trust

After having identified cases in which the courts have shown their willingness to go behind the trust, the next challenge is to explain the theoretical basis which could justify such a course of action. It has been argued that the sham trust concept¹¹⁶ does not provide such an explanation, and in my view, the cases discussed in the previous section confirm this. In all of them the courts’ premise was that the trusts in question were valid trusts. Nowhere was the spectre of a sham trust raised, in the sense that no valid trust came into existence.

The search for a theoretical explanation should, in my view, start at the very essence of trust theory itself – the so-called “trust idea”. In the leading South African case of *Parker*,¹¹⁷ Cameron J.A. (as he then was) formulated this basic idea in the following terms:¹¹⁸

“The core idea of the trust is the separation of ownership (or control) from enjoyment. Though a trustee can also be a beneficiary, the central notion is that the person entrusted with control exercises it on behalf of and in the interests of another.”

And again:¹¹⁹

“The essential notion of trust law ... is that enjoyment and control should be functionally separate.”

However, in a “newer type of trust”¹²⁰ – especially certain business and family trusts, such as the ones encountered in the previous section – things are different. Here, the functional separation between control and enjoyment is entirely lacking,¹²¹ with the result that the core idea of the trust is “debased”.¹²² The trust form is employed not to separate beneficial interest from control, “but to permit everything to remain ‘as before’, though now on terms that privilege those who enjoy benefit as before while simultaneously continuing to exercise control”.¹²³

According to Cameron J.A. in *Parker*, it is evident that this “rupture of the control/enjoyment divide invites abuses”.¹²⁴ In my view this concept of the “abuse” of the trust is central to the theoretical explanation of why a

¹¹⁶ See supra II.

¹¹⁷ *Land and Agricultural Bank of South Africa v. Parker* (supra n. 113) and see supra III. 2.

¹¹⁸ *Land and Agricultural Bank of South Africa v. Parker* (supra n. 113) para 19.

¹¹⁹ *Land and Agricultural Bank of South Africa v. Parker* (supra n. 113) para 22.

¹²⁰ *Land and Agricultural Bank of South Africa v. Parker* (supra n. 113) para 26, with reference to *Nieuwoudt v. Vrystaat Mielies (Edms.) Bpk.* 2004 (3) SA 486 (SCA) para 17.

¹²¹ *Land and Agricultural Bank of South Africa v. Parker* (supra n. 113) para 25.

¹²² *Land and Agricultural Bank of South Africa v. Parker* (supra n. 113) para 26.

¹²³ *Land and Agricultural Bank of South Africa v. Parker* (supra n. 113) para 26.

¹²⁴ *Land and Agricultural Bank of South Africa v. Parker* (supra n. 113) para 29.

court could under certain circumstances – while still acknowledging the existence of the trust – go behind a trust and use the trust assets for purposes such as a redistribution order or the satisfaction of the trustee’s private creditors. In *Parker* it was stated explicitly that a court would “in appropriate cases” ensure that the trust form is not abused.¹²⁵ It also set out a number of methods, appropriate to each case, which could be employed in this regard.¹²⁶ The important one for present purposes is the suggestion that it may, in a suitable case, be necessary to extend well-established principles of trust law by holding that a trustee’s conduct invites the inference that the trust form was a “mere cover” for the conduct of business “as before”.¹²⁷ Under such circumstances, a court can consequently hold that the trust form “is a veneer that in justice should be pierced in the interests of creditors”.¹²⁸ In *Van der Merwe*¹²⁹ the Court likewise indicated a clear link between the possibility of going behind the trust and the abuse of the trust form.¹³⁰ The facts of that case, the Court said, established a “classic example of an abuse of the trust form” flowing directly from the conduct of the trustees in question.¹³¹

Although it is already very useful to know that the “abuse” of a trust could invite such drastic action from a court, it still remains too vague to be of much practical assistance. The next challenge would be to explain the concept of “abuse” in this situation, and also to provide some concrete guidelines which could be employed to test a trustee’s conduct in this regard. As the correct theoretical context cannot be the requirements for the creation of a valid trust,¹³² the explanation must lie elsewhere. The case analysis in the previous section, in my view, points strongly towards what may be called the “principles of trust administration”. In South African law, these principles have been formulated as follows:¹³³ (1) the trustee is bound to exercise an independent discretion; (2) the trustee must give effect to the trust deed (or instrument), properly interpreted; and (3) the trustee must, in the performance of duties and the exercise of powers, act with care, diligence and skill. Instead of referring to these as “principles”, one may also call them the core “duties” of a trustee (as I will do in what follows).

¹²⁵ *Land and Agricultural Bank of South Africa v. Parker* (supra n. 113) para 37.

¹²⁶ *Land and Agricultural Bank of South Africa v. Parker* (supra n. 113) paras 37 1–37.3.

¹²⁷ *Land and Agricultural Bank of South Africa v. Parker* (supra n. 113) para 37.3.

¹²⁸ *Land and Agricultural Bank of South Africa v. Parker* (supra n. 113) para 37.3.

¹²⁹ *Van der Merwe NO and Others v. Hydraberg Hydraulics CC* (supra n. 114) and see supra III. 2.

¹³⁰ *Van der Merwe NO and Others v. Hydraberg Hydraulics CC* (supra n. 114) para 38. See also *First Rand Limited Trading as First National Bank v. Britz* (supra n. 112) para 61.

¹³¹ *Van der Merwe NO and Others v. Hydraberg Hydraulics CC* (supra n. 114) para 39.

¹³² See supra II. 2.

¹³³ See *Cameron/De Waal/Wunsh/Solomon/Kahn* 262.

My submission is that the analysis in the previous section illustrates that cases where the courts have considered, or in fact decided, to go behind the trust are indeed cases where the trustees have failed in one or more of these duties. Regarding the duty of independence, the practical administration of the trusts or the trusts deeds themselves in cases such as *Badenhorst* and *Thorpe* show how this independence can be compromised in at least one or more of the following ways:¹³⁴ (1) a trustee with the right to dismiss co-trustees; (2) a trustee having the right to appoint new trustees in the place of those dismissed; (3) a trustee who cannot be removed at all; or (4) a trustee being subservient to a dominant co-trustee. Cases such as *Parker* and *Van der Merwe*, on the other hand, show clear non-compliance with the duties to give effect to the trust deed and to act with care, diligence and skill. In fact, in *Parker*, the Court went as far as to call the conduct of the trustees in this regard a “breach of trust”.¹³⁵

IV. The importance of the distinction between the “sham” and “abuse” issues

It has been argued that sham situations on the one hand, and abuse situations on the other, are approached from different theoretical angles. In the case of a sham, the question is whether a valid trust has been created at all.¹³⁶ Here, the emphasis falls on the requirements for the creation of a valid trust; specifically that the founder must have the intention to create a trust. In the case of an abuse situation, the premise is that there is a valid trust, but that there may exist a justification for going behind the trust, and ignoring the trust for a particular purpose.¹³⁷

However, the distinction between the two situations is not only important for theoretical clarity. It also has practical implications. The most important one – and the one to which I will briefly refer here – is that it is decisive for the application (or destination) of the trust assets. This, in turn, has implications for both the trust beneficiaries and third parties (such as a trustee’s spouse or private creditors).

In South African law, the effect of a lack of intention to create a trust will depend on the circumstances of each case. For example, if the intention was to benefit the recipient, but not to create a trust, the supposed trust will be

¹³⁴ Note, however, that this lack of independence can manifest itself also in numerous other guises. Examples include a founder retaining control over trustees or trust assets or the issuing of a so-called “letter of wishes” by a founder.

¹³⁵ *Land and Agricultural Bank of South Africa v. Parker* (supra n. 113) para 14.

¹³⁶ See supra II. 2.

¹³⁷ See supra III.

disregarded and the recipient will take free from any burden.¹³⁸ If the intention was to create something other than a trust (such as agency, a partnership or a *fideicommissum*), the transaction will be interpreted in accordance with the intention of the parties.¹³⁹ But for present purposes, the case of a simulation or a sham in the true sense of the word is the important one. In such an instance, no effect will be given to the transaction.¹⁴⁰ One important implication of this in the trust context will be that the “founder” will remain owner of the “trust assets”. Consequently, neither the “trustee” nor the “beneficiaries” will acquire any rights with regard to these assets. And, of course, the same is true for the “trustee’s” spouse or private creditors.

In English law, the effect of a trust being identified as a sham has been worked out more elaborately than in South African law. So, for example, are sham trusts often discussed in the context of the resulting trust,¹⁴¹ which South African law does not recognise. However, it is interesting to note that, broadly speaking, the effect of a sham trust would be the same in the two systems. In English trust law language, Hudson describes this effect as being that “no equitable interest will be deemed to have been created in that property on the basis that no trust ever came into existence”.¹⁴² Mowbray and others put it more directly:¹⁴³

“The effect of a trust being held to be ineffective as a sham is that third parties can treat the trust property as still belonging to the settlor or the settlor’s estate.”

In other words, also in English law neither the “trustee” nor the “beneficiaries” will acquire any rights with regard to these assets.

However, matters are quite different in the abuse situation. Because here the premise is that a valid trust does exist, both the trustees and the beneficiaries will acquire rights with regard to the trust assets. This opens the door for the possibility that a court may go behind the trust and order the application of the trust assets for a particular purpose, or may order an alternative course of action. What are the possibilities for a court? The

¹³⁸ *Cameron/De Waal/Wunsh/Solomon/Kahn* 137 and the cases cited there.

¹³⁹ *Cameron/De Waal/Wunsh/Solomon/Kahn* 137. See also *Khabola NO v. Ralitabo NO* [2011] ZAFSHC 62 (unreported, accessible at <<http://www.saflii.org/za/cases/ZAFSHC/2011/62.html>>).

¹⁴⁰ This is trite law, for which no authority needs to be cited, but the sham cases discussed supra II. 1 all support this approach. E.g. in *Hippo Quarries (Tvl.) (Pty.) (Ltd.) v. Eardley* 1992 (1) SA 867 (A) 877C-E the Court said the following with reference to a simulated cession: “Conversely, if their intention to cede is not genuine because the real purpose of the parties is something other than cession, their ostensible transaction will likewise be ineffectual.”

¹⁴¹ See e.g. *Hudson* 488 ff.

¹⁴² *Hudson* 490.

¹⁴³ *Mowbray/Tucker/Le Poidevin/Simpson/Brightwell* (supra n. 64) 95. See also *Conaglen* (supra n. 61) 203; *Moffat* (supra n. 64) 245.

answer obviously depends on the circumstances of each particular case, but by way of summary, and with reference to the analysis of the cases above,¹⁴⁴ the following are definite possibilities: (1) in the insolvency context, a court can order that trust assets should be made available for the satisfaction of a trustee's private creditors; (2) in the matrimonial property law context, a court can order that trust assets should be counted as a trustee's private assets for the purposes of a redistribution order at a divorce (thus making the trust assets available for the trustee's spouse); (3) a court can hold a "delinquent" trustee personally liable for the performance of an obligation undertaken on behalf of the trust;¹⁴⁵ or (4) a court can order that the trust be performed "as if the obligation had been properly incurred by the trustees acting in the capacity that they purported to act".¹⁴⁶

Any course of action which a court may choose will necessarily entail a careful weighing up of the interests of, on the one hand, the trust beneficiaries and, on the other hand, third parties (such as the trustee's spouse or private creditors). This will often be a difficult exercise, which may require some or other compromise between the interests of these two groups. But it tends to confirm that the flexible approach followed by the South African courts – with the aim of reaching an "equitable" or a "just" outcome in each particular case¹⁴⁷ – has much to commend it.

V. Concluding remarks

In this contribution, I have drawn attention to a relatively new development in the South African law of trusts, namely that a court may, under certain circumstances, go behind a trust (or ignore the trust) in order to apply the trust assets for purposes such as the satisfaction of the trustee's private creditors, or for redistribution in matrimonial property disputes. With reference to English trust law, I have attempted to indicate that this particular issue should be distinguished from that of the sham trust issue. This distinction is important not only for theoretical clarity, but also because it has practical implications for the application (or destination) of trust assets – which, in turn, may affect both trust beneficiaries and third parties.

In the light of the growing interest in the development of a continental European trust law, the South African experience in this context may be of value. This is so because the South African trust is a typical example of what one may call a "civilian" trust. In such a trust, the concept of a separation between trust assets and a trustee's private assets – or the existence of a

¹⁴⁴ See *supra* III. 2.

¹⁴⁵ *Van der Merwe NO and Others v. Hydraberg Hydraulics CC* (*supra* n. 114) para 41.

¹⁴⁶ *Van der Merwe NO and Others v. Hydraberg Hydraulics CC* (*supra* n. 114) para 41.

¹⁴⁷ See *infra* V.

segregated fund – is absolutely vital. This concept is also acknowledged in the European context in, for example, the Principles of European Trust Law, the DCFR, and in trusts and trust-like institutions in individual jurisdictions.

One of the implications (perhaps the most important one) of the separation between trust and private assets is that trust assets should not be available for the satisfaction of a trustee's private creditors, or for redistribution in matrimonial property disputes. Again, this is acknowledged in, for example, the Principles of European Trust Law and the DCFR. The fact that there is now a growing body of cases in South African trust law where this separation has been breached can therefore be of interest to European trust lawyers. There are, in particular, two important questions in this regard. First, under what circumstances can such a breach be justified? And, secondly, what may be the result of such a breach? In this contribution, I have suggested answers to both of these questions as far as South African law is concerned. These answers are typical of the pragmatic nature of the development of South African trust law.¹⁴⁸ South African law does not possess the sophisticated equitable remedies available to English and other common law jurisdictions. However, the solutions suggested by the South African courts in this context are nevertheless characterised by their flexibility, and have been typified as advancing "equity"¹⁴⁹ – not in the technical English sense, but certainly in the sense that they can accomplish results which may be regarded as "just".¹⁵⁰ Therefore, it is hopefully not too presumptuous to think that these solutions may be helpful in the development of this area of a Continental European trust law.

Reinhard Zimmermann – in whose honour this special edition of the journal has been published – has always been interested in the mixed legal systems. This is especially so regarding South Africa, a country with which he has such close personal links. What he finds particularly fascinating about these legal systems is the coming together of two of the world's great legal traditions, namely the civil law and the common law. And it has been remarked that the development of a proper continental European trust law could be the "crowning glory" of his own quest to bring these two traditions closer to each other.¹⁵¹ He should find it heartening that South African trust

¹⁴⁸ See e.g. the following remark by Joubert J. A. in *Braun v. Blann and Botha NNO* 1984 (2) SA 850 (A) 859F: "Our Courts have evolved and are still in the process of evolving our own law of trusts by adapting the trust idea to the principles of our own law."

¹⁴⁹ See e.g. *Van der Merwe NO and Others v. Hydraberg Hydraulics CC* (supra n. 114) para 21; *First Rand Limited Trading as First National Bank v. Britz* (supra n. 112) para 69.

¹⁵⁰ See *Land and Agricultural Bank of South Africa v. Parker* (supra n. 113) para 37.3 where Cameron J. A. mentioned the possibility that the "vener" of a trust should sometimes "in justice" be "pierced" in the interests of creditors.

¹⁵¹ See *Marius J. de Waal, A European Law of Trusts?*, in: *European Private Law Beyond*

law – both regarding its broader structure and in the minutiae of the treatment of particular trust problems (such as the one addressed in this contribution) – may play a role in this development.

the Common Frame of Reference, *Essays in Honour of Reinhard Zimmermann* (2008) 166–179 (179).