SETTLOR CONTROL AND TRUSTEE LIABILITY: AN ANALYSIS OF ENGLISH AND OFFSHORE TRUST LAW WITH INDICATORS FOR THE DEVELOPMENT OF SOUTH AFRICAN TRUST LAW

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DECLARATION

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OPSOMMING

Die trust, ‘n regsverskynsel vanuit die Engelse reg wat vandag deel is van talle ander regstelsels, is bekend as ‘n effektiewe instrument vir belasting- en boedelbeplanningsdoeleindes. Transnasionale bewegings ter bevordering van belastingdeursigtigheid en -nakoming het gedurende die laaste dekade of twee druk geplaas op die gebruik van trusts, veral die gebruik van sogenaamde “offshore” trusts. Daarbenewens, as gevolg van ekonomiese, finansiële en sosio-ekonomiese veranderinge oor die afgelope 50 jaar, het die wyse waarop en redes waarvoor trusts gebruik word ook verander. Dit kom voor asof die fokus verskuif het van voorsiening vir en beskerming van begunstigdes na ‘n belastingdoeltreffende voertuig om die oprigter se beleggings te hou.

Teen hierdie agtergrond ondersoek die proefskrif hoe die Suid Afrikaanse trustreg met twee spesifieke kwessies omgaan: die toenemende behoefte van oprigters aan beheer oor trustbates, asook die moontlikheid dat trustees aanspreeklikheid vir trustbreuk kan uitsluit. Die vraag is of so ‘n verhouding nogsteeds as ‘n trust geklassifiseer kan word. Die posisie in die Suid Afrikaanse reg word vergelyk met die posisie in Engeland en Jersey deur middel van ‘n studie van, onder andere, wetgewing en regspraak.

Die proefskrif begin met ‘n ontleding van die geskiedenis en huidige stand van die trustreg in die drie relevante jurisdiksies en beklemtoon ‘n aantal kernwaardes wat in al drie jurisdiksies teenwoordig is. Die volgende hoofstuk ondersoek die verpligtinge van trustees in die drie jurisdiksies, insluitende die vraag of, en indien wel, tot watter mate, aanspreeklikheid vir trustbreuk in die trustakte uitgesluit kan word. Verskille tussen die drie jurisdiksies word uitgelig. Vervolgens word die verskynsel van oormatige beheer deur die oprigter ondersoek, asook die omstandighede waarin dit kan lei tot ongeldigheid van die trust, of tot ‘n uitspraak dat die normale gevolge van die trust geïgnoreer moet word (bekend in Engels as “going behind the trust”).

Die proefskrif kom tot die gevolgtrekking dat, in sekere omstandighede, buitensporige beheer deur ‘n oprigter (veral in kombinasie met ‘n oprigter wat ook ‘n begunstigde is) en ‘n gebrek aan toerekenbaarheid van die trustee kan lei tot ‘n besluit dat ‘n trust ongeldig is of dat die gevolge van ‘n geldige trust geïgnoreer moet word. Alhoewel howe in die algemeen onwillig is om geldige trusts te ignoreer, word dit nou aanvaar dat billikheid en regverdigheid so ‘n stap kan vereis. Dit is duidelik dat trustee-onafhanklikheid so ‘n besluit kan verhoed, en die proefskrif kom tot die gevolgtrekking dat trustee onafhanklikheid ‘n gebied is waar die Suid Afrikaanse trustreg voordeel sal trek uit verdere ontwikkeling.

ABSTRACT

The trust, a creature of English law that has found its way into many other legal systems, is well known as a useful succession and tax planning tool for wealthy individuals. In recent years, globalised moves towards increased tax transparency and compliance have put pressure on the use of trusts, particularly on so-called "offshore trusts". In addition, due to economic, financial and socio-economic changes over the last 50 years, the ways in which and reasons why trusts are used have also changed. The focus has, in some cases at least, shifted from providing for and protecting beneficiaries to providing a tax efficient vehicle for holding the settlor's investments.

Against this background, this dissertation examines how South African trust law deals with two main issues: the increased demand for settlor control over trust assets, as well as the possibility for trustees to exclude liability for breach of trust. The question arises whether, in such circumstances, a proper trust remains. The position under South African law is compared to that under English law and the law of the Channel Island of Jersey, by way of a study of legal sources including legislation and case law.

The dissertation starts with an analysis of the history and state of trust law in the three relevant jurisdictions and highlights a number of core values that are present in all three jurisdictions. It then continues to examine the duties and obligations of trustees under the law of these jurisdictions, including the possibility to exclude liability for breach of trust in the trust deed. Differences between the three jurisdictions are highlighted. The next chapter investigates the phenomenon of excessive settlor control and the circumstances in which this can lead to either invalidity of the trust or to a court "going behind the trust", thereby ignoring the normal consequences of the trust, and applying the trust assets in favour of someone other than the beneficiaries.

The dissertation concludes that, in certain circumstances, excessive settlor control (particularly where powers and entitlements are combined) and a lack of trustee accountability can result in either invalidity or a court going behind the trust. Courts appear reluctant to ignore validly constituted trusts, but it is now accepted that circumstances may exist where justice and fairness would require such a step. The virtue of trustee independence emerges as an important counter to the argument of settlor control, and the dissertation proposes that this is an area where South African trust law would benefit from further development.

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CHAPTER 1

INTRODUCTION

1 Introduction to the research question

This dissertation analyses the development, through legislation and case law, of English, Jersey and South African trust law, with a particular focus on the phenomena of (i) excessive settlor control and (ii) limitation or exclusion of trustee liability for breach of trust. The aim of this comparative study is to determine, firstly, whether and to what extent the trust concept can withstand these developments and, secondly, to what extent South African trust law can benefit from developments and experiences in the other jurisdictions.

The following elements will be examined briefly in this introductory chapter:

(a) contextualising the research question;
(b) the jurisdictions used in the comparative study and the reasons for choosing those jurisdictions;
(c) the two principal focal points of the dissertation;
(d) a brief summary of the issues to be examined in the chapters that follow; and
(e) the research methodology.

2 Contextualising the research question

This dissertation has a strong focus on comparing 'offshore' trust law with that of South Africa and, therefore, it may be helpful at the outset to provide some context as to the background and use of offshore trusts.[1] This will make a comparison of trusts in onshore and offshore jurisdictions more useful.

[1] With regard to the terminology used, the following should be noted: The word "settlor" will be used rather than "founder" or "truster"; the trustee will be referred to in the male gender, unless it is a female or corporate trustee, in which case it will be clear from the context; the document containing the terms of the trust will be referred to as the "trust deed"; the male gender will be used for references to natural persons unless it is clear from the context that a female is concerned; and although references are made to the law of England, it is, in fact, the law of England and Wales.

The trust concept itself will be analysed in detail in later chapters, but in brief a trust can be said to refer to the legal relationship created – *inter vivos* or on death – by a person, the settlor, when assets have been placed under the control of a trustee for the benefit of a beneficiary or for a specified purpose.[2] This is similar to what is described in South African law as a trust in the strict or narrow sense.[3]

Lawyers in common law jurisdictions assert that the trust has its origins in English law. This underplays the fact that there is a trust in non-common law countries, such as Scotland, that owe little as regards their origin to English law.[4] Whatever the case, the concept of trust has made its way, in some shape or form, into the legal systems of numerous other countries. This will be examined in more detail in chapter 2.

2 1 Uses of trusts

Trusts are used all over the world for a wide variety of purposes. Common examples include charitable trusts, employee benefit trusts and, of course, the focus of this study, private or family trusts, set up by individuals for the benefit of beneficiaries who may include themselves and their family members. Such trusts can be testamentary or can be created during the lifetime of the individual. This dissertation focuses on private *inter vivos* trusts set up expressly by way of a trust deed.

In the South African context, so-called "business" or "trading" trusts are used frequently. Business trusts refer to trusts that are used to own a business carried on for profit, including the owning and letting of property, and can, in that sense, be distinguished from trusts set up to hold and preserve or grow passive investments.[5] Many such trusts are, however, still private trusts set up by individuals for the benefit of themselves and their families and, therefore, form part of the study. Similarly, in the offshore context, trusts are often used to hold operating businesses. Many of the issues under discussion in this dissertation arise from the use of family trusts for business purposes (including abuse and liability issues), and will be analysed in detail in the appropriate chapters.

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[2] Hague Convention of 1 July 1985 on the Law Applicable to Trusts and on their Recognition s 2.
[3] Cameron *et al Honoré's South African Law of Trusts* 4.
[4] Cameron *et al Honoré's South African Law of Trusts* 24; see ch 2 para 2 3. For Scottish law, see Paisley and De Waal in *Mixed Legal Systems in Comparative Perspective: Property and Obligations in Scotland and South Africa* 819-848.
[5] Wunsh (1986) 103 *SALJ* 561.

Providing for descendants and holding business assets can also be achieved by other means. However, the trust is particularly attractive for the multitude of other benefits it offers, explaining the widespread use of the trust.

Very often, the use of a trust affords the settlor and beneficiaries substantial tax benefits. Many jurisdictions have in recent decades introduced anti-avoidance legislation to counter this, and it should be borne in mind that the tax benefits of a trust resident for tax purposes in England or South Africa have always been less than those of offshore trusts. This is especially true of discretionary trusts, where the trustee has discretion as to which beneficiaries to benefit, at what time, and to what extent. Provided that it is set up and administered correctly, generally speaking, neither the settlor nor the beneficiaries will be liable to tax on the assets or income of the trust (unless distributed to them). Furthermore, on the death of the settlor, those assets generally do not form part of the settlor's estate for estate tax purposes.

Another reason for using a trust is the protection of assets against a variety of threats, including government action, divorce, creditors, or other litigation. This use of a trust is legal in some jurisdictions only if the trust was set up prior to any notice of claims or, in other jurisdictions, if the motivation in setting up the trust was not one involving a desire to defeat pre-existing claims. Provided that it was properly set up, the segregation of assets from the settlor's personal assets means that the trust assets are no longer his own and therefore, in principle, they are protected from claims made against him personally.

Succession planning is one of the most common reasons for setting up a trust. Giving assets away to a trustee to hold on trust for the settlor's descendants prevents younger family members from having access to substantial wealth at a young age, which may diminish their motivation to work hard and earn their own living. It also means that those assets do not pass through the estate of the deceased, thereby easing the administrative burden on the executors. Trusts are also a useful way to provide for incapacitated family members who will never be able to look after their own financial affairs. The reason for the last aspect is that the beneficiary generally requires no active capacity to benefit from a trust.

A further benefit of using a trust is that it affords privacy and confidentiality. Given that the assets contributed to a trust are not registered in the name of the settlor or beneficiaries, and do not attract probate proceedings on the death of the settlor, using a trust offers a degree of secrecy that can offer protection against kidnapping, expropriation of assets or simply unwanted attention.

Finally, a trust provides a way of consolidating assets under one umbrella. This can be particularly helpful for a settlor with a wide variety of assets in different countries and even more so after his death, especially where family members were not aware of the extent of a settlor's wealth.

However, as a result of, *inter alia*, the developments explained below, many of the advantages of a trust related to tax and confidentiality have been curtailed over the last two decades.

2 2 Offshore trusts

2 2 1 Background to the use of offshore trusts

Although trusts form part of the local law of numerous jurisdictions, residents of these countries often do not (or not only) create a trust in their country of residence, but may decide to create an offshore trust. So may settlors from civil law jurisdictions where the trust does not form part of local law. What is meant by an "offshore trust" and why is it so popular?

The term "offshore" can be defined as juridical spaces characterised by a relative lack of regulation and taxation.[6] Such jurisdictions are often referred to as "tax havens". The Organisation for Economic Co-operation and Development (OECD) lists the following criteria to identify a tax haven: (i) no or minimal taxation; (ii) a lack of transparency; (iii) a lack of provision of information; and (iv) lack of substance in the relevant jurisdiction.[7] The conventional view is that the rise of tax havens and other offshore centres can be explained

[6] Palan *The Offshore World: Sovereign Markets, Virtual Places and Nomad Millionaires* 9. Although regulation is now on the increase, as explained later.
[7] Hudson *Equity and Trusts* 67.

with reference to the significant increase in state regulation and taxation in the 1960s and 1970s.[8]

Many of the traditional offshore centres such as Jersey, Guernsey, the Cayman Islands and Bermuda started to attract offshore banking and trust business during the 1960s. The combination of having a trustworthy legal system based on English common law and a tax neutral position gave these jurisdictions the opportunity to capitalise on the growing development and liberalisation of international finance in the post-war world.[9]

For individuals residing in high tax jurisdictions, it offered a way of protecting their assets in a trust whilst at the same time saving, or completely avoiding, tax on those assets. At the time these developments took place, many of these high tax countries had fairly relaxed tax rules relating to non-resident trusts. That meant that even if tax mitigation, deferral or avoidance was not the main reason for creating a trust in an offshore jurisdiction, it was an added benefit and in many cases entirely legal.[10]

Of course there are, as mentioned before, many other, non-tax, reasons for using trusts. Offshore trusts proved to be particularly suitable for international business deals as well as for families where different family members live in different countries, and with assets in various locations. Offshore jurisdictions also came to play an important role in complex, multi-jurisdictional structuring, providing a jurisdiction, perceived to be "neutral", to hold all the elements of a structure together.[11]

In addition, gifting assets to an offshore trust guaranteed the settlor confidentiality with regard to the ownership of such assets. Before the turn of the millennium, confidentiality, often simply referred to as secrecy, was a generally acceptable reason for transferring assets into an offshore structure.

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[8] Palan *The Offshore World: Sovereign Markets, Virtual Places and Nomad Millionaires* 5-6. Although this may not be the only explanation, it is not the focus of this dissertation and the question will therefore not be examined further.

[9] Anonymous "The Cayman Islands – A Premiere Offshore Banking Center" (accessed 27-01-2015).

[10] A distinction should be made between the law governing the trust and the jurisdiction where the trustee is resident. The governing law determines the laws applicable to the terms of the trust. The residence of the trustee may determine, amongst other things, the tax regime applicable to the trust. There should be some link between the trust structure and the chosen governing law, but the governing law does not have to be the same as the residence of the trustee. One could, for example, set up a trust governed by English law, with a trustee based in Jersey. Such a trust would be regarded as an "offshore" trust.

[11] Downie "Client Confidentiality Under Attack" *STEP Journal Roundtable* (accessed 04-04-2015).

2 2 2 Current attitudes towards offshore trusts

However, times have changed. Even before the watershed events of 11 September 2001, the OECD was laying the foundations for an increase in the exchange of tax-related information and a levelling of the playing field in international taxation, for example by blacklisting so-called tax havens, thereby penalising those who made use of such jurisdictions. After the terrorist attacks in the United States of America of 11 September 2001, the focus of governments shifted from fighting tax evasion to fighting terrorism, including the financing thereof.[12] Prior to that date, for example, much of the terrorism in Northern Ireland was funded through the use of trusts by Americans claiming to have Irish ancestry, enabling the origin of the funds to be disguised, at the very same time when the United Kingdom was the closest ally of the United States.

The financial needs of governments, coupled with the fact that offshore jurisdictions were being used to launder the ill-gotten gains of terrorists, drug dealers and dictators, have led to a relentless drive towards global tax transparency and compliance. This is evidenced by a large number of supra-national initiatives in the field of wealth planning, all working towards an automatic exchange of tax and other information.[13] This has inevitably led to offshore centres losing a fair amount of business, even though it is fair to say that not all tax evasion and money laundering occurs in offshore jurisdictions.[14] Because offshore trusts are used not only for tax and confidentiality reasons, many structures will remain offshore despite these developments.

Over the course of the last decade or two, most countries with well-developed tax and legal systems have enacted laws to curb the use of offshore trusts. Wealthy individuals with offshore trusts have been advised for some time now to ensure that their structures are compliant with the tax rules of their country of residence. The so-called "trust industry", both onshore and offshore, has had to deal with a wave of new regulations in order to remain competitive and for jurisdictions not to be blacklisted by other countries and by

[12] Noseda *The Big Debate: Transparency Versus Privacy, Common Reporting Standard and Beneficial Ownership Registers* 15-19.
[13] Riches "Supranational Initiatives and their Impact on Wealth Planning" *Trust Quarterly Review* (accessed 04-04-2015).
[14] Hines *STEP Report: International Financial Centers and the World Economy* 13, 29-30.

intergovernmental organisations such as the OECD and the Financial Action Task Force (FATF).[15]

In addition, in 2017 and 2018, a network of investigative journalists known as the International Consortium of Investigative Journalists revealed information about hundreds of thousands of offshore entities and the holdings of numerous politicians, public officials and celebrities in the largest information leak of its kind, known as the "Panama Papers".[16] Although not all of the leaked information revealed wrongdoing on the part of the users of offshore structures, it highlighted only the very negative side of the offshore world. Given the current political climate, the occurrence of more investigations and revelations of this kind would not be surprising.

Although many of the tax and confidentiality advantages related to offshore trusts have all but disappeared, this does not mean that offshore trusts have disappeared as well. For many individuals setting up offshore trusts today, the focus, or at least a part thereof, must be on long-term succession planning and asset preservation. Given the increasingly antagonistic political and economic environment, the choice of a reputable offshore jurisdiction and service provider is more important than ever.[17]

The following opening paragraph from the Privy Council judgment (on appeal from the High Court of the Isle of Man) in *Schmidt v Rosewood Trust Ltd*[18] paints a particularly bleak picture of the use of offshore trusts:

> "It has become common for wealthy individuals in many parts of the world (including countries which have no indigenous law of trusts) to place funds at their disposition into trusts (often with a network of underlying companies) regulated by the law of, and managed by trustees resident in, territories with which the settlor (who may be also a beneficiary) has no substantial connection. These territories (sometimes called tax havens) are chosen not for their geographical convenience (indeed face-to-face meetings between the settlor and his trustees are often very inconvenient), but because

[15] Examples include the United States Foreign Account Tax Compliance Act and the OECD Common Reporting Standard.
[16] Anonymous "The Panama Papers: Exposing the Rogue Offshore Finance Industry" (accessed 25-07-2018).
[17] Downie "Client Confidentiality Under Attack" (*STEP Journal Roundtable* (accessed 04-04-2015).
[18] *Schmidt v Rosewood Trust Ltd* [2003] 2 AC 709.

> they are supposed to offer special advantages in terms of confidentiality and protection from fiscal demands (and sometimes problems under the insolvency laws, or laws restricting freedom of testamentary disposition, in the country of the settlor's domicile). The trusts and powers contained in a settlement established in such circumstances may give no reliable indication of who will in the event benefit from the settlement. Typically it will contain very wide discretions exercisable by the trustees (sometimes only with the consent of a so-called protector) in favour of a widely-defined class of beneficiaries. The exercise of those discretions may depend upon the settlor's wishes as confidentially imparted to the trustees and the protector. As a further cloak against transparency, the identity of the true settlor or settlors may be concealed behind some corporate figurehead."[19]

3 Chapter 2: jurisdictions used in the comparative study

The three main jurisdictions used in the comparative study are England,[20] the Channel Island of Jersey and South Africa. Chapter 2 contains a summary of the history and development of trust law in these jurisdictions. This is intended to aid the understanding of the comparative study that follows in chapters 3 and 4.

Although the three jurisdictions mentioned above form the main jurisdictional focus of the dissertation, trust law developments in other jurisdictions, particularly offshore ones, are highlighted where relevant and beneficial to the research exercise.

3 1 England

The law of trusts is asserted by English lawyers as having its origins in English law. English trust law, being centuries old, is well developed and a rich body of case law exists. In addition to that, the Trustee Act 2000 (replacing the Trustee Act 1925) regulates many aspects of trusts and trusteeship.

It is a well-known fact that English law has been used as a basis for the trust law of many offshore jurisdictions; most of them are after all British Overseas Territories, British Crown

[19] *Schmidt v Rosewood Trust Ltd* [2003] 2 AC 709 para 1.
[20] See ch 1 fn 1.

Dependencies, or form part of the Commonwealth. Similarly, South African trust law owes a great deal to its English counterpart.

It is for the above reasons that English trust law forms part of the study. In many ways it will provide the benchmark for comparing legal developments in different jurisdictions.

The dissertation briefly examines the origins of English trust law and, importantly, the concept of dual ownership. This concept – that the trustee has legal ownership of the trust property and the beneficiaries have beneficial ownership thereof – is a fundamental principle of English trust law. It means that the trustee has legal title to the trust assets and a duty to manage and control those assets for the benefit of the beneficiaries, who in turn have the right to hold the trustee to account for his administration of the trust.

An examination is made of the requirements for a valid trust under English law, as well as the historical development of trust legislation and the common law of trusts (meaning judge-made law, as opposed to legislation).

3 2 Offshore jurisdictions: Jersey

The Channel Island of Jersey is a British Crown Dependency and, given its tax neutrality, has been a pre-eminent location for offshore trust administration and trusteeship since the 1960s. Jersey has a well-developed legal system, excellent infrastructure and is economically very stable. It also has a very good reputation amongst international trust practitioners and has quickly adapted to the new regulatory framework alluded to above.

Jersey has a well-developed trust law based on English common law. The Trusts (Jersey) Law 1984 remains the most important piece of legislative material in the Jersey trust law context. It has been amended on various occasions, most recently in 2013. The Trusts (Jersey) Law 1984 is considered by many practitioners as the “grandmother” of offshore trust law and has been used as a model by various other offshore jurisdictions. It is therefore considered very well suited to a comparative study.

Jersey has its own court system, which is described in more detail in the next chapter. Importantly, the Judicial Committee of the Privy Council in England is the court of final

appeal for the British Crown Dependencies. Furthermore, if no judicial authority exists on a specific issue, the Jersey court may have regard to English case law for guidance. This ensures that English law continues to have an influence on Jersey trust law.

Like most other offshore jurisdictions, Jersey has been very proactive in terms of legislative developments catering to the needs of high net worth individuals, sometimes to the extent that questions are raised about the validity of such trusts, as seen in chapters 3 and 4. Jersey, amongst others, has, however, maintained its reputation as a jurisdiction compliant with supra-national initiatives aimed at tax transparency.[21]

This part of the dissertation covers the requirements for a valid trust under Jersey law, the historical development of the Jersey common law of trusts, the role of the local courts and the influence of English law on those court decisions, and the effect of legislative developments.

3 3 South Africa

South Africa's unique trust law is the result of the incorporation of the English trust as an institution in the early nineteenth century, combined with the lack of incorporation of English law as such. As a result, South African courts had to interpret English trusts, drafted by practitioners trained in English law, with reference to Roman-Dutch legal principles.[22] The dissertation identifies how this has led to differences with the trust law in England and other common law jurisdictions, focusing mainly on the differences relevant to this study.

South African trust law has not been codified, with the Trust Property Control Act 57 of 1988 being the only partial "codification" that has taken place. This Act regulates only the registration and some aspects of the administration of South African trusts.

Despite South African trust law being well established, uncertainty seems to exist in relation to a number of issues. Some of these issues, as well as possible solutions to address them, are examined in the course of the dissertation.

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[21] OECD *Global Forum on Transparency and Exchange of Information for Tax Purposes: Jersey 2017 (Second Round): Peer Review Report on the Exhange of Information on Request*.
[22] Cameron *et al Honoré's South African Law of Trusts* 21.

This part of the dissertation examines the reception of the trust institution into South African law, the development of South African trust law through legislation and case law, the requirements for a valid trust under South African law, and highlights relevant differences between South African trust law and that of the other two jurisdictions.

4 The two core issues to be analysed

The following two topics form the focal point of the dissertation and a separate chapter is devoted to each topic:

(a) chapter 3: trustee obligations and liability for breach of trust; and
(b) chapter 4: excessive settlor control: invalidity, sham and going behind the trust form.

These issues are relevant and topical in a number of trust jurisdictions, not least in South Africa.

The comparative study examines the development of the trust law in the chosen jurisdictions by focusing on the two issues specified above, and looking at how the different jurisdictions have dealt with such issues through legislation, by way of case law, or both.

In each case the English position, being the benchmark, is examined first. Thereafter the offshore position is analysed (which may include jurisdictions other than Jersey, where relevant), and finally the South African position. This order is chosen specifically so that the position under South African law can easily be compared to the position in the other jurisdictions.

5 Chapter 3: trustee obligations and liability for breach of trust

Chapter 3 contains an analysis of the fiduciary duties of the trustee and the extent to which trust deeds can exclude liability for a trustee's breach of those duties.

5 1 Fundamental trustee duties

As a first step, the fundamental duties of a trustee under the law of each of the chosen jurisdictions, as well as the origin of these duties, are examined. Specific attention is given to the fiduciary role of the trustee as well as the duty of care. A comparison is made of the strictness of the duties imposed on a trustee in the different jurisdictions.

5 2 Breaches of trust

Thereafter, the dissertation focuses on the circumstances in which a breach of trust occurs, the requirements for liability and the consequences thereof. Jurisdictional differences will be highlighted.

5 3 *Hastings-Bass* rule

The next part of this chapter briefly examines a particular rule of English law that allows, in appropriate circumstances, the setting aside of the exercise of certain trustee powers. This rule, known as the rule in *Hastings-Bass*,[23] was originally intended to protect beneficiaries, but has been very useful for trustees to avoid the unintended tax consequences of certain actions and the need for beneficiaries to sue them for negligence or breach of trust.

The Supreme Court in England has now restricted the ability of a trustee to rely on this rule.[24] In response, some offshore jurisdictions have passed legislation to preserve the rule in its previous form,[25] an example of how offshore legislation attempts to counter a common law development perceived by offshore jurisdictions as having a negative or limiting impact on the use of trusts.

5 4 Extent of trustee exoneration clauses

Chapter 3 further examines trustee exoneration clauses and the extent to which such clauses can offer a trustee relief from liability for breach of trust. It is easy to imagine that a trustee

[23] *Re Hastings-Bass (Deceased), Hastings v Inland Revenue Commissioners* [1974] 2 All ER 193.
[24] *Pitt v Holt, Futter v Futter* [2013] UKSC 26 (combined judgment).
[25] Trusts (Amendment No 6) (Jersey) Law 2013; Trustee Amendment Act, 2014.

can be sued for breach of trust when, perhaps, it is not the trustee's fault that the trust has sustained economic loss. The loss could be as a result of the fault of an investment adviser, or could simply be as a consequence of falling stock markets and an economic downturn. Furthermore, the increasingly litigious nature of society, and the perception that corporate trustees have deep pockets, mean that trust disputes are on the increase.

On the other hand, the position of trustee, being a fiduciary one, should not be taken lightly. Beneficiaries of a trust should be able to hold the trustee to account for his administration of the trust, and where a trustee has committed a breach of trust, the beneficiaries are not the ones who should suffer the loss.

Trustee exoneration clauses are standard in trust deeds in many trust jurisdictions, although the legal foundation and the ambit of such clauses differ from one jurisdiction to the next. In England, for example, trustees can be protected against gross negligence, although some hold the view that such clauses go too far, especially in the case of professional trustees. In Jersey, on the other hand, a trustee cannot exclude liability for gross negligence. An analysis is made of the law as it stands in the chosen jurisdictions, as well as recent legislative interventions and developments in case law.

6 Chapter 4: excessive settlor control: invalidity, sham and going behind the trust form

Chapter 4 examines the extent to which a settlor can exercise control over the trust and its assets without invalidating the trust or abusing the trust form. The consequences in the event that an abuse does occur are also examined.

6 1 Traditional role of the settlor and requirement of certainty of intention

With regard to the role of settlors, the general position under English law is that once a trust has been established, the settlor drops out of the picture and retains no interest in the trust (unless he is also a beneficiary or a trustee or a protector, but then his interest is in that role).[26]

[26] *Re Astor's Settlement Trusts, Astor v Scholfield* [1952] 1 All ER 1067.

In principle, when setting up a trust, the settlor has to hand over legal title and control over the assets to the trustee.[27] If this is not done, the benefits of establishing a trust may be lost. For many settlors, the handing over of control is a daunting prospect, especially if they are not familiar with the concept of a trust, or if the trustee is a large corporation in another country. Other settlors simply do not intend to properly hand over control, even though they go through the motions of setting up a trust, or they may decide after setting up the trust that they prefer having control over "their" assets after all. Although a certain level of involvement is acceptable, it is often taken too far.

The concept of a sham trust is examined briefly, given that settlor control can, in certain circumstances, lead to a finding that the trust is a sham.

In the South African context, the debate is complicated by the fact that, very often, the settlor and/or one or more beneficiaries are also trustees. It is easy to imagine how, in the case of a beneficiary, there could be a lack of separation between the control such a person has as trustee, and his expectations as a beneficiary. Furthermore, in many of the cases dealing with abuse of the trust form, it is one or more of the trustees who is or are responsible for the "abuse". It may, therefore, look like a simple breach of trust case, but it appears that in many of these cases the trustee or trustees in question are also settlors or beneficiaries.[28] As a result, it may be argued that this is still a case of settlor control and, therefore, abuse of the trust form.

In the offshore context, the settlor and beneficiaries normally do not act as trustees (with the exception of private trust companies, mentioned below). Very often the trustee is a corporate body, far removed from the settlor, so that this confusion of interests does not normally arise. That does not mean that settlors and beneficiaries of offshore trusts do not wish to be involved with "their" trusts, and therefore methods are devised to achieve this.

[27] The South African "bewind" trust should be distinguished. Here the ownership of property is retained or transferred to the beneficiaries, but control over it is given to the trustee.
[28] See, for example, *Land and Agricultural Bank of SA v Parker* 2005 (2) SA 77 (SCA); *Badenhorst v Badenhorst* 2006 (2) SA 255 (SCA).

6 2 Settlor control

The reasons why settlors are increasingly expecting (and even demanding) control over a trust and the trust assets are examined as a next step. Thereafter, different methods of achieving such control are discussed. Many offshore jurisdictions have responded to the desire of settlors to retain varying degrees of control, by developing laws that enable a settlor to have an influential role with regard to the trust, without invalidating the trust itself or otherwise putting the trust assets at risk. These trusts are generally referred to as "reserved powers trusts" or "settlor directed trusts". This type of legislation is examined in detail in chapter 4, together with the question of its effectiveness *vis a vis* other, onshore, jurisdictions, and whether it is contrary to the fundamental principles of a trust.

Although other ways of affording a settlor control or, at least, some influence over the trust and its assets are also discussed, the focus in this context is on reserved powers trusts.

In the South African context, control is often exercised by the settlor in his capacity as a co-trustee, and this part of the dissertation examines how this can be similar to other methods of offering settlors control over a trust.

6 3 Consequences of excessive control: review of case law

Questions relating to the validity or effectiveness of a trust normally come to light when there is a dispute involving the trust. The disputes may look as follows:

(a) in the context of a divorce settlement, a disgruntled spouse demands that assets of a trust, of which the other spouse was the settlor, be taken into account in calculating the settlement amount;

(b) a creditor who obtained judgment against the settlor as debtor finds that the settlor owns very little in his own name, but transferred most of his assets to a trust, making it more difficult for the creditor to obtain repayment;

(c) a tax authority in the settlor's country of residence questions the tax planning behind the trust and argues that the trust assets should be regarded as the settlor's own for tax purposes; or

(d) in the case of a business trust, where a commercial transaction has gone wrong, the trustee (who is also a settlor or beneficiary) tries to find a way of invalidating the transaction when, in fact, it is the confusion of interests that has led to the transaction being entered into in the first place.

The abuse of the trust form is prevalent in many jurisdictions. This may be because the benefits offered by trusts – tax mitigation or deferral, asset protection, succession planning, confidentiality – are often "too good to resist". In the case of trusts used to own businesses, the flexibility and relative lack of formalities associated with trusts (as opposed to corporate entities) make them very attractive.

Increasingly, however, courts in different jurisdictions are illustrating that this abuse will not be tolerated.[29] This part of the chapter looks at whether a trust can be held to be ineffective (can the "veneer" of the trust be "pierced" or "lifted", or can a court "look behind" the trust) because of the way the trust is being managed or administered, even if a valid trust is found to have come into existence. Alternatively, could such control lead to a finding that a valid trust never existed?

A detailed examination is made of relevant case law in order to find answers to these questions.

7 Chapter 5: conclusion

The final chapter examines the question of whether a trustee who allows a settlor too much control over the trust can be liable for breach of trust and whether, if that is the case, an exoneration clause should protect the trustee from liability. In such cases, does the irreducible core of the trust remain, or is this pushing the boundaries of the traditional trust too far?

[29] For example in *Abdel Rahman v Chase Bank (CI) Trust Company Limited and Others* [1991] JLR 103; *Van der Merwe NO v Hydraberg Hydraulics CC; Van der Merwe NO v Bosman* 2010 (5) SA 555 (WCC); *Tasarruf Mevduati Sigorta Fonu v Merrill Lynch Bank and Trust Company (Cayman) Ltd* [2011] UKPC 17; *North Shore Ventures Ltd v Anstead Holdings Inc.* [2012] EWCA Civ 11.

Is the designer legislation of the offshore jurisdictions the answer? Can such legislation survive the scrutiny of foreign courts, even though it may be a successful marketing tool for the offshore jurisdiction itself? Should the judiciary rather take a firmer stance and perhaps take note of positive developments in other countries, even though this is a slower process that legislative change?

It is widely accepted that a comparative study of different legal systems and jurisdictions can aid the development of a particular national law by, on the one hand, influencing the judiciary and, on the other hand, influencing the drafting of legislation. There are, of course, limits to the extent to which one jurisdiction can copy developments that take place in the context of another jurisdiction. The results of the research undertaken will be used to analyse these questions in the final chapter, and to ascertain whether the developments in England and Jersey examined in this dissertation may aid the development of South African trust law.

8 The research methodology

This dissertation, as the title indicates, contains a comparative examination of trust law in specific jurisdictions, which implies the use of a comparative method of legal research. An element of historical background is, however, required, especially in the context of trust law, a field of law that developed centuries ago. Some historical research, therefore, supports and complements the comparative research.

The research required to write the dissertation is conducted by analysing the following sources of information for each of the chosen jurisdictions:

(a) textbooks and journal articles by leading authors are examined to ascertain the common law position regarding trusts in each jurisdiction. Admittedly there is a scarcity of textbooks regarding Jersey trust law, but in many aspects that law is the same as in England, and where this is not the case, journal articles and other resources available on the internet provide sufficient information;

(b) the trust legislation, previous and current, of each jurisdiction (including, where relevant, background as to why and how such legislation was developed), as well as relevant laws from other jurisdictions, are examined; and

(c) case law relevant to the three focus points forms an important part of the dissertation. Case law from other jurisdictions is included where relevant and helpful.

CHAPTER 2

THE HISTORICAL DEVELOPMENT AND CURRENT STATE OF TRUST LAW IN ENGLAND, JERSEY AND SOUTH AFRICA

1 Introduction

This chapter contains a summary of the history and development of trust law in the three chosen jurisdictions, namely England, the Channel Island of Jersey and South Africa. It also examines the characteristics and fundamental requirements for a valid trust in each of these jurisdictions and highlights the role of the judiciary, legislation and other policy-driven initiatives in the development of the law applicable to trusts.

The purpose of this chapter is to provide an overview of, on the one hand, the historical development and, on the other hand, the current state and most important aspects of the law of trusts, in the chosen jurisdictions. Aspects that are regarded as relevant to the two focal points receive more attention. The first focal point, examined in chapter 3, is concerned with the standard of care expected of trustees, the liability of trustees for breach of trust and the extent to which liability for negligence can be excluded in the trust deed, as well as other rules affecting the accountability and liability of trustees. The second, examined in chapter 4, relates to the extent to which a settlor can exercise control over a trust without risking the validity or integrity of the trust (or, to use different phraseology, without abusing the trust form) and the consequences of such control.

This chapter is not intended as a detailed account of all aspects of the history and current state of trust law in the three jurisdictions. Rather, the intention is to sketch sufficient background to aid a better understanding of the issues examined in more detail in the following chapters. Certain similarities between the different legal systems will be apparent, as will the diverging ways in which certain hurdles are dealt with.[1]

[1] An example of this is the fact that neither Jersey nor South African property law recognises dual ownership rights, as is the case in England. In Jersey, this has been dealt with by legislating that immovable property located in Jersey cannot be subject to a trust. Beneficiaries may have equitable proprietary rights in other types of property. In South Africa, the courts have always held that beneficiaries do not have proprietary rights, but merely personal rights against the trustee, thereby avoiding the need to recognise two types of ownership in the same property. To this extent, the law of South Africa is identical with the law of Scotland.

One of the significant themes that this chapter will draw attention to is the importance of the different dimensions of a trust, namely property and obligation. A trust imposes obligations on the trustee, and these obligations must relate to property. A trust cannot exist without these two dimensions and, not surprisingly, they are found in the definition of a trust across all three jurisdictions. Although both these dimensions are essential to the trust concept, an interesting question is whether placing more emphasis on the obligation dimension, rather than seeing trust law as a branch of property law, would provide more satisfactory answers to questions such as the nature of trusts in civil law or mixed jurisdictions, where dual ownership rights in property are not recognised.

Is it possible that the obligation on the trustee to deal with the trust property in a certain way, and the fact that the beneficiaries can enforce these obligations, can give rise to equitable proprietary rights? Even if it does not, the existence and enforceability of such obligations may provide sufficient protection for the beneficiaries without the need to have recourse to a proprietary interest.

Looking at the obligation dimension from a different angle, it may be interpreted to indicate a responsibility on the part of trustees, settlors and beneficiaries to respect the boundaries set by the applicable law in order to continue to benefit from the relatively unregulated construct of a trust. Each party in the trust relationship has certain duties and responsibilities, even the settlor and beneficiaries who have to refrain from interfering too much with the trustee's control over the trust assets.

With the trust industry and the future of trusts under scrutiny,[2] playing by the rules is more important than ever. Tax authorities looking to broaden their tax base will find it much easier to succeed in attacking a trust, if the trust form is being abused and the settlor or a beneficiary effectively controls the trust assets.

Another important theme is the renewed focus on the "irreducible core" of the trust. The irreducible core refers to the minimum of duties a trustee needs to fulfil and the corresponding rights of one or more beneficiaries to hold the trustee accountable. What is the standard of

[2] As explained in ch 1 para 2 2 2.

care expected of a trustee in different jurisdictions and, just as importantly, what are the penalties for breaching this standard?[3]

These issues will form part of the focus of chapters 3 and 4, and this chapter will attempt to explain the historical and theoretical foundations thereof.

As far as the offshore component is concerned, developments in other offshore jurisdictions are examined in the following chapters where this is useful to the dissertation and where, perhaps, other jurisdictions offer different solutions. Jersey trust law shows many similarities with the trust laws of other offshore jurisdictions, given that the majority of these laws have been influenced heavily by English trust law. An in-depth study of the trust law of more than one offshore jurisdiction is not considered appropriate to this dissertation, but a more rounded picture of the offshore trust world is acquired by examining specific, relevant developments in other offshore jurisdictions in the following chapters.

2 England

2 1 Introduction

As mentioned before,[4] reference is made in this dissertation to "English law" and "the law of England", although it is more correct to refer to "the law of England and Wales", as English law is the applicable law in England and Wales.[5] However, for ease of reading, reference will simply be made to "English law" and "the law of England".

English law consists of common law, legislation passed by the United Kingdom Parliament, and European law. Common law refers to the law made by judges in court cases, when they apply their common sense and their knowledge of legal precedent (which is binding and not merely persuasive) to the facts of the case they are dealing with. Parliament can, however,

[3] Clarry (2014) 1 *JGLR* paras 1-3.
[4] See ch 1 fn 1.
[5] England and Wales are constituent parts of the United Kingdom of Great Britain and Northern Ireland (the UK), but Scotland and Northern Ireland, the other constituent countries, have their own legal systems (although the law is similar in many areas, particularly in Northern Ireland which is a common law jurisdiction whilst Scotland is a mixed jurisdiction similar to South Africa). Unlike Scotland and Northern Ireland, Wales is not a separate jurisdiction within the UK. In the past, references to England in legislation were deemed to include Wales. This changed with the enactment of the Welsh Language Act 1967 and as a result the jurisdiction is now commonly referred to as "England and Wales".

alter common law through legislation. English trust legislation will be examined, but the law is largely based on common law. Given that the United Kingdom remains a member of the European Union (at least until the implementation of Brexit), the European Court of Justice can direct English and Welsh courts on the meaning of areas of law in which the European Union has passed legislation. European law has, however, little relevance to this dissertation.

2 2 Introduction to equity

In order to properly understand English trust law, it is necessary to first examine its origins. As alluded to in the preceding paragraph, English law has more than one source, namely legislation and common law, being the law created by judges. The phrase common law can, in the English context, also be used more specifically to describe only the body of law developed by judges in the common law courts. This body of law is distinct from the body of law called equity, which was developed by judges in the chancery courts.[6]

2 2 1 Development of equity as a body of law

The original common law courts, namely the Court of Common Pleas and the King's Bench, had developed in England by 1234. These courts developed the basic rules and principles now known as the law of tort, the law of contract, the law of restitution and the law of property.[7] In order to start an action in one of these courts, a plaintiff had to purchase a writ from the King's Chancery. New writs were developed to deal with new legal problems until the Provisions of Oxford in 1258 prevented the issue of new writs without the permission of the King's Council. This effectively closed the categories of writs available to plaintiffs and limited the ability of the common law to develop effective remedies for new types of cases. In addition, there was a limited range of remedies available to successful plaintiffs, most remedies being in the form of monetary damages.[8]

These restrictions led to the development of the Court of Chancery, and of equity as a body of law. If a party to a dispute heard in one of the common law courts was not satisfied with the outcome, he could appeal directly to the King, who retained a *residuum* of justice, to provide

[6] Pearce *et al The Law of Trusts and Equitable Obligations* 13; Virgo *The Principles of Equity and Trusts* 4.
[7] Penner *The Law of Trusts* 1.
[8] Pearce *et al The Law of Trusts and Equitable Obligations* 14-15.

a remedy through the exercise of his discretion. The limitation on the category of writs or actions and remedies available meant that an increasing number of appeals were made to the King by discontented plaintiffs. Eventually, these appeals were delegated to the Chancellor, the King's chief minister.[9] This discretionary jurisdiction of the Chancellor developed to become the body of law known as equity.

Equity has two essential features, namely flexibility and a foundation on conscience. Because it is flexible, or discretionary, it was able to modify the harshness and rigidity of the common law. Because it was founded on the Chancellor's discretion by reference to his conscience, it brought fairness, justice and morality into law. Originally, the Chancellor was an ecclesiastical figure and biblical notions of fairness and justice may have played a part too.[10]

Eventually, separate courts, known as the courts of chancery, were established, as the Chancellor himself could not deal with the increasing number of petitions brought before him. The law developed and applied in this court became known as equity.[11] It was much more discretionary than the common law and the judges of the courts of chancery had at their disposal powers and remedies specifically developed by the Chancellors that was not available in the common law courts. Of course, different Chancellors had different ideas of what was fair and just, and there must have been an element of arbitrariness.[12]

Over the course of time, equity has, however, become more of a rule-based and principled body of law, with identifiable features, so that the arbitrariness has mostly disappeared.

2 2 2 Relationship between equity and common law

Although equity as a body of law became more systematic and rational from the seventeenth century onwards, there was a realisation in the nineteenth century that the legal system that had emerged was not ideal. Two parallel systems of law, common law and equity, administered by different courts, meant that a plaintiff had to choose the right court from the beginning, or face starting all over again in the other court. This caused delays, inconvenience

[9] Pearce *et al The Law of Trusts and Equitable Obligations* 15; Virgo *The Principles of Equity and Trusts* 5.
[10] Davies and Virgo *Equity & Trusts: Text, Cases, and Materials* 5-7; Virgo *The Principles of Equity and Trusts* 5-6.
[11] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 6.
[12] Davies and Virgo *Equity & Trusts: Text, Cases, and Materials* 4; Pearce *et al The Law of Trusts and Equitable Obligations* 16; Virgo *The Principles of Equity and Trusts* 6.

and unnecessary costs.[13] The two systems also struggled for dominance, with proponents from each side believing that their approach should prevail over the other.[14]

The Judicature Acts 1873 and 1875[15] simplified litigation by abolishing the common law courts and chancery courts and replacing them with a single High Court.[16] For administrative ease, the High Court is (today) divided into the Chancery Division, the Queen's Bench Division and the Family Division. Each division is responsible for an area of law, the Chancery Division dealing mostly with equity business.[17] As a result of the Judicature Acts,[18] the rules of both equity and common law are now concurrently applied and administered in all courts.[19]

Importantly, the effect of this legislation was *not* to fuse common law and equity as different bodies of law; it was simply to fuse the administration of the two bodies of law.[20] Where there is a conflict between the rules of equity and the rules of common law, the legislation provided that the rules of equity will apply.[21] The supremacy of equity was therefore ensured, and this is still the case today.[22]

Great controversy still reigns about whether or not common law and equity should exist separately or whether they should be, or are already, substantially merged. This is examined further below.[23]

2 3 The trust as equity's greatest contribution to English law

The English trust has its origins in a thirteenth-century property device called the use.[24] Following the conquest of England by the Normans in the eleventh century, land was held

[13] Pearce *et al The Law of Trusts and Equitable Obligations* 17-19; Virgo *The Principles of Equity and Trusts* 7-8.
[14] Penner *The Law of Trusts* 5-6.
[15] Supreme Court of Judicature Act 1873; Supreme Court of Judicature Act 1875.
[16] Penner *The Law of Trusts* 6-7.
[17] Virgo *The Principles of Equity and Trusts* 7.
[18] Supreme Court of Judicature Act 1873; Supreme Court of Judicature Act 1875.
[19] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 6.
[20] Virgo *The Principles of Equity and Trusts* 8.
[21] Supreme Court of Judicature Act 1873 s 25.
[22] Supreme Court Act 1981 s 49.
[23] See ch 2 para 2 4 3.
[24] Virgo *The Principles of Equity and Trusts* 40. The term use is misleading and means "on behalf of" or "for the benefit of".

through a feudal system. Very briefly, this meant that rights in land were in fact rights in a hierarchical system of tenures of land, with the King at the top, various lords below him, and the person in possession of the land at the bottom. The system operated in an oppressive and unfair way, which caused creative medieval lawyers to find ways to avoid the negative elements of land tenure. The mechanism by which these elements were avoided was the use.[25]

As an example, at the time of the Crusades,[26] when a tenant of land was fighting in another country, a trustee would be appointed to manage the land on his behalf, and had to give the land back to the tenant upon his return, or, if he did not return, to his family members. This ensured that the land did not fall into the hands of a lord higher up the hierarchical chain, but rather stayed in the tenant's family. The person the tenant wanted to benefit was called the *cestui que use* (or *cestuis que use* if more than one). In effect, the use was a conveyancing device for the holding of land and its purpose was to avoid financial liabilities and restriction on the inheritance of property.[27]

The common law did not recognise the use as such nor the interests of the *cestuis que use*. It only recognised legal interests in property. As the feudal system declined, and given the inability of the common law courts to assist the *cestuis que use*, failures to perform uses were increasingly brought before the Chancellor in the hope that his discretionary jurisdiction would assist the *cestuis que use*.

The King at the time, Henry VIII, convinced England's Parliament to pass the Statute of Uses in 1535 to eradicate the use.[28] This made it impossible for someone holding the legal title to land to be bound to benefit another, as there was no use by which he could be bound. The Statute of Uses did not, however, abolish all uses and, over time, loopholes were found by creative lawyers to replicate the use in all but name. As a result of political and social changes, by the turn of the eighteenth century, the courts of chancery recognised the equitable interest of a person, B, then called the *cestui que trust* and today called the beneficiary, where S, the settlor, transferred legal title to land to T, the trustee, to hold for the benefit of B.[29]

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[25] Penner *The Law of Trusts* 8-12.
[26] Religious military campaigns that started in 1095 and continued for over 200 years.
[27] Virgo *The Principles of Equity and Trusts* 40-41.
[28] Penner *The Law of Trusts* 12.
[29] Pearce *et al The Law of Trusts and Equitable Obligations* 55-58; Penner *The Law of Trusts* 8-12; Virgo *The Principles of Equity and Trusts* 40.

2 4 Definition of a trust

2 4 1 Property definition and obligation definition

Given the evolving nature of trusts, and the wide variety of uses it can be put to, it is difficult to give an exhaustive definition of a trust. English judges are able to adapt the characteristics of the English trust in appropriate cases, in order to take account of changing practical realities.[30] No statutory definition is provided in either the Trustee Act 1925 or the Trustee Act 2000, unlike the position in Jersey[31] and South Africa.[32] It was presumably not considered necessary, given the long history of trusts in England.

Hayton's definition of an English trust is a good starting point. According to him, a trust can be defined as an equitable obligation, binding a person (the trustee) to deal with property (the trust property) owned by him as a separate fund, distinct from his own private property, for the benefit of persons (the beneficiaries), of whom he may himself be one, and any one of whom may enforce the obligation.[33]

From this definition of a trust, two fundamental features of the trust can be deduced – a property dimension and an obligation dimension. These two dimensions, holding property rights for persons (or purposes), and the personal obligations of the trustee to manage the property in the exclusive interest of the beneficiaries, is said to distinguish the trust from other legal concepts.[34]

The obligation can be described as a tie or bond of equity, a *vinculum iuris*, whereby one person is bound to perform or forebear some act for another. It is an equitable obligation, so called because it was initially only recognised in courts of equity, and it is an obligation that must relate to property. The trustee's obligations to the beneficiaries are in respect of specific property owned by the trustee, and the beneficiaries have an equitable interest in such

[30] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* v; Virgo *The Principles of Equity and Trusts* 40. This is also the case in South Africa where the courts develop the trust by adapting the trust idea to the principles of South African law. See ch 2 paras 4 2 2, 4 2 3. See also ch 2 paras 3 2 2 2, 3 8 in relation to the development of the Jersey trust by the courts.
[31] Trusts (Jersey) Law 1984 art 2.
[32] Trust Property Control Act 57 of 1988 s 1.
[33] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 2.
[34] Virgo *The Principles of Equity and Trusts* 42.

property. If someone is obliged to do something or to refrain from doing something not relating to property, that obligation is not a trust.[35]

Traditionally, the property dimension was considered more important than the obligation dimension. The argument behind this view is that the division between legal and equitable title to property is the essence of the trust. Trust law is as such traditionally considered a branch of property law.[36]

Although the importance of the property dimension cannot be doubted, the significance of the obligation dimension has recently been highlighted. This view emphasises the fact that the trustee's ownership of the trust property is burdened by his obligations towards the beneficiaries.[37]

One extreme theory from the United States, the "contractarian account of the trust",[38] concludes that the trust should be considered as a bargain between the settlor and the trustee as to how the trust assets should be managed and distributed. This argument does not define the trust only by reference to the obligation dimension (the obligation deriving from contract), but rather regards the trust as a hybrid of contract and property – "a contract about how property should be deployed".[39] The property dimension is therefore not ignored.

It is true that the duties and discretions of the trustee can be prescribed in great detail in the trust deed, with the governing law simply being a default system of rules that will apply if no alternative provision was made in the trust deed. However, the problem with this theory is that, under English law, the trust is not a contract.[40] Although the settlor may bargain with the trustee with regard to the terms of the trust, once the trust has been created, the settlor has no right to enforce the bargain and typically has no rights relating to the trust, unless he reserved specific rights in the trust deed. The beneficiaries, who were not parties to the bargain, are the ones with the right to enforce the trust.[41]

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[35] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 56.
[36] Virgo *The Principles of Equity and Trusts* 42-43.
[37] Virgo *The Principles of Equity and Trusts* 44.
[38] Langbein (1995) 105 *Yale LJ* 625.
[39] Langbein (1995) 105 *Yale LJ* 625 669, 671. This argument finds resonance in the South African view of an *inter vivos* trust being, or at least being created by way of, a contract for the benefit of a third party, as examined in ch 2 paras 4 2 2, 4 3 2 1.
[40] Virgo *The Principles of Equity and Trusts* 43-44.
[41] Virgo *The Principles of Equity and Trusts* 42-43.

Any useful definition of the trust must therefore encapsulate both a property dimension and an obligation dimension.[42]

2 4 2 Distinction between legal and equitable ownership

Crucial to the property dimension of the definition of a trust, is the division of property rights. Under English law, this enables one person to hold property for the benefit of another. The trustee holds the legal title to the trust property. In the eyes of the common law, he is the absolute owner of that property. Historically, the common law courts only recognised legal proprietary rights, and would not have protected the interests of the beneficiary of a trust, who is not a legal owner. Equity was, however, able to recognise that the trustee holds the property not for himself, but for the benefit of the beneficiary. Generally speaking, the beneficiary of an English law trust has an equitable interest in the trust property, the word equitable indicating that the right was originally only recognised in courts of equity.[43]

The trustee, the legal owner of the trust property, who is obliged to look after it for the benefit of the beneficiary, stands in a fiduciary relationship with the beneficiary. An act or omission on the part of the trustee that is not authorised or excused by the terms of the trust deed, is regarded a breach of trust, and renders the trustee liable to compensate the beneficiary for any loss suffered.[44] This is because the beneficiary, and not the trustee, is entitled to the benefit and enjoyment of the trust property.[45]

Similarly, it is not the settlor who has an equitable interest in the property (unless he is himself a beneficiary). When the settlor creates a trust, he imposes obligations onto the trustee. These obligations are owed to and enforceable only by the beneficiaries and not by

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[42] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 56; Virgo *The Principles of Equity and Trusts* 44. A more detailed discussion of the obligations-based approach, *ie*, an analysis of trusts as a species of obligation rather than property, can be found in ch 2 para 2 7 3 2.

[43] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 73; Pearce *et al The Law of Trusts and Equitable Obligations* 53; Virgo *The Principles of Equity and Trusts* 13.

[44] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 3; Virgo *The Principles of Equity and Trusts* 13.

[45] It is perhaps because the beneficiary is the one entitled to the benefit and enjoyment of the trust property that equitable interests are sometimes confusingly referred to as beneficial interests. However, it is not exactly the same thing. An outright owner of property has a legal beneficial interest in that property, whereas the beneficiary of a trust has an equitable beneficial interest in the trust property. For more on this distinction, see Penner *The Law of Trusts* 21-22.

the settlor (unless he is a beneficiary or reserved rights to himself in the trust deed).[46] The core obligation created by the settlor is the personal obligation of the trustee to produce an account of his trusteeship to the beneficiaries.[47]

It should be noted that a beneficiary of a trust only has an equitable proprietary right to a trust asset if the trust asset is ascertained and it is clear that the specific beneficiary will benefit from that asset. Therefore, in the case of a fully discretionary trust with a wide class of beneficiaries, the objects (beneficiaries) do not have ownership rights relating to the trust property, unless and until the trustee exercises his discretion in favour of a specific beneficiary.[48] However, reference is often simply made to beneficiaries of English law trusts having equitable proprietary rights, although it is submitted that this is a generalisation. Perhaps the important point is that beneficiaries of an English law trust *can* have ownership rights in relation to the trust property, such rights being equitable, whereas this is not possible under, for example, South African law. Alternatively, the distinction can be explained by classifying the rights of a beneficiary of a fixed trust as an equitable proprietary interest in the narrow sense, and that of an object of a discretionary trust as an equitable proprietary interest in the wide sense – such a right is not transmissible.[49]

The recognition of equitable personal rights has also been instrumental to the development of English trust law, being a right that all beneficiaries have, unlike equitable proprietary rights.[50] The rights arising from a fiduciary relationship fall under this category. A fiduciary relationship is characterised by trust and confidence, such as the relationship between a solicitor and his client. A fiduciary owes specific duties to his principal, these duties being more onerous than the ordinary common law negligence standard of skill and care.[51] This fiduciary obligation is essential to the notion of a trust and will be examined in greater detail in chapter 3. Again, the two dimensions of the trust emerge – property and obligation.

Where a trustee commits a breach of trust by transferring trust property to himself, the beneficiaries can therefore rely on their equitable proprietary rights to claim recovery of the

[46] *Re Murphy's Settlements, Murphy v Murphy* [1998] 3 All ER 1 9.
[47] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 4.
[48] Virgo *The Principles of Equity and Trusts* 59-60.
[49] Virgo *The Principles of Equity and Trusts* 359-360.
[50] Virgo *The Principles of Equity and Trusts* 21.
[51] Penner *The Law of Trusts* 398-399, where a description is given of a fiduciary relationship. This will be returned to in ch 3.

property, or they can claim compensation from the trustee for the loss suffered based on their equitable personal rights. The dividing line between proprietary and personal rights may not always be clear and will depend on the particular circumstances.[52]

2 4 3 Legal and equitable interests and the "fusion" argument

The fundamental division between legal interests (or estates) and equitable interests (or estates) is, therefore, at the heart of equity.[53] Equity developed to protect interests other than legal interests, and recognises that various persons simultaneously could have different interests in the same piece of property.[54] Without this distinction, English trust law would not have developed in the way it did.

It is important to note that not all property has a legal owner *and* an equitable owner. Equitable proprietary rights must be created specifically, by separating the beneficial interest from the legal title. This can be done either by the express creation of a trust over property, a presumed intent to create a trust over property, or by the operation of law. Where no equitable interest is created, the legal owner of property is also the beneficial or equitable owner of that property and can obtain all the benefits of the property.[55] This is the normal case of owning one's own property.

Importantly, once an equitable interest in property is created, one person alone cannot have both the legal and equitable ownership of that property.[56] Although it is possible to be a trustee and one of the beneficiaries, it is not possible to be the only trustee and the only beneficiary. This also means that where an equitable interest was created and one person alone subsequently acquires both the legal and equitable interest, the equitable interest will be destroyed.[57] An example is the case where X is the trustee and also one of three beneficiaries. If the other two beneficiaries are later excluded from benefit under the trust, leaving X as the only trustee and the only beneficiary, and thus the legal and equitable owner, the equitable

[52] See Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 76-79 on the nature of equitable interests as proprietary or personal; Virgo *The Principles of Equity and Trusts* 21-22.
[53] The phrases "beneficial interest" and "beneficial owner" *etc* are used interchangeably with "equitable interest" and "equitable owner", although the latter is probably strictly more correct in the English context.
[54] Virgo *The Principles of Equity and Trusts* 17-18.
[55] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 5; Virgo *The Principles of Equity and Trusts* 19.
[56] Penner *The Law of Trusts* 21-22.
[57] Virgo *The Principles of Equity and Trusts* 20.

interest will be extinguished. X as trustee would then hold the property on resulting trust for the settlor.

A legal estate or interest is a proprietary interest (meaning an interest in or relating to property) that was acquired with all the formalities required by common law or statute for conferring legal title to such interest. For example, a transfer of the legal title to land requires that certain formalities must be fulfilled, whereas legal ownership of a movable asset, such as a work of art, can be transferred with fewer or no formalities. A trustee normally has legal title to the trust property, but this is not necessarily always the case – it is possible to hold an equitable interest on trust for beneficiaries.[58]

An important difference between a legal proprietary interest and an equitable proprietary interest is that legal title prevails against the whole world, but the equitable interest of a beneficiary does not prevail against a *bona fide* purchaser for value of the legal interest who did not have notice of the equitable interest.[59] This means that if a trustee sold a trust asset to a *bona fide* third party who paid market value for the asset in question, and who was not aware that the asset formed part of a trust, the beneficiaries cannot claim the asset back from the third party.

Despite some arguing[60] that there has been (or should be) a substantive fusion of common law and equity, the fundamental distinction between legal and equitable interests in property remains. When the Judicature Act 1873[61] was introduced in the House of Lords, it was said that in order for trusts to continue, there must be a distinction between what is called a legal estate and an equitable estate. It was further said that the distinction between law and equity is, subject to certain limitations, real and natural, and that it would be a mistake to disregard this distinction.[62]

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[58] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 73-74.
[59] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 74-76; Virgo *The Principles of Equity and Trusts* 17-21.
[60] Davies and Virgo *Equity & Trusts: Text, Cases, and Materials* 8; Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 73-74; Burrows (2002) 22 *OJLS* 1. For the purposes of this dissertation it is not necessary to enquire into these arguments in more depth.
[61] Supreme Court of Judicature Act 1873.
[62] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 73-74.

More recently, it has been argued[63] that the duality of systems has an important function in that one system, common law, provides certainty, and the other system, equity, provides the necessary flexibility and adaptability to enable justice to be done. However, common law and equity are not two separate and parallel systems of law. The argument is that common law is a complete system of law, which could stand alone, but which would lead to injustice if it were not for the tempering effect of equity. Equity, on the other hand, is not a complete and independent system of law and cannot stand on its own.[64] Therefore, although the two systems are becoming assimilated in some areas,[65] the better view may be that the two systems should continue to co-exist.[66]

2 5 Classifications of trust

This dissertation focuses on private *inter vivos* trusts created expressly and documented in the form of a trust deed or instrument. It does not cover testamentary trusts or public trusts such as charitable trusts or pension fund trusts.

The following classifications of trust are not exhaustive, and are not mutually exclusive. A particular trust can fall under more than one category.

2 5 1 Express trusts and trusts arising by operation of law

An express trust is created intentionally by the settlor's declaration to that effect.[67] Not all trusts are created intentionally though. A trust can be imposed by statute and is then called a statutory trust. Under English law, a trust could also be imposed by the court, applying equitable principles. This could be either a resulting trust or a constructive trust. These types of trust will not themselves form part of the dissertation, but a brief description is useful as they are later mentioned in specific instances.

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[63] Davies and Virgo *Equity & Trusts: Text, Cases, and Materials* 9 where reference is made to the views of Lord Millett.
[64] Virgo *The Principles of Equity and Trusts* 23.
[65] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 74; Virgo *The Principles of Equity and Trusts* 23-24.
[66] Virgo *The Principles of Equity and Trusts* 25.
[67] Virgo *The Principles of Equity and Trusts* 79.

A resulting trust exists where the transferor was presumed to have intended that property should be held on trust for him. Although a transfer of property takes place, the transferor fails to divest himself completely of his beneficial interest in the property.[68] An example of this is the case of a failed express trust. In such a case the trustee holds the trust property on resulting trust for the settlor.[69]

A constructive trust, on the other hand, arises as a result of the application of legal rules. In most instances this occurs where the recipient of the property is considered to have acted in an unconscionable manner.[70] For example, where property was obtained fraudulently, the recipient of the property is deemed to hold it on constructive trust for the claimant.[71] No formalities are required for the creation of a resulting or constructive trust.[72]

2 5 2 Fixed and discretionary trusts

Within the category of express private *inter vivos* trusts, a distinction can be made between fixed and discretionary trusts. (The same distinction can also be made with regard to testamentary trusts.) A fixed trust is one where the trust deed stipulates the interests of the beneficiaries in the capital and income of the trust, and the trustee does not have discretion to distribute the trust fund in a different way.[73] A trust is discretionary if the trustee has discretion to distribute the trust property in the way he deems fit to persons from a specific class of potential beneficiaries. The persons in the class of potential beneficiaries are called objects, and they do not have an equitable proprietary interest in the narrow sense in the trust property (in other words, they do not have a transmissible right),[74] as the trustee may decide not to exercise his discretion in favour of a particular object. A beneficiary of a discretionary trust has a mere hope that the trustee will exercise his discretion in favour of the beneficiary.[75] Such a beneficiary does have personal rights, however.

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[68] Virgo *The Principles of Equity and Trusts* 243-244.
[69] Virgo *The Principles of Equity and Trusts* 265-275.
[70] Virgo *The Principles of Equity and Trusts* 291-292.
[71] Virgo *The Principles of Equity and Trusts* 293-294.
[72] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 79-80; Virgo *The Principles of Equity and Trusts* 63.
[73] Penner *The Law of Trusts* 68-69.
[74] Virgo *The Principles of Equity and Trusts* 359-360.
[75] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 97-98; Penner *The Law of Trusts* 69-70; Virgo *The Principles of Equity and Trusts* 59-60.

In the case of a fixed trust, where the beneficiary has a current fixed entitlement to a certain or ascertainable part of the income or capital of the trust fund, his interest is called an interest in possession. This has tax consequences as the beneficiary is entitled to a part of the trust fund.[76]

A beneficiary who may or may not benefit under a discretionary trust has no interest in possession and generally will only be liable to tax once he has received a benefit from the trust. This is, of course, one of the reasons for the great popularity of discretionary trusts.

2 6 Characteristics of an English law trust

2 6 1 The trust

A trust can be defined as an equitable obligation that relates to property.[77] A trust under English law does not have legal personality and is not a separate legal entity. Instead, the trustee, in whom the legal title to the trust property is vested, must act personally (but in his capacity as trustee) in respect of the trust property.[78] It is therefore not correct for trustees to enter into an agreement as "the XYZ Trust", but rather as "A and B as trustees of the XYZ Trust".[79]

2 6 2 The trust property

A trust must relate to property. This is clear from the definition of a trust[80] and the substantial requirement of certainty of subject matter.[81] The trust property constitutes a separate fund and does not form part of the trustee's personal estate. It is thus protected against claims made by the trustee's private creditors. Of course, beneficiaries are also protected by virtue of having an equitable interest in the trust property.

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[76] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 98.
[77] See ch 2 para 2 4 1.
[78] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 3; Penner *The Law of Trusts* 32-33.
[79] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 57, where it is also stated that the courts are willing to construe references to a trust as references to the trustee. See in this regard *T Choithram International SA v Pagarani (British Virgin Islands)* [2000] UKPC 46 para 31.
[80] See ch 2 para 2 4 1.
[81] See ch 2 para 2 7 1 2.

Trust property has a ring-fenced, protected nature and will include trust assets the trustee has wrongfully acquired for himself. The trust fund includes the original trust property, accruals thereto, and property acquired in exchange for trust property (for example, if an asset is sold and a different asset purchased with the proceeds). Even if the trustees purchased an asset in breach of trust, it still forms part of the trust fund and the beneficiaries have an equitable interest in it.[82]

The trustee of an English law trust must own the trust property. It is not sufficient to merely have control over it. Older cases and textbooks approved the notion that the trustee does not need to own the property but merely have to have control over it.[83] The position now is that ownership by the trustee is required.[84] There is very old authority for this point, preceding the older cases mentioned above.[85]

2 6 3 The trustee

The office of trustee is subject to onerous fiduciary and equitable duties. This is analysed in depth in chapter 3. The enforcement of these duties by the beneficiaries is at the core of the trust concept.[86] In the well-known case of *Armitage v Nurse*,[87] Millet LJ said the following:

> "If the beneficiaries have no rights enforceable against the trustees, there are no trusts."[88]

[82] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 9, 57; Penner *The Law of Trusts* 43-44. The position of the trustee is examined in more detail in ch 3.
[83] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 8; *Re Marshall's Will Trusts* [1945] 1 All ER 550 551; *Green v Russell* [1959] 2 All ER 525 531. In the two latter cases, references were made to older editions of Underhill's work.
[84] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 8. Here it is stated that in the previous editions of this work, up to the 16th edition, reference was made to "control" rather than ownership.
[85] Smith v Anderson (1880) 15 Ch D 245 275 where James LJ said: "A trustee is a man who is the owner of the property and deals with it as principal as owner and as master…".
[86] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 57; *Armitage v Nurse* (1998) Ch 241. The duties of trustees are examined in more detail in ch 3.
[87] *Armitage v Nurse* (1998) Ch 241.
[88] *Armitage v Nurse* (1998) Ch 241 253. There is no reference here to proprietary rights and in fact the statement is made in the context of obligations owed by the trustees to the beneficiaries, which must indicate personal rights rather than proprietary rights. See also the discussion at ch 2 paras 2 4 2, 2 4 3.

However, he also said:

> "But I do not accept the further submission that these core obligations include the duties of skill and care, prudence and diligence. The duty of the 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."[89]

The decision in *Armitage*[90] confirmed that a trustee of an English law trust can be exempted from liability for gross negligence.[91] The correctness of the decision has been questioned and there appears to be a need for either a decision at the highest appellate level or statutory intervention in order to provide certainty with regard to the permissible scope of trustee exemption clauses.[92]

Another development affecting the liability of trustees is in relation to the rule known as the *Hastings-Bass* rule.[93] Under this rule, a court in England can, in certain circumstances, set aside the exercise by a trustee of a discretionary dispositive power.[94] In *Sieff v Fox*,[95] the rule was described as follows:

> "Where trustees act under a discretion given to them by the terms of the trust, in circumstances in which they were free to decide whether or not to exercise that discretion, but the effect of the exercise is different from that which they intended, the court will interfere with their action if it is clear that they would not have acted as they did had they not failed to take into account considerations which they ought to have taken into account, or taken into account considerations which they ought not to have taken into account."[96]

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[89] *Armitage v Nurse* (1998) Ch 241 253-254.
[90] *Armitage v Nurse* (1998) Ch 241.
[91] Trustees of Jersey and South African law trusts are subject to a higher standard of care. See ch 2 paras 3 5 3, 4 3 5 3. See also the discussion regarding legislative developments in ch 2 para 2 8.
[92] Clarry (2014) 1 *JGLR* para 43.
[93] The rule has its origin in the English Court of Appeal case *Re Hastings-Bass (Deceased), Hastings v Inland Revenue Commissioners* [1974] 2 All ER 193.
[94] Dispositive powers refer to powers authorising the trustee to dispose of the trust fund, *eg* to make a distribution to a beneficiary. This must be distinguished from administrative powers allowing the trustee to manage the trust and invest the trust fund.
[95] *Sieff v Fox* [2005] EWHC 1312 (Ch).
[96] *Sieff v Fox* [2005] EWHC 1312 (Ch) para 119.

Although the rule was originally intended to protect beneficiaries, it has been useful for trustees whose actions have led to unintended (and unwanted) tax consequences, as their actions could be nullified without the need for the beneficiaries to sue them for negligence or breach of trust. The rule became unpopular with some academics, practitioners and English judges, as it made it relatively easy for trustees to escape the tax consequences of their actions.[97] A recent Supreme Court decision (which combined two cases)[98] has now significantly restricted the ability of trustees to rely on the rule.

The above developments and their effect on the liability of trustees of English law trusts and the irreducible core approach will be examined further in chapter 3.

2 6 4 The settlor

The settlor of an English law trust cannot enforce the trust, unless he is a beneficiary or reserved certain rights to himself in the trust deed. If the settlor declares himself a trustee of his property, he retains the legal title to the trust property but disposes of his beneficial interest by creating an equitable interest for the beneficiaries. If the settlor transfers the assets to another person as trustee and is not a beneficiary of the trust, he disposes of his legal and equitable interest in the property and falls out of the picture.[99]

One of the rights the settlor may reserve to himself is a right to revoke the trust. A revocable trust can be brought to an end by the settlor with the result that the trust property is transferred back to the settlor. Unless this right is expressly reserved in the trust deed, the trust would be irrevocable. A settlor can also reserve lesser powers to himself, such as to replace the trustee or to have some say in the investment of the trust fund. Reserving rights, especially the right to revoke the trust, may have tax and other consequences for the settlor.[100] Chapter 4 focuses on the effect of too much control being exercised by a settlor.

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[97] As Park J commented in *Breadner v Granville-Grossman* [2000] 4 All ER 705 para 61: "It cannot be right that whenever trustees do something which they later regret and think that they ought not to have done, they can say that they never did it in the first place."
[98] *Pitt v Holt, Futter v Futter* [2013] UKSC 26 (combined judgment).
[99] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 58; Penner *The Law of Trusts* 24. The position of the settlor is examined in more detail in ch 3.
[100] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 58; Penner *The Law of Trusts* 24-25.

2 6 5 The beneficiaries

The beneficiaries play an essential part in the trust relationship, being the ones who can enforce the trust against the trustee. Without this enforceability, a trust cannot exist.[101]

Beneficiaries of English law trusts have equitable rights, which may be proprietary or personal.[102] In the case of a fixed trust, the beneficiary has an equitable proprietary interest in the trust assets and this right can be enforced against anyone in possession of the trust property, unless such person purchased the legal title for value and without actual or constructive notice of the beneficiary's interest. The beneficiary also has personal rights, such as the right to ensure proper administration of the trust, rights to information or documents relating to the trust, or rights in connection with breaches of trust.[103]

In the case of a discretionary trust, the objects do not have proprietary rights because it is not clear whether they will benefit from the trust or not. It depends on the exercise of the trustee's discretion. Such objects do have personal rights though, which mainly relate to ensuring that the trustee is held accountable for the obligations he owes to the beneficiaries.[104]

2 6 6 Trusts and powers

An understanding of the difference between trusts and powers as they exist in English trust law is important to the understanding of the issues examined in subsequent chapters, especially in relation to the duties and obligations of trustees, examined in chapter 3.

In this context, the word trust has a specific meaning, narrower than the meaning generally given to that word. A trust imposes an obligation that must be performed. A power is discretionary and may be exercised, but does not have to be exercised.[105] The same trust deed can impose trust obligations on the trustee and also create discretionary powers that may be exercised by the trustee, and it can be difficult to distinguish between the two. The importance of the distinction lies therein that it enables one to determine whether the trustee *must* act or

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[101] See ch 2 para 2 6 3.
[102] Virgo *The Principles of Equity and Trusts* 353; see also ch 2 para 2 4 3.
[103] Virgo *The Principles of Equity and Trusts* 354-359.
[104] Virgo *The Principles of Equity and Trusts* 359-364; see also ch 2 par 2 5 2.
[105] Virgo *The Principles of Equity and Trusts* 73.

may act. Furthermore, unexecuted trusts can (and will) be executed by the court, but powers will not be exercised by the court.[106]

The distinction between trusts and powers is a traditional one. These were the two main classes of obligation recognised in equity. Classifying an obligation as a trust or a power has significant consequences, but distinguishing between the two can be difficult. It is essentially a matter of construction of the language used in the trust deed.[107] It has been acknowledged in *McPhail v Doulton*,[108] the watershed case in this regard, that the distinction between trusts and powers was narrow and could be artificial, and that it depended on "delicate shading".[109] In practice, a competent trustee may act in the same manner whether a trust or a power is imposed on them. The courts nowadays have a less orthodox view and enforce fiduciary obligations not strictly on the distinction between trusts and powers.[110]

2 7 Substantive requirements for the creation of a valid express trust under English law

2 7 1 The three certainties

As long ago as 1840, a test was devised for the validity of express trusts. This test is referred to as the three certainties, and was identified in *Knight v Knight*.[111] The three certainties are: certainty of intention, certainty of subject matter, and certainty of objects.[112]

2 7 1 1 Certainty of intention

It is necessary to show that the owner of the property had the intention to subject the property to a trust obligation. In the case of a trust expressed in writing (the type of trust this dissertation is concerned with), the settlor must use language from which an intention to create a trust can be ascertained. It is a question of fact and depends on construction of the

[106] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 39-40; Virgo *The Principles of Equity and Trusts* 73.
[107] Pearce *et al The Law of Trusts and Equitable Obligations* 83-87.
[108] *McPhail v Doulton* [1970] UKHL 1.
[109] *McPhail v Doulton* [1970] UKHL 1 10.
[110] Pearce *et al The Law of Trusts and Equitable Obligations* 87-92.
[111] *Knight v Knight* (1840) 3 Beav 148.
[112] Pearce *et al The Law of Trusts and Equitable Obligations* 184; Virgo *The Principles of Equity and Trusts* 80.

trust deed. No specific words or phrases are required, although older authorities accepted that certain key words or phrases would create a trust.[113]

If a trust deed can be interpreted in more than one way, according to a general rule of construction in English law, a court would prefer the one that gives effect to the purpose of the person drawing up the document.[114] The test is not what the settlor subjectively intended, but what a reasonable person objectively would have concluded the settlor's intention to be. An intention to create a trust may thus be inferred from the context.[115]

Despite the fact that a document might be objectively construed as creating a valid *inter vivos* trust, a third party may allege that the trust is invalid because it is a sham. This may be inferred from the alleged subjective intentions of the settlor and the trustee, and from conduct subsequent to the creation of the trust, which may indicate that the settlor did not genuinely intend to create a trust, but rather to create a different set of rights and obligations.[116] Sham trusts are examined in greater detail in chapter 4.

A fundamental principle of English trust law is that a court will try to uphold a trust if it is able to do so. Although a stricter approach was followed in the past, the more recent[117] tendency is to respect the settlor's intention to create a trust. In *McPhail v Doulton*,[118] Lord Wilberforce said:

> "[A] trust should be upheld if there is sufficient practical certainty in its definition for it to be carried out, if necessary with the administrative assistance of the court, according to the expressed intention of the settlor."[119]

[113] Pearce *et al The Law of Trusts and Equitable Obligations* 184-187.
[114] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 112.
[115] Virgo *The Principles of Equity and Trusts* 81-82.
[116] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 88-93; Virgo *The Principles of Equity and Trusts* 85-87.
[117] *Pearson v Lehman Brothers Finance SA* [2010] EWHC 2914 (Ch).
[118] *McPhail v Doulton* [1970] UKHL 1.
[119] *McPhail v Doulton* [1970] UKHL 1 12.

2 7 1 2 Certainty of subject matter

Although, in principle, any kind of property can be subject to a trust, a valid trust can only be created if specific property is identified which is intended to be subject to the trust obligation. It is not necessary for the purposes of this dissertation to examine this requirement in too much detail. There must be conceptual certainty as to the property subject to the trust, it must be possible to identify the trust property and, in some cases, where a trust is declared of part of a larger bulk of property, the trust property must be earmarked or segregated. A settlor cannot create a trust of property he hopes or expects to own in the future.[120]

2 7 1 3 Certainty of objects

Not considering charitable and non-charitable purpose trusts, a trust will only be valid if the objects are defined in such a way that the trustee (or the court, in default of the trustee) will be able to execute the trust according to the settlor's intention. There must be one or more persons, identified with sufficient clarity, for whom the trust property is held and who can hold the trustee to account. Discretionary trusts often refer to a wide class of beneficiaries, and problems arise if it is not possible to ascertain who is within and who is outside the class of beneficiaries.[121]

English law has developed different tests for fixed trusts and discretionary trusts to determine whether there is certainty of objects. With regard to fixed trusts, the test is whether a complete list of beneficiaries can be drawn up. All beneficiaries must be ascertainable at the outset or at least when the time comes to distribute capital or income.[122]

Originally, the test for certainty of objects of discretionary trusts was the same as for fixed trusts. In *McPhail v Doulton*[123] the House of Lords decided that the test should be similar to that used for certainty of objects of powers, namely that it must be possible to say of any

[120] Pearce *et al The Law of Trusts and Equitable Obligations* 189-193; Virgo *The Principles of Equity and Trusts* 88-94.
[121] Pearce *et al The Law of Trusts and Equitable Obligations* 193-196; Virgo *The Principles of Equity and Trusts* 94-95.
[122] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees*129; Virgo *The Principles of Equity and Trusts* 96. This test was confirmed in *Re Gulbenkian's Settlement Trusts* [1968] UKHL 5.
[123] *McPhail v Doulton* [1970] UKHL 1.

given person whether or not he is within the class. This case reached the Court of Appeal[124] and it was held that the requirement of certainty would be met if it can be said, at least with regard to a substantial number of objects, that they fall within the class, even if, with regard to a substantial number of others, it cannot be proved whether they are within or outside the class.[125] This more sophisticated approach of the court required that there must be sufficient certainty in the language to enable distribution to be made to identifiable persons.[126]

A trust must also be administratively workable. In essence this means that the definition of the class of beneficiaries must not be so wide as to make it impossible, or at least not extremely difficult and time-consuming, to ascertain who the beneficiaries are. There must be clear criteria to enable the trustee, or the court, to control and execute the trust.[127] An example of an administratively unworkable trust would be "any or all or some of the inhabitants of the County of West Yorkshire", a class of more than two and a half million potential beneficiaries.[128]

2 7 2 The beneficiary principle

Once it is clear that the three certainties are satisfied, one must determine whether the beneficiary principle is satisfied. A trust must have a definite object – there must be somebody in whose favour the court can decree performance.[129]

Although this principle may be confused with the principle of certainty of objects and administrative workability, it is a separate requirement and has a distinct function. A trust for the relatives of the settlor may be conceptually and evidentially certain, but if none of the settlor's relatives are alive there will be no one to enforce the trust and therefore the intended trust will fail. The transferee trustee will thus hold the assets on resulting trust for the transferor settlor. The principle does not require that there is an identifiable beneficiary at the

[124] Known as *Re Baden's Deed Trusts (No 2)* [1973] Ch 9.
[125] It appears from the judgment that the application of the test is not as simple as it may appear, but it is outside the scope of this dissertation to examine this in more detail.
[126] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 130-132; Pearce *et al The Law of Trusts and Equitable Obligations* 195.
[127] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 135, 140.
[128] The case of *R v District Auditor, ex parte West Yorkshire Metropolitan County Council* [2001] WTLR 785 seems to be the only reported case of a trust failing as a result of administrative unworkability.
[129] This principle has its origins in the case of *Morice v Bishop of Durham* (1804) 9 Ves 399.

time of creation of the trust, as long as there is an identifiable beneficiary at some point before expiration of the trust period.[130]

The beneficiary principle also implies that an express trust must be a trust for persons and not for purposes, as a purpose cannot sue to enforce the trust.[131] In certain cases decided in the twentieth century, the beneficiary principle has been used as a ground on its own for invalidating purported trusts.[132] In *Re Astor's Settlement Trusts*[133] the principle was explained by reference to the division of legal proprietary rights and equitable proprietary rights. The legal owner of property is either under an equitable obligation or not. If he is, there must be someone else who must have corresponding equitable rights against the trustee, which rights can be enforced. If he is not under an equitable obligation, he can deal with the property as he wishes because he will be the legal and beneficial owner.[134]

The existence of a trust depends on there being someone other than the trustee who has an equitable right to the trust property and who can enforce the trust obligations against the trustee.[135] Once more, the importance of the obligation component of the trust comes to the fore. Even beneficiaries of discretionary trusts, who do not have equitable proprietary interests in the narrow sense, have the personal right to enforce the trust obligations against the trustee.

In *Re Denley*[136] and other cases[137] the beneficiary principle was, however, developed to allow trusts that are expressed as a purpose but are, directly or indirectly, for the benefit of one or more individuals.

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[130] Virgo *The Principles of Equity and Trusts* 114-115.
[131] Charitable trusts are an exception to this, being enforceable by the Attorney General of the Charity Commission.
[132] *Re Wood (deceased), Barton v Chilcott* [1949] 1 All ER 1100; *Re Astor's Settlement Trusts, Astor v Scholfield* [1952] 1 All ER 1067; *Re Endacott (deceased), Corpe v Endacott* [1959] 3 All ER 562.
[133] *Re Astor's Settlement Trusts, Astor v Scholfield* [1952] 1 All ER 1067 1071.
[134] See ch 2 paras 2 4 2, 2 4 3.
[135] Penner *The Law of Trusts* 245-248; *Re Astor's Settlement Trusts, Astor v Scholfield* [1952] 1 All ER 1067 1071.
[136] *Re Denley's Trust Deed, Holman v HH Martyn & Co Ltd* [1968] 3 All ER 65 69. Here the trust property was land that was to be maintained and used as and for the purpose of a recreation or sports ground, primarily for the benefit of the employees of a specific company and secondarily for the benefit of such persons as the trustees may allow to use the facilities.
[137] *Re Lipinski's Will Trusts, Gosschalk v Levy* [1977] 1 All ER 33 44; *Grender v Dresden* [2009] EWHC 214 (Ch) para 18.

The difference may not be easily ascertainable. It is a question of construction in each case whether the trust is primarily for the benefit of one or more individuals, with the specifics of the way in which the benefit is to be enjoyed being secondary; or whether the specified purpose in which the assets will be involved being the essence of the gift, with the indirect benefit to individuals being secondary. The benefit to individuals must however not be so incidental and intangible that it does not give them *locus standi* to enforce the trust.[138] Penner[139] is of the view that these cases do not extend the scope of valid purpose trusts, but rather justifies the validity of such trusts as "valid trusts for persons limited by a purpose". This category of trust has always been allowed by equity, the leading case, *Re Sanderson's Trust*,[140] being decided in 1857.

2 7 3 Further developments regarding the substantive requirements

2 7 3 1 An enforcer principle and the recognition of purpose trusts

Hayton[141] is of the view that there is scope for the further development of the beneficiary principle into an "enforcer principle". His argument is that, provided there is an identifiable enforcer, appointed by or in accordance with the wishes of the settlor, who is positively interested in the performance of the purpose of the trust, the trust should not fail for not satisfying the beneficiary principle. He questions why the English courts cannot accept that enforceable obligations to account to an interested person are at the core of the trust concept,[142] whether that person is a beneficiary, an object of a power of appointment (someone who may benefit subject to the contingency that the trustee exercises his discretion in favour of the person), a new trustee, the Attorney-General of the Charity Commission (in the case of charitable trusts), or an expressly appointed enforcer.

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[138] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 165-169.
[139] Penner *The Law of Trusts* 255-261.
[140] *Re Sanderson's Trust* (1857) 26 LJ Ch 804.
[141] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 169-172; Hayton (2001) 117 *LQR* 96.
[142] As recognised in *Schmidt v Rosewood Trust Ltd* [2003] 2 AC 709, a landmark case where the Privy Council held that the rights of beneficiaries to trust documents are not based on their proprietary interests, but on the court's inherent jurisdiction to supervise trusts and make trustees account for their trusteeship at the request of persons with sufficient interest, which would include objects of fiduciary powers.

He suggests that a trust governed by English law would then be described as:

> "…[A]n equitable obligation binding a person ("the trustee") to deal with property owned by him as a trust fund segregated from his private property whether for the benefit of persons ("the beneficiaries") of whom he may himself be one, and any one of whom has the right to enforce the obligation, or for the furtherance of a purpose which can be enforced by an enforcer provided for in the trust deed or, in the case of charitable purpose trusts, by operation of law."

He argues that an enforcer, like a beneficiary, would have personal *and* proprietary rights against the trustee.[143]

Penner,[144] on the other hand, considers that this construction cannot really be treated as creating a true private purpose trust. His view is that the only rights under a trust are those that are given to specific individuals or classes of individuals by the settlor. In a worst-case scenario, it is not inconceivable for a trustee and enforcer to agree to split the trust money between them and abandon the trust's purpose. No one else, neither a third party nor the court, would have any independent right to enforce any duties against the trustee. No one may even be aware of this scenario. No one can insist that the enforcer exercises his power to make the trustee apply the trust fund in furthering the purpose.

Penner[145] argues further that true private purpose trusts can only be created if the law is changed. This would give public force to the purpose trust, so that the trust property would not be governed only by the private rights of individuals. He suggests that, as a result, they should not necessarily be called "private" purpose trusts.

Many offshore jurisdictions have enacted legislation that allows non-charitable purpose trusts and recognises the concept of an enforcer.[146] The legislation of some jurisdictions gives the

[143] Hayton (2001) 117 *LQR* 96 107-108.
[144] Penner *The Law of Trusts* 253-255.
[145] Penner *The Law of Trusts* 255.
[146] The most well-known purpose trust legislation is the Cayman STAR Trust legislation, known as the Special Trusts (Alternative Regime) Law 1997. Other examples include Jersey's purpose trust legislation, enacted by the Trusts (Amendment No 3) (Jersey) Law 1996.

court power to enforce a purpose trust at the application of any interested party,[147] while others subject the enforcer to a fiduciary duty to ensure that the enforcer does what he is supposed to do, namely to enforce the trust.[148] This type of legislation has not escaped criticism.

It would appear that, should a decision be made to allow non-charitable purpose trusts under English law, a legislative change would be preferred over development through case law, as legislation makes it possible to provide clarity at the outset with regard to the rights and obligations of all parties involved. The main concern relates to the methods of ensuring that the enforcer keeps the trustee accountable. It may result in an artificial attempt to create an obligation that does not really exist.

2 7 3 2 The obligation and property dimensions of the trust

Parkinson[149] contends that the law of trusts may be better conceptualised as a species of obligation rather than being understood as a form of property ownership. He admits that the separation of legal and equitable estates forms an essential part of the understanding of the English law trust and in most cases where the legal estate to property is held on trust, there is a corresponding equitable estate located in another person or persons. However, he cites various examples of trusts, especially discretionary trusts, where it is difficult to point to a person who has a symmetrical equitable right to the trust property vested in him. This is because beneficiaries of discretionary trusts do not have proprietary interests in the strict sense, at least not until the trustee has exercised his discretion in favour of the beneficiary.[150]

After some consideration, he comes to the conclusion that a valid private express trust can exist without the symmetry of legal and equitable estates. Rather than focusing on legal and equitable ownership, the core of the private express trust lies in the equitable obligations in relation to property (which, in most, but not all, cases will also give beneficiaries corresponding equitable proprietary rights). The point he makes is that the interest a

[147] This is the case in Bermuda under the Trusts (Special Provisions) Act 1989 as amended by the Trusts (Special Provisions) Amendment Act 1998.
[148] Such as the Trusts Law (2001 Revision), incorporating the Special Trusts (Alternative Regime) Law 1997 of the Cayman Islands.
[149] Parkinson (2002) 61 *CLJ* 657.
[150] Parkinson (2002) 61 *CLJ* 657 658. See also ch 2 par 2 5 2.

beneficiary or object has in the trust property is proportionate to the protection that will be given to him should the trustee fail to execute the trust in the appropriate manner.[151]

Parkinson does not agree with Hayton's enforcer principle insofar as the enforcer has no particular reason to enforce the trust. He does think, however, that an obligations-based approach enables a better understanding of the irreducible core content of the trust idea, namely that there must be enforceable obligations. This implies that there must be someone who was intended to benefit from the trust to whom the trustee is accountable.[152]

An analysis of the trust in terms of a species of obligation leads to further questions. Can the trust be seen as a contract? Does such a view bridge the divide between common law trusts and civil law trusts?[153]

The first question is answered in the negative. Admittedly, recent legislation[154] has made it possible to understand trusts created by transfer as agreements to benefit third parties, similar to the position in South Africa. Furthermore, the irreducible core of trustee obligations that cannot be amended by contract is, at least in England, very small.[155] However, the trust cannot be equated to a contract. The relationships between settlor, trustee and beneficiary are simply not always contractual.[156]

The second question is answered in the affirmative, although it is stated that common law trusts, being creations of equity, will always be distinguishable from trusts created in civil law or mixed legal systems. The proprietary significance of many trust obligations would continue to exist even if trusts are understood more in terms of obligation than property.[157]

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[151] Parkinson (2002) 61 *CLJ* 657 659-660. It is interesting to note that De Waal makes a similar observation in De Waal (2000) 117 *SALJ* 548 557, namely that the ratio for the dual ownership of the English trust is the protection of the beneficiary. He shares the view that the protection of the beneficiary does not depend on a symmetry of legal and equitable estates.
[152] Parkinson (2002) 61 *CLJ* 657 668-669.
[153] See also ch 2 para 4 3 1 1.
[154] Contracts (Rights of Third Parties) Act 1999.
[155] Given that the Trustee Act 2000 allows liability for trustee negligence to be excluded. See also ch 2 para 2 8.
[156] Virgo *The Principles of Equity and Trusts* 64, although there is reference to a growing number of situations in which the dividing line between trusts and contracts are blurred.
[157] Parkinson (2002) 61 *CLJ* 657 670. See also ch 2 para 4 3 1 1 where the argument is examined from the South African angle.

2 7 4 Rule against perpetuities

This rule forms part of a more general rule that an English law trust cannot have an illegal purpose. It applies to private trusts for persons, not to charitable trusts or non-charitable purpose trusts. The rule against an illegal purpose means that, amongst others, a trust that ties property up for an unlawful period or one that allows accumulation of income beyond the period allowed by law[158] would be void.[159] For the purposes of this dissertation, only the rules relating to the duration of a trust are relevant.

The rule against perpetuities does exactly what the name implies – it prevents settlors from creating perpetual trusts and locking wealth away indefinitely.[160] The rule requires that the beneficiaries' interests in the trust property must vest in interest, and vest absolutely, within a certain period from the date that the trust was created. An interest is vested when it does not depend on the fulfilment of a prior condition, such as a beneficiary reaching a certain age, or the trustee exercising his discretion in favour of the beneficiary. By the end of the perpetuity period (also referred to as the trust period),[161] the beneficiaries must be identified and their interests definitely determined to be theirs, so that they can require that the trustee transfers the trust property to them pursuant to the rule in *Saunders v Vautier*.[162]

At common law, a determination was made at the time of creation of the trust and if it were possible that the property might vest outside the perpetuity period, the interest in that property would be void. The new "wait and see" rule introduced by the Perpetuities and

[158] The accumulation period no longer applies to private trusts created after 6 April 2010.
[159] See Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 260-314 for a detailed discussion of all the grounds of invalidity of the expressed object.
[160] It is interesting to note that many offshore jurisdictions as well as various states in the United States of America (USA) have abolished the perpetuity period in recent years. Offshore jurisdictions include Jersey, where the perpetuity period was abolished by Trusts (Amendment No 4) (Jersey) Law 2006 and Bermuda, where the Perpetuities and Accumulations Act 2009 abolished the rule in all cases except in respect of Bermuda real estate. For the USA, see Weisbord (2015) 67 *Fla L Rev* 73, which questions the sensibility of removing the perpetuity period.
[161] At common law, the perpetuity period was determined by reference to a relevant life in being, plus twenty-one years. In practice, for the sake of certainty, many trust deeds referred to a member of the English royal family as the life in being. The common law position was reformed by the Perpetuities and Accumulations Act 1964, which made it possible to specify a perpetuity period of a maximum of eighty years. The Perpetuities and Accumulations Act 2009 reformed the position again by introducing a single perpetuity period of 125 years for trusts taking effect on or after 6 April 2010. Trusts taking effect before this date will be governed either by the common law "lives in being plus twenty-one years" period (or if it is difficult to determine whether the lives have ended, a period of one hundred years), or by a fixed period of up to eighty years specified in the trust deed.
[162] *Saunders v Vautier* [1841] EWHC Ch J82. This rule, very briefly, enables the beneficiaries of a trust, provided they are all adult and *sui iuris*, and all in agreement, to call for the legal estate to be vested in them, in other words, for the assets to be distributed to them and the trust brought to an end.

Accumulations Act 1964 and the Perpetuities and Accumulations Act 2009 means that an interest in trust property will not be treated as void until it is clear that the property must vest, if at all, after the end of the perpetuity period. Everything done before this point remains valid.[163]

2 8 Role of legislative developments

Legislation is intended to provide certainty and consistency with regard to the law. In civil law systems, the law is codified to a much greater extent than in common law systems, such as England. The extent to which legislation determines the legal position depends, of course, on the area of law. In the field of trust law, case law has traditionally played a more important role than legislation in determining the legal position. However, the role of legislation cannot be overlooked. Legislative change is faster and provides more certainty, and so may be the preferred solution for certain administrative issues, or in areas where uncertainty has hindered the application of the law for a prolonged period. (However, it is of course only the case that legislative change is faster if politicians are interested in the matter and regard it as a priority. There are usually few votes to be gained by reforming the law of trusts, but recently the public interest in the closing down of taxation loopholes may have altered this somewhat.)

The predecessor to the Trustee Act 2000, the Trustee Act 1925, was intended to be an act consolidating previous acts[164] relating to trustees so as to simplify parliamentary procedure. In the 75 years between the coming into force of the Trustee Act 1925 and the Trustee Act 2000, there was not much in the sense of legislative change with regard to trustees' duties and investment powers apart from the Trustee Investments Act 1961. This was, however, a period of profound change in the trust industry in England and abroad.

Hayton[165] remarks that, during this period, the judiciary had started to adopt a more liberal and pragmatic approach inclined to uphold trusts, in contrast to the stricter, more conceptualist approach of the preceding period. During the same period, the legislature did little to develop the English trust heritage.

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[163] Penner *The Law of Trusts* 83-85; Virgo *The Principles of Equity and Trusts* 116-118.
[164] Those previous acts included the Trustee Act 1893, the Law of Property Act 1922, the Law of Property Amendment Act 1924 and the Law of Property Act 1925.
[165] Hayton (1990) 106 *LQR* 87.

Important changes in the practical use and application of trusts during this period include the nature of trusteeship and the development of new investment opportunities. Trustees were traditionally selected for their trustworthiness rather than for their expertise in managing investments and other administrative tasks. Professional trustees, many of whom operate as corporate enterprises specialising in the setup and administration of trusts, have by now become commonplace. At the same time, the opportunities for utilising trust property increased greatly. The investment products available to trustees grew in number and sophistication, helped on by the globalisation of financial markets.[166]

Questions were being raised about the standard to be expected of paid professional trustees, for example in the well-known case of *Bartlett v Barclays Bank Trust Co Ltd*.[167] In the *Bartlett* case, which was decided in 1980, it was already being suggested that paid professional trustees should be judged against the standards of skill and expertise that they claim to possess.[168] On the other hand, these professional trustees wanted more freedom in terms of their investment powers. The view was that professional trustees, being or, at least, having access to, investment experts, should not be bound to be as prudent and conservative in investment matters as their laymen counterparts. It also enabled trustees to generate more income and gains for beneficiaries, which in turn helped them attract more business.

Thus, with regard to trustees' duties, there was a need for setting standards and accountability beyond the traditional expectations, and with regard to trustees' powers, there was a need for more liberalisation.[169]

The policy movement towards change continued with the Law Reform Committee[170] making recommendations for reform with regard to trustees' powers and duties in 1982,[171] and the Law Commission issuing a report about the same topic in 1999.[172] The recommendations were then implemented in the form of the Trustee Act 2000.

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[166] Wilson *Todd & Wilson's Textbook on Trusts* 312-315.
[167] *Bartlett v Barclays Bank Trust Co Ltd* [1980] 1 All ER 139.
[168] *Bartlett v Barclays Bank Trust Co Ltd* [1980] 1 All ER 139 140.
[169] Wilson *Todd & Wilson's Textbook on Trusts* 315-316.
[170] A committee of the English Bar Council that develops and considers proposals for law reform and submit views to the government and other bodies.
[171] Law Reform Committee *Trustees' Powers and Duties: Giving Trustees the Powers They Need* No 146 (1982).
[172] Law Commission *Trustees' Powers and Duties* No 260 (1999).

One of the main features of the Trustee Act 2000 (the 2000 Act) is that it created a uniform standard of care expected from trustees. Equity has always imposed a duty of care on trustees, but the 2000 Act provided certainty and consistency with regard to the standard of competence and behaviour expected of trustees. Given the context of an increasing number of professional trustees, the duty of care refers specifically to the standard expected of those professionals.[173]

Significantly, the duty of care can be excluded by adding a provision to this extent in the trust deed.[174] One cannot help but wonder whether this is unfairly biased towards trustees, and especially professional trustees who would be aware of the legislation and the ability to exclude the application of the duty of care. Even though the rules of equity will still apply, it seems counterproductive, as the 2000 Act was intended to introduce standardisation and consistency and a higher expectation from professional trustees, and this is potentially lost by allowing an exclusion of the duty of care.

The other important feature of the 2000 Act is the abolition of restrictions with regard to the kind of investments trustees could make. A trustee may now make any kind of investment he would have been able to make if he were absolutely entitled to the trust assets.[175] This gives trustees much more freedom in terms of investments, but they are still bound by the duty of care, and the 2000 Act also includes a number of restrictions designed to protect the trust property. This includes the trustee having to have regard to standard investment criteria[176] and seeking expert investment advice in appropriate circumstances.[177] Again, the investment powers provided for in the 2000 Act can be restricted or excluded by the provisions of the trust deed.[178]

From the trustee's point of view, it is understandable that with the ability, and need, to make a wider range of investments to ensure good performance for beneficiaries, comes a higher degree of risk of liability for loss to the trust fund. But is the level of accountability and

[173] Trustee Act 2000 s 1(1). This will be examined in more detail in ch 3.
[174] Trustee Act 2000 sch 1 para 7.
[175] Trustee Act 2000 s 3(1).
[176] Trustee Act 2000 s 4.
[177] Trustee Act 2000 s 5.
[178] Trustee Act 2000 s 6.

liability of trustees of English law trusts commensurate with the irreducible core approach?[179] This is examined further in chapter 3.

2 9 The Law Commission

The Law Commission of England is an independent statutory body set up by Parliament and created by the Law Commissions Act 1965, which sets out the functions of the Law Commission. The purpose of the Law Commission is to keep the law under review and recommend reform where this is required, so as to ensure that the law is fair, modern, simple and as cost-effective as possible.[180]

Apart from the two reports mentioned below, there have been a number of projects in the area of trust law. In 1998, a report was published on the rules against perpetuities and excessive accumulations and this resulted, albeit many years later, in the recommendations for reform being enacted in the Perpetuities and Accumulations Act 2009. The two projects mentioned below are relevant to the issues covered in this dissertation and therefore deserves more than a mere mention, although the projects and their practical effect will be examined in more detail at a later stage.[181]

2 9 1 Report on trustees' powers and duties

This report[182] reviewed the law regarding trustees' powers to invest trust funds in the absence of express powers of investment in the trust deed, and also included recommendations for reform in the field of trust administration, including collective delegation by trustees, the use of nominees and custodians, and so forth. This was a joint project with the Scottish Law

[179] See ch 2 paras 1, 2 6 3.
[180] The work of the Law Commission involves the codification of laws to make it easier for normal citizens to have access to the law and for courts to understand and apply the law; the consolidation of statutes with the aim of making it easier to find legislative information; and the repeal of old, unused statutes. The Law Commission also conducts research and consultations to enable it to make recommendations to Parliament. Before deciding which projects to take forward, the Law Commission consults with judges, lawyers, government departments, the business sector and the general public. The Law Commission can make recommendations about a certain area of law but it is up to Parliament to change the law by enacting the recommendations of the Law Commission. Although there is already a high rate of implementation of recommendations (more than two thirds), the Law Commission Act 2009 was enacted to improve the rate at which recommendations for reform are implemented. It creates a duty on the Lord Chancellor to report annually to Parliament on the extent to which the government has implemented the Law Commission's recommendations.
[181] See ch 3 which deals with the position of trustees.
[182] Law Commission *Trustees' Powers and Duties* No 260 (1999).

Commission and was finalised in 1999. The recommendations in this report were implemented in the 2000 Act, an example of how swiftly legislative change can be accomplished. Some aspects of this report will be examined in chapter 3.

2 9 2 Report on trustee exemption clauses

This report[183] dealt with clauses in trust deeds that have the effect of limiting or excluding liability for negligence. It recommended a non-statutory rule of practice for the trust industry, which should be enforced by the regulatory and professional bodies in this industry, such as the Law Society, the Institute of Chartered Accountants in England and Wales, and the Society of Trust and Estate Practitioners (STEP). The recommended non-statutory rule requires that professional trustees (generally the same as paid trustees) and drafters of trust deeds take reasonable steps to ensure that settlors understand the meaning and effect of exemption clauses if the trust instrument is intended to contain such a clause.

Although some feel that such a non-statutory rule is preferable to a legislative change, it is unlikely to have the same practical impact. This is examined further in chapter 3.

2 10 Role of the courts and case law

Equity, that body of law out of which the trust was born, was itself developed through the courts. Historically, equity was founded on the Lord Chancellor's discretion, exercised with reference to his conscience.[184] In light of this, it is impossible to ignore the importance of the role the courts have played in the development of English trust law.

Very early cases recorded the struggle between the chancery courts and the common law courts, which came to a head in 1615. Equity, the function of which was to soften and mollify the extremity of the law, prevailed.[185] An unsatisfactory system had, however, developed and having two systems of law administered by different courts was not ideal. The solution came

[183] Law Commission *Trustee Exemption Clauses* No 301 (2006).
[184] Davies and Virgo *Equity & Trusts: Text, Cases, and Materials* 6; see ch 2 para 2 2 1.
[185] Davies and Virgo *Equity & Trusts: Text, Cases, and Materials* 4.

in the form of legislation. The Judicature Acts 1873 and 1875 rectified the situation by fusing the administration of common law and equity.[186]

Nowadays, equity is characterised as a doctrinal system. There are identifiable rules that must be applied strictly without judicial discretion. It was said in *Re Diplock*[187] that, just because the justice of a case seems to require it, a new jurisdiction cannot be invented in order for a claim in equity to exist.[188]

This does not mean that equity is immutable. In *Re Hallet's Estate*[189] it was acknowledged that the courts of chancery have not existed as long as the common law courts and that they have been altered, improved and refined from time to time. The older cases are therefore less useful than the more modern ones.[190]

It also does not mean that there is no discretion left within equity. The court retains discretion in the application of equitable rules and the award of equitable remedies, and takes questions of justice and fairness into account in order to secure a just and fair result.[191]

Therefore, although modern equity is built on the old cases, the underlying principles have been refined over the years and new remedies have been developed by equity, such as the order of specific performance to make a defendant perform obligations under contract.[192]

Apart from discretion, the other important feature of equity is the prevention of unconscionability.[193] In *Westdeutsche Landesbank Girozentrale v Islington*,[194] Lord Browne-Wilkinson said that the key justification for the recognition of a trust is that equity operates on the conscience of the owner of the legal interest.[195] This is another statement that recognises the importance of the obligation dimension of the trust.

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[186] See ch 2 para 2 2 2.
[187] *Re Diplock's Estate, Diplock v Wintle* [1948] 2 All ER 318.
[188] Davies and Virgo *Equity & Trusts: Text, Cases, and Materials* 6.
[189] *Re Hallett's Estate* (1880) 13 Ch D 696.
[190] Davies and Virgo *Equity & Trusts: Text, Cases, and Materials* 6-7.
[191] Davies and Virgo *Equity & Trusts: Text, Cases, and Materials* 7.
[192] Davies and Virgo *Equity & Trusts: Text, Cases, and Materials* 10-11.
[193] The important question is, of course, how to determine unconscionability. Initially, this was by reference to the conscience of the Lord Chancellor, which led to arbitrary results. Although equity is nowadays more rule-based, it remains unclear how unconscionability is to be determined.
[194] *Westdeutsche Landesbank Girozentrale v Islington LBC* [1996] AC 669 705.
[195] Davies and Virgo *Equity & Trusts: Text, Cases, and Materials* 7.

In many areas of trust law, landmark cases have contributed greatly to the development of the law. This was highlighted in the preceding paragraphs. In the following two chapters, where the focal points of trustee duties and liabilities and settlor control will be examined in detail, the important and continuing role of the courts in determining and shaping substantive trust issues will again come to the fore.

3 Jersey

3 1 Introduction

The Channel Island of Jersey is a British Crown Dependency. It forms part of the British Isles, but is not part of Great Britain or the United Kingdom. In the year 933, Jersey was annexed to Normandy, and became the property of England in 1066 when the Duchy of Normandy joined England. In 1204, the Duchy was separated from England, leaving Jersey to become self-governing – not part of Normandy, and not within the English legal system either.[196]

Jersey therefore has a high level of autonomy with regard to jurisprudence and legislation, and the only law that definitely applies is legislation passed by the States of Jersey (the Jersey Parliament and government) and the case law of the Jersey courts. Legislation passed by the UK Parliament only applies in limited circumstances.[197]

Jersey can be described as a customary law jurisdiction.[198] Its law is based on the customary law of the Duchy of Normandy prior to 1204.[199] However, after the separation of Jersey from the Duchy of Normandy in 1204, the legal systems started to diverge. The ancient Norman law remained the common law, and was separate from the law of England and Wales.[200] However, Jersey law developed independently of Norman law, and a customary Jersey law

[196] Brown *The Jersey Law of Trusts* 1.
[197] Brown *The Jersey Law of Trusts* 2.
[198] Brown *The Jersey Law of Trusts* 2.
[199] Kelleher (1999) 1 *JLR.*
[200] Southwell (1997) 3 *JLR.*

was developed. Not surprisingly, ascertaining the old customary law position, and knowing where to find it, is not always easy.[201]

Apart from customary law, which has its roots in ancient Norman law, other sources of Jersey law are English common law and modern French civil law. Different areas of the law have drawn on different sources to different extents. There seems to be some disagreement as to the extent to which these two legal systems have assisted, and should continue to assist, the development of Jersey law.[202]

For the purposes of a study of the law of trusts, it is not necessary to delve into the ancient history too deeply, as trusts did not feature regularly in case law until the nineteenth century. There is therefore very little customary Norman law relevant to trusts in Jersey.[203] The extent to which trust law was, and still is, influenced by English law will be examined below.

Jersey has its own court system. The Royal Court hears both civil and criminal matters. Appeals against Royal Court decisions are heard by the Jersey Court of Appeal, and from there, appeals go to the Judicial Committee of the Privy Council in England. The Judicial Committee is in fact the court of final appeal for all the UK overseas territories and Crown dependencies, and for certain Commonwealth countries.[204]

Although the doctrine of *stare decisis* does not strictly apply in Jersey, judicial precedent plays an important role. Practically speaking, the Royal Court is obliged to follow its own decisions unless they were wrong. The Jersey Court of Appeal can overturn decisions of the Royal Court. A decision of the Judicial Committee of the Privy Council on an appeal from Jersey will bind all Jersey courts. If a case is on appeal from another jurisdiction, the decision of the Judicial Committee will not be binding in Jersey, but will have persuasive authority.[205]

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[201] See Kelleher (1999) 1 *JLR*, where this is examined in more detail with regard to the law of contract and Southwell (1997) 3 *JLR* for the more general position.
[202] Binnington (1997) 1 *JLR*.
[203] Brown *The Jersey Law of Trusts* 2.
[204] Anonymous http://jcpc.uk (accessed 20-01-2016).
[205] Brown *The Jersey Law of Trusts* 4-6.

3 2 Historical development of Jersey trust law

3 2 1 Jersey customary law

In relation to trusts, the only clear Jersey law available is the Trusts (Jersey) Law 1984, as amended from time to time (the TJL),[206] and Jersey case law relating to Jersey trusts.

In other areas of the law, the customary Jersey law, found mainly in two ancient Norman documents known as the *Ancienne Cotume* (Ancient Customs) and *Cotume Reformée* (Reformed Customs), is an important source of law, together with laws passed by the States of Jersey and case law.[207] In the middle of the nineteenth century, commissioners were appointed to enquire into the criminal law of Jersey and later, around 1860,[208] into the civil law. This resulted in the *Report of the Commissioners appointed to inquire into the Civil, Municipal & Ecclesiastical Laws of the Island of Jersey*[209] (the "Civil Report"). These reports are relied upon to a great extent in order to ascertain customary Jersey law.[210]

Only as from the latter part of the nineteenth century were trusts regularly the subject of court cases. The concept of applying funds to public or charitable purposes by gifting property to trustees was known in Jersey before this time, but there is a dearth of Jersey authority on trusts prior to this date.[211]

Although the TJL has almost completely superseded the customary law of trusts, it is important to note that the TJL was never intended to be a complete codification of the Jersey law of trusts and, as such, there is case law predating the TJL that is still relevant today.[212]

This was confirmed, not only in the TJL[213] itself, but also in a judgment of the Royal Court that formed part of the litigation surrounding the *Esteem Settlement*,[214] where the following was stated:

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[206] The version of the Trusts (Jersey) Law 1984 referred to in this dissertation is the Revised Version, showing the law as at 1 January 2014, which incorporates all the amendments made to date.
[207] Brown *The Jersey Law of Trusts* 2.
[208] Different sources refer to different dates, all between 1859 and 1861.
[209] *Flynn v Reid* [2012] (1) JLR 370 398.
[210] Southwell (1997) 3 *JLR.*
[211] Brown *The Jersey Law of Trusts* 2-3.
[212] Brown *The Jersey Law of Trusts* 11.

> "[T]he 1984 Law was not a codification, nor was it enacted in a vacuum. There was already a customary law of trusts in existence. Many of the provisions of the 1984 Law were simply reflections of the pre-existing law or of English principles. There is no implication that, because a provision is included in the 1984 Law, it is something which did not exist beforehand."[215]

As one can expect, given Jersey's importance as an offshore trust jurisdiction, there is now a wealth of case law postdating the TJL, and clearly this will be of more relevance in ascertaining the current legal position than much older cases.

Looking at the development of trust law in Jersey before the coming into force of the TJL, whilst the influence of English law on the TJL and on Jersey jurisprudence relating to trusts cannot be ignored, this was an influence that mainly affected the latter part of the development of Jersey trust law, from the nineteenth century onwards.[216]

In terms of the earlier development of Jersey trust law (and focusing only on trusts created *inter vivos*), two restrictions that have helped shape the law are the rules relating to Jersey immovable property (the property law does not recognise dual ownership rights)[217] and restrictions on testamentary freedom. Prior to 1984, there was no prohibition against such a trust being established, as long as the creation of the trust did not breach another rule of law.[218] The TJL now expressly provides that a trust shall be invalid if it purports to apply directly to immovable property situated in Jersey.[219]

Norman customary law did not prohibit *inter vivos substitutions* of immovable property. A *substitution* in this sense refers to the French *substitution fidecommissaire*, which is the direct successor to the Roman law *fideicommissum*. It can be described as an attempt to give full legal ownership to someone for his lifetime, with an obligation resting on him not to dispose

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[213] Trusts (Jersey) Law 1984 art 1(2) which provides: "This Law shall not be construed as a codification of laws regarding trusts, trustees and persons interested under trusts."
[214] *In the matter of the Esteem Settlement and the No. 52 Trust* [2002] JLR 53.
[215] *In the matter of the Esteem Settlement and the No. 52 Trust* [2002] JLR 53 92.
[216] Brown *The Jersey Law of Trusts* 5.
[217] See ch 2 para 3 3 2.
[218] Brown *The Jersey Law of Trusts* 13.
[219] Trusts (Jersey) Law 1984 art 11(2)(a)(iii).

of the property, coupled with a second gift of the absolute ownership, but only in the future. If the first owner imposed his own *substitution* on the second owner, the property could become inalienable for another generation.[220]

In 1560, the French King Charles IX issued an *ordonnance* that forbade the creation of *substitutions* (both testamentary and *inter vivos*) beyond the second degree removed from the creator, but this of course had no effect in Jersey.[221] Le Geyt, a famous seventeenth-century Jersey lawyer, was of the view that the donor must be able to choose whom to benefit and on what terms, but there is no clear precedent confirming this. However, no law to forbid *inter vivos substitutions* of immovables was ever enacted in Jersey.[222]

Trusts split up the beneficial enjoyment of immovable property in the same way as *substitutions* do, and therefore the argument was that Jersey law should not forbid *inter vivos* trusts of immovable property either. In the Civil Report, the commissioners found that there was no law expressly forbidding the creation of trusts *inter vivos*, but that trusts of immovables, in favour of private individuals and unconnected to public purposes, were up to then unknown. The commissioners recommended the enactment of a law to deal with public trusts of immovables, but found that the law of Jersey did not recognise trusts and declined to suggest a general introduction of trusts, given that it would require fundamental changes to the whole system of immovable property.[223]

In 1866, the Judicial Committee of the Privy Council remarked, albeit *obiter*, that the law of Jersey does not forbid the creation of trusts by *inter vivos* acts.[224] A series of cases concerning private *inter vivos* trusts followed, some recognising the validity of *inter vivos* trusts of immovable property, others rejecting it.[225] The TJL now makes the position clear. A trust governed by Jersey law cannot have immovable property situated in Jersey as its subject.[226] Practically speaking, this has not been an impediment to Jersey's success as an offshore trust

[220] Brown *The Jersey Law of Trusts* 17, 22-23.
[221] Brown *The Jersey Law of Trusts* 23.
[222] Brown *The Jersey Law of Trusts* 24.
[223] Brown *The Jersey Law of Trusts* 24-25.
[224] *Godfray v Godfray* [1866] UKPC 7 18.
[225] Brown *The Jersey Law of Trusts* 25-27. Unfortunately the judgments are hard to obtain but apparently do not give much insight into the court's reasoning in any event.
[226] Trusts (Jersey) Law 1984 art 11(2)(a)(iii); see also ch 2 para 3 3 2 with regard to proprietary rights in Jersey. Further to Trusts (Jersey) Law 1984 art 49(2)(a)(iii) Jersey law will also regard as unenforceable a foreign trust that has Jersey immovable property as its subject.

jurisdiction, given that most settlors setting up Jersey trusts do so for the purpose of holding foreign assets.

The development of the law relating to trusts holding movable property, or immovable property situated outside of Jersey, has been less controversial. Such trusts have apparently been accepted as valid and enforceable since the eighteenth century, whether they were for public or private purposes.[227] An important case in which the Privy Council recognised private *inter vivos* trusts in 1866 is *Godfray v Godfray*.[228] Of course, private trusts have enjoyed statutory recognition as valid and enforceable since the coming into force of the TJL.[229]

3 2 2 Influence of English law

It is clear that Jersey did not simply take over the whole of the English law of trusts without any adaptation. There is, however, little doubt that English trust law played (and still plays) an important part in the development and application of trust law in Jersey. In the matter of the *Esteem Settlement*,[230] the Royal Court confirmed that the English concept of the trust was incorporated into Jersey customary law notwithstanding the fact that Jersey and English law have different roots.

Two important areas where the English influence on Jersey trust law can be observed, are the equitable jurisdiction of the Jersey courts and the authority of English case law in the absence of Jersey authority on a specific point.

3 2 2 1 Equitable jurisdiction of Jersey courts

Jersey never knew equity as a distinct body of law, or separate courts of equity, such as exist in England.[231] Given that the trust would not have developed, or at least not in the way it did, was it not for the courts of equity, one may be inclined to think that the division of law and equity is a prerequisite for having and sustaining a law of trusts. However, trusts flourish in

[227] Brown *The Jersey Law of Trusts* 27.
[228] *Godfray v Godfray* [1866] UKPC 7 18. The statement that Jersey law does not forbid the creation of trusts by acts *inter vivos* is based on statements in the Civil Report. See ch 2 para 3 2 1.
[229] Trusts (Jersey) Law 1984 art 3.
[230] *In the matter of the Esteem Settlement and the No. 52 Trust* [2002] JLR 53 96.
[231] See ch 2 para 2 2.

many countries that do not have separate systems, or courts, of law and equity,[232] and even in England, law and equity is now administered by the same High Court.[233]

References to the Jersey courts having an equitable jurisdiction can be found in both nineteenth and twentieth-century cases.[234] The Royal Court has expressly confirmed that it is a court of equity. However, doubt seems to exist concerning the interpretation of the word equity in this regard.

In the case of *Ex Parte Viscount Wimborne*[235] the court considered, seemingly for the first time, the extent of the application of equity in Jersey. The court stated that the Royal Court is a court of equity in the widest sense, but that this does not mean that it has wider powers than the former Chancellors of the Court of Chancery. The principles that guided the Chancellors were conscience, reason and good faith, and not any Chancellor's own or other common opinions as to what was right and convenient.[236]

Furthermore, the court mentioned that the conditions in the English common law courts which gave rise to the system of equity[237] were never present in Jersey, and that equity in Jersey may be closer to the French *equité* – a just tempering or benevolent construction of statute law – than to the English version.[238] After quoting a passage from a French legal dictionary, Deputy Bailiff Crill came to the conclusion that not all the principles developed in the English chancery courts necessarily apply in the Jersey courts.[239] Nevertheless, he confirmed that the Royal Court will award equitable remedies, and has done so in the past, when considered necessary.[240]

This view, that equity in Jersey is closer to the broader French concept of *equité* than to the narrower interpretation of equity under English law, has been confirmed in *Lane v Lane*[241] and *Trollope v Jackson*.[242]

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[232] See ch 2 para 4 3 1 1.
[233] See ch 2 para 2 2 2.
[234] See Brown *The Jersey Law of Trusts* 7 where the cases are cited.
[235] *Ex Parte Viscount Wimborne* (1983) JJ 17.
[236] *Ex Parte Viscount Wimborne* (1983) JJ 17 19-20.
[237] See ch 2 para 2 2 1.
[238] Brown *The Jersey Law of Trusts* 8.
[239] *Ex Parte Viscount Wimborne* (1983) JJ 17 20-22.
[240] *Ex Parte Viscount Wimborne* (1983) JJ 17 22.
[241] *Lane v Lane* [1985-86] JLR 48.

A more recent case, *Fiduciary Management v Sheridan*,[243] took a stricter view of the equitable jurisdiction of the Royal Court, and compared it to the English concept of equity rather than the French *equité*. The court was of the view that, as the TJL makes specific provision for a constructive trustee[244] by reference to an established product of English jurisprudence, the requirements in Jersey for the establishment of a constructive trust should generally be the same as the requirements in England.[245]

Therefore, even if it is difficult to define the precise nature and extent of the equitable jurisdiction of the Jersey courts, in practice, equitable remedies known in England, such as recognising constructive and resulting trusts, promissory estoppel and specific performance, are regularly used by the courts in Jersey.[246]

3 2 2 2 Authority of English case law

Jersey law has its roots in Norman customary law. It is therefore not surprising that in many areas of the law, the Jersey courts would, in the absence of earlier authority, look to French law for guidance. This is not the case with trust law.

Given that there is only a limited number of older cases dealing with trusts, the Jersey courts have had to look elsewhere for guidance on points where no Jersey authority existed. This seems to be widely accepted.

In the case of *Re Malabry Investments Ltd*,[247] a case from 1982, Deputy Bailiff Crill said that none of the counsel involved in the case was able to draw his attention to any Jersey case on the subject of trusts.[248] The case was concerned with whether a trust of certain monies had

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[242] *Trollope v Jackson* 1990 JLR 192.
[243] *Fiduciary Management v Sheridan* [2002] JRC 34, a case which dealt with the recognition of constructive trusts in Jersey.
[244] Trusts (Jersey) Law 1984 art 33.
[245] *Fiduciary Management v Sheridan* [2002] JRC 34.
[246] Brown *The Jersey Law of Trusts* 9.
[247] *Re Malabry Investments Ltd* (1982) JJ 117.
[248] Perhaps Deputy Bailiff Crill meant that there were no Jersey cases dealing with the specific issues raised by this case, as clearly older Jersey case law on trust do exist. However, he clearly felt that there were no Jersey cases that could assist him in reaching a conclusion in this case.

been created, which meant that the funds represented by such trust were not available for distribution to the general creditors of the creator of the trust. Deputy Bailiff Crill stated:

> "I am satisfied, however, that the general equitable jurisdiction which the Royal Court has exercised particularly in recent years enables me to take note of the English Common Law and to find that if the concept of a Trust of the nature propounded by the Viscount is known to the law of Jersey then the Court may have regard to the principles creating such a Trust which apply under English Law."[249]

Given the reliance of the Jersey judiciary on English case law, it is not surprising that Jersey trust law has developed in such a way that it closely resembles English trust law. The TJL now regulates a large part of the trust law, but the legislation is based largely on the law that existed at the time it was drafted, and at that point in time, the influence of English law on Jersey trust law was already substantial.

So although the TJL is not a codification of the Jersey trust law, what is regulated by the TJL bears close resemblance to English trust law principles. In areas that are not covered by the TJL, the Jersey courts continued to have recourse to English cases, especially in the years immediately following the coming into force of the TJL. More recently, as Jersey is building up its own body of case law on the subject of trusts, reliance on English trust law seems to be diminishing.[250]

There is, however, still some unchartered territory. As recently as 2002 the Royal Court had to determine, amongst other questions, whether Jersey law recognised that the victim of fraud has a proprietary interest, arising under a constructive trust, in the proceeds of the fraud; whether Jersey law recognised the ability to trace trust assets; and, if so, which principles should apply.[251] Tracing has in fact been allowed in earlier unreported cases,[252] where it was stated that the court should allow tracing as part of its equitable jurisdiction to remedy fraud,

[249] *Re Malabry Investments Ltd* (1982) JJ 117 118.
[250] Brown *The Jersey Law of Trusts* 28.
[251] *In the matter of the Esteem Settlement and the No. 52 Trust* [2002] JLR 53 70-71.
[252] *Re PKT Consultants (Jersey) Ltd* Royal Ct, August 1st, 1991, unreported; *Royal Bank of Scotland Ltd v Khan* Royal Ct, October 19th, 1999, unreported.

but in these cases full arguments on whether tracing forms part of Jersey law were not heard.[253]

Without going into too much detail of the case at this point, it is clear that the court decided to follow only certain parts of English law. The principle of tracing was held to form part of Jersey law where there is an underlying proprietary interest on the part of the claimant, but more flexible rules than the English ones were adopted.[254] Avoiding archaic and inflexible rules is, of course, positive for the development of a modern trust law.

Furthermore, with regard to the question of whether a debt had to precede the creation of a trust in order for the creditor to be able to attack the validity of the trust, the court considered both English law and French law prior to and after the introduction of the Civil Code in France. The court decided to follow the older French position that the debt had to precede the transaction, in other words, a person who becomes a creditor of the settlor after he settled the trust, cannot attack the validity of the trust if the settlor subsequently becomes insolvent.[255] This, of course, makes Jersey a more attractive trust jurisdiction for settlors looking for asset protection against creditors, but presumably the decision was taken free of this sort of policy consideration.

The court did feel that if it was considered necessary to depart from the existing Jersey customary law position, this was not a task for the judiciary and should be a legislative change.[256] They also stated that, in the modern world where assets are more fluid and can be spread out over the world, thus complicating information gathering, the customary law principles must be applied with that in mind. Rather than a meticulous balance sheet exercise, the court must simply determine whether there is a close connection in time and effect between the disposition and the subsequent insolvency.[257] The courts therefore seem willing to develop the trust law to adapt to the changing needs of society, but is of the view that certain changes are better made by legislation.

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[253] *In the matter of the Esteem Settlement and the No. 52 Trust* [2002] JLR 53 95-97.
[254] *In the matter of the Esteem Settlement and the No. 52 Trust* [2002] JLR 53 97-99.
[255] *In the matter of the Esteem Settlement and the No. 52 Trust* [2002] JLR 53 119-121.
[256] *In the matter of the Esteem Settlement and the No. 52 Trust* [2002] JLR 53 121.
[257] *In the matter of the Esteem Settlement and the No. 52 Trust* [2002] JLR 53 127.

In summary therefore, case law from England (and occasionally other jurisdictions) may be used as authority in Jersey cases where the law is unclear because it is not covered by the TJL and there is no previous Jersey case law dealing with the specific issue at hand. Over time, and as Jersey builds up its own body of case law, reliance on English law is expected to decrease even further. It is also clear that the Jersey courts will not follow English law if they feel that the English principle in question is outdated, controversial or disputed, leads to unfair results, or may be susceptible to change in the future.

3 3 Definition of a trust

3 3 1 Definition under the TJL

Although this is of historical interest only and not much seems to be written about it, prior to the coming into force of the TJL, a trust was presumably defined in terms resembling the definition of an English law trust, given that the concept of the English trust was incorporated into Jersey customary law.[258]

Article 2 of the TJL now defines a trust as follows:

> "A trust exists where a person (known as a trustee) holds or has vested in the person or is deemed to hold or have vested in the person property (of which the person is not the owner in the person's own right) –
> (a) for the benefit of any person (known as a beneficiary) whether or not yet ascertained or in existence;
> (b) for any purpose which is not for the benefit only of the trustee; or
> (c) for such benefit as is mentioned in sub-paragraph (a) and also for any such purpose as is mentioned in sub-paragraph (b)."

Whilst this may not be the most exhaustive definition, it is not perceived as unclear. It contains the necessary elements of property and obligation, as also found in the definition of a trust under English and South African law.[259]

[258] See ch 2 para 3 2 2.
[259] See ch 2 paras 2 4 1, 4 3 3 respectively.

Although the definition does not clearly state that the trustee has legal ownership of the trust assets, it indicates that he is not the owner of the property in his own right and that he owns it for the benefit of the beneficiaries or a purpose. The only logical conclusion, therefore, is that he has legal title.[260] Read in conjunction with article 54 of the TJL, this becomes more evident. It states that, unless the trustee is also a beneficiary, his interest in the trust property is limited to that which is necessary for the proper performance of the trust and that the trust property shall not be deemed to form part of the trustee's assets.

Sub-paragraph (b) of the above definition indicates that Jersey law recognises non-charitable purpose trusts. Although the same wording appeared in the original version of the TJL, article 10(2)(a)(iv) of that version stated that non-charitable purpose trusts were invalid. The TJL was amended in 1996 to make clear provision for the recognition of non-charitable purpose trusts.[261] The recognition of non-charitable purpose trusts is relevant in the context of the obligation dimension of the trust,[262] and in the context of how offshore jurisdictions fashion their trust laws in order to attract business.[263]

3 3 2 Distinction between legal and equitable ownership

Article 11(2)(a)(iii) of the TJL clearly states that immovable property situated in Jersey cannot be the subject of a Jersey law trust.[264] The reason for this exclusion can be found in the history of Jersey property law. Jersey customary law, being founded on Norman law rather than English law, did not recognise a division between beneficial (or equitable) and legal interests in Jersey immovable property.[265]

In *Flynn v Reid*,[266] the Royal Court considered the historical background of Jersey property law in some detail in an attempt to decide whether a constructive trust of immovable property could be possible. The court referred to the Civil Report and to the *Loi (1880) sur la Propriété Foncière* that was adopted as a result of the Civil Report, and confirmed that the

[260] Brown *The Jersey Law of Trusts* 132.
[261] Trusts (Amendment No 3) (Jersey) Law 1996.
[262] See ch 2 para 2 7 3.
[263] See ch 1 para 2 2; ch 2 para 3 7.
[264] Trusts (Jersey) Law 1984 art 49(2)(a)(iii) provides that a foreign trust will be unenforceable in Jersey to the extent that it has immovable property located in Jersey as its subject matter.
[265] Brown *The Jersey Law of Trusts* 86; *Flynn v Reid* [2012] (1) JLR 370 398-401.
[266] *Flynn v Reid* [2012] (1) JLR 370.

starting point was that there was no distinction between legal and equitable interests in immovable property and that the substance of Jersey property law has remained unchanged for centuries.[267]

The court conceded that it may in fact be desirable to recognise such a distinction, but if so, it would have to be introduced by the legislature.[268] On the facts of this case, the court found that a constructive trust of Jersey immovable property did not arise, although they did not say that it was impossible in principle.[269]

For the purposes of this dissertation, the important point is that, unlike English law, Jersey law does not recognise dual ownership of immovable property. However, as far as the rights or interests of beneficiaries are concerned, the TJL states that a beneficiary's interest shall constitute movable property, which, subject to the terms of the trust, can be sold, transferred or otherwise dealt with.[270] That must indicate a proprietary interest. Given that there cannot be a trust of Jersey immovable property, this does not seem controversial in itself. It must also mean, however, that Jersey recognises dual ownership of movable assets, because the TJL states that the trustee is the owner of the trust property, although not in his own right.[271]

3 4 Classifications of trust

Given the extent to which a Jersey trust resembles an English trust, in this paragraph reference is made to the corresponding English law parts of the dissertation rather than repeating the same information, with the differences between the two systems being emphasised.

3 4 1 Express trusts and trusts arising by operation of law

The position is broadly the same as in England.[272] Although most trusts are express trusts, meaning that they are created through a voluntary act of the settlor and the trustees willingly accept the duties and responsibilities of trusteeship, in some cases the law imposes the

[267] *Flynn v Reid* [2012] (1) JLR 370 398-399.
[268] *Flynn v Reid* [2012] (1) JLR 370 400-401.
[269] *Flynn v Reid* [2012] (1) JLR 370 402.
[270] Trusts (Jersey) Law 1984 art 10(10) and (11).
[271] Trusts (Jersey) Law 1984 art 2; see also ch 2 para 3 5 5 with regard to the rights of beneficiaries.
[272] See ch 2 para 2 5 1 for an explanation of the basic differences between express trusts and trusts arising by operation of law.

liabilities of trusteeship upon a person.[273] Trusts arising by operation of law, known as resulting trusts and constructive trusts, are recognised in Jersey, as they are in England.[274] It is unclear whether a resulting or constructive trust of Jersey immovable property will be recognised.[275]

3 4 2 Fixed and discretionary trusts

The same distinction as in England exists between fixed and discretionary trusts.[276] Article 1(1) of the TJL makes this clear by stating that a beneficiary is a person who is either entitled to benefit under a trust or in whose favour the trustee may exercise discretion to distribute property held on trust.[277]

In Jersey, and other offshore jurisdictions, discretionary trusts have sometimes been misused by only appointing one or two charities as beneficiaries in the original trust deed, without any intention on the part of the settlor to benefit such charities. The "real" beneficiaries are appointed at a later date when there is an intention to make a distribution to them.[278] Such trusts are sometimes referred to as "blind trusts", and may be relevant in the context of excessive settlor control, examined in chapter 4.

3 4 3 Object trusts and purpose trusts

Jersey trust law differs markedly from its English counterpart in that it recognises non-charitable purpose trusts.[279] Even though arguments have been advanced for the recognition of such trusts under English law, the general position is still that, unless a trust is charitable, it should have one or more beneficiaries as its object.[280]

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[273] Brown *The Jersey Law of Trusts* 60-61.
[274] Brown *The Jersey Law of Trusts* 93-99 describes the recognition of resulting and constructive trusts in Jersey. As these types of trust do not form part of the focus of this dissertation, they will not be examined further.
[275] *Flynn v Reid* [2012] (1) JLR 370.
[276] Brown *The Jersey Law of Trusts* 101. See ch 2 para 2 5 2 for the English position and ch 2 para 3 5 5 for more on the nature of the rights of discretionary beneficiaries under Jersey law.
[277] Note that it was held in *West v Lazard Brothers and Company (Jersey) Limited* [1993] JLR 165 that a beneficiary under a discretionary trust must be either named in the trust deed or there must be some formal indication that he is going to have the trustee's discretion exercised in his favour at a future date, and that it is not sufficient to be named in the settlor's letter of wishes. Such a person is not an object of the trust.
[278] Brown *The Jersey Law of Trusts* 101-102.
[279] Trusts (Jersey) Law 1984 art 12.
[280] See ch 2 paras 2 7 1 3, 2 7 2, 2 7 3. An analysis of these arguments contributes to the examination of the obligations-based approach of understanding trusts.

The provisions regulating non-charitable purpose trusts were introduced in the Trusts (Amendment No 3) (Jersey) Law 1996 (1996 Law) and were incorporated into the TJL. There is a requirement for the trust deed to provide for the appointment of an enforcer, who cannot be a trustee, and for the appointment of a new enforcer if at any time there is no enforcer. All the provisions added by the 1996 Law relate to the enforcer, which seems to indicate that the legislator was of the view that any reservations about non-charitable purpose trusts are solved with the appointment of an enforcer.[281]

This is but one example of the desire and ability of offshore jurisdictions to increase the attractiveness of a particular jurisdiction by way of innovative legislation.[282] It has the advantage of certainty and immediate change. There are, however, arguments that many offshore jurisdictions have gone too far in attempting to attract trust business and that the essence of the trust and trusteeship may come under threat.[283]

3 5 Characteristics of a Jersey trust

3 5 1 The trust

A Jersey trust does not have legal personality.[284] It has been described by the Royal Court as "essentially the same animal as is found in English law, subject to certain local modifications".[285]

3 5 2 The trust property

The position with regard to trust property is similar to the position under English law. The trustee of an express trust must own the property subject to the trust.[286] The trust property does not form part of the trustee's personal estate, as confirmed in the TJL.[287] This offers protection

[281] See ch 2 para 2 7 3 1 for the English view.
[282] More examples are found in ch 2 para 3 7 2.
[283] See ch 2 para 3 7.
[284] Brown *The Jersey Law of Trusts* 175.
[285] *In the matter of the Esteem Settlement and the No. 52 Trust* [2002] JLR 53 90.
[286] Trusts (Jersey) Law 1984 art 2 which states "…a person (known as the trustee) holds or has vested in the person…property".
[287] Trusts (Jersey) Law 1984 art 54(1)(b).

to the beneficiaries against claims made by the trustee's personal creditors, although they generally also have the benefit of a proprietary interest in the trust property.

3 5 3 The trustee

The trustee of a Jersey trust has both powers and duties. The TJL[288] specifies certain duties of trustees, which, it seems, reflects the customary law position prior to the coming into force of the TJL.

Article 21(1) of the TJL sets the standard expected of a trustee – he must act with due diligence, as would a prudent person, to the best of his ability and skill, and must observe the utmost good faith. It is furthermore not possible to exclude liability for a trustee's fraud, wilful misconduct or gross negligence in the trust deed.[289] In this respect, Jersey law sets a higher benchmark for the standard of care expected from trustees than English law.[290]

However, whereas in England the application of the *Hastings-Bass* rule in the context of trustee mistakes has now effectively been limited,[291] this is not the case in Jersey, where specific legislation has been enacted to preserve the wider application of the rule, enabling trustees to set certain actions aside.[292] On the one hand, a high standard of care and skill is required of trustees and gross negligence cannot be excluded. On the other hand, certain trustee actions may be set aside on the ground of mistake or if certain considerations were not taken into account. The interaction of these rules will be examined in the following chapters.

3 5 4 The settlor

The TJL defines a settlor as a person who provides trust property or makes a testamentary disposition on trust or to a trust.[293] The settlor may also be a beneficiary of the trust.[294] A rule from Jersey customary law, known as *donner et retenir ne vaut (rien)*, and meaning that a person cannot give away property and at the same time retain it, caused some uncertainty

[288] Trusts (Jersey) Law 1984 art 21-23.
[289] Trusts (Jersey) Law 1984 art 30(10).
[290] See ch 2 para 2 6 3.
[291] See ch 2 para 2 6 3.
[292] Trusts (Amendment No 6) (Jersey) Law 2013; see also ch 2 para 3 7.
[293] Trusts (Jersey) Law 1984 art 1(1).
[294] Trusts (Jersey) Law 1984 art 10(12).

regarding the question whether a settlor can benefit from a trust he has settled.[295] The TJL now (although not in the original enactment) provides that the rule does not apply to any question regarding the validity, effect or administration of a trust, or regarding a transfer or other disposition of property to a trust.[296] The question may still arise in relation to trusts created before the coming into force of the Trusts (Amendment) (Jersey) Law 1989 on 21 February 1989.

Jersey, like various other offshore jurisdictions,[297] recognises trusts in which the settlor reserves certain powers to himself.[298] A power of revocation was contained in the TJL when it was enacted.[299] The Trusts (Amendment No 4) (Jersey) Law 2006 went substantially further and introduced provisions enabling the settlor to retain a beneficial interest and a range of powers in relation to the trust, including the power to revoke the trust.[300] Such trusts are referred to as "settlor reserved powers trusts" or "reserved powers trusts".

Therefore, the settlor does not necessarily have to fall out of the picture after setting up the trust, which may give settlors the degree of comfort they need in order to part with their assets. The extent to which a settlor can retain powers over the trust and the trust fund, without jeopardising the validity of the trust, as well as the effect of the rule *donner et retenir ne vaut* in this regard, are examined in depth in chapter 4.

3 5 5 The beneficiaries

Although it is clear that the Jersey law of property does not recognise a division between legal ownership and equitable or beneficial ownership of Jersey immovable property,[301] and that there cannot be a trust of Jersey immovable property,[302] there seems to be some uncertainty with regard to the nature of the interest of beneficiaries in the trust property (which can be any

[295] Brown *The Jersey Law of Trusts* 125.
[296] Trusts (Jersey) Law 1984 art 9(5). This provision was first introduced by the Trusts (Amendment) (Jersey) Law 1989 and subsequently amended to its current form by the Trusts (Amendment No 4) (Jersey) Law 2006.
[297] For example, the Trusts (Guernsey) Law 2007 and the Trusts (Special Provisions) Amendment Act 2014 in Bermuda.
[298] Trusts (Jersey) Law 1984 art 9A.
[299] This power was contained in art 36 of the original enactment of the Trusts (Jersey) Law 1984 and is now contained in art 40. Presumably, a power of revocation could also be given to someone other than the settlor.
[300] This is now contained in Trusts (Jersey) Law 1984 art 9A.
[301] Brown *The Jersey Law of Trusts* 80-88; see also ch 2 para 3 3.
[302] Trusts (Jersey) Law 1984 art 11(2)(a)(iii).

movable property within or outside of Jersey or any immovable property situated outside of Jersey).[303]

The TJL states that the interest of a beneficiary shall constitute movable property,[304] and that, subject to the terms of the trust, the beneficiary can deal with his interest in any manner.[305] This seems to indicate that the interest is proprietary in nature. It is, however, hard to imagine that a person who may or may not benefit under a discretionary trust (referred to as an object, rather than a beneficiary) should have a proprietary interest that he can deal with as he pleases.[306] Unless the trustee has already exercised his discretion in favour of the particular beneficiary, how would the beneficiary's interest be quantifiable? If a discretionary beneficiary, a mere object of the trust, had a proprietary interest in the trust fund, it would negate at least some of the benefits associated with discretionary trusts, namely that there is no fixed interest in the trust property, which can, for example, be subjected to tax.

However, the TJL defines a beneficiary as "a person entitled to benefit under a trust or in whose favour a discretion to distribute property held on trust may be exercised".[307] It also defines property as "property of any description wherever situated, and, in relation to rights and interests includes those rights and interests whether vested, contingent, defeasible or future".[308]

Reading these provisions[309] of the TJL together, a logical conclusion is that all beneficiaries, whether they have a fixed entitlement or a mere hope of receiving something should the trustee exercise his discretion in the beneficiary's favour, have a proprietary interest in the trust property. This does not seem correct.

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[303] Brown *The Jersey Law of Trusts* 113-115 where reference is made to the previous edition of the same work where it seems to have been suggested that all beneficiaries of Jersey trusts have proprietary interests in the trust property. See also *Mubarik v Mubarak* [2008] JLR 430 473-474, where reference is made to the Privy Council decision in *Schmidt v Rosewood Trust Ltd* [2003] 2 AC 709, an Isle of Man case, where it was stated that "…on his own the object of a discretionary trust has no more of an assignable or transmissible interest than the object of a mere power."

[304] Trusts (Jersey) Law 1984 art 10(10).

[305] Trusts (Jersey) Law 1984 art 10(11).

[306] Brown *The Jersey Law of Trusts* 113-115; *Mubarik v Mubarak* [2008] JLR 430 473-474.

[307] Trusts (Jersey) Law 1984 art 1(1).

[308] Trusts (Jersey) Law 1984 art 1(1).

[309] Trusts (Jersey) Law 1984 art 1(1), which defines "beneficiary" and "property" and art 10(10) and (11) which states that the interest of a beneficiary shall constitute movable property that he can deal with in any manner, subject to the terms of the trust.

A recent case of the Royal Court, *In re Tantular*,[310] provides some elucidation. The question in this case was whether the assets of a trust could be made subject to a restraining order as being realisable assets, and in particular whether the defendant, a discretionary beneficiary, was beneficially entitled to all, or any of, the trust property.

The court referred[311] to English authority confirming that the beneficiary of a discretionary trust has only the right to be considered for the exercise of the trustee's discretion and to compel due administration of the trustee's duties. He does not have a *transmissible* interest. However, the interest is *proprietary* in nature as it gives him a stronger equitable title to the trust property than a third party with no entitlement. He can trace and recover trust property transferred by the trustee in breach of trust, but he can only compel the third party to reinstate the misapplied property to the trust fund. He cannot require the third party to transfer the property directly to him. This is a proprietary interest, but it is a proprietary interest only in the *broad sense*. It is to be distinguished from an equitable proprietary interest in the *narrow sense*, which refers to equitable ownership.

Reference was also made to Jersey authority[312] stating that, unless and until the discretion is exercised in favour of a particular person, that person, although he is a beneficiary in terms of the TJL, does not have an individual right to call for any part of the distributable assets of the trust.

The court therefore found that it would be incompatible with fundamental trust law principles to say that a beneficiary of a discretionary trust is beneficially entitled to all or indeed any of the assets of the trust.[313] This appears to be the correct, and most sensible, position.

3 5 6 Trusts and powers

With regard to the trustee's fiduciary obligations there is, as in England, a distinction between trusts, which oblige the trustee to act, and powers, which enable the trustee to act but do not impose an obligation to act on the trustee. By and large, the English position seems to be followed. It is not considered necessary to examine the Jersey position in more detail for the

[310] *Re Tantular* 2014 (2) JLR 25.
[311] *Re Tantular* 2014 (2) JLR 25 34-36.
[312] *Re Tantular* 2014 (2) JLR 25 36.
[313] *Re Tantular* 2014 (2) JLR 25 37-40.

purposes of this dissertation, and reference is therefore made to the corresponding paragraph dealing with the English position.[314]

3 5 7 Duration of the trust

Although a rule against perpetuities previously existed in Jersey, this is no longer the case. The rule against perpetuities was aimed at preventing wealthy families from making their property inalienable through the use of *fideicommissa* or *substitutions*. The use of such legal constructs was therefore constrained even in Roman times.[315]

The TJL[316] originally provided for a maximum duration of 100 years for trusts other than charitable trusts. The Trusts (Amendment No 4) (Jersey) Law 2006 substituted this provision for one that states that, unless the terms of the trust provide otherwise, a trust may continue in existence for an unlimited period.[317]

There is no rule against excessive accumulations of income in the TJL[318] neither does there appear to ever have been such a rule in customary Jersey law.[319]

The Jersey law relating to the duration of a trust is another example of an area of trust law that has developed independently from the law in England, and that may be regarded as biased in favour of the settlor and beneficiaries.

3 6 Substantive requirements for the creation of a valid express trust under Jersey law

The definition of a trust under the TJL[320] contains the essential elements of a valid trust under Jersey law. It refers to property being held by the trustee for the benefit of a beneficiary or a purpose.

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[314] See ch 2 para 2 6 6.
[315] Brown *The Jersey Law of Trusts* 15-19, 239-240.
[316] This provision was found in art 11 of the original enactment of the Trusts (Jersey) Law 1984, and in art 15 prior to its substitution in 2006.
[317] Trusts (Jersey) Law 1984 art 15(1).
[318] Trusts (Jersey) Law 1984 art 38.
[319] Brown *The Jersey Law of Trusts* 240-241.
[320] Trusts (Jersey) Law 1984 art 2. See also ch 2 para 3 3 1 for the wording of the definition.

The test for the creation of a valid express trust under English law, known as the three certainties,[321] has been accepted in Jersey.[322] This test requires that, in order for a valid trust to exist, there must be certainty of intention, certainty of subject matter, and certainty of objects. Should the terms of a trust be so uncertain as to render performance of the trust impossible, a court may declare the trust invalid, either as a whole, or to the extent of the uncertainty.[323]

3 6 1 Certainty of intention

It must be sufficiently clear that the settlor intended to create a trust. This entails the intention not only to create a legal relationship, but also that the legal relationship is a trust, and not another legal relationship such as a contract. Sometimes, precatory words – words expressing a wish or hope – rather than peremptory words, are used by the settlor. This may lead to difficulty in construing the trust deed and ascertaining whether the settlor had the necessary intention.[324]

In *Re Malabry Investments*[325] the Royal Court referred to the English case *Re Kayford*,[326] where it was held that specific words were not required, but that the vital question was whether in substance a sufficient intention to create a trust has been manifested. It is a matter of true interpretation of the document, rather than a matter of law.[327] There does not seem to be agreement about whether or not extrinsic evidence as to the intention of the settlor of an *inter vivos* trust is admissible.[328]

Should the settlor and the trustee both have the subjective intention that the deed, which purports to establish a trust, is, in fact, not to create the legal rights and obligations required for a trust, and both have the common intention to mislead, the trust would be considered a sham under Jersey law. It would therefore be invalid. It appears that the circumstances under which a trust would be considered a sham may be narrower than in England,[329] again benefitting the settlor.

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[321] See ch 2 para 2 7 1 for detail on this test under English law.
[322] Brown *The Jersey Law of Trusts* 76, 80, 88; *Re Malabry Investments Ltd* (1982) JJ 117 119, 123.
[323] Brown *The Jersey Law of Trusts* 76.
[324] Brown *The Jersey Law of Trusts* 76-77.
[325] *Re Malabry Investments Ltd* (1982) JJ 117 119.
[326] *Re Kayford Ltd* [1975] 1 WLR 279.
[327] *Re Don Benest* [1989] JLR 330 345-348.
[328] Brown *The Jersey Law of Trusts* 91.
[329] Brown *The Jersey Law of Trusts* 48-49; *CI Law Trustees Limited v Minwalla* [2005] JLR 359 366-367.

3 6 2 Certainty of subject matter

Any type of property may be subject to a Jersey trust, apart from immovable property situated in Jersey. For a valid trust to exist, the property subject to the trust must be ascertainable.[330] If that is not the case, a court will hold that, either the settlor did not dispose of the property or the trustee holds it on resulting trust for the settlor.[331]

3 6 3 Certainty of objects

The beneficiaries must be identifiable or ascertainable, as must their interests under the trust.[332] If no beneficiary is named, even if there is a power to add beneficiaries, the trust will be void from the outset.[333] The TJL provides guidance on this requirement in article 10(1) and requires a beneficiary to be identifiable by name or ascertainable by reference to a class or a relationship to some person, for example, the children and remoter issue of the settlor.

Quite often, beneficiaries of discretionary trusts are defined by reference to a class or relationship, enabling the settlor to provide for successive generations. Whether a class is suitably defined to fulfil the requirement of certainty of objects has been the subject of various court cases.[334] The Jersey court has expressed a willingness to try and uphold the validity of a trust by interpreting it as far as possible to give effect to the intention of the settlor. However, at the same time it has stressed the importance of careful drafting of trust deeds so that the beneficiaries are easily ascertainable or identifiable, as the court will allow a trust to fail if the subject matter or beneficiaries are uncertain, or if the trust deed is incoherent.[335] This does not sit well with the use of blind trusts, where the charities named as the only beneficiaries are usually not the intended recipients of any trust assets.[336]

Non-charitable purpose trusts are, of course, not subject to this rule.[337]

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[330] *Re Malabry Investments Ltd* (1982) JJ 117 119.
[331] Brown *The Jersey Law of Trusts* 80.
[332] Brown *The Jersey Law of Trusts* 88-89; *Re Malabry Investments Ltd* (1982) JJ 117 119, 124.
[333] *Re Exeter Settlement* [2010] JLR 170. In this case, rectification of the trust was ordered.
[334] Brown *The Jersey Law of Trusts* 103-105. Examples of cases include *Meaker v Picot* [1972] JJ 162; *Re Double Happiness Trust* [2002] JLR N48.
[335] Brown *The Jersey Law of Trusts* 105-106; *Re Double Happiness Trust* [2002] JLR N48.
[336] See ch 2 para 3 4 2.
[337] Trusts (Jersey) Law 1984 art 11(2)(a)(iv) read with art 12 of the same law.

3 7 Role of legislative developments

3 7 1 Background

In examining the role of legislative developments in Jersey (and other offshore jurisdictions), it needs to be borne in mind that the provision of trustee and trust administration services forms an integral part of the Jersey economy. Legislation always aims to provide certainty with regard to the law, but in this case it is also intended to attract business.

It has already become apparent that legislation has played a crucial role in the development of Jersey trust law. A customary trust law existed prior to the coming into force of the TJL, but the law was unclear in many areas and, importantly, the outside world did not have confidence that Jersey was an established and regulated trust jurisdiction.[338]

The enactment of the TJL was a huge step forward for Jersey. The legislation is considered as extremely successful, which has been proven by the fact that various other offshore jurisdictions, including Guernsey, Belize and Malta, have based their trust laws on that of Jersey.[339]

Given that Jersey does not share England's legal history where equitable principles led to the development of the trust, the law is regarded as more easily readable and understandable, especially to lawyers from civil law jurisdictions, such as Switzerland and Italy. However, practitioners from other jurisdictions have expressed concern regarding certain developments and whether they may be considered as too biased towards settlors. There is also uncertainty whether trusts taking advantage of some of the more controversial laws examined below would be regarded as valid in the courts of other jurisdictions.[340] This is further examined in chapters 3 and 4.

[338] Atkins (2013) 1 *JGLR* para 16.
[339] Atkins (2013) 1 *JGLR* para 1.
[340] Atkins (2013) 1 *JGLR* para 35.

Although the TJL was not meant to be a codification of the trust law in Jersey,[341] it covers a very wide range of administrative and substantive issues, and was certainly not a piecemeal attempt to reform trust laws, as seen, for example, in England.[342] Having said that, the TJL has been amended seven times between 1989 and 2018.[343] This could be ascribed to the fast-changing nature of the global trust business and Jersey's desire to maintain its position as a forward-thinking and attractive trust jurisdiction. Specific developments are listed below and, where appropriate, discussed further in chapters 3 and 4.

The TJL applies to trusts created before or after its commencement, but it does not affect the validity of acts done before its commencement in respect of trusts existing before it came into force. Neither does the TJL affect the validity of trusts arising from a document or disposition taking effect prior to the commencement of the TJL.[344] Legal disputes concerning trusts set up prior to the coming into force of the TJL will, of course, decrease over time as such trusts come to an end, but they have been the subject of a number of cases and the TJL has been held to apply to such trusts.[345] Some, but not all, provisions of the TJL also apply to foreign trusts, in other words, trusts with a governing law other than Jersey.[346]

3 7 2 Specific developments

The amendments to the TJL that are considered relevant to this dissertation are listed below. From this list it is evident that legislative changes are aimed at increasing Jersey's competitiveness as an offshore jurisdiction. All of these developments have already been highlighted, and some will be examined in more depth in chapters 3 and 4. These are:

(a) trustees cannot exclude liability for gross negligence in a trust deed;[347]
(b) the rule *donner et retenir ne vaut* does not apply to Jersey trusts;[348]

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[341] This was confirmed in the Trusts (Jersey) Law 1984 art 1(2) and in *In the matter of the Esteem Settlement and the No. 52 Trust* [2002] JLR 53.
[342] Atkins (2013) 1 *JGLR* para 16.
[343] Trusts (Amendment) (Jersey) Law 1989; Trusts (Amendment No 2) (Jersey) Law 1991; Trusts (Amendment No 3) (Jersey) Law 1996; Trusts (Amendment No 4) (Jersey) Law 2006; Trusts (Amendment No 5) (Jersey) Law 2012; Trusts (Amendment No 6) (Jersey) Law 2013; Trusts (Amendment No 7) (Jersey) Law 2018. The current revised version of the TJL contains all these amendments and is the version referred to in this dissertation.
[344] Brown *The Jersey Law of Trusts* 33-35; Trusts (Jersey) Law 1984 art 58 and 59.
[345] One example is *West v Lazard Brothers and Company (Jersey) Limited* [1993] JLR 165 204-205.
[346] Trusts (Jersey) Law 1984 Part 3 and 4.
[347] Trusts (Amendment) (Jersey) Law 1989; see also ch 2 para 3 5 3.

(c) non-charitable purpose trusts are recognised as valid;[349]

(d) trusts in relation to which the settlor has reserved wide-ranging powers are valid;[350]

(e) trusts can continue for an unlimited period;[351] and

(f) the rule known in England as the rule in *Hastings Bass* is confirmed by statute.[352]

3 8 Role of the courts and case law

Jersey trust law is to a large extent regulated by the TJL. The courts have nevertheless contributed substantially to the development of the trust law. Prior to the coming into force of the TJL, the role of the courts was presumably to find and apply the customary Jersey trust law to the case at hand, and where this did not provide a satisfactory answer, to look to English authority for guidance. The customary law position was not always easy to ascertain, and reliance on English authority was a frequent occurrence.[353]

Since the coming into force of the TJL in1984, the court's role would have changed in that it now needs to ascertain whether a specific issue is covered by the TJL and whether this provides a satisfactory result. Where the issue is not covered by the TJL, the old customary law would still apply, and the court would first look to any Jersey authority that exists on the issue, and if there is none, to English law. Whilst the law of England (and other Commonwealth jurisdictions) will continue to play a role in the development of Jersey trust law, especially where Jersey law is silent on the issue in question or does not provide a satisfactory outcome, reliance on English case law is slowly decreasing as Jersey builds up its own wealth of case law on trusts.

Even where Jersey law is unclear and the court may look at what an English court would have done in the same circumstances, the Jersey judiciary has shown the confidence not blindly to follow English law if that would lead to an unfair result, or if the English position has been

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[348] Trusts (Amendment) (Jersey) Law 1989; see also ch 2 para 3 5 4.
[349] Trusts (Amendment No 3) (Jersey) Law 1996; further refinements were made in the Trusts (Amendment No 5) (Jersey) Law 2012; see also ch 2 para 3 4 3.
[350] Trusts (Amendment No 4) (Jersey) Law 2006; see also ch 2 para 3 5 4.
[351] The Trusts (Amendment No 4) (Jersey) Law 2006 abolished the previous trust period of a maximum of 100 years; see also ch 2 para 3 5 7.
[352] Jersey was the first offshore jurisdiction to enact provisions of this kind in the form of the Trusts (Amendment No 6) (Jersey) Law 2013; see also ch 2 para 3 5 3.
[353] See *eg Ex Parte Viscount Wimborne* (1983) JJ 17 19, where Deputy Bailiff Crill said: "I was referred exclusively to English cases as if this application were being heard in the Chancery Division of the High Court.".

shown to be outdated, given changes in social and economic circumstances.[354] The court has thus demonstrated a willingness to continue to develop Jersey trust law in accordance with the evolving needs of society. However, the judiciary has also clearly indicated that to change the law in certain areas, legislative intervention would be required.[355]

4 South Africa

4 1 Introduction

South African law is based on Roman-Dutch law. When the Cape was settled by the Dutch East India Company and Jan van Riebeeck arrived in 1652, they brought with them the system of Roman-Dutch law. The term Roman-Dutch law refers to a system of law based on Roman law. Whether the legal system that was brought to South Africa was the law applied in the province of Holland, where Jan van Riebeeck hailed from, or whether it was the law of the whole of the Netherlands, or even a European *ius commune* based on Roman law, is debatable, and for the current purposes not essential to determine. What is clear is that it was a system of law based on Roman law, and in that sense could be distinguished from English (common) law, which was influenced by Roman law in a very limited manner only.[356]

The influence of English law on the development of South African law can, however, not be denied. Given the political power of the English during this formative period, it may be considered surprising that English law did not replace Roman-Dutch law as the foundation of South African law altogether.[357] The reasons why this did not happen fall outside the scope of this dissertation.[358] The fact is that many English legal principles and institutions were absorbed into the local legal system, including the concept of the trust, as well as the English court system and the *stare decicis* rule whereby courts are generally bound by previous judgments of higher courts and by its own judgments unless satisfied that it was wrong.[359] This rule has proven rather important for the development of the law of trusts in South Africa,

[354] *In the matter of the Esteem Settlement and the No. 52 Trust* [2002] JLR 53 98-99, 112.
[355] Examples include *In the matter of the Esteem Settlement and the No. 52 Trust* [2002] JLR 53 121 with regard to asset protection trusts and the effect of the insolvency of the settlor on the validity of a trust; and *Flynn v Reid* [2012] (1) JLR 370 400-401 with regard to recognising a distinction between legal and equitable interests in immovable property.
[356] Du Plessis and du Plessis *Inleiding tot die Reg* 16-18, 46-47.
[357] Du Plessis and du Plessis *Inleiding tot die Reg* 18, 48-49; Du Toit (2015) 79 *Rabel Journal* 852 855.
[358] See Du Plessis and du Plessis *Inleiding tot die Reg* 48-50, 187.
[359] Du Toit *South African Trust Law: Principles and Practice* 13.

which, as will become evident, has developed to a large extent through the efforts of the judiciary.

Today, it would be fair to say that South African law is a mixture of civil and common law. At least since the Napoleonic age, civil law systems tend to be codified to a large extent, whereas Anglo-American common law systems are generally not. Law in these systems is mostly judge-made and, hence, more flexible.[360]

4 2 Reception of the trust concept into South African law

4 2 1 Historical context

As previously explained,[361] English law distinguishes between equity and common law as distinct but parallel bodies of law. Historically, common law was strictly rule- based, and equity acted as a corrective, bringing fairness and consciousness into the law. The trust was born out of equity.[362] This type of distinction is foreign to Roman- Dutch law, where equity and fairness form part of the normal application of law. The same can be said for South African law.[363] Furthermore, South African law adheres to a unitary concept of ownership, which means that ownership cannot be split between those holding legal title and those holding equitable (or beneficial) title as is possible under English law.

With the British occupation of the Cape, first from 1795 to 1803, and then finally from 1806, it was inevitable that, not only would English legal principles and institutions be absorbed into South African law, but also that many of the legal practitioners stationed at the Cape would have been trained in English law. After the second occupation, an "aggressive policy of Anglicisation"[364] was followed. Although Roman-Dutch law was not abolished, a gradual importation of English law was envisaged. This was initially confined to the Cape, but soon spread further north.[365]

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[360] Du Plessis and du Plessis *Inleiding tot die Reg* 71-77.
[361] See ch 2 para 2 2.
[362] See ch 2 para 2 3.
[363] Du Plessis and du Plessis *Inleiding tot die Reg* 70.
[364] Du Toit (2015) 79 *Rabel Journal* 852 854.
[365] Du Toit (2015) 79 *Rabel Journal* 852 854-855.

English practitioners incorporated trusts in the Cape, and also used the terms trust and trustee in other documents, such as wills, land transfers and deeds of gift, so that, quite unintentionally, the trust became an integral part of the legal and commercial landscape.[366]

South African judges, being trained in Roman-Dutch law, were left to interpret essentially English concepts. This happened despite the fact that English trust law as such was only partially received into South Africa.[367] It is not difficult to imagine how this caused the trust, as used in South Africa, to acquire different characteristics from its original source, the English trust. Du Toit rightly points out that much of the distortion of trust terminology was caused by the court's attempt to give linguistic expression to the trust in civilian terms.[368]

The development of the trust and trust law in South Africa was clearly not in line with developments in England, even though it was the English concept that was originally brought into South Africa. This is not intended to indicate that there was something amiss with the development of South African trust law, but to highlight the reasons why the South African trust has come to be such a different creature compared to the English trust.

It must be pointed out at this juncture, that similarities between the English law trust and civil law institutions such as the *fideicommissum*[369] and the *Treuhand*[370] have indeed been found. One could argue that it would otherwise have been very difficult for the trust to have been received and found workable in civil law and mixed jurisdictions. To this should be added that Roman-Dutch law has proved itself to be remarkably adaptable in absorbing foreign concepts, developing in new directions and adapting to the ever-changing needs of society. An inflexible, codified system of law would not have been able to go through the same process of absorption, but Roman- Dutch law has the advantage of having its roots in broad

[366] Du Toit *South African Trust Law: Principles and Practice* 13; Cameron *et al Honoré's South African Law of Trusts* 21; Hahlo (1961) 78 *SALJ* 195 198-199.
[367] Cameron *et al Honoré's South African Law of Trusts* 22.
[368] Du Toit (2015) 79 *Rabel Journal* 852 857.
[369] A *fideicommissum* can be described as a legal institution of Roman law whereby the owner of property transfers it to another person subject to it being transferred from that person to yet another person at a later stage. Both persons to whom the property is transferred in this chain become the full owners of the property.
[370] *Treuhand* is a German term and can refer to a variety of relationships between two or more parties where legal authority is transferred from one party to the other. This can be the result of an agreement or some other legal construct. It can, but does not have to, involve the transfer of ownership of property.

general principles and this has been very valuable in receiving the trust into South African law.[371]

For many years, there was no legislative intervention to make the position of trusts in South Africa clear. There was only the interpretation of an essentially English legal construct by reference to Roman-Dutch law as it was then practiced at the Cape. This meant that, over many years, slowly but surely, the South African courts pragmatically developed a trust law that was, at least on one view, unique to South Africa. (On another view, the South African law of trusts is very similar indeed to the law of trusts in Scotland.)[372] Unfortunately, this way of development also led to uncertainty and disagreement regarding a number of issues.

4 2 2 Role of the courts and case law in the reception of trust law and characterisation of the trust

Court cases dealing with trusts can be traced back as far as 1833, and in the time that followed, the use of trusts spread throughout South Africa. The first trust companies, being companies that offer trustee services in exchange for a fee, were founded in South Africa in the 1830s and, interestingly, appear to be some of the first of their kind worldwide.[373]

Given that there was no trust legislation to speak of, the questions of whether to accept trusts into South African law and how to construe them were left to the courts. According to Hahlo there were three options: the courts could refuse to recognise trusts as they were not a part of South African law; they could take over the English law of trusts as a whole; or they could construe trusts in terms of Roman-Dutch doctrines known to them.[374]

It was only in 1915 that the Appellate Division (as it was then called) had the opportunity to decide whether South African law could and should give effect to the trust. In *Estate Kemp v McDonald's Trustee*[375] the court, dealing with a testamentary trust drawn up by an English lawyer, confirmed that the English law of trusts does not form part of South African law, but that it does not follow that testamentary dispositions contained in a trust cannot be given

[371] Corbett (1993) 56 *THRHR* 262 264.
[372] Honiball and Olivier *The Taxation of Trusts in South Africa* 2, 10.
[373] Cameron *et al Honoré's South African Law of Trusts* 21-22.
[374] Hahlo (1961) 78 *SALJ* 195 199.
[375] *Estate Kemp v McDonald's Trustee* 1915 AD 491.

effect to in terms of South African law. Innes CJ said that a testamentary trust would, in the phraseology of South African law, be a *fideicommissum* even though in the case of a trust there is no element of personal benefit on the trustee (the fiduciary).[376] This has since been criticised, as discussed further below.

The learned judge repeatedly emphasised the separation of legal ownership from beneficial enjoyment as essential to the relationship that was being created[377] and was of the view that such separation was also possible under Roman-Dutch law and, more precisely, the *fideicommissum*.[378] (The comparison with a *fideicommissum* may have been inaccurate, but the importance of the separation of legal ownership and beneficial enjoyment remains valid.)

Solomon JA made the important point that the trust had become so entrenched in South African legal and commercial practice that it would be nearly impossible to put an end to its use, and furthermore that there was nothing in South African law that was inconsistent with the concept of a trust.[379] Unlike Innes CJ, he found it unnecessary to translate English legal and technical terms into the corresponding expressions of South African law. He took the view that the most important rule in constructing testamentary documents was to discover the intention of the testator, and that effect had to be given thereto.[380]

Trying to explain the English trust in Roman law terms has caused confusion and distortion in the theory and terminology of South African trust law during its formative years.[381] It took the Appellate Division until 1984 to review whether the above explanation of a testamentary trust in terms of a *fideicommissum* was correct.

However, well before that, the court had the opportunity to deal with the characterisation of *inter vivos* trusts. This happened mainly in three landmark cases in the 1940s and 1950s, namely *Commissioner for Inland Revenue v Estate Crewe*,[382] *Commissioner for Inland Revenue v Smollan's Estate*[383] and *Crookes NO v Watson*.[384]

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[376] *Estate Kemp v McDonald's Trustee* 1915 AD 491 499.
[377] *Estate Kemp v McDonald's Trustee* 1915 AD 491 498, 500, 502.
[378] *Estate Kemp v McDonald's Trustee* 1915 AD 491 502-503.
[379] Du Toit *South African Trust Law: Principles and Practice* 13-14; *Estate Kemp v McDonald's Trustee* 1915 AD 491 499, 508.
[380] *Estate Kemp v McDonald's Trustee* 1915 AD 491 508, 512.
[381] De Waal (2000) 117 *SALJ* 548 556.
[382] *Commissioner for Inland Revenue v Estate Crewe* 1943 AD 656.
[383] *Commissioner for Inland Revenue v Smollan's Estate* 1955 (3) SA 266 (A).

The first two cases were concerned with estate duties. Very generally, the question was whether certain interests of beneficiaries under an *inter vivos* trust can constitute vested proprietary interests forming part of such (deceased) beneficiary's estate for estate duty purposes. In dealing with this question, however, the court found that it had to characterise the trust in question in order to ascertain the rights of the beneficiaries in question.

In *Commissioner for Inland Revenue v Estate Crewe*[385] Watermeyer CJ referred to the principles of English trust law whereby beneficiaries had an equitable estate in the trust property. He also referred the following statement of the English academic Frederick Pollock:

> "Although every trust may… in this sense… include a contract, it includes so much more… The complex relations involved in a trust cannot be reduced to the ordinary elements of contract. Trust, in fact, is a legal category *sui generi[s]*…"[386]

Both the statement that a trust may include a contract, but is more than just a contract, and that a trust is an institution *sui generis*, have found resonance in subsequent South African academic writing and in case law.[387]

Returning to the *Crewe*[388] judgment, Watermeyer CJ then continued to state that there was no reason why the problem presented by trusts in South African law should not be solved by the application of contractual principles.[389] He referred to remarks of Innes CJ in *Estate Kemp v McDonald's Trustee*,[390] but it is submitted that the judge in that case made no reference to contractual principles, and merely said that testamentary dispositions in the form of trusts should be given effect to in terms of South African law.

Watermeyer CJ went on to examine the trust deed in order to ascertain the nature of the rights arising under it. He stated that the trust deed was, in effect, an agreement between the settlor and the trustees whereby the settlor transferred certain property to the trustees and the trustees

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[384] *Crookes NO v Watson* 1956 (1) SA 277 (AD).
[385] *Commissioner for Inland Revenue v Estate Crewe* 1943 AD 656.
[386] *Commissioner for Inland Revenue v Estate Crewe* 1943 AD 656 673.
[387] *Braun v Blann and Botha NNO* 1984 (2) SA 850 (A) 859D; see also ch 2 para 4 3 2 1.
[388] *Commissioner for Inland Revenue v Estate Crewe* 1943 AD 656 673.
[389] *Commissioner for Inland Revenue v Estate Crewe* 1943 AD 656 673.
[390] *Estate Kemp v McDonald's Trustee* 1915 AD 491 499.

agreed to apply the income of the property for the benefit of third parties – it was a contract for the benefit of a third party, a *stipulatio alteri*.[391] A reading of this judgment does not leave one with the feeling that there were compelling reasons for characterising a trust as a contract,[392] and in fact there was and still is disagreement as to whether this was the correct way to account for the legal nature of the *inter vivos* trust in South African law.[393]

An important consequence of a *stipulatio alteri* is that, until the third party (the beneficiary) has accepted the benefit or promise thereof, the contract may be varied or cancelled by agreement between the contracting parties, namely the settlor and the trustee.[394]

In *Commissioner for Inland Revenue v Smollan's Estate*[395] Van den Heever JA agreed that trusts *inter vivos* should be given effect to. He found that an essential element of a *fideicommissum inter vivos* was lacking, but that, at the same time, there seems to be a contract between two persons in which one stipulates a benefit for third persons. He further stated that difficulties arising from the requisite acceptance by the third party did not concern the court *in casu*, as the deceased beneficiary had undoubtedly accepted.[396] This may have been a good opportunity for the court to analyse this problem but unfortunately it was not done.

The third case, *Crookes NO v Watson*,[397] concerned exactly this question – can a settlor (who is also one of the trustees and who, presumably, had some influence over the co-trustee) amend the trust provisions with the agreement of his co-trustee and the beneficiary who had already accepted a benefit under the trust, if the amendment will prejudice the rights of the beneficiaries who had not accepted yet and who have not agreed to the amendment?[398] Again, the court had to examine the more fundamental question regarding the legal nature of an *inter vivos* trust in order to assess the rights of the relevant parties.

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[391] *Commissioner for Inland Revenue v Estate Crewe* 1943 AD 656 674.
[392] This is also the view of Schreiner JA in the minority decision in *Crookes NO v Watson* 1956 (1) SA 277 (AD) 294.
[393] See ch 2 para 4 3 2 1.
[394] Corbett (1993) 56 *THRHR* 262 264.
[395] *Commissioner for Inland Revenue v Smollan's Estate* 1955 (3) SA 266 (A).
[396] *Commissioner for Inland Revenue v Smollan's Estate* 1955 (3) SA 266 (A) 272.
[397] *Crookes NO v Watson* 1956 (1) SA 277 (AD).
[398] *Crookes NO v Watson* 1956 (1) SA 277 (AD) 284.

Three out of the five judges, Centlivres CJ, Van den Heever JA and Steyn JA, held that a trust constituted a contract between the settlor and the trustee for the benefit of a third person and that the settlor and trustee could agree to cancel this contract prior to acceptance by the beneficiary.

The minority, Schreiner JA and Fagan JA, disagreed. Schreiner JA was of the view that, irrespective of whether an English law trust could be assimilated with, or even had its origins in, the *fideicommissum* of Roman law, the more important issue was the development of the modern South African law of trusts and that this should not be hampered by views regarding its association with other branches of South African law. He suggested that analogies with other portions of the law are only useful if they provide solutions that are convenient and fair in relation to the intentions and expectations of the parties involved.[399]

Even more importantly, a legal instrument such as the trust should not be forced into a framework of another portion of the law merely in order to find a solution to the problem at hand. Schreiner JA admitted that an *inter vivos* trust was normally the outcome of a contract between the settlor and the trustee and that it was generally designed to benefit other persons. However, a contract for the benefit of a third person is in fact more than that; it is a contract designed to enable the third person to come in as a party to the contract with one of the other two parties.[400] This is clearly not the intention in the case of a trust. And although the settlor cannot unilaterally cancel the contract (revoke the trust), it is hard to imagine that the consent of the trustee, whom he appointed and can probably replace, will not be forthcoming.[401]

The issue of revocation of a trust, and the above decision, is examined further at a later point.[402]

A few decades later, in *Braun v Blann and Botha NNO*,[403] another case involving a testamentary trust, Joubert JA held that a trust, in a strictly technical sense, is a legal institution *sui generis*,[404] meaning "peculiar" or "the only one of its kind".[405] This is perhaps

[399] *Crookes NO v Watson* 1956 (1) SA 277 (AD) 290.
[400] *Crookes NO v Watson* 1956 (1) SA 277 (AD) 291.
[401] *Crookes NO v Watson* 1956 (1) SA 277 (AD) 292-293.
[402] See ch 2 para 4 3 2 1.
[403] *Braun v Blann and Botha NNO* 1984 (2) SA 850 (A).
[404] *Braun v Blann and Botha NNO* 1984 (2) SA 850 (A) 859D.
[405] Hiemstra and Gonin *Trilingual Legal Dictionary* 293.

the closest one can come to fitting the South African trust into a mould of some kind. Joubert JA makes no reference to testamentary trusts when he makes this statement, and in fact the context in which it is made is the general reception of the English trust into South African law and the development of the South African law of trusts. It is therefore likely that this characterisation also applies to trusts created *inter vivos*.[406]

It was further held that it was both historically and jurisprudentially wrong to identify the testamentary trust with the *fideicommissum* and to equate a trustee to a fiduciary.[407] Before reaching this conclusion, Joubert JA referred to previous case law criticising Innes CJ's equation of a testamentary trust with a *fideicommissum*.[408] He refers, amongst others, to *Estate Watkins-Pitchford v Commissioner for Inland Revenue*,[409] where Van den Heever JA suggested reconsideration of the proposition that merely because the testator did not intend to confer personal benefit upon his trustees, they are not prevented from being treated legally or technically as fiduciary heirs.[410] On examination of this judgment, further instructive passages are found, such as:

> "…[T]he property covered by the disposition is not for a moment merged in his own estate in the manner in which property subject to *fideicommissum* undoubtedly vests for the time being in the estate of the fiduciary."[411]

With the judgment in the *Braun*[412] case, it seems that the characterisation of the testamentary trust was settled, although future amendments and refinements were by no means excluded. Joubert JA said:

> "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."[413]

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[406] See also ch 2 para 4 3 2 1.
[407] *Braun v Blann and Botha NNO* 1984 (2) SA 850 (A) 866A-B.
[408] *Braun v Blann and Botha NNO* 1984 (2) SA 850 (A) 865.
[409] *Estate Watkins-Pitchford v Commissioner for Inland Revenue* 1955 (2) SA 437 (A).
[410] *Estate Watkins-Pitchford v Commissioner for Inland Revenue* 1955 (2) SA 437 (A) 460C.
[411] *Estate Watkins-Pitchford v Commissioner for Inland Revenue* 1955 (2) SA 437 (A) 460E.
[412] *Braun v Blann and Botha NNO* 1984 (2) SA 850 (A).
[413] *Braun v Blann and Botha NNO* 1984 (2) SA 850 (A) 859F.

4 2 3 Conclusion

Compared to the vital role the courts have played in the development of South African trust law, legislative intervention, further discussed below,[414] has been limited. A decision was taken not to codify the South African trust law. The Trust Property Control Act 57 of 1988 (TPCA) is the most important piece of legislation regarding trusts, and regulates only the registration and administration of trusts.

The South African trust law of today can therefore be described as a mixture of English, Roman-Dutch and South African rules.[415] These typically South African rules have become the more important component of South African trust law over time, and are continuously developed by the courts.[416] In the *Braun* case[417] Joubert JA said:

> "It is one of the functions of our law to keep pace with the requirements of changing conditions in our society… The approach of our Courts is to apply the principles of our law to the development of our law of trusts."[418]

This power and duty of the court to evolve the law of trusts was confirmed more recently by the Supreme Court of Appeal in *Land and Agricultural Bank of SA v Parker*.[419]

4 3 The trust under South African law

4 3 1 Contrast with the dual ownership concept of English law

4 3 1 1 Is the South African trust a real trust?

At the heart of the English law trust is the division of property rights, which enables the trustee to hold the legal title to trust property and the beneficiary to have an equitable interest in trust property.[420] Many authors are of the opinion that a legal system that does not recognise

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[414] See ch 2 para 4 5.
[415] Cameron *et al Honoré's South African Law of Trusts* 23.
[416] The role of the courts in developing South African trust law is further discussed in ch 2 para 4 7.
[417] *Braun v Blann and Botha NNO* 1984 (2) SA 850 (A).
[418] *Braun v Blann and Botha NNO* 1984 (2) SA 850 (A) 866-867.
[419] *Land and Agricultural Bank of SA v Parker* 2005 (2) SA 77 (SCA) para 37.
[420] See ch 2 para 2 4 2.

this division of property rights cannot have as part of their law a true or proper trust. Examples of such authors include the famous English legal historian Maitland, and more current authors such as Hayton.[421] This view places much emphasis on the property dimension of the trust.[422] It also ignores the fact that, under English law, beneficiaries, or objects, of discretionary trusts do not acquire proprietary rights until such time as the trustee exercises his discretion in favour of such an object. In the meantime, the object has to rely on the personal rights he has against the trustee, much like the position in South Africa.[423]

Opponents of this view argue that one can have a proper trust without it having to be based on a division between legal and equitable ownership. This, for example, is certainly the case with Scottish trusts. In an article that compares trustee duties in, amongst others, England, Jersey, Guernsey and South Africa, South Africa has been referred to as an "excellent example" of a jurisdiction that has not only embraced the trust, but made it its own by accommodating it into its own legal system.[424] Various South African authors state that the most important function of dual ownership is to protect the rights and interests of trust beneficiaries.[425] Furthermore, they argue that the protection of such interests could also be achieved in other ways.[426]

Whether the South African trust (and trusts from other mixed jurisdictions) are real trusts should, according to this argument, not depend on whether the law of property of such jurisdictions recognise dual ownership rights, but rather whether these trusts share certain essential elements with their English counterpart, which affords beneficiaries a similar level of protection.

De Waal identifies four such "core elements", described below.[427]

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[421] See Hayton (1987) 37 *ICLQ* 260 262 where he refers to the South African trust as a "trust-like" institution. This is further examined in De Waal (2000) 117 *SALJ* 548 550-552.
[422] See ch 2 para 2 4 1 where the property component and obligation component are discussed. It is noteworthy though that Hayton has more recently been arguing that more weight should be given to the obligation component of the trust, as is clear from ch 2 para 2 7 3 2.
[423] See ch 2 paras 2 4 2, 2 4 3.
[424] Clarry (2014) 1 *JGLR* paras 28, 30. See also generally Valsan *Trusts and Patrimonies*.
[425] Looking back at the development of equity as a body of law, this seems to be correct. Equity was developed by the Courts of Chancery to protect the *cestui que use*, the forerunner of the beneficiary of today, as described in ch 2 para 2 3.
[426] Du Toit *South African Trust Law: Principles and Practice* 14; De Waal (2000) 117 *SALJ* 548 557. This is also confirmed in Clarry (2014) 1 *JGLR* para 29 where it is suggested that a higher standard of care is expected of trustees in South Africa than in England and that beneficiaries of South African trusts are therefore better protected than their English counterparts, despite the latter having an equitable interest in the trust property.
[427] De Waal (2000) 117 *SALJ* 548 557.

(a) The trustee is in a fiduciary position *vis à vis* the trust beneficiaries. Although English law and South African law are not similar in all detailed aspects of a trustee's fiduciary duties, the essence of the duty is the same – the trustee owes a duty of care towards the beneficiaries in the way he administers and deals with the trust property.[428] Should the trustee breach this general fiduciary obligation or any of the more specific duties imposed by the applicable trust law or the provisions of the trust deed, it constitutes a breach of trust and, in both jurisdictions, the basic rule (although the remedies may differ) is that the trustee personally must make good the loss to the beneficiaries.[429]

(b) There is some sort of separation of estates. Under English law, the trustee holds the legal title to the trust property while the beneficiaries, at least the beneficiaries of fixed trusts, have an equitable proprietary interest. The trust assets effectively have two owners. In South Africa, the separation is on a different level. The trustee has full ownership of the trust assets, but the assets are held in a separate estate, the trust estate. His personal assets are held in his private estate. This separation is confirmed in the TPCA.[430] As a result, the beneficiaries are protected, at least in theory, in the event of the insolvency of the trustee.[431]

(c) The continuity of the trust fund is ensured. If a trust asset has been sold or exchanged, the proceeds or replacement asset would therefore also form part of the trust. In South African trust law, real subrogation applies in the event of the lawful replacement of trust assets, but not when trust assets were unlawfully replaced, for example where the trustee sells a trust asset in breach of trust. In such a case, the beneficiary can claim the profit made by the trustee in a restitutionary action for unjust enrichment. English trust law has developed complex "tracing" rules whereby beneficiaries, as a result of their equitable title to the trust assets, can follow such assets into the hands of third parties. It also recognises the concept of constructive trusts, whereby a trust can be imposed by the court as a result of the conduct of the trustee, and here tracing is important. The same result is therefore achieved by different means.[432]

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[428] See ch 2 para 2 6 for the English position and ch 2 para 4 3 5 for the South African position.
[429] De Waal (2000) 117 *SALJ* 548 557-559.
[430] Trust Property Control Act 57 of 1988 s 12.
[431] De Waal (2000) 117 *SALJ* 548 559-564.
[432] De Waal (2000) 117 *SALJ* 548 564-565.

(d) The trustee holds an office, in other words, there is a public element not found in contractual relationships, agency relationships and other relationships sometimes compared to trusts. A court will, if requested and if appropriate, interfere in the administration and execution of trusts if the trustee does not carry out his duties properly. South African law has developed specific duties for trustees, which reflect that trusteeship is an office. For example, trusts must be registered with the Master of the High Court and a person can only act as trustee if the Master's written authorisation has been obtained.[433] English law imposes less official control but also recognises the court's supervisory role in the administration of trusts.[434] It can therefore be said to be an element common to South African and English trust law.[435]

English law recognises two dimensions of the definition of a trust – a property dimension and an obligation dimension.[436] The core elements defined above are centred around the property dimension. It may, however, be useful to consider the South African trust from the obligation angle as well. The obligation dimension of the English trust refers to the personal obligations of the trustee to manage the property in the exclusive interest of the beneficiaries.[437] Some, but not all, explanations of the obligation dimension focus on it being an equitable obligation, and the beneficiaries having equitable interests in the property to which the trustee's obligation relates.[438]

More recently, Hayton[439] has argued for an "enforcer principle" which would allow a non-charitable purpose trust to be regarded as a valid trust by an English court, even though such trust does not fulfil the beneficiary principle. The beneficiary principle of English trust law requires a non-charitable trust to have a beneficiary in whose favour the court can decree performance.[440]

[433] Trust Property Control Act 57 of 1988 s 4(1) and 6(1).
[434] As recognised in *Schmidt v Rosewood Trust Ltd* [2003] 2 AC 709.
[435] De Waal (2000) 117 *SALJ* 548 565-567.
[436] See ch 2 para 2 4 1.
[437] Virgo *The Principles of Equity and Trusts* 42.
[438] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 56.
[439] Hayton (2001) 117 *LQR* 96. See ch 2 para 2 7 3 1 for a discussion of the enforcer principle.
[440] See ch 2 para 2 7 2.

In making this argument, Hayton relies on the importance of the obligation dimension of the trust. He proposes a "new" definition of a trust governed by English law, which is similar to his definition referred to earlier in this dissertation,[441] but which also includes trusts for the furtherance of non-charitable purposes, as recognised by the legislation of many offshore jurisdictions. For the present purposes the relevant part of this definition is:

> "[A]n equitable obligation binding a person ("the trustee") to deal with property owned by him as a trust fund segregated from his private patrimony whether for the benefit of persons ("the beneficiaries") of whom he may himself by one, and any one of whom has the right to enforce the obligation…".[442]

Hayton continues to say that the beneficiary (or enforcer, as the case may be) has personal rights against the trustee to ensure that the trustee makes good any loss occasioned to the trust fund by any breach of trust, while also having proprietary rights against the trustee and, in certain circumstances, a third party in possession of the whole or a part of the trust fund.[443]

This definition is not free from the terminology associated with the division between legal and beneficial ownership. However, an "equitable obligation" may well be described as an obligation based on the conscience of the trustee. Is that so different from the obligation conferred on the trustee of a South African trust? It is suggested that the elements of this definition, namely the equitable obligation of the trustee, the separate trust estate or patrimony, and the existence of beneficiaries who can enforce the trust, are not inconsistent with a valid South African trust.

Other authors have also placed emphasis on the importance of the obligation dimension of the trust in recent years. There is an argument that an obligations-based approach (rather than a property- or ownership-based approach) is better able to identify the irreducible core content of the trust idea, namely that there must be enforceable obligations.[444]

This notion of the trust as an obligation could open the way for eradicating the division between the common law and civil law understandings of the trust, as it does not rely on the

[441] See ch 2 para 2 4 1.
[442] Hayton (2001) 117 *LQR* 96 107.
[443] Hayton (2001) 117 *LQR* 96 108.
[444] Parkinson (2002) 61 *CLJ* 657 668-669.

division between legal and equitable ownership.[445] In fact, the definition of the trust in the Hague Convention[446] places more emphasis on the obligations of trusteeship than on the interests of the beneficiaries. The suggestion is that the position of the beneficiaries depends more on whether the trustee takes his fiduciary obligations seriously, than on the proprietary rights of the beneficiaries.

Therefore, although the South African and the English trust differ in certain fundamental, theoretical aspects, one can argue that sufficient commonality exists for South African trusts to be treated as proper trusts, and this dissertation will proceed on that basis.

4 3 1 2 Separation of ownership or control from enjoyment

In addition to offering protection to beneficiaries, the essential feature of an English trust, namely that legal ownership and beneficial ownership are divided, also leads naturally to a separation of ownership or control from enjoyment of the trust property. The importance of the principle of separation is evident in South African trust law as well,[447] and is sometimes described as the core idea of the trust.[448] In *Braun v Blann and Botha*[449] Joubert JA quoted from an unpublished doctoral dissertation on the reception of the English law trust in civil law and confirmed his agreement with the following:

> "The essence of the trust is the separation of titular from beneficial rights over property."[450]

The duties and standard of care expected from a trustee, his independence, as well as his liability to the beneficiaries, all flow from this separation. It should also mean that the settlor and beneficiaries do not have control over the trust property or the trustee.

Although this implies that the trustee is not also a beneficiary of the trust, this is not necessarily always the case, as long as the sole trustee is not also the sole beneficiary.[451]

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[445] Parkinson (2002) 61 *CLJ* 657 669-670.
[446] Art 2 Hague Convention of 1 July 1985 on the Law Applicable to Trusts and on their Recognition.
[447] Cameron *et al Honoré's South African Law of Trusts* 17; Hahlo (1961) 78 *SALJ* 195; *Badenhorst v Badenhorst* 2006 (2) SA 255 (SCA) paras 9-11; *Thorpe v Trittenwein* [2006] SCA 30 (RSA) para 17.
[448] *Land and Agricultural Bank of SA v Parker* 2005 (2) SA 77 (SCA) paras 19, 22.
[449] *Braun v Blann and Botha NNO* 1984 (2) SA 850 (A) 865.
[450] Ryan *The Reception of the Trust in Civil Law* Cambridge (1959) 232.

However, enjoyment and control should be functionally separate so as to avoid abuse of the trust.[452] On the assumption that there is separation of ownership and enjoyment and that this results in trusts being administered properly, the South African courts and legislature have allowed trusts to develop relatively autonomous and without the same level of formality and scrutiny attracted by companies and other legal entities.[453] Chapter 4 will examine the increasing number of trusts where this functional separation is lacking and which, therefore, leads to an abuse of the trust form.

4 3 2 Legal nature of inter vivos trusts

Two questions appear relevant in the enquiry as to the legal nature of *inter vivos* trusts under South African law. Is a trust relationship a contractual relationship? And is a trust a separate legal entity? These questions have vexed academics and the judiciary for decades.[454]

4 3 2 1 Is the South African trust a contract?

A trust under English law is not a contract.[455] In South Africa, although the trust concept was imported from England, English law as such was not. It has been illustrated that this has led to difficulties and uncertainty in many aspects related to trusts. One such issue is whether a trust can be construed as a contract or not.

Following much uncertainty, around the middle of the previous century, the courts came to the conclusion that a trust *inter vivos* is created by way of a *stipulatio alteri*: a contract between the settlor (the *stipulans*) and the trustee (the *promittens*) for the benefit of the beneficiary (the third party).[456] This is another example of how the courts have managed to accommodate essentially English trust concepts in South African law. There does not appear to be agreement on whether this was the correct way to account for the legal nature of the *inter vivos* trust in South African law, but this is now largely historical. Examples of

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[451] Cameron *et al Honoré's South African Law of Trusts* 11.
[452] Cameron *et al Honoré's South African Law of Trusts* 17.
[453] Cameron *et al Honoré's South African Law of Trusts* 19-20; *Land and Agricultural Bank of SA v Parker* 2005 (2) SA 77 (SCA) para 23.
[454] As examined in ch 2 para 4 2 2.
[455] Virgo *The Principles of Equity and Trusts* 42-43; see also ch 2 para 2 4 1.
[456] *Commissioner for Inland Revenue v Estate Crewe* 1943 AD 656; *Commissioner for Inland Revenue v Smollan's Estate* 1955 (3) SA 266 (A); *Crookes NO v Watson* 1956 (1) SA 277 (AD).

objections to this view include that, in a contractual obligation under a *stipulatio alteri*, there is no fiduciary obligation as in the case of trusts; that the third party is meant to take the place of one of the contracting parties, which does not happen in a trust; and that the proper execution of a *stipulatio alteri* is not subject to the control and supervision of the court, as is the case with a trust.[457]

Despite these objections, the status of an *inter vivos* trust as a *stipulatio alteri* was confirmed by the South African Law Commission.[458] This does not imply that a trust can be equated with a *stipulatio alteri* in all respects, as confirmed by the court in *Doyle v Board of Executors*.[459] It may be possible to explain certain aspects, especially those relating to the creation, variation or revocation[460] of a trust, in contractual terms. The terms of the trust deed are often agreed between the settlor and the trustee, and the amendment of the terms thereof may require agreement as well.

On the other hand, many other aspects of a trust clearly do not fit the contractual mould, such as the fiduciary duties and obligations owed by the trustee to the beneficiaries of the trust.[461] These duties and obligations are essential to the very existence of a trust, but are not regulated by contractual principles. A successor trustee would also not have been a party to the original "contract" with the settlor. It would therefore be difficult to state with certainty that under South African law, the trust itself is regarded as a contract.[462]

A solution that has met with judicial acceptance is to regard a trust *inter vivos* as an institution *sui generis*, as in the case of a testamentary trust.[463] It is submitted that this is a more appropriate description.

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[457] Du Toit *South African Trust Law: Principles and Practice* 18; Corbett (1993) 56 *THRHR* 262 264-265. This was examined in more detail in ch 2 para 4 2 2.
[458] SA Law Commission *Review of the Law of Trusts* (1987).
[459] *Doyle v Board of Executors* 1999 (2) SA 805 (C).
[460] The revocation of an *inter vivos* trust is examined in ch 3.
[461] Hahlo (1961) 78 *SALJ* 195 204.
[462] See Du Toit *South African Trust Law: Principles and Practice* 19-20 who shares the same view.
[463] *Braun v Blann and Botha NNO* 1984 (2) SA 850 (A) 859D; *Badenhorst v Badenhorst* 2006 (2) SA 255 (SCA) para 8.

4 3 2 2 Is the South African trust a legal entity?

Whereas it is unequivocally clear that an English law trust is not a separate legal entity, the point is still being debated in South Africa. It seems that the debate originated from uncertainty about the ownership of the trust property. In English law the trustee owns the legal estate in the trust property and the beneficiaries have an equitable interest in the property, which gives them the protection they need should the trustee mismanage the trust property. In South African law the trustee has full ownership of the trust property (apart from the, more rare, case of the *bewind* trust[464]).

A theoretical basis for the protection of the beneficiaries was found in the common law position where the trustee owns two separate estates. This position has subsequently been confirmed in legislation.[465] An alternative view, focusing on the obligation dimension of the trust rather than the property dimension, could be that the protection of the beneficiaries is based on the accountability of the trustees.

Confirming that the trustee owns two estates – one made up of his privately owned assets and the other made up of the assets forming part of the trust – may, however, lead to the conclusion that a trust is a separate estate and has legal personality.[466] Adding to the confusion is the fact that, for certain purposes, legislation and case law consider a trust a juristic person and thus treats it as a separate legal entity. Examples of this include certain sections of the taxation Acts, the fact that a trust created by contract can be sequestrated, and registration practices with regard to immovable property.[467]

In *Ex Parte Milton NO*,[468] it was held that the sequestration of an "administrative" trust created by contract should be allowed, even if a trust does not strictly speaking possess legal personality. The reasons for the court's decision were twofold. First, the definition of "debtor" in the Insolvency Act[469] was wide enough for a trust to be regarded as a "debtor in the usual sense of the word" – it has the ability to hold property separate from its members,

[464] See ch 2 para 4 3 3.
[465] Trust Property Control Act 57 of 1988 s 12.
[466] De Waal (2000) 117 *SALJ* 548 563.
[467] De Waal and Theron (1991) 3 *TSAR* 499; De Waal (1993) 56 *THRHR* 1.
[468] *Ex Parte Milton NO* 1959 (3) SA 347 (SR). This is a case from Southern Rhodesia, which, for judicial purposes, formed part of South Africa at the time of the decision.
[469] Insolvency Act 24 of 1936 s 2.

similar to an unincorporated club, as the trustee holds the assets in his capacity as trustee and so there must be a separate trust estate to which creditors would look in the case of claims. Secondly, legal personality is not a prerequisite for sequestration given that the estate of a partnership can be sequestrated under the Insolvency Act.[470]

In *Magnum Financial Holdings (Pty) Ltd v Summerly*[471] the court followed the decision in *Milton*[472] and confirmed that a trust is not a corporate body and thus is not excluded from the definition of "debtor". However, the court went on to state that a trust does possess legal personality in certain respects.[473] Unfortunately the court did not clarify this statement.

However, the current position, which seems to be widely accepted, is that a trust is not a separate legal person, and that ownership of the trust assets vest in the trustee, not in the trust itself. This was confirmed in *CIR v MacNeillie's Estate*[474] and referred to with approval in *Braun v Blann and Botha NNO*.[475]

It has been suggested that, in order to answer the question of the legal nature of a South African trust with certainty, legislation should provide that trusts should be clothed with legal personality.[476] This may create a further divide between the South African trust and its English counterpart, but may be outweighed by the benefit of certainty.

4 3 3 Current definition

Although the word "trust" can also be used in a wide sense, this dissertation is concerned with what is known in South African law as a trust in the narrow or strict sense. A trust in the wide sense refers to any relationship where someone is bound to hold or administer property on behalf of another or for an impersonal object and not for his own benefit, but where that person acts in a private capacity and does not hold an office.[477]

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[470] Insolvency Act 24 of 1936.
[471] *Magnum Financial Holdings (Pty) Ltd (in liquidation) v Summerly* 1984 (1) SA 160 (W).
[472] *Ex Parte Milton NO* 1959 (3) SA 347 (SR).
[473] *Magnum Financial Holdings (Pty) Ltd (in liquidation) v Summerly* 1984 (1) SA 160 (W) 163.
[474] *CIR v MacNeillie's Estate* 1961 (3) SA 833 (A) 840F-G.
[475] *Braun v Blann and Botha NNO* 1984 (2) SA 850 (A).
[476] De Waal and Theron (1991) 3 *TSAR* 499; De Waal (1993) 56 *THRHR* 1; *Joubert v Van Rensburg* 2001 (1) SA 753 (W) 766-772.
[477] Cameron *et al Honoré's South African Law of Trusts* 1-4. Examples of such relationships are curators of persons with a mental disability, executors of deceased estates, as agents holding money for the principals.

A trust in the narrow sense is a specific instance of the *genus* trust in the wide sense. Such a trust exists when the settlor (the creator of the trust) has handed over or is bound to hand over to another (the trustee) the control of property which, or the proceeds of which, is to be administered or disposed of by the trustee for the benefit of a person or persons other than the trustee (the beneficiaries) or for an impersonal object. A fiduciary obligation is created.[478] This definition clearly contains the two dimensions of the trust: property and obligation.

Furthermore, one of the fundamental features of the trust, namely the separation of ownership or control over property from the enjoyment of the property, is clear from this definition.

An authoritative statutory definition of the trust was introduced with the TPCA. According to section 1:

> " '[T]rust' means the arrangement through which the ownership in property of one person is by virtue of a trust instrument made over or bequeathed –
>
> (a) to another person, the trustee, in whole or in part, to be administered or disposed of according to the provisions of the trust instrument for the benefit of the person or class of persons designated in the trust instrument or for the achievement of the object stated in the trust instrument; or
>
> (b) to the beneficiaries designated in the trust instrument, which property is placed under the control of another person, the trustee, to be administered or disposed of according to the provisions of the trust instrument for the benefit of the person or class of persons designated in the trust instrument or for the achievement of the object stated in the trust instrument,
>
> but does not include the case where the property of another is to be administered by any person as executor, tutor or curator in terms of the provisions of the Administration of Estates Act[479]…"[480]

Two types of trust are envisaged by this definition. The first is the normal arrangement of a trust where the trustee owns the trust assets. The second is the so-called *bewind* trust, where

[478] Cameron *et al Honoré's South African Law of Trusts* 4; Du Toit *South African Trust Law: Principles and Practice* 2.
[479] Administration of Estates Act 66 of 1965.
[480] Trust Property Control Act 57 of 1988 s 1.

the beneficiaries own the trust property, but the trustee has the power to control and dispose of the trust property. The *bewind* trust is derived from similar arrangements under Roman-Dutch and modern Dutch law whereby an administrator or *bewindhebber* is appointed to control property owned by another person.[481]

Although the *bewind* trust is an accepted part of South African trust law, it is not encountered very commonly in practice,[482] and is also not covered by this dissertation.

As the TPCA regulates administrative control over trust property and is not a codification of South African trust law as such, definitions provided by the judiciary have over the years also played an important role in clarifying the concepts of trust and trustee.

Important examples of such contributions span the last century. Already in 1915, in *Estate Kemp v MacDonald's Trustee*,[483] it was stated that the underlying conception of a trust is that, while legal *dominium* is vested in the trustee, the trustee has no beneficial (or equitable) interest in the trust property and is bound to hold and apply the property for the benefit of the beneficiaries or the achievement of a special purpose. In 2005, the Supreme Court of Appeal in *Land and Agricultural Bank of SA v Parker*[484] confirmed that the separation of ownership (or control) from enjoyment constitutes the core idea of the trust. The court also stated that the guiding principle for the court's major decisions over the last century is that the trustee has to safeguard the interests of others. He occupies an office and has to exercise fiduciary responsibility over the trust property on behalf of and in the interests of another.[485]

4 3 4 Classifications of trust

For the purposes of this dissertation, the focus will be on private *inter vivos* trusts created expressly and documented in a trust deed or instrument. Testamentary trusts and public trusts such as charitable trusts or pension fund trusts are therefore not covered.

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[481] Cameron *et al Honoré's South African Law of Trusts* 6; Du Toit *South African Trust Law: Principles and Practice* 4.
[482] Cameron *et al Honoré's South African Law of Trusts* 7-9.
[483] *Estate Kemp v McDonald's Trustee* 1915 AD 491.
[484] *Land and Agricultural Bank of SA v Parker* 2005 (2) SA 77 (SCA).
[485] *Land and Agricultural Bank of SA v Parker* 2005 (2) SA 77 (SCA) paras 19-20.

Unlike English law, South African law does not recognise the unintentional creation of trusts. Resulting and constructive trusts, which arise by operation of law, therefore do not form part of South African law.

The following classifications are not exhaustive. Furthermore, one trust can fall under more than one of the categories.

4 3 4 1 Vested trusts and discretionary trusts

Private express trusts taking effect *inter vivos* can be categorised as either vested (or vesting) trusts or discretionary trusts.

A vested or vesting trust refers to a trust where the beneficiaries have vested rights to the income or capital of the trust fund, and the trustee does not have discretion as to whether to make distributions of income or capital, or to which beneficiaries to make such distributions. Although the ownership of the assets still vests in the trustee, the right to receive income or capital (or both) is vested in the beneficiary.

The word vested in this sense therefore implies a distinction between what is certain and what is conditional.[486] In reality, the word vested is not intended to aid a comparison of different classes of rights, but rather to distinguish a right from a chance or a possibility of a right. However, the expressions vested right and conditional or contingent right are well known and will be used in this dissertation as well, although a contingent or conditional right is, strictly speaking, not a right.

A vested right does not necessarily equate to ownership of or *dominium* in the property, or even immediate enjoyment thereof, and may be a mere personal right.[487] It is therefore not quite the same as the equitable proprietary interest of the beneficiary of a fixed trust under English law. The right is, however, immediate (or definite) insofar as it does not depend on a contingency such as the beneficiary reaching a certain age. Should the beneficiary die or

[486] *Jewish Colonial Trust v Estate Nathan* 1940 AD 163 175-176.
[487] *Greenberg v Estate Greenberg* 1955 (3) SA 361 (A) 364-365.

become insolvent before the income or capital accrues to him, the right to receive the same will pass to his estate.[488]

By contrast, a discretionary trust refers to a trust where the trustee has discretion with regard to the distribution of income and capital to the beneficiaries. Unlike the beneficiary with a vested interest, the discretionary beneficiary does not have a vested right in relation to the trust property, but has a mere contingent right. In *Stern and Ruskin NO v Appleson*[489] Millin J stated that a contingent right is:

> "something that may ripen into a vested interest on the happening of an event, but it must be such that the happening of the event, without more, gives the vested interest."[490]

The beneficiary with a contingent right has a mere hope or *spes* that the trustee will apply trust property to his benefit. A right is contingent only if the trustee has discretion to decide *whether* to distribute income or capital to the beneficiary, or discretion as to the *amount* to be distributed. If the trustee has discretion only with regard to the *manner* in which to apply income or capital for the benefit of a beneficiary, that beneficiary still has a vested right in the income or capital.[491] So although the trust may be described as discretionary, such a beneficiary has a vested right and not a contingent right. Having a contingent as opposed to a vested right has certain tax and other advantages, as no entitlement to the property can be said to form part of the beneficiary's taxable estate.

4 3 4 2 Business trusts

In South Africa, a category of trust known as business or trading trusts has developed and has been extremely popular in recent decades. It should be mentioned that trusts have been used to own businesses for much longer than this, and that this use of trusts is well known in other jurisdictions as well. Where such a trust is set up by individuals and have as ultimate

[488] Cameron *et al Honoré's South African Law of Trusts* 556-557; Honiball and Olivier *The Taxation of Trusts in South Africa* 5-6.
[489] *Stern and Ruskin NO v Appleson* 1951 (3) SA 800 (W).
[490] *Stern and Ruskin NO v Appleson* 1951 (3) SA 800 (W) 805. It must be more than the mere possibility of acquiring something in the future. This quote was also referred to with approval in *Wasserman v Sackstein NO* 1980 (2) SA 536 (O) 540.
[491] Cameron *et al Honoré's South African Law of Trusts* 556-558.

beneficiaries family members of the settlor, it is a private express trust taking effect *inter vivos* and as such it is not clear that different rules should apply to these trusts in principle.

A combination of factors has led to this type of trust acquiring a somewhat notorious status in South Africa. A precise definition of a business trust is difficult, but the distinguishing feature seems to be that such trusts have as principal purpose the carrying on of business for profit, including the owning or letting of immovable property, and distributing the profit among the beneficiaries, as opposed to the protection and conservation of assets.[492]

One of the factors that has led to the particular status of business trusts in South Africa is the level of trustee liability. Under South African law the extent of a trustee's liability to beneficiaries and trust creditors is limited to the trust fund, unless he held himself out as undertaking personal responsibility. Trustees under English law are in a more vulnerable position than South African trustees who have, in effect, limited liability akin to that of a company director.[493]

Trusts are, however, not subject to the same level of statutory regulation as companies and other corporate entities. Audited financial statements are, for example, not required. There are, or at least were, many tax-related advantages of using trusts as opposed to companies, although this has decreased over the years as the legislature is trying to clamp down on the abuse of trusts. It is more difficult for third parties to discover the terms of a trust and the details of the trustees than to obtain information about a company and its directors, making it easier to maintain confidentiality as to the interests and operations involved in a trust.[494]

It is clear from the above that there is much more flexibility and less regulation in the use of trusts when compared to a company, partnership or close corporation. One only needs to look at the index to the Companies Act[495] to see that this is the case.

Under the previous Companies Act,[496] it could be said that trustees had more onerous duties than directors. The TPCA requires a trustee to act with the care, diligence and skill that can

[492] Honiball and Olivier *The Taxation of Trusts in South Africa* 303; Wunsh (1986) 103 *SALJ* 561.
[493] Cameron *et al Honoré's South African Law of Trusts* 26-28.
[494] Cameron *et al Honoré's South African Law of Trusts* 91-95; Wunsh (1986) 103 *SALJ* 561 562-563, 568-570.
[495] Companies Act 71 of 2008.
[496] Companies Act 61 of 1973. This act was repealed by Companies Act 71 of 2008 s 224(1).

reasonably be expected of a person who manages the affairs of another.[497] In the past, company directors were merely expected to maintain the standard it would be reasonable to observe in the management of their own affairs.[498] Under the new Companies Act,[499] directors must act in good faith and for a proper purpose; in the best interests of the company; and with the degree of care, skill and diligence that may reasonably be expected of a person carrying out the relevant functions in relation to the company and having the general knowledge, skill and experience of that director.[500] This is definitely a higher standard, especially in the case of professional directors. The standard of care required of trustees may therefore not be so different to those of company directors any longer.

Apart from their statutory duties, trustees are also in a fiduciary position and must be able to account to the beneficiaries for their proper execution of the trust. This accountability lies at the heart of the trust, and encourages both diligence and independence on the part of the trustee.[501]

Thus it appears that the relative autonomous development of the trust and the greater flexibility that it offers have been countenanced by the legislature and courts precisely for this reason. Because of the trustee's fiduciary position and accountability, and the separation of ownership or control over the assets from the enjoyment thereof, a trust will under normal (or perhaps rather ideal) circumstances be properly governed, and third parties dealing with the trustees will be adequately protected.[502] Unfortunately, in the last few decades, numerous cases have come before the courts where business trusts were being abused. No objection exists against the use of trusts for business purposes *per se*. The objection is against the lack of separation between ownership or control on the one hand and enjoyment on the other hand.

The particular advantages offered by trusts and the fact that less formalities are required in comparison to corporate entities, may explain why a large proportion of cases involving abuse of the trust concern trusts that own businesses. More specifically, it often is a trust involving a small circle of family members (rather than "public" business trusts), where the trustees and

[497] Trust Property Control Act 57 of 1988 s 9(1).
[498] Cameron *et al Honoré's South African Law of Trusts* 93.
[499] Companies Act 71 of 2008.
[500] Companies Act 71 of 2008 s 76(3).
[501] *Land and Agricultural Bank of SA v Parker* 2005 (2) SA 77 (SCA) paras 19-22. This is also a principle of English trust law, see *Armitage v Nurse* (1998) Ch 241 and ch 2 para 2 6 3.
[502] *Land and Agricultural Bank of SA v Parker* 2005 (2) SA 77 (SCA) paras 23-24.

beneficiaries are essentially the same persons, or where the beneficiaries exercise control over the trustees.[503] Not surprisingly, questions regarding the need for separate regulation of business trusts are being raised.

Business trusts and the particular opportunities for abuse will be examined in more detail in chapters 3 and 4.

4 3 5 Characteristics of a South African trust

4 3 5 1 The trust

The South African trust, an arrangement that has its roots in English law but has been adapted by the South African courts and legislature over the years, share many essential features with its forefather, the English trust. This has been highlighted in the examination of whether a South African trust is a "proper" trust.[504]

This view is confirmed when comparing the main characteristics of the South African trust with those of the English trust,[505] as stated by influential academics in both jurisdictions. Although differences exist, there are by far more common features.

A South African trust is not a legal person, unless a statute declares that for a certain purpose, for example income tax, the trust is to be regarded as a separate legal entity. It can be described as an institution *sui generis*.[506] A trust under English law is never a legal entity, although some taxation statutes operate as if the body of trustees were a legal entity.

4 3 5 2 The trust property

Ownership of the trust property vests in the trustee, apart from the rather uncommon case of the *bewind* trust, where the trustee controls the trust property, but the beneficiaries are the

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[503] Cameron *et al Honoré's South African Law of Trusts* 95-96; *Land and Agricultural Bank of SA v Parker* 2005 (2) SA 77 (SCA) paras 24-26. See also Wunsh (1986) 103 *SALJ* 561 575-576, where he discusses certain United States decisions where beneficiaries retained control over the trustees and were held liable for the debts of the trust.
[504] See ch 2 para 4 3 1.
[505] See ch 2 para 2 6.
[506] See ch 2 para 4 2 2.

owners thereof.[507] This is different to the position under English law where it is now clear that the trustee must always be the owner of the trust property as well as having control over it.[508]

For a valid South African trust to exist, the settlor must have handed over, or be bound to hand over, ownership and control of the trust property to the trustee. The trustee must be able to administer the trust property free from the settlor's control.[509] The issue of control is an important focus of the dissertation and will be returned to in chapter 4.

The trustee is vested with two separate estates: the trust estate and the trustee's personal or private estate. The ring-fencing of trust property has been laid down in the TPCA[510] and is now an accepted principle of South African trust law. One of the most important results of this is that the beneficiary, although having a mere personal right against the trustee (as opposed to the proprietary right of the beneficiary of an English law trust), is protected in the event of the trustee's insolvency. Generally speaking, the trustee's private creditors have to claim against his private estate, and the beneficiaries have to claim against the trust estate.[511]

The concept of real subrogation applies to trust property to ensure the continuity of the trust fund. If an asset is lawfully disposed of, the proceeds or the replacement asset also form part of the trust fund.[512]

4 3 5 3 The trustee

A trustee is in a fiduciary position and has the power and duty to manage, employ or dispose of the trust property in accordance with the terms of the trust instrument and applicable legislation. As a result of this fiduciary duty, the trustee can be held to account if he does not fulfil these duties in good faith.[513] There is also a statutory duty of care requiring trustees to

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[507] Cameron *et al Honoré's South African Law of Trusts* 6-7; Du Toit *South African Trust Law: Principles and Practice* 9.
[508] See ch 2 para 2 6.
[509] Du Toit *South African Trust Law: Principles and Practice* 34-35; *Ex Parte Leandy* 1973 (4) SA 363 (N) 368, where the judge found that, given that the settlor did not interfere with the trustee's administration for eight years after setting up the trust, he clearly gave up control and therefore the judge did not have an objection to him being appointed a co-trustee with two others.
[510] Trust Property Control Act 57 of 1988 s 12.
[511] Cameron *et al Honoré's South African Law of Trusts* 28; De Waal (2000) 117 *SALJ* 548 560-562.
[512] Du Toit *South African Trust Law: Principles and Practice* 10; De Waal (2000) 117 *SALJ* 548 564.
[513] Cameron *et al Honoré's South African Law of Trusts* 11; Du Toit *South African Trust Law: Principles and Practice* 10; De Waal (2000) 117 *SALJ* 548 557-559.

act with the care, diligence and skill that can reasonably be expected of a person who manages the affairs of another.[514] Furthermore, a trust deed cannot exempt a trustee from liability if he fails to fulfil the statutory duty of care.[515]

There is a requirement for the trustee to have a degree of independence, although the extent of such independence has not been clarified with any certainty and may be described as a matter of degree. In *Goodricke v Registrar of Deeds, Natal*[516] four persons founded a trust of which they were the only beneficiaries and also four out of five trustees. The other trustee was a corporate entity. Although the fifth trustee was stated to be the executive trustee carrying out the powers and duties of the trustees, a majority of the other four trustees could remove the fifth trustee.

Despite these facts pointing to a lack of independence, Muller J found that the trust was valid. He argued that neither of the settlors acting alone could revoke the trust and that there was a "multiplicity of parties". He said that the trust fund was a common fund held at least in part for the benefit of someone else.[517]

The compatibility of the trustee's independence with the settlor's power to unilaterally revoke the trust has been questioned, and has not been finally settled by the judiciary.[518] The right of the settlor to revoke the trust and the degree of independence of the trustees are examined in more detail in chapters 3 and 4.

The trustee acts in an official capacity and trusteeship is an office. Although trusts, especially the type examined in this dissertation, are normally created by individuals, there is a public element insofar as the Master of the High Court and the courts themselves play a supervisory role and may, on request, interfere to ensure proper administration of trusts.[519] There is, however, more detailed control over the actions of executors of deceased estates than the actions of trustees of *inter vivos* trusts.[520]

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[514] Trust Property Control Act 57 of 1988 s 9(1).
[515] Trust Property Control Act 57 of 1988 s 9(2).
[516] *Goodricke v Registrar of Deeds, Natal* 1974 (1) SA 404 (N).
[517] *Goodricke v Registrar of Deeds, Natal* 1974 (1) SA 404 (N) 408. This decision is questioned by Wunsh (1986) 103 *SALJ* 561 566.
[518] Cameron *et al Honoré's South African Law of Trusts* 11, 89-91, 492-493.
[519] Cameron *et al Honoré's South African Law of Trusts* 11-12; Du Toit *South African Trust Law: Principles and Practice* 10; De Waal (2000) 117 *SALJ* 548 565-567.
[520] Cameron *et al Honoré's South African Law of Trusts* 20.

4 3 5 4 The settlor

In most cases, the requirement for the settlor to give up control is fulfilled by virtue of the transfer of ownership. The settlor cannot remain the sole owner of the trust property, but can be a co-trustee. He must therefore divest himself of at least some part of the legal proprietary power over the trust property. Should the settlor as co-trustee subsequently become the sole trustee (for example due to the death of the other trustee), the trust will not be extinguished unless the settlor is also the sole beneficiary.[521] The settlor's ownership of the trust property will only be in his official capacity as trustee and subject to the limitations imposed by the terms of the trust.

The settlor (just like anyone else) therefore cannot be both the only trustee and the only beneficiary of the trust. Essentially, there must be at least some element of holding or administering property for a person or object other than the trustee.[522]

The settlor may retain a power to vary or revoke the trust during his lifetime. It appears that the settlor would need the consent of the trustee to do this. Some argue that allowing revocation or variation without trustee consent interferes with the trustee's independence, in the same way as being bound by the instructions of the settlor interferes with the trustee's independence.[523] The extent to which a settlor can unilaterally revoke or vary the terms of a trust, or exercise control over the trust's administration, will be examined in chapter 4.

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[521] Cameron *et al Honoré's South African Law of Trusts* 6. The position in England is the same, see ch 2 para 2 4 3. In the recent case of *Groeschke v Trustee, Groeschke & Others* 2013 (3) SA 254 (GSJ) para 31-32 Bester AJ held that although a trust cannot be validly created if the sole trustee is also the sole beneficiary, a trust would not fail if, as a result of intervening circumstances, the sole trustee is left as sole beneficiary, although it would be undesirable. The judge relied on the judgment in *Land and Agricultural Bank of SA v Parker* 2005 (2) SA 77 (SCA).

[522] Cameron *et al Honoré's South African Law of Trusts* 6, 11.

[523] Cameron *et al Honoré's South African Law of Trusts* 89-91, 492-493, 503-506.

4 3 5 5 The beneficiaries

The fundamental right of beneficiaries is to insist on proper administration of the trust so that the beneficiaries can enjoy the benefits to which they are actually or potentially entitled.[524] This is similar to the position in other jurisdictions.

In general, beneficiaries of South African trusts do not have real rights in the trust property (or proprietary rights, to use the English terminology), but only personal rights against the trustee. The trustee, who owns the trust property, can therefore deal with the trust property in any way provided it is done within the terms of the trust and not in breach of trust. The beneficiaries are protected to some extent by virtue of the fact that the trust property does not form part of the trustee's personal estate. The beneficiaries only compete with creditors of the trust, not with the trustee's personal creditors. This does not make the beneficiary's right proprietary, but it does afford better protection and make it more valuable.[525]

Another distinction from English law is that a beneficiary of a South African trust must accept the benefit in order to obtain an indefeasible right under the trust. There seems to be some disagreement about the role played by the acceptance of benefits. The requirement stems from the characterisation of an *inter vivos* trust, or at least the creation of such a trust, as a contract for the benefit of a third party.[526] Under the law relating to contracts for the benefit of third parties, until the third party (the beneficiary) has accepted the benefit or promise thereof, the contract may be varied or cancelled by the other parties (the settlor and trustee).[527]

This seems contrary to the obligation dimension of the trust, which does not originate from contractual principles, but rather from the fiduciary duty of the trustee towards the beneficiaries. It implies that someone must be able to hold the trustee to account. This right to require performance of the trust clearly lies with the beneficiaries. It is submitted that this right should not be subject to acceptance on the part of the beneficiary. This would, for example, be in accordance with Scots law, with which South African trust law shares numerous similarities.

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[524] Cameron *et al Honoré's South African Law of Trusts* 556; see ch 2 para 4 3 4 1 for the different interests arising under different types of trusts.
[525] Cameron *et al Honoré's South African Law of Trusts* 558-559.
[526] Cameron *et al Honoré's South African Law of Trusts* 498-501; Du Toit *South African Trust Law: Principles and Practice* 116-118.
[527] See ch 2 para 4 2 2.

4 3 5 6 Duration of the trust

In South Africa, there is no rule against perpetuities, in contrast with the position in England.[528] It appears that a trust under South African law can exist for an indefinite period, and further that there is no time limit within which the interests of capital beneficiaries must vest. Clearly, there is much sense in the argument that the freedom given to settlors in this respect should be limited. Locking wealth away for many generations may cause social and economic problems. Suggestions have been made for a periodic capital transfer tax, not unlike that found in England with regard to certain discretionary trusts, but others argue that a statutory rule setting a time limit for vesting would be preferable.[529]

4 4 Substantive requirements for the creation of a valid express trust under South African law

4 4 1 Intention

A settlor needs to illustrate a clear and unambiguous intention to create a trust. This is because creating a trust over property imposes a burden on the property, namely that the property must be administered according to the terms and provisions of the trust deed.[530] It must also be clear that the intention was to create a trust and not another legal construct, such as a partnership or an agency.[531]

Importantly, the intention to create an *inter vivos* trust must be shared by the settlor and the intended trustee.[532] What this means is that no-one can be forced to be a trustee against his will.

Whether the settlor had the intention to create a trust will be inferred from the circumstances. Factors to be taken into account include the words that are used, the formality of the arrangement, and what the usual practice is. In general, when interpreting a trust deed, the

[528] Cameron *et al Honoré's South African Law of Trusts* 125-127; see ch 2 para 2 7 4 for the English position.
[529] Cameron *et al Honoré's South African Law of Trusts* 601.
[530] Cameron *et al Honoré's South African Law of Trusts* 118.
[531] Du Toit *South African Trust Law: Principles and Practice* 28.
[532] Cameron *et al Honoré's South African Law of Trusts* 119; see also ch 2 para 4 4 2.

rules applicable to the interpretation of written contracts are used.[533] As far as the wording of the trust instrument is concerned, peremptory language is preferable to precatory words, such as wish or desire. However, although using peremptory words like trust or trustee does indicate an intention to create a trust, it is not necessarily conclusive, as the circumstances may clearly indicate that a different arrangement was intended.[534]

The use of precatory words may lead to confusion and has been dealt with in many court cases.[535] The interpretation of such trust deeds can be dealt with in two possible ways. Either one tries to ascertain what the words mean as used by the testator, or one tries to ascertain what the testator meant by using those words.[536] South African courts have generally followed the second approach and therefore, in summary, it can be said that precatory words may or may not create a trust, depending on the circumstances.[537]

If the document does not express the intention of the founder correctly, rectification of the trust deed may be applied for by the settlor, trustee or other interested party. The settlor's intention at the time of creation of the trust will be decisive.[538]

Under South African law, trusts cannot be created unintentionally. Resulting trusts and constructive trusts form part of the English law of trusts and arise by operation of law. These types of trust have not been received in South Africa, mainly because South African law offers sufficient remedies in case of unjust enrichment.[539]

4 4 2 Obligation

In addition to the settlor having an intention to create a trust, this intention must be expressed in a manner appropriate to create an obligation. The intention must be contained in a form apt to create a legal obligation.[540] The different sources of trusts constitute the requisite modes: A

[533] Cameron *et al Honoré's South African Law of Trusts* 268.
[534] Cameron *et al Honoré's South African Law of Trusts* 119; Du Toit *South African Trust Law: Principles and Practice* 28.
[535] See Cameron *et al Honoré's South African Law of Trusts* 119-127 for a discussion of these cases.
[536] *Harter v Epstein* 1953 (1) AllSA 273 (A) 280. Although this case concerned a testamentary trust, according to Cameron *et al Honoré's South African Law of Trusts* 120 it also applies to *inter vivos* trusts.
[537] Cameron *et al Honoré's South African Law of Trusts* 120, 127.
[538] Cameron *et al Honoré's South African Law of Trusts* 268-269.
[539] Cameron *et al Honoré's South African Law of Trusts* 128-136; see ch 2 para 2 5.
[540] Cameron *et al Honoré's South African Law of Trusts* 137-138.

testamentary trust must be contained in a will, and an *inter vivos* trust generally in a written agreement. Such a trust may also be created orally, but the trust and its creation will then be governed by common law, and the TPCA[541] will not apply to it.[542] Other modes include a court order, statute or treaty.[543] The focus will remain on private *inter vivos* trusts created expressly.

It is only sensible to reduce a trust to writing so as to avoid disputes about the terms thereof, and to provide proof of the intention to create a binding obligation and avoid challenges to its existence in the first place.[544]

The obligation that is created is either the obligation on the trustee to administer the trust property in accordance with the terms of the trust deed, or the obligation on the settlor to take the necessary steps to ensure that the property will be administered by a trustee, mostly by transferring the property to the trustee.[545] This will depend on the circumstances and whether or not a trustee has already been appointed and taken office. The absence of a validly appointed trustee therefore does not preclude the creation of a valid trust, as long as the obligation exists to create a trust and transfer the property to a trustee.[546]

However, given the view that a trust *inter vivos* is created by way of a *stipulatio alteri*,[547] it would be necessary for a trustee to have been appointed and to have accepted the appointment at the time of execution of the contract, in this case the trust deed.[548]

Unlike the position in England, an *inter vivos* trust cannot be created unilaterally under South African law. In other words, a trust cannot be "declared". The reason provided is that a person cannot during his lifetime unilaterally sequester a portion of his estate and dedicate it to certain ends.[549] The agreement of at least one fellow trustee is required, which conforms to the

[541] Trust Property Control Act 57 of 1988 s 1, which defines "trust" with reference to "trust instrument", being a written agreement, testamentary writing or court order creating a trust.
[542] Unless it was reduced to writing afterwards.
[543] Cameron *et al Honoré's South African Law of Trusts* 137-140; Du Toit *South African Trust Law: Principles and Practice* 28-29.
[544] Cameron *et al Honoré's South African Law of Trusts* 140.
[545] Cameron *et al Honoré's South African Law of Trusts* 138.
[546] Cameron *et al Honoré's South African Law of Trusts* 138; Du Toit *South African Trust Law: Principles and Practice* 29-30.
[547] See ch 2 para 4 3 2 1.
[548] Cameron *et al Honoré's South African Law of Trusts* 176; Du Toit *South African Trust Law: Principles and Practice* 30.
[549] *Crookes NO v Watson* 1956 (1) SA 277 (AD) 298.

characterisation of an *inter vivos* trust as a *stipulatio alteri*.[550] One may ask whether this is very different to a settlor transacting with a trustee who will be paid and therefore may not have an incentive to disagree with the settlor, or where the settlor is one of the trustees and controls the co-trustees, as in the *Goodricke* case.[551]

4 4 3 Property

The trust property, which could be any type of asset or group of assets, must be defined or identifiable with reasonable certainty.[552] Although virtually any type of asset can be subject to a trust, the property must be determined with reasonable certainty in order to create a valid trust. In the event that the description of the trust property is unclear, any ambiguity will be resolved, in the case of an *inter vivos* trust, by having regard to any admissible intrinsic or extrinsic evidence.[553]

In case of doubt, the extent of trust property will be determined having regard to how much is needed to fulfil the purpose of the trust. Discretion can also be conferred on the trustee to determine the amount of the trust property, provided however that objective criteria were provided by the settlor.[554]

There is no requirement for the trustees to own all of the trust property at the inception of the trust, so that the settlor is able to transfer additional property to the trust subsequent to its creation. The same applies to transfers by third parties. It has been decided by the Appellate Division (as it was then known) in *Deedat v The Master*[555] that, as long as the property is duly identifiable, additional trust property can be acquired by the trustees in the future.[556]

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[550] Du Toit *South African Trust Law: Principles and Practice* 38-39.
[551] *Goodricke v Registrar of Deeds, Natal* 1974 (1) SA 404 (N).
[552] Trust Property Control Act 57 of 1988 s 1 defines trust property as "movable or immovable property and includes contingent interests in property which in accordance with the provisions of a trust instrument are to be administered or disposed of by a trustee".
[553] Cameron *et al Honoré's South African Law of Trusts* 146-148; Du Toit *South African Trust Law: Principles and Practice* 30.
[554] Cameron *et al Honoré's South African Law of Trusts* 149-150.
[555] *Deedat v The Master* 1995 (2) SA 377 (A).
[556] *Deedat v The Master* 1995 (2) SA 377 (A) 384-385.

4 4 4 Object

A further requirement for a valid trust is that the trust object must be sufficiently certain. South African law recognises trusts for the benefit of persons as well as trusts for impersonal objects. A trust intended to benefit persons can be for one or more named or ascertainable persons or one or more named or ascertainable classes of person, including legal persons. If the person or class is not named or ascertainable, the trust will fail for want of a certain object.[557]

A trust may also have an impersonal object. In most cases the object will be charitable, but it appears that South African law does not necessarily prohibit non-charitable purpose trusts, which is the position in England.[558] Charitable trusts, which are not covered in this dissertation, receive a more benevolent construction in terms of their object because of the public element involved, and therefore the same precision in the description of the object is not required. There seems to be disagreement on whether all trusts for the public benefit are to be construed as charitable. Some take a narrow view, requiring benefit to the underprivileged or a connection to religion. The better view seems to be that human excellence, for example, in science, or the promotion of natural beauty, also benefits the public.[559]

The more difficult question relates to objects that are clearly non-charitable and impersonal. Honoré mentions the fact that in English law, the rule against perpetuities[560] militates against such non-charitable purpose trusts, but that this should not preclude such trusts from being recognised as valid by South African law.[561]

Under English law, another objection against this type of trust is the absence of someone to enforce the trust or, to use English terminology, someone with an equitable right to the trust property who can enforce the trust obligations against the trustee.[562] In the case of a trust for human beneficiaries, the beneficiaries will hold the trustee to account if he does not fulfil his duties with the necessary care and skill. In the case of charitable trusts, the Attorney-General

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[557] Cameron *et al Honoré's South African Law of Trusts* 151.
[558] See ch 2 paras 2 7 2, 2 7 3. Arguments have been advanced for recognising non-charitable purpose trusts in England as discussed in para 2 7 3 1.
[559] Cameron *et al Honoré's South African Law of Trusts* 161-167.
[560] See ch 2 para 2 7 4.
[561] Cameron *et al Honoré's South African Law of Trusts* 170.
[562] This is known as the beneficiary principle, see ch 2 para 2 7 2.

of the Charity Commission is able to enforce the trust. The position in South African law should be similar. It should be considered whether a trustee in such a case will be held to account by any person or organisation in the event of a breach of trust. Can a valid trust exist in the absence of accountability of the trustee?

Arguably, the categories of trust mentioned by Honoré would (at least on an English interpretation) fall either in the category of trusts for individual beneficiaries, trusts for charitable purposes, or "valid trusts for persons limited by a purpose".[563] There is no mention of the type of non-charitable purpose trust recognised by many offshore jurisdictions but not, as yet, by English law. These trusts often have as their sole purpose the holding of shares in a private trustee company, or some other passive holding function. Law in an offshore jurisdiction often allows the appointment of an enforcer, which, in theory, overcomes the objection that no one can enforce the trust, but this may be construed as artificial.[564]

4 4 5 Legality

The final substantive requirement for the creation of a valid trust is that the trust object must be lawful. If the object of a trust is illegal, contrary to public policy or *contra bonos mores*, it is unlawful and the trust would not be valid.[565] Illegality may be easier to identify than a conflict with public policy or public morality, partly because the latter are not constant, unchanging concepts. An example of this is the changed attitude towards the racially discriminatory allocation of trust benefits, mostly found in charitable testamentary trusts. While such provisions were in the past accepted by the courts, recent case law indicates a change in attitude.[566]

There does not appear to be many decided cases where the trust object was found to be unlawful. One example of illegality is a trust created to give a beneficial interest to an

[563] See ch 2 para 2 7 2.
[564] See ch 2 para 3 4 3.
[565] Du Toit *South African Trust Law: Principles and Practice* 32.
[566] Du Toit *South African Trust Law: Principles and Practice* 32-33. See also *Minister of Education v Syfrets Trust Ltd NO* 2006 (4) SA 205 (C), where it was held that provisions discriminating on the grounds of gender and race in a charitable testamentary trust was contrary to public policy (even if it was not so at the time the will was executed) and have to be struck out of the will. Note that the trust itself was not held to be invalid; the court was not asked to consider whether the trust object was rendered unlawful as a result of the discriminatory provisions. A trust *inter vivos* has not come under scrutiny in this regard yet, but it may well lead to a similar result.

insolvent person, depriving the insolvent's creditors from that interest.[567] This is clearly a fraud on the insolvency law (and many jurisdictions have enacted statutory provisions to prohibit trusts set up to avoid creditors).

A recent case has drawn attention to the distinction between a trust's object and its purpose.[568] In *Peterson NO v Claassen*[569] the court found that a trust with a lawful object may nevertheless have an unlawful purpose. Unlike an unlawful object, an unlawful purpose does not invalidate the trust. The judge was of the view that there is a considerable difference between the object and purpose of a trust, and that the purpose cannot in all circumstances be equated to the object of the trust. The object is openly proclaimed and ascertainable by parties dealing with the trust. A trust with a lawful object, such as benefiting the children of the settlor, may nevertheless have an unlawful purpose, and this will normally be "jealously guarded by those who harbour such purpose".[570]

The words 'object' and 'purpose' may be considered to mean the same thing in ordinary, non-trust parlance. If one looks at the English law requirement of certainty of objects (a requirement for a valid trust)[571] it becomes clear that, at least in English law, the object of a trust is either to benefit one or more persons, mostly individuals, or it is to further a purpose, quite often a charitable one. Thus, in some cases the object of the trust is a purpose.

4 4 6 Further requirements?

Du Toit[572] mentions two possible additional requirements, namely the absence of control by the founder, and functional separation between a trustee's control over the trust property and the benefit derived from such control. Both these points have been touched on already, and will be examined in more detail in chapter 4. These requirements may indeed be covered by the requirements of intention and obligation.

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[567] Cameron *et al Honoré's South African Law of Trusts* 172.
[568] *Peterson NO v Claassen* 2006 (5) SA 191 (C). See also Du Toit *South African Trust Law: Principles and Practice* 32.
[569] *Peterson NO v Claassen* 2006 (5) SA 191 (C).
[570] *Peterson NO v Claassen* 2006 (5) SA 191 (C) paras 16-17. In this case, the trusts in question were said to have as their purpose placing assets beyond the reach of creditors. Could the validity of the trusts or the transactions have been attacked on another ground? Although the published judgment does not indicate who the beneficiaries of the trust were, it likely included the close family members of the sole trustee. Can this case also fall in the category of abuse of the trust form by excessive settlor or beneficiary control?
[571] See ch 2 para 2 7 1 3.
[572] Du Toit *South African Trust Law: Principles and Practice* 34-36.

4 5 Role of legislative developments

Although much can be said for the certainty provided by legislation, it is clear that most of South African trust law is judge-made. Apart from the taxation of trusts, legislative intervention has been minimal.

The Trust Moneys Protection Act[573] provided directives regarding the furnishing of security by trustees, and was the first statute dealing with trusts in the strict sense. Chapter 3 of the Administration of Estates Act[574] (which never came into operation) attempted to provide for the issue of letters of administratorship to trustees. Both these Acts were repealed by the TPCA, which is the most important legislative document in the field of trusts.[575]

After many years of developing mainly through the courts, in the 1980s the Law Commission considered whether to codify the law of trusts. Although many fundamental issues were dealt with by the courts, there was disagreement with regard to some of the solutions, and a feeling that some of the problematic issues could not be solved by the judiciary.[576] Legislative intervention was considered by some as the most appropriate solution[577] and the Law Commission played a vital part in this process.[578]

A decision against total codification, and the increased state control it brings, was taken. The result is that the TPCA regulates only the registration and administration of trusts, and not their formation as such. Many problems related to trusts have therefore to be addressed without reference to the TPCA, although there seemed to be consensus that less state control is preferable.

It has been stated that one of the main aims of the TPCA is the establishment of firmer control over trustees and their management of the trust by the Master of the High Court.[579] This seems

[573] Trust Moneys Protection Act 34 of 1934.
[574] Administration of Estates Act 66 of 1965.
[575] Du Toit *South African Trust Law: Principles and Practice* 21.
[576] And the fact that the judiciary did not always feel that it was their task to change the law. See *Crookes NO v Watson* 1956 (1) SA 277 (AD) 287 as an example.
[577] Corbett (1993) 56 *THRHR* 262 267.
[578] See ch 2 para 4 6.
[579] Corbett (1993) 56 *THRHR* 262 267.

to be correct. The TPCA has also been held to protect the interests of the ultimate beneficiaries of the trust.[580]

If one looks at the length of the TPCA and the issues it regulates, it is apparent that it regulates only limited aspects of trusts. These include the definition of a trust, trustee, trust instrument and trust property.[581]

The duty to act with care, diligence and skill was a confirmation of the existing common law position. However, the limitation on excluding this duty in the trust deed[582] constitutes one of the main innovations.[583] (The provision presumably leaves some room for interpretation by the courts.) There seems to have been doubt regarding the existence of a fiduciary duty of trustees given the contractual nature of creation of an *inter vivos* trust. Making the duty of care an obligatory legal requirement had the advantage of clarifying any uncertainty about whether trustees had a fiduciary duty or not.[584]

Of crucial importance in the South African context is the statutory confirmation of separation of trust property from the personal estate of the trustee,[585] as this protects beneficiaries in the absence of a proprietary interest in the trust property.[586]

Another important provision, which presumably confirms the pre-existing common law position, is that the Master of the High Court can request a trustee to account to the Master for his administration and disposal of trust property.[587] The trustee's duty to account to the beneficiaries for his stewardship of the trust has been said to be one of the main features of the trust.[588]

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[580] *Kropman NO v Nysschen* 1999 (2) SA 567 (T) 576.
[581] Trust Property Control Act 57 of 1988 s 1.
[582] Trust Property Control Act 57 of 1988 s 9.
[583] Wunsh (1988) *De Rebus* 547 550-552. This is further examined in ch 3.
[584] Schoenblum *Multistate and Multinational Estate Planning* §18-13.
[585] Trust Property Control Act 57 of 1988 s 11-12; see also Wunsh (1988) *De Rebus* 547 550-551.
[586] See ch 2 paras 4 3 1, 4 3 2 2.
[587] Trust Property Control Act 57 of 1988 s 16.
[588] Cameron *et al Honoré's South African Law of Trusts* 11.

The powers of the court to vary the provision of trusts and to order the termination of trusts have also been confirmed.[589] These powers existed under common law, but have been substantially enlarged.[590]

Many of the other provisions can be described as more administrative in nature. Although it is important to regulate such issues, these provisions do not necessarily contribute to more certainty regarding substantive trust issues.

4 6 The South African Law Commission

The South African Law Commission was constituted by the South African Law Reform Commission Act.[591] The objects of the commission are to do research with reference to all branches of the law in order to make recommendations to the government for the development, improvement, modernisation or reform of the law.[592]

Two documents are of importance in the trust sphere, both of these leading to the enactment of the TPCA; firstly, a working paper on the law of trusts[593] and, secondly, a project report regarding the revision of trust law.[594]

It was clear from the working paper that no revision of trust law in its totality was considered necessary, but rather more detailed regulation of the control over trust property. Issues that were considered in this working paper included the question of whether, on insolvency of the trustee, the trust property forms part of the insolvent estate of the trustee. As there was uncertainty regarding this issue, it was, rightly, felt that there was a need for statutory regulation. A balance had to be struck between the interests of the trust beneficiaries and the personal creditors of the trustee. [595]

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[589] Trust Property Control Act 57 of 1988 s 13.
[590] Corbett (1993) 56 *THRHR* 262 268.
[591] South African Law Reform Commission Act 19 of 1973. This act was previously called the South African Law Commission Act 19 of 1973. The title was amended by Judicial Matters Amendment Act 55 of 2002 s 8.
[592] Anonymous http://justice.gov.za (accessed 26-11-2015).
[593] SA Law Commission *Working Paper 3 Law of Trusts* (1984).
[594] SA Law Commission *Report Regarding Revision of Trust Law, Project 9* (1987).
[595] This was dealt with by way of Trust Property Control Act 57 of 1988 s 12.

Other issues included the need for the courts to have the power or discretion to vary the provision of trust deeds and the need for trustees to consent to amendments to a trust deed, given the classification of an *inter vivos* trust, or at least the creation thereof, as a *stipulatio alteri*.

A few vexed issues were not dealt with in the TPCA, such as whether trusts should have legal personality, and whether business or trading trusts should be regulated separately, given that they seem to offer the benefit of limited liability without the regulation related to corporate entities.[596]

4 7 Role of the courts and case law

The role of the judiciary in shaping and developing the trust law in South Africa has already become clear. To a large extent, the courts have defined what a trust is under South African law, especially where it was felt that divergence from the English rules was desirable. Considering the extent of the issues that have been dealt with by legislation,[597] there is no doubt that the majority of trust law is judge-made.

The preceding paragraphs have highlighted certain cases that were vital to the development of the law of trusts in South Africa. The judiciary's view that the trust law is not fully developed and, like any other field of law, is not static, is also clear. The judiciary appears to feel a duty continually to develop South African trust law.

Although it is accepted that certain areas of trust law would best be altered by way of legislation (for example the question of whether trusts should be irrevocable upon entering into the trust deed and transferring the property to the trustee[598]), the courts do play a more active role in the development of South African trust law. A relevant and recent example is the way the courts are dealing with the issues surrounding abuse of the trust form by trying to define the circumstances in which a court will ignore or look through a trust and suggesting appropriate and equitable (just) remedies in such cases.[599]

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[596] Wunsh (1988) *De Rebus* 547 547-548.
[597] See ch 2 para 4 5.
[598] *Crookes NO v Watson* 1956 (1) SA 277 (AD) 287.
[599] *Land and Agricultural Bank of SA v Parker* 2005 (2) SA 77 (SCA) para 34. See ch 4 para 4 3 for a discussion of other relevant cases.

5 Conclusion

A few significant themes are present throughout the examination of the historical development and current state of trust law in England, Jersey and South Africa. These themes, which appear to cross the jurisdictional divide, will be referred to in this dissertation as 'core values' and can be summarised as follows:

5 1 Analysis in terms of obligation rather than property

Trusts can be analysed in terms of property or in terms of obligation. Both these dimensions are essential to the existence of a trust. Although some would argue that it is an academic question whether trusts are analysed in terms of property or in terms of obligation, it appears that an obligations-based approach has certain practical advantages. This includes offering a better explanation of civil law trusts where no equitable proprietary rights exist. It also supports the importance of the irreducible core approach by placing emphasis on the obligations of the trustee towards the beneficiaries.

5 2 The irreducible core of the trust

An irreducible core of duties is owed by the trustee to the beneficiaries. This relates to the fiduciary obligations of the trustee, the standard of care expected of him in fulfilling these obligations, and the penalties for non-fulfilment of these duties.

The standard of care and the ability to exclude liability differs from one jurisdiction to the next, and it may be that more focus on the irreducible core approach may add weight to the argument that trustees should be subjected to higher standards of care and should not be able to escape liability too easily. This would be relevant not only in the case of professional trustees who charge for their services and hold themselves out as experts, but also in the situation where family members of the settlor, who may benefit from the trust themselves, also serve as trustees and may be inclined to think that they do not have to take their trustee duties seriously.

5 3 Accountability of the trustee

In all three jurisdictions, in order for a valid trust to exist, the beneficiaries (or someone else) must be able to enforce the trust and hold the trustee to account for the fulfilment of his duties. Without this accountability, imposing onerous duties and obligations on a trustee has little meaning or substance.

The ability to create non-charitable purpose trusts in offshore jurisdictions threatens this accountability, as although an enforcer is able to hold the trustee to account, there is doubt regarding the enforcer's incentives to do so.

5 4 Overarching fiduciary duty to act in best interest of beneficiaries

A trustee has an overarching duty to act in the best interests of the beneficiaries of the trust. The fiduciary nature of the trustee's position is examined in detail in chapter 3, but it is already evident that, more than anything else, a trustee has to put the interests of the beneficiaries first.

5 5 Separation of ownership/control and enjoyment

Although not all three jurisdictions recognise dual ownership rights, all three do recognise that there should be a functional separation between the ownership and control of the trust property by the trustee, and the enjoyment thereof by the beneficiaries. Enjoyment in this sense refers to being able to benefit from the trust assets, but does not always indicate a proprietary right. The right of the beneficiary may also be personal. It has been shown that this does not necessarily mean that the beneficiary is in a worse position than if he had a proprietary right. In South Africa, this separation between control and enjoyment is often referred to as the "core idea" of the trust, from which many consequences flow, including the accountability of trustees.

5 6 Separation of trust assets

In all three jurisdictions, the assets donated by the settlor to the trustee no longer form part of the settlor's estate. Neither do these assets form part of the trustee's personal estate. Although

a trust is not a separate entity, the assets forming the subject matter of the trust are ring-fenced. In South Africa, a separate trust estate is more clearly recognised than in England and Jersey, but the principle is that the trust assets are held separately and protected from claims made against the trustee personally.

The following two chapters will illustrate how the themes summarised above can have an important bearing on the focal points of this dissertation. Chapter 3 examines the duties and liabilities of a trustee and to what extent liability can be excluded by the terms of the trust and chapter 4 the phenomenon of excessive settlor control and the consequences thereof.

CHAPTER 3

TRUSTEE OBLIGATIONS AND LIABILITY FOR BREACH OF TRUST

1 Introduction

"The main duty of a trustee is to commit *judicious* breaches of trust."[1]

This chapter is concerned with the duties or obligations owed by trustees of an express *inter vivos* trust to the beneficiaries of such a trust. The focus will not be on individual, specific duties[2] although such duties, often described in detail in the trust deed, are essential to the office of trustee. These specific duties are a result of the overarching, more general obligation to manage the trust fund in the best interest of the beneficiaries.[3]

According to Hayton, the fundamental duty of a trustee includes acting within the terms of the trust, while at the same time acting with undivided loyalty and exclusively in the best interests of the beneficiaries and with the appropriate level of care, unless ousted by the terms of the trust deed.[4] It will become clear that (apart from the ability to exclude the duty of care) this is an apt description for the fundamental duties of trustees in all three jurisdictions under review. It encapsulates the three main strands of a trustee's core duties – the terms of the trust deed, fiduciary duties and the duty of care.

Given the context of this dissertation and specifically the topic of the following chapter, the focus will be on those duties that form the antithesis of relinquishing control to the settlor. The focus will therefore be on fiduciary duties and the duty of care and skill (which is not considered a fiduciary duty in all jurisdictions) and specifically how this duty relates to the vital task of investing the trust fund.

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[1] This quote is credited to a 19th century English judge. See *Armitage v Nurse* (1998) Ch 241 251. It may be an exaggeration, but the relevance and irony of the quote will become clear.
[2] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 673-924 describes these duties in great depth, including the duty to act impartially between beneficiaries, duties concerning acceptance of the trust property, delegation of powers and so forth.
[3] According to Tucker *et al Lewin on Trusts* 1508 the trustees have numerous powers and duties for the purpose of the overriding obligation to preserve and safeguard the trust property, and in exercising these powers and duties have to bear in mind their general duty to exercise care to the extent that they are not relieved of this duty.
[4] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 3.

Subsequent to analysing the core duties of a trustee, a conclusion will be drawn in the next chapters as to whether an abuse of trust is, at least in certain circumstances, effectively the result of a breach of trust on the part of the trustee.

As alluded to at the end of chapter 2, certain core values pervade the discussion in this dissertation. These core values are:

(a) a focus on an obligations-based approach (rather than a property-based approach), being an approach that analyses the rights of beneficiaries in terms of the duties owed to them by the trustees rather than their interest in the trust property;
(b) the content of the irreducible core of a trust, in other words, the absolute minimum duties that need to be fulfilled in order to constitute a trust;
(c) the importance of the accountability of the trustee towards the beneficiaries of the trust;
(d) the overarching fiduciary duty to act in the best interests of the beneficiaries of the trust, a topic closely aligned with the irreducible core of the trust;
(e) the separation of ownership and control of the trust property from the enjoyment thereof, indicating that dealing with the trust fund is the duty of the trustee and not the settlor or beneficiaries; and
(f) the separation of the trust assets from the trustee's personal assets.

These core values will form the framework against which the legal developments in the different jurisdictions will be considered in this chapter and will be referred to where relevant (some of these themes being more relevant in the next chapter).

A comparative study will be made of the legal *status quo* in the three chosen jurisdictions, England, Jersey (and some other offshore jurisdictions) and South Africa, including an examination of developments driven by case law and legislation. Parallels will be drawn and an attempt will be made to identify developments from which South African trust law, being comparatively new, can learn.

As a first step, the position of the trustee as a fiduciary, the nature of fiduciary duties and their relationship to the core principles of trusteeship will be examined. Another fundamental

aspect of the role of a trustee is the duty of care and skill. The duty of care covers many areas of trusteeship and, in fact, refers not to a singular duty but to a standard that regulates the manner in which trustees perform their duties. It is because of the duty of care that not only positive actions, such as misapplication of the trust fund, can be a breach of trust, but also omissions, such as failing to monitor the performance of trust investments.[5] This duty existed in common law and has been entrenched in legislation in most trust jurisdictions. The background to this legislation will be studied briefly to give insight into what the statutory duty was set out to achieve in each of the jurisdictions. The required standard is, at least *prima facie*, not the same in all trust jurisdictions and the effect of this on the protection of beneficiaries and on the trust industry itself will be highlighted.

Not surprisingly, the duties and obligations of a trustee are of most practical importance when those duties are not fulfilled so that there is a breach of trust and, as is frequently the case, a trustee is attempting to escape liability or accountability for his action or inaction. As a trust is not a legal entity, the trustee is personally liable for breaches of trust. It has been stated before that if the trustee is not accountable to the beneficiaries, then there is no trust.[6] Therefore, the consequences of a trustee not fulfilling the duties imposed on him will be studied as a next step.

A comparative study will be made of the concept of breach of trust. The remedies available to beneficiaries and third parties dealing with a trustee will not form part of the dissertation, although it will be appropriate to refer to the remedies at certain stages. Instead, the aim is to characterise the essential trustee duties and obligations as well as the circumstances that cause a breach of those duties, with a view to drawing a conclusion regarding the nature of an abuse of trust. Such abuse is regularly the result of a settlor (who may also be a beneficiary) exercising excessive control over a trust and its assets. The question arises as to who should be accountable to the beneficiaries in such circumstances. With whom do the fiduciary responsibilities lie if the trustee has abdicated those duties? And if there is no one accountable to the beneficiaries, is there still a trust? These questions will be examined further in chapters 4 and 5.

[5] Clarry (2014) 12 *TQR* 31 para 5.
[6] *Armitage v Nurse* (1998) Ch 241 253. In this respect the duties of trustees are vital in determining what the trustees are being held accountable for.

The widening of trustees' investment powers from the 1980s onwards resulted in the area of trust investments becoming increasingly complex. Even where the trustee is a professional person, he cannot be expected to be an investment specialist. As a result, trustees have increasingly been relying on investment advisers and managers to take care of trust investments. This increasing complexity brought with it increased risks, and a comparison will be made of how the different jurisdictions dealt with this issue.

Another focus point will be the ability of a trustee to rescind incorrect or inadequate trustee decisions, achieved in England and in certain offshore jurisdictions under a rule known as the rule in *Hasting-Bass*,[7] and the attitude of courts and legislators towards this development. The extent to which this rule has been used (and, according to many commentators, abused) by trustees to escape the consequences of certain actions, coupled with the reaction of the offshore world to a recent judicial limitation of this rule in England, makes for an interesting development in the context of this dissertation. Although no similar rule exists under South African law, interesting parallels can be drawn with regard to issues surrounding trustee liability for wrongdoing.

Finally, a study will be made of the legal attitude towards the extent of trustee exoneration clauses in the three jurisdictions under review. The standard against which trustees are or should be judged has been examined in great detail in reports of law commissions, case law and commentary thereon. In England, although the position is much debated, it is currently possible for a trustee to exclude liability for gross negligence, whereas this is not the case in Jersey (and many other offshore jurisdictions) and South Africa. In South Africa, a trustee is in fact liable for ordinary negligence as well. The overriding question is whether the possibility to exclude liability for gross negligence is in conflict with the core duties of a trustee or, stated differently, with the irreducible core of the trust. How far can the boundaries of acceptable trustee behaviour be pushed?

Varying approaches in the different jurisdictions and the theoretical underpinnings of each approach will be examined. In order to have a holistic overview, other factors that impact upon trustee liability will also be considered, as will the demands of settlor freedom and pressures resulting from the financial importance of the trust industry in each of the

[7] The rule has its origins in the case of *Re Hastings-Bass (Deceased), Hastings v Inland Revenue Commissioners* [1974] 2 All ER 193.

jurisdictions. This point is particularly important in the context of the following chapters where the relationship between trustee liability and settlor control will be examined further.

2 Fundamental trustee duties and obligations

2 1 England

2 1 1 The trustee as a fiduciary

The position under English law is clear. A trustee is a fiduciary.[8] Trustees are not the only examples of fiduciaries, although the relationship of trustee and beneficiary can be described as the archetypal or leading fiduciary relationship, and the characterisation has subsequently been used to describe other types of relationship as fiduciary as well.[9]

Despite the unequivocal statement that a trustee is a fiduciary, there does not seem to be a widely accepted definition of the term fiduciary under English law.[10] Underhill and Hayton list the following characteristics:

(a) the fiduciary has undertaken to act in the interests of the principal;
(b) as part of this arrangement the fiduciary has powers and discretions that can be used to affect the interest of the principal in a legal or practical sense;
(c) the principal is vulnerable to an abuse by the fiduciary of his position as such; and
(d) the principal has not agreed, as a person of full capacity who is fully informed, to allow the fiduciary to use his powers and discretions in the furtherance of the fiduciary's own interests.[11]

Underhill and Hayton explain that a transition from fiduciary *disabilities* to fiduciary *duties* has led to much of the uncertainty today. The origins of fiduciary duties can be found in equitable rules that prevented a fiduciary from acting in a specific way rather than requiring

[8] Hudson *Equity and Trusts* 52.
[9] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 37; Hudson *Equity and Trusts* 53; Pettit *Equity and the Law of Trusts* 436. Other examples of fiduciaries include estate agents, solicitors, discretionary portfolio managers and company directors.
[10] Hudson *Equity and Trusts* 593; Virgo *The Principles of Equity and Trusts* 479.
[11] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 37.

him to perform certain duties. Analysing fiduciary obligations as disabilities rather than duties does indeed contribute to a better understanding of the concept.[12]

Thus, for example, where a trustee who made unauthorised profits is directed to account for it, this is not a monetary award resulting from his wrongdoing, but rather an order that gives effect to the rule that a fiduciary is disabled from retaining unauthorised profits.[13]

The authors further explain that the principle that a trustee owes negative fiduciary duties to beneficiaries was developed by the Courts of Chancery and has been part of English law since the early 18th century.[14] However, it is only since the late 20th century that a different way of thinking pervaded the courts and these fiduciary disabilities were rephrased as a duty on a trustee not to promote his personal interest in circumstances where there is a conflict, or a real or substantial possibility of conflict, between the personal interests of the trustee and those of his principal.[15]

Turning to more recent attempts to define fiduciary duties, Millet LJ provided the following definition in *Bristol & West Building Society v Mothew*,[16] a case regarding actions of a solicitor in the same transaction acting for both mortgagor and mortgagee, but which has been very influential in English trust law:

> "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. This 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 for the benefit of a third person without the informed consent of his principal. This is not intended to be an

[12] As explained later in ch 3 para 2 1 3 the duty of care is not considered a fiduciary duty under English law and not part of the irreducible core duties of trustees either. Could this have anything to do with the origin of fiduciary duties as fiduciary disabilities, i.e. a negative rather than a positive duty?
[13] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 512.
[14] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 514.
[15] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 513.
[16] *Bristol & West Building Society v Mothew* [1996] 4 All ER 698.

> exhaustive list, but it is sufficient to indicate the nature of fiduciary obligations. They are the defining characteristics of the fiduciary."[17]

Returning to the meaning of the word fiduciary, Hudson explains that the etymology of the word indicates connections with the notions of faith, belief, confidence and trust.[18] Given the trust and confidence placed in someone who acts in a fiduciary capacity, it is not surprising that strict rules governing fiduciary behaviour have been developed by equity and common law. The fiduciary is subject to the rights of the person who places trust in them (in the trust context, the beneficiary, whose rights have been examined),[19] and is the one taking on onerous obligations.

Penner states that the ideas of discretion and (avoidance of) conflict of interest, in other words to act exclusively in the interests of his principal, lie at the heart of the fiduciary relationship. The fiduciary has to act only in the interest of the persons on whose behalf he is acting and must not allow any conflict of interest between his or someone else's interests and the interests of the principal.[20]

Underhill and Hayton confirm this view. However, according to the authors the exclusivity is not concerned with undivided loyalty in the usual sense, but refers instead to a "deliberative exclusivity", meaning that the trustee does not necessarily have to have the same subjective outlook as his principal, but he must deliberately exclude his own and any other parties' interests from consideration in exercising his judgment.[21]

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[17] *Bristol & West Building Society v Mothew* [1996] 4 All ER 698 711-712. Although Millett LJ admitted that the list is not exhaustive and that there may be other obligations that are fiduciary in nature, the characteristics listed here may have been focused specifically on the facts *in casu*, which involved a situation of conflict with a fiduciary acting for two principals. In the (still) leading (but criticised) English case on the permissible extent of trustee exemption clauses, *Armitage v Nurse* (1998) Ch 241, which will be studied later in this chapter, Millet LJ built on his findings in the *Mothew* judgment to find that a trustee under an English law trust can be exempted from gross negligence, a concept that relates to the duty of care, which is not considered a fiduciary duty under English law.

[18] Hudson *Equity and Trusts* 594.

[19] See ch 2 para 2 6 5.

[20] Penner *The Law of Trusts* 22-23. This is examined below.

[21] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 511-512.

According to Virgo, who agrees that the identification of fiduciary relationships and duties are fraught with difficulties, a fiduciary relationship is one of trust and confidence,[22] echoing Hudson's findings above.

It appears that a fiduciary is not subject to fiduciary duties because he is a fiduciary, but rather that, because he is subject to fiduciary duties, he is a fiduciary.[23]

2 1 2 Fiduciary duties

2 1 2 1 General

What then is meant by the term fiduciary duty?[24]

Firstly, not all fiduciaries owe the same duties or obligations in the same type of circumstances, and even in the case of trustees it seems hard to define the fiduciary duties of a trustee without regard to the circumstances of each specific case.[25] Another view is that there is one fiduciary duty, comprising a number of overlapping obligations focused on loyalty and faithfulness, and being the defining duty of trusteeship.[26]

A trustee, being a fiduciary, is liable for all loss suffered by the beneficiary, not only for contractual or tortious loss (although, as discussed below, the liability of a trustee may be limited by the trust deed).[27] Being in a fiduciary position carries with it greater responsibility[28] than, for example, being in a simple contractual relationship, where the liability of the parties will always be limited to the terms of the contract. This is because public policy requires

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[22] Virgo *The Principles of Equity and Trusts* 479-480.
[23] Virgo *The Principles of Equity and Trusts* 479; *Bristol & West Building Society v Mothew* [1996] 4 All ER 698 712.
[24] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 510 explains that the term fiduciary duty is used in two different but overlapping senses. The first refers to the duty to avoid conflict, discussed below. The second meaning is a looser reference to duties owed by trustees or other fiduciaries, and can refer either to the duty to avoid conflict or, confusingly, also to the general duty to comply with the terms of authority applicable to the trustee when dealing with the trust property. This is what Millet LJ referred to in *Bristol & West Building Society v Mothew* [1996] 4 All ER 698 when he stated that it was inappropriate to apply the expression fiduciary duty to the obligation of a trustee to act with proper skill and care in the discharge of his duties.
[25] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 517; Hudson *Equity and Trusts* 596.
[26] Watt *Trusts and Equity* 322.
[27] Hudson *Equity and Trusts* 595-596.
[28] Watt *Trusts and Equity* 323-324. Public policy requires rigorous enforcement of fiduciary duties.

rigorous enforcement of fiduciary duties.[29] Where a contract exists between the parties to a fiduciary relationship, the fiduciary relationship creates different duties and obligations than those arising by virtue of the contract.[30] Furthermore, the threshold for a fiduciary being liable for loss is lower than that applying to a person who does not act in a fiduciary capacity.[31]

Crucially, not all duties owed by a fiduciary to his principal are fiduciary in nature. In the case of a trustee, a distinction should be made between the peremptory fiduciary duties of no profit and no conflict of interest, and the prescriptive duties such as the non-fiduciary duty of care and skill.[32] Both these categories are discussed below.

Admitting that uncertainty exists regarding the exact meaning of fiduciary duties, in the *Mothew*[33] case, Millet LJ stated:

> "The term 'fiduciary duty' is properly confined to those duties which are peculiar to fiduciaries and the breach of which attracts legal consequences differing from those consequent upon the breach of other duties. Unless the expression is so limited it is lacking in practical utility. In this sense it is obvious that not every breach of duty by a fiduciary is a breach of fiduciary duty."[34]

He also stated:

> "Breach of fiduciary obligation, therefore, connotes disloyalty or infidelity. Mere incompetence is not enough. A servant who loyally does his incompetent best for his master is not unfaithful and is not guilty of a breach of fiduciary duty."[35]

These *dicta* confirm that breaching the duty of care, which, as explained below, is non-fiduciary, for example by acting negligently or incompetently, is not the same as breaching a

[29] Watt *Trusts and Equity* 323-324.
[30] *Re Goldcorp Exchange Ltd (in receivership)* [1994] 2 All ER 806 821-822.
[31] Hudson *Equity and Trusts* 604.
[32] See ch 3 para 2 1 3 for a discussion of the duty of care.
[33] *Bristol & West Building Society v Mothew* [1996] 4 All ER 698.
[34] *Bristol & West Building Society v Mothew* [1996] 4 All ER 698 710. In reaching this conclusion, Millett LJ refers to and endorses Canadian and Australian case law to the same effect.
[35] *Bristol & West Building Society v Mothew* [1996] 4 All ER 698 712.

fiduciary duty. In this case, the solicitor was found guilty of a breach of the duty of care, but not of breach of fiduciary duty.[36]

Resonance is found in academic writing for the proposition that the overriding duties of loyalty, good faith and faithfulness constitute the origin of those specific duties that can be described as fiduciary duties.[37] A fiduciary power, as opposed to a personal power, cannot be exercised in the fiduciary's own interest, echoing the fiduciary duty of no conflict.[38]

Fiduciary duties flow from a fiduciary relationship, and also come to an end when the relationship comes to an end. However, the scope of the duties, although generally determined by the type of fiduciary relationship, can be limited contractually (in the case of trusts this would be by virtue of provisions in the trust deed). Thus, the scope of fiduciary duties can have a contractual source and the extent and nature of the duties can be amended contractually.[39]

2 1 2 2 Recognised fiduciary duties: no conflict and no profit

The core fiduciary duties making up the obligation of loyalty are the duty of no conflict and the duty of no profit.[40] A trustee, being in a fiduciary relationship with the beneficiaries of a trust he administers, owes these fiduciary duties to the beneficiaries, although he also owes the beneficiaries other duties that cannot be described as fiduciary in nature, such as the duty to use proper skill and care.[41] These duties will be examined later on.

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[36] *Bristol & West Building Society v Mothew* [1996] 4 All ER 698 717-718.
[37] For example, Watt *Trusts and Equity* 322 where it is stated that "The fiduciary duty comprises a number of overlapping obligations concerned to promote loyalty or faithfulness. It is the defining duty of trusteeship."; Hudson *Equity and Trusts* 596 where it is stated that "Such an atomisation of fiduciary obligations into particular factual circumstances contributes to our difficulty in defining precisely what is meant by labeling someone a fiduciary. We return to the general ideas of good faith and loyalty outlined above for a more general understanding of what it means to be a fiduciary."
[38] Hudson *Equity and Trusts* 126-137.
[39] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 517-519.
[40] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 510; Penner *The Law of Trusts* 399-404.
[41] Virgo *The Principles of Equity and Trusts* 480-481.

(a) No conflict

The duty of no conflict prohibits a fiduciary whose interests conflict with those of his principal from preferring his own interest above that of his principal, and also requires a fiduciary to avoid situations where his personal interests (or those of his other principals) conflict with the interests of his principal. (In the context of trusts, the beneficiaries of the trust would be the trustee's principals.) Actual conflict is not required to establish a breach of this duty; the existence of potential conflict is sufficient.[42]

The no conflict rule encompasses two further rules, namely the self-dealing rule and the fair-dealing rule.[43] Pettit describes these rules in terms of the disability of the trustee to the purchase trust property or an equitable interest therein, the purpose of the rules being to prevent the trustee from abusing his position or profiting (unduly) from the trust.[44]

The self-dealing rule provides that a fiduciary is not allowed to deal on behalf of himself and the principal in the same transaction.[45] Such a transaction can be set aside.[46] Limitations exist, and it is clear that conflicts may be authorised or acquiesced to.[47]

The fair-dealing rule operates by requiring a fiduciary who transacts with his principal to show that he did not abuse his position as fiduciary, that he made full disclosure to the principal and that the transaction was fair and honest, for example because the best price was

[42] Hudson *Equity and Trusts* 329; Penner *The Law of Trusts* 399; Virgo *The Principles of Equity and Trusts* 495-496; Watt *Trusts and Equity* 327-329. Penner explains the rule by saying that, based on equitable principles, if a transaction entered into by a fiduciary turns out to be made in conflict of interest, the transaction can be set aside. Somewhat confusingly, Penner cites the case of *Boardman v Phipps* [1972] 2 AC 46 as an example of breach of the no conflict rule, whereas Hudson *Equity and Trusts* 331-332 describes it as an example of the no profit rule. Clearly the rules are closely related.

[43] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 510, 886-899.

[44] Pettit *Equity and the Law of Trusts* 442-446. See also *Tito v Waddell (No. 2)* [1977] 3 All ER 129 246-247 where Megarry VC agreed that equity subjects trustees to particular disabilities where the self-dealing and fair-dealing rules are concerned.

[45] Virgo *The Principles of Equity and Trusts* 497-499. This would clearly create a conflict in that, if the trustee wishes to sell trust property to himself in his personal capacity, his personal interest would be to obtain the lowest price, whereas as trustee he should be concerned with obtaining the best price for the benefit of the beneficiaries.

[46] Hudson *Equity and Trusts* 332; Penner *The Law of Trusts* 421-422.

[47] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 896. In *Sargeant v National Westminster Bank plc* (1990) 61 P&CR 518, which dealt with a testamentary trust, the trust deed allowed trustees to purchase trust assets notwithstanding that they were trustees and the Court of Appeal upheld this ability, notwithstanding that it puts the trustees in a position of conflict of interest.

obtained for the principal.[48] If this is not done, the transaction is voidable and can be set aside.[49] The rule operates less strictly than the self-dealing rule,[50] as it does not involve a trustee selling to himself but rather involves two real parties.[51]

(b) No profit

The second of the fundamental fiduciary duties is the no profit rule. At first glance, this rule may appear to be difficult to distinguish from the no conflict rule. It prohibits the fiduciary from obtaining a benefit, either for himself or for a third party, by virtue of his position as fiduciary, unless full disclosure has been made to the principal and he has given his consent.[52] This would include the case of a trust deed providing that a trustee can charge for his services.[53]

In fact, the rule may be better described as a rule against unauthorised profits, given that most trustees nowadays are professionals and therefore are being paid out of the trust fund and because there may be other instances where the beneficiaries consent to the trustee's retention of a profit.[54]

Unless an exception applies, the rule operates strictly.[55] It applies even where the trustee makes a profit for the beneficiaries that they would not otherwise have obtained and where there was no question of the trustee acting dishonestly.[56]

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[48] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 898; *Tito v Waddell (No. 2)* [1977] 3 All ER 129 241.
[49] Virgo *The Principles of Equity and Trusts* 499-500. An example would be where the trustee purchases a beneficiary's interest in the trust. The beneficiary would be able to set the transaction aside, unless the trustee can prove that the transaction was fair.
[50] Watt *Trusts and Equity* 330.
[51] Penner *The Law of Trusts* 422.
[52] Hudson *Equity and Trusts* 330-332; Virgo *The Principles of Equity and Trusts* 503-504.
[53] Pettit *Equity and the Law of Trusts* 438-442. There is no rule as such preventing trustees from being paid but the *onus* is on the trustee to show either a provision in the trust deed or a provision of general law to the effect that he can charge for his services as trustee.
[54] Penner *The Law of Trusts* 411-415.
[55] Watt *Trusts and Equity* 338-346.
[56] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 510. This happened in *Boardman v Phipps* [1972] 2 AC 46, where the solicitor acting for the trustees of a family trust purchased a majority shareholding in a company in which the trustees have invested but that has been performing poorly in recent years. It would not have been prudent for the trustees to make a further investment and he decided to do so in his own name instead. However, he did not obtain the consent of all the trustees. His intention was that, once he and the trustees had control over the company, they would improve the profitability of the company and thereby benefit the beneficiaries. A large profit was realised, for the trustees and for the solicitor personally, and

Many modern trust deeds authorise the trustee to breach these rules, for example where the trustee company forms part of a bigger banking group that provides banking services to the trust and earns fees and commissions as a result. This is but one example of how the practical requirements of the modern trust industry do not always go hand in hand with the age-old institution of the trust. This is considered further below.[57]

2 1 3 The duty of care

The fiduciary duties of a trustee under English law were briefly examined above. Clearly there are many other duties and obligations that rest on the shoulders of a trustee, and the fact that these are not fiduciary in nature does not indicate that they are less important. The most important non-fiduciary trustee duty is arguably the duty of care.[58]

In *Bristol & West Building Society v Mothew*[59] Millett LJ confirmed that the duty of care is not fiduciary in nature:

> "It is similarly inappropriate to apply the expression [fiduciary duty] to the obligation of a trustee or other fiduciary to use proper skill and care in the discharge of his duties."[60]

A few years later, in *Armitage v Nurse*[61] the same judge held that the irreducible core obligations owed by a trustee to the beneficiaries do not include the duty of care, skill, prudence and diligence.[62]

Whereas fiduciary duties are concerned with undivided loyalty on the part of the trustee, the duty of care relates to the care and skill expected of a trustee in managing the trust and the

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although he had the interests of the trust and its beneficiaries at heart in making the investment, the majority of the House of Lords held that he was holding his personal profit on constructive trust for the beneficiaries.

[57] See ch 3 para 2 4.

[58] Hudson *Equity and Trusts* 313.

[59] *Bristol & West Building Society v Mothew* [1996] 4 All ER 698.

[60] *Bristol & West Building Society v Mothew* [1996] 4 All ER 698 710.

[61] *Armitage v Nurse* (1998) Ch 241.

[62] *Armitage v Nurse* (1998) Ch 241 253-254. Millett LJ also said that it would be sufficient if a trustee fulfilled the duty to perform the trusts honestly and in good faith for the benefit of the beneficiaries. Presumably he intended to equate these duties to the fiduciary duties of a trustee.

assets belonging to it. It is probably most relevant in the context of trustee investment of the trust fund, but applies in other cases as well.

In exercising any non-fiduciary trustee duty, for example the duty of care with regard to making investments, the fiduciary duties of loyalty (such as not to make an unauthorised profit or not to act in a manner in which the trustee's interests conflict with those of the beneficiaries) are inextricably part of the exercise. It is, however, possible to commit a breach of fiduciary duty whilst exercising, and fulfilling, the duty of care.[63] The converse is also true – a trustee who is incompetent but attempts honestly and loyally to do the best for the beneficiaries does not breach his fiduciary duty but may breach his duty of care.[64]

2 1 3 1 Common law duty of care and skill

The general duty of care and prudence has existed under common law (or in equity) for more than a century[65] before it was enshrined in the Trustee Act 2000[66] (2000 Act). At the time the 2000 Act was being negotiated, the general equitable duty of care was not yet laid down with precision and was regarded as a developing duty.[67]

Case law from the 19th century indicates that the common law duty of care and skill centred around what an ordinary prudent man of business would have done in the management of his own affairs, and who, when selecting investments, had to consider that he was acting for someone he felt morally obliged to provide for.[68] Given this moral duty, no speculative investments were allowed and safety had to come first.[69] Such a test is objective and does not take account of the skills or expertise of the particular trustee.

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[63] Watt *Trusts and Equity* 354, where the example is used of a trustee making an unauthorised but prudent investment in his own business using money belonging to the trust.
[64] *Bristol & West Building Society v Mothew* [1996] 4 All ER 698 712.
[65] Tucker *et al Lewin on Trusts* 1508-1511; Watt *Trusts and Equity* 354.
[66] Trustee Act 2000 s 1.
[67] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 787.
[68] Hudson *Equity and Trusts* 320; *Cowan v Scargill* [1984] 2 All ER 750 762, where reference is made to the older case of *Learoyd v Whiteley* (1887) 12 App Cas 727. In the latter case, it was held that a trustee must take such care as an ordinary prudent man would take if he had to make an investment on behalf of someone to whom he owed a moral obligation.
[69] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 787-788; Hudson *Equity and Trusts* 324; Virgo *The Principles of Equity and Trusts* 422-425; *Speight v Gaunt* (1883) 22 Ch. D. 727; *Learoyd v Whiteley* (1887) 12 App Cas 727, where it was held at 733 that "…it is the duty of a trustee to confine himself to the class of investments which are permitted by the trust, and likewise to avoid all investments of that class which are attended with hazard." However, in *Re Godfrey* (1883) 23 Ch D 483 493 the court noted that prudent businessmen do incur risk as part of their business.

During the 20th century it was recognised that a prudent degree of risk could be accepted, but it had to be distinguished from the type of risk that constituted a hazard. If a trustee who acted honestly and reasonably competent and with reasonable prudence made an error of judgment, it was considered unjust to hold him liable.[70] Even in the relatively modern case of *Nestle v Westminster Bank plc*,[71] a case concerning the narrowness of the range of equities the trustee invested in, the prudent investor rule was used and it was held that preserving a trust fund is always more important than advancing, or growing, it.[72] The court admitted that what a prudent man should do at any given time depends to a large extent on the prevailing economic and financial conditions, and would not necessarily be the same as that which a judge 50 or 100 years ago would have held to be a prudent investment. This case was an extreme example, as the trust existed for a very long time (since 1922 and the judgment was given in 1994), a period during which the investment world changed dramatically.[73]

Even under the common law duty of care it was recognised that a paid trustee should generally be held to a higher standard of diligence and knowledge than an unpaid trustee.[74] An important case signalling a further change in approach in so far as professional trustees are concerned was *Bartlett v Barclays Bank*.[75]

The trustee in question held a controlling interest in a company that made hazardous and speculative investments. These investments caused a substantial loss to the trust fund, as the shares of the holding company plummeted in value. The court felt that a prudent man of business would have safeguarded his investment by taking action if he became aware of certain facts in relation to the company and would not have been content merely to receive the information a shareholder normally receives at annual general meetings of the company.[76]

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[70] *Bartlett v Barclays Bank Trust Co Ltd* [1980] 1 All ER 139 150.
[71] *Nestle v National Westminster Bank plc* [1994] 1 All ER 118
[72] *Nestle v National Westminster Bank plc* [1994] 1 All ER 118 140-142. The standard of prudence was referred to in this case as "undemanding" and the bank, in its capacity as trustee (not as investment expert), was not found guilty of a breach of trust resulting in loss.
[73] *Nestle v National Westminster Bank plc* [1994] 1 All ER 118 126-134.
[74] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 787; *Re Waterman's Will Trusts* [1952] 2 All ER 1054 1055.
[75] *Bartlett v Barclays Bank Trust Co Ltd* [1980] 1 All ER 139.
[76] *Bartlett v Barclays Bank Trust Co Ltd* [1980] 1 All ER 139 150-151.

It was held that a higher standard of care, thus higher than the prudent man of business standard, should be expected of a corporate trustee that carries on a specialised business of trust administration, that has specially trained staff and holds itself out as having specialist skills and expertise, a standard that cannot be expected of ordinary prudent persons who act, often unpaid and out of a sense of moral or family duty, as trustees.[77] It appears as if the requirements of this higher standard have never been examined in case law, so that there is no guidance as to how strictly this will be applied.[78] Even in the *Bartlett*[79] case it was found that both standards were breached and there was no need to analyse the requirements of a higher standard, apart from saying that a trustees must be liable for loss caused by the trustee's neglect to exercise the special care and skill it professes to have.[80] One can expect much to depend on the circumstances of the specific case.

It is worth noting that, as a result of the decision in *Bartlett*,[81] many English law and offshore[82] trust deeds now contain so-called anti-*Bartlett* clauses, allowing the trustee not to interfere in the management of companies in which he invests on behalf of the trust, unless he has actual knowledge of dishonesty on the part of the directors or officers of such companies.[83] Here we see another example of how the modern trust industry adapts to take account of judicial or legislative developments that are not in line with current reality, in this case by having an impact on the ability of a trustee to partake in investment opportunities without incurring too much risk.

As mentioned above, in *Armitage v Nurse*,[84] Millett LJ held that the duty of skill and care, prudence and diligence, is not part of the irreducible core obligations of the trustee. In his view the core obligations only include the duty to perform the trusts honestly and in good faith for the benefit of the beneficiaries.[85]

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[77] Virgo *The Principles of Equity and Trusts* 424-425; *Bartlett v Barclays Bank Trust Co Ltd* [1980] 1 All ER 139 152.
[78] Penner *The Law of Trusts* 289-290.
[79] *Bartlett v Barclays Bank Trust Co Ltd* [1980] 1 All ER 139 153.
[80] *Bartlett v Barclays Bank Trust Co Ltd* [1980] 1 All ER 139 152.
[81] *Bartlett v Barclays Bank Trust Co Ltd* [1980] 1 All ER 139.
[82] Although many offshore jurisdictions, including Jersey, do not allow the blanket exclusion of the duty of care.
[83] A typical clause may read: The trustees need not interfere in the management or conduct of any company even if they hold shares or securities giving them control of the company and in particular in the absence of actual notice of dishonesty on the part of the directors of the company the trustees may leave the conduct of the business of the company to its directors and need not require any information to which any other shareholder would not be entitled.
[84] *Armitage v Nurse* (1998) Ch 241.
[85] Hudson *Equity and Trusts* 325; *Armitage v Nurse* (1998) Ch 241 253-254.

To say that the requirement of prudence is not a core trustee obligation goes against previous case law and waters down the concept of an irreducible core of trusteeship. It is, however, explained as an attempt by Millet LJ to avoid setting the standard expected of a trustee too high, thereby discouraging individuals and corporations from taking on trusteeship. The same may be said of the industry-driven reaction to *Bartlett*,[86] intended to effectively negate the effect of the judgment so as to ease the pressure on trustees. This is especially relevant in the modern and highly technical world of financial investments where a trustee needs more freedom to make high-yielding and fast-growing investments that, inevitably, carry a higher degree of risk.[87]

2 1 3 2 Background to the statutory duty of care

This explanation of Millet LJ's thinking fits in well with what is understood to have been the general mood at the time. The statutory duty of care enacted by the 2000 Act was the result of a clear desire on the part of practitioners, trustees and academics to modernise the ability of a trustee to invest and manage the trust fund with fewer restrictions.[88] As in other jurisdictions, the flexibility of the trust idea meant that it was developed primarily by the judiciary and not by the legislature. However, the legislation that did exist was becoming more and more outdated, and by the 1980s there was a clear understanding that the principles relating to the powers and duties of trustees had to be modernised, particularly in relation to investments.[89] The statutory duty of care was a reaction to the widening of trustee powers, an attempt to afford protection to the beneficiaries of a trust who would be exposed to more investment risk.

Given the fast-paced development of global financial markets during this period, the trustee investment powers, contained mainly in the Trustee Act 1925 and the Trustee Investments Act 1961, were considered too restrictive.[90] Although it was possible to include more liberal

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[86] *Bartlett v Barclays Bank Trust Co Ltd* [1980] 1 All ER 139.
[87] Hudson *Equity and Trusts* 324-325.
[88] Hayton (1990) 106 *LQR* 87; Law Commission *Trustees' Powers and Duties* No 260 (1999) 2-4.
[89] Hayton (1990) 106 *LQR* 87 87-96.
[90] In *Trustees of the British Museum v Attorney General* [1984] 1 All ER 337 it was held at 342-343 that, given the greatly changed circumstances of the last 20 years, trustee powers of investment should be revised and extended, but as a counter to that there should be provisions for advice and control. Furthermore, the size of the trust fund may be relevant in so far as a larger trust fund may justify a wider range of investments and greater

investment powers in the trust deed, this was, for various reasons, not always done. Trustees in the 1980s and 1990s operated in a totally different investment environment compared to their counterparts in the early 1900s, but were not able to take full advantage of the investment opportunities on offer in order to do the best they could for the trust beneficiaries.[91]

Another changing factor was that trustees were, more often than not, paid professionals or trust corporations, and not the typical traditional trustee who, even if he was a professional such as a solicitor or accountant, was selected for his utmost good faith, and often had a personal relationship with the settlor or beneficiaries. This led to a reconsideration of the traditional governance applicable to trustees, which was now considered out of date, and formed a foundation for the reform achieved by the 2000 Act.[92]

The focus of this discussion will be on investment powers as the main driver for change, although it should be borne in mind that other powers and duties were also at stake in the consideration of a statutory duty of care.[93]

2 1 3 3 Role of the Law Commission

The Law Commission published a report entitled *Trustees' Powers and Duties* in 1999.[94] This report sets out the background and reasoning to the introduction of a statutory duty of care. The recommendation that a trustee should have wider powers of investment, in fact the same powers as an absolute beneficial owner of property, was countered by a further recommendation to safeguard the position of beneficiaries.[95] An absolute owner of property may, if he wishes, invest in highly speculative or depreciating investments. This may not be appropriate for a trustee, given that he has a moral duty towards the beneficiaries, who are entitled to the enjoyment of the property, and the trustee therefore needs to exercise his powers in their best interest. In order to take this into account, a recommendation was made to

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risks than a smaller fund, and the object of the trust, whether there is a greater need for income generation or capital preservation, for example, would be very important.

[91] Penner *The Law of Trusts* 284-285; Law Commission *Trustees' Powers and Duties* No 260 (1999) 1, 4, 12.

[92] Wilson *Todd & Wilson's Textbook on Trusts* 312-313.

[93] Law Commission *Trustees' Powers and Duties* No 260 (1999) 1. Other issues that placed unnecessary constraints on trustees included the limited ability to delegate fiduciary discretions and to hold property through nominees and custodians.

[94] Law Commission *Trustees' Powers and Duties* No 260 (1999).

[95] Clements and Abass *Complete Equity & Trusts: Text, Cases, and Materials* 361-363.

introduce statutory duties, such as ensuring the diversification of assets, having in place an investment policy and requiring a trustee to obtain and consider proper advice in appropriate circumstances.[96]

Moreover, it was recommended that the specific safeguards mentioned in the report, also in relation to other trustee powers, should be underpinned by a more general statutory duty of care that should apply whenever a trustee carries out any functions covered by the report.[97] As discussed above, trustees were already subject to a common law duty of care in the exercise of investment and other powers. The introduction of a statutory duty was not intended to change the common law duty to act in the best interests of the beneficiaries, but presumably there was a feeling that a stronger message underpinned by legislation had to be given to trustees.

Importantly, the decision whether to exercise their discretion would remain a matter for the trustee, but once a trustee has decided to exercise a discretionary function that is subject to the new duty, the manner in which it is exercised had to comply with the new duty of care.[98] If the power were not subject to the statutory duty of care, the common law duty of care would still apply.

The Law Commission considered five standards against which the conduct of a trustee could be measured. This ranged from a mere duty to act in good faith, to being vicariously liable for the acts and defaults of the trustee's agents, two extreme opposites.[99] It was felt that the new duty should have regard to the skills of the particular trustee and to the circumstances of the trust in question, introducing a subjective element. As an important regulator of trustee conduct, it had to set a robust standard, but also be flexible enough to allow a professional trustee to be held to a higher standard than a non-professional trustee.[100]

The solution was to recommend that every trustee should be required to exercise such care and skill as is reasonable in the circumstances. If the trustee has, or holds himself out as having, special knowledge or experience, this shall be taken into account in judging the

[96] Law Commission *Trustees' Powers and Duties* No 260 (1999) 22-25.
[97] Law Commission *Trustees' Powers and Duties* No 260 (1999) 36.
[98] Virgo *The Principles of Equity and Trusts* 460; Law Commission *Trustees' Powers and Duties* No 260 (1999) 36-37.
[99] Law Commission *Trustees' Powers and Duties* No 260 (1999) 40-41.
[100] Law Commission *Trustees' Powers and Duties* No 260 (1999) 42.

trustee, as will any special knowledge or experience that can reasonably be expected of a person acting in a professional trustee capacity.[101]

The Law Commission report discussed above was part of a policy movement that, coupled with dissatisfaction with the relevance of the law relating to trustee powers and duties, led to the enactment of the 2000 Act. Although many see the statutory duty of care as the centrepiece of the 2000 Act, the duty has always existed, as discussed above. However, the statutory duty, signifying a duty to take care to avoid causing injury or loss, was now considered to be uniform and was meant to improve certainty and consistency regarding the standard of competence and behaviour expected of trustees, given the increase in professional trustees and the changing context within which trustees operated.[102]

2 1 3 4 Statutory duty of care

The wording of the statutory duty[103] implies that its application is limited to the exercise of certain powers by a trustee, rather than affecting the process of consideration whether to exercise a power or not. Very importantly, it is possible to exclude the application of the duty of care by an appropriate clause in the trust deed,[104] as discussed below.

Some take the view that there is little difference between the standard imposed by the common law duty of care and the statutory duty of care and the consensus is that only a rare case would turn on the difference between the common law duty and the statutory duty in any event.[105]

Previously the test was what a prudent person of business would have done in administering his own affairs, but there was no differentiation between a professional and lay trustee.[106] The

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[101] Law Commission *Trustees' Powers and Duties* No 260 (1999) 42-43.
[102] Pettit *Equity and the Law of Trusts* 400-401; Wilson *Todd & Wilson's Textbook on Trusts* 313-314.
[103] Trustee Act 2000 s 1(1) reads "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 to (a) 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." and sch 1 para 2 lists the circumstances where the duty applies, including any exercise of investment powers, the purchasing of land, appointing agents, nominees and custodians and so forth.
[104] Trustee Act 2000 sch 1 para 7.
[105] Tucker *et al Lewin on Trusts* 1511-1513.
[106] Tucker *et al Lewin on Trusts* 1514.

inclusion in the statute of a reference to what is *reasonable in the circumstances* can be interpreted to be raising the standard for a professional trustee,[107] or, on the other hand, that a lay trustee with limited business knowledge would be subject to a lower standard as he can assert that he acted reasonably in the circumstances even if a prudent person of business would not have acted in the same way. This could mean that negligence claims against lay trustees would be easier to defend.[108]

Underhill and Hayton's view is that the wording of the statutory duty, "to exercise such care and skill as is necessary in the circumstances", includes consideration of the fact that the trustee is not acting for himself when making investments and also of the fact whether he is paid or not. Special knowledge or experience that is objectively reasonable to expect of a person acting in the course of that kind of business or profession would be taken into account. Thus it imposes an objective minimum standard on trustees, accountants and other paid professionals acting as trustees, but the standard is raised further if the trustee holds himself out as having special knowledge or expertise, which would be the case with trust companies.[109]

Neither view has yet been confirmed by case law and it is submitted that the question is open to interpretation. Even if the two tests were effectively identical, it would be extraordinary if an exclusion of the statutory duty of care in the trust deed also implied an exclusion of the common law duty that has existed for such a long time.[110]

2 1 4 Ability to exclude duty of care

Significantly, although being crowned the centrepiece of the 2000 Act, the duty of care can be excluded by the terms of a particular trust deed.[111] Although a trustee would presumably still be subject to the common law duty of care, it does detract, at least at face value, from the importance attributed to the statutory duty of care.

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[107] Watt *Trusts and Equity* 355-356.
[108] Tucker *et al Lewin on Trusts* 1515.
[109] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 788.
[110] Virgo *The Principles of Equity and Trusts* 427.
[111] Trustee Act 2000 sch 1 s 7.

The ability to exclude this duty is seemingly in line with comments made about the *Armitage* judgment,[112] namely a sense that the judiciary was conscious of not setting the standard of trustee conduct so high as to discourage the taking up of the office of trustee. The requirement of prudence had existed in common law for a long time, but Hudson explains that the 2000 Act has changed the ordinary obligations of a trustee from being based on prudence to being based on reasonableness, which implies a lower standard.[113] The common law duty of care demanded that a trustee must always act in the best interest of the beneficiaries,[114] indicating a positive obligation to do something. The new duty of care is judged by a more subjective test based on reasonableness in the circumstances and only applies to the categories of power described in the 2000 Act. This may indeed seem like a lowering of the standard of care.

Penner, on the other hand, describes the approach of the 2000 Act as a prudent investor approach – the trustee has very broad powers of investment but a duty of care is imposed to ensure that the power is exercised in a prudent manner.[115] Watt also makes reference to the explanatory notes to the 2000 Act,[116] stating that the statutory duty of care merely codifies, or makes explicit, the common law duty, which uses prudence as a measure of trustee conduct. However, as mentioned, the 2000 Act itself makes no reference to prudence and the explanatory notes are not binding.

Watt is in favour of an argument that what is "reasonable in the circumstances", refers to the same level of care and skill as is required by prudence,[117] presumably because there is a clear reference to a higher standard being expected of professional trustees who hold themselves out as experienced. A duty of prudence implies cautiousness, whereas a trustee who is only expected to act reasonable may take more risks, but the trustee would still be subject to the safeguards built into the 2000 Act.

Taking more investment risk may be appropriate and in the interest of the beneficiaries in certain cases, although not in all. At this point the subjective element becomes useful in giving trustees more freedom in appropriate circumstances.[118] Coupled with the possibility of

[112] *Armitage v Nurse* (1998) Ch 241.
[113] Hudson *Equity and Trusts* 326.
[114] *Cowan v Scargill* [1984] 2 All ER 750 760.
[115] Penner *The Law of Trusts* 284-286.
[116] Watt *Trusts and Equity* 356-357.
[117] Watt *Trusts and Equity* 357.
[118] Hudson *Equity and Trusts* 326-327.

excluding liability for certain trustee actions, this signals a more liberal environment for trustees. It may well be argued that this is required in the modern financial world, but the corollary seems to be an erosion of the irreducible core of the trust.[119]

2 2 Offshore: Jersey

2 2 1 The trustee as a fiduciary and the fiduciary duties of a trustee

Not much is written about the customary law position of the trustee, but English law on the fiduciary obligations owed by a trustee to beneficiaries has been held to apply equally under Jersey law.

In *Re Don Benest*,[120] a case that dealt with the validity of a testamentary trust, the testatrix left property to the public officers of a church parish for the benefit of poor people in that parish. In the context of fiduciary duties, the court held that the officers already owed fiduciary duties to the parish at large, but that the testatrix wanted to impose more specific duties towards poor members of the parish when dealing with the property she left. A separate trust was thus created for the benefit of poor members of the parish. The court was referred to the 14th edition of Underhill & Hayton's *Law Relating to Trusts and Trustees* and the explanation contained therein of a fiduciary relationship. This was cited with approval and read as follows:

> "A fiduciary relationship exists whenever there is a relationship of confidence such that equity imposes duties or disabilities upon the person in whom confidence is reposed (the fiduciary) in order to prevent possible abuse of the confidence…Where a fiduciary *qua* fiduciary does have vested in him – or under his control – property, such property has the essential characteristic of trust property in that it cannot be used or disposed of by the fiduciary for his own benefit but must be used or disposed of for the benefit of other persons."[121]

[119] See ch 3 para 2 4.
[120] *Re Don Benest* [1989] JLR 330.
[121] *Re Don Benest* [1989] JLR 330 336-337.

In the Matter of the E, L, O and R Trusts[122] dealt with conflict of interest on the part of a trustee. Here the Royal Court held that the nature of the fiduciary duty of a trustee under Jersey law is as set out by Millet LJ in the *Mothew*[123] case. No earlier Jersey case law was referred to.

The court set out its own summary of the fiduciary duty, using extracts from the *Mothew*[124] judgment. The court summarised the fiduciary duty as follows:

> "(i) The expression "fiduciary duty" is properly confined to those duties which are peculiar to fiduciaries and the breach of which attracts legal consequences differing from those consequent upon the breach of other duties. For example, the obligation of a trustee (who is undoubtedly a fiduciary) to use proper skill and care in the discharge of his duties is not a fiduciary duty nor is the duty of a director (who undoubtedly owes fiduciary obligations to his company) to exercise skill and care in the performance of his duties.
>
> (ii) A fiduciary duty is one which is special to fiduciaries which attracts those remedies which are peculiar to the equitable jurisdiction and are primarily restitutionary or restorative rather than compensatory. 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.
>
> (iii) The distinguishing obligation of a fiduciary is the obligation of loyalty. The principal is entitled to the single-minded loyalty of his fiduciary."[125]

More recently, in *Crociani v Crociani*,[126] the Royal Court confirmed that a trustee has a duty of undivided loyalty to the beneficiaries and must put those interests above his personal interests or any conflicting duties he may have. Reference was again made to English

[122] *In the Matter of the E, L, O and R Trusts; BA, SA and HA v Verite Trust Company Limited, Appleby Trust (Jersey) Limited and James* [2008] JLR 360.
[123] *Bristol & West Building Society v Mothew* [1996] 4 All ER 698.
[124] *Bristol & West Building Society v Mothew* [1996] 4 All ER 698.
[125] *In the Matter of the E, L, O and R Trusts; BA, SA and HA v Verite Trust Company Limited, Appleby Trust (Jersey) Limited and James* [2008] JLR 360 374.
[126] *Crociani v Crociani* [2015] JRC 178.

academic writing, signifying that the approach is closely aligned to that of English law and also, more generally, that English trust law still plays an important role in Jersey.

The Trusts (Jersey) Law 1984 (TJL), the most important legislation governing trusts and trustees in Jersey, does not specifically refer to fiduciary duties, although it deals with other trustee duties, described below. The TJL does refer to the need for a trustee to observe the utmost good faith,[127] thereby giving confirmation to the role of a trustee as a fiduciary.[128]

Furthermore, article 21(4) of the TJL provides that a trustee shall not, unless permitted by the court, the TJL or the terms of the trust, profit from his trusteeship, cause or permit another person to profit therefrom, or enter into a transaction on the trustee's own account which may result in a profit. This is clearly a reference to the no profit rule of English law, a rule that is recognised as one of the fundamental fiduciary duties.[129]

It has been held that discretionary beneficiaries have standing to sue for breaches of trust and that the relief can include reconstitution of the trust fund where loss was caused by a trustee's breach of trust.[130] Although it was not explicitly stated, one can deduce that a trustee owes fiduciary duties not only to beneficiaries with vested interests, but also to those with contingent interests.

Based on the limited Jersey case law and academic writing available, it is submitted that the general position with regard to the fiduciary duties of a trustee is substantially the same as in England.

2 2 2 Trustee duties under customary law and the duty to act en bon père de famille

One of the most important recent Privy Council judgments dealing with the liability of a trustee for breach of trust, and the extent to which such liability can be excluded, dealt with a

[127] Trusts (Jersey) Law 1984 art 21(1)(b).
[128] Brown *The Jersey Law of Trusts* 166.
[129] See ch 3 para 2 1 2 2.
[130] *Freeman v Ansbacher Trustees (Jesey) Limited* [2009 JLR 1] 14-18, where reliance was placed on the Privy Council decision in *Schmidt v Rosewood Trust Ltd* [2003] 2 AC 709 that the type of interest a beneficiary has in the trust property is not the most important deciding factor when it comes to protection of beneficiaries' rights (in this case the disclosure of information regarding the trust), and that the court has inherent jurisdiction to supervise and, where required, to interfere in the administration of trusts.

Guernsey law trust. The principal question was whether Guernsey law, prior to the enactment of a statutory provision prohibiting the exclusion of liability for gross negligence, allowed a trustee to be exempted from such liability. The judgment in *Spread Trustee Company Limited v Hutcheson*[131] has been analysed in detail on various occasions and has implications wider than Guernsey. It will be analysed in greater detail as part of the examination of trustee exemption clauses.[132]

For the present purposes, the background of the duty of care is relevant and some comparisons will be drawn with Guernsey law.

Like Jersey, it is a British Crown Dependency, and it shares many other characteristics with Jersey.[133] The earlier development of trust law in the two jurisdictions followed a similar pattern, both having Norman customary law as the origin of its common law, although, more recently, legislation in the two jurisdictions have not necessarily developed in tandem, as discussed below.

The historical basis of the Guernsey customary law relating to the duty of care seems more certain than that of Jersey law. It is widely accepted that a trustee is required to act *en bon père de famille* both under Guernsey customary and statutory trust law.[134] The concept of a *bon père de famille* was imported from Norman law, which played a similar part in the development of Jersey trust law,[135] and the Normans appeared to have taken the concept from the Roman concept of *bonus paterfamilias*.[136] It is referred to in case law unrelated to trusts as well, for example in the context of the liability of a guardian *ad litem* of a minor. It has been held that a person so appointed is under the same obligation as a *tuteur* (another fiduciary position) at customary law to act as a *bon père de famille* in relation to the interests of the minor.[137]

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[131] *Spread Trustee Company Limited v Hutcheson* [2011] UKPC 13.
[132] See ch 3 paras 5 1, 5 2 2.
[133] See ch 2 para 3 1.
[134] See Trusts (Guernsey) Law 2007 s 22 for the statutory position; the customary law position is described in *Spread Trustee Company Limited v Hutcheson* [2011] UKPC 13 paras 139, 145, 176.
[135] See ch 2 paras 3 1, 3 2 1.
[136] *Spread Trustee Company Limited v Hutcheson* [2011] UKPC 13 para 19.
[137] *Payne (a minor) by Kendall (guardian ad litem) v Pirunico Trustees (Jersey) Limited* [2001 JLR 1].

Obiter remarks in Jersey case law[138] indicate that although the duty was incorporated into the duties of a trustee in the Trusts (Guernsey Law)[139] but not expressly into the TJL provisions dealing with trustee duties,[140] the TJL was not intended as a codification of the pre-existing customary trust law in Jersey and therefore one can argue that the *bon pére* duty formed part of Jersey customary law. As a result it would apply to a Jersey trustee, especially in relation to family trusts where there are minor children involved. Even though the duty may not add much to the statutory duties of a Jersey trustee, it has a "powerful paternalistic element".[141] An example of the recognition by Jersey law of the paternalistic nature of trustee powers can be found in the well-known litigation regarding the *Esteem Settlement*.[142]

Further confirmation that the *bon père* duty formed part of Jersey customary law can be found in *Midland Bank Trust Company (Jersey) Limited v Federated Pension Services*,[143] where Commissioner Hamon stated:

> "The standards that this court expects are high. It has always been so for anyone who holds himself in a fiduciary position, whether as trustee in the modern concept or in the "pre-trust concept of a *bon père de famille*".[144]

It is not clear whether this duty, literally meaning to act like a good father, is effectively the same as the prudent man of business test under English law. The majority of the Privy Council in *Spread*[145] was of the view that the two tests were essentially the same and that the duty is as set out in the *Bartlett*[146] judgment. However, it may be argued that a prudent man of business would be prepared to take more risks than a *bon père de famille* and therefore that a lower standard of care is required from a prudent man of business than from a *bon père de*

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[138] *In re A&B, re C Trust* [2012] JRC 086B (unreported).
[139] Trusts (Guernsey) Law 2007 s 18(1).
[140] Trusts (Jersey) Law 1984 art 21.
[141] *In re A&B, re C Trust* [2012] JRC 086B (unreported)
[142] *In the matter of the Esteem Settlement and the No. 52 Trust* 2001 JLR 7 para 38, where the trustee was allowed to exercise a power of advancement for the benefit of the beneficiary by paying off a debt of the beneficiary against the beneficiary's wishes.
[143] *Midland Bank Trust Company (Jersey) Limited, Establishment Committee and Day v Federated Pension Services* 1994 JLR 276 (which was later taken on appeal in *Midland Bank Trust Company (Jersey) Limited v Federated Pension Services* 1995 JLR 352).
[144] *Midland Bank Trust Company (Jersey) Limited, Establishment Committee and Day v Federated Pension Services* 1994 JLR 276 290.
[145] *Spread Trustee Company Limited v Hutcheson* [2011] UKPC 13. The two judges who wrote the minority judgments did not agree and felt that the duty to act *en bon père de famille* was clearly fiduciary and thus could be differentiated from the English duty of care, see para 176-177.
[146] *Bartlett v Barclays Bank Trust Co Ltd* [1980] 1 All ER 139.

famille.[147] Futhermore, the duty to act *en bon pére de famille* is clearly categorised as a fiduciary duty, at least in Guernsey,[148] whereas the duty of care under English law is not.

As in England, it is accepted in Jersey that a professional trustee should be held to a higher standard than an ordinary lay trustee.[149] In *Midland Bank*[150] the judge approved Lightman J's judgment in *Bartlett*,[151] as follows:

> "There is, in our view, a higher duty imposed on those who…claim a long and detailed expertise in the field in which they practise."[152]

The duties of a trustee under Jersey customary law were, at least according to the Royal Court in the *Esteem*[153] judgment, substantially the same as the position under the TJL. The nature of trustee duties was used in this case merely to illustrate the wider point that there was a customary law of trusts in existence, and unfortunately no further references were made to the customary law duties of a trustee.

The duty to act *en bon père de famille* provides insight into the development of Jersey and Guernsey trust law and, assuming it does in fact indicate a higher standard of care, may explain why these jurisdictions do not allow the exclusion of the duty of care or the exemption from liability for gross negligence.[154] It has indeed been suggested that, at least in Jersey and Guernsey, the accountability of an offshore trustee towards beneficiaries is higher than those of the trustee of an English law trust.[155]

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[147] Shearman and Pearce (2011) 23 *DLJ* 181 189-190 where it is stated that for this reason the prudent man of business test was qualified by adding that the standard is that which would apply when he acts for the benefit of other people for whom he felt morally bound to provide. Looking at it this way, the two tests may not be so different.
[148] *Spread Trustee Company Limited v Hutcheson* [2011] UKPC 13 para 177; Trusts (Guernsey) Law 2007 s 22 for the statutory position.
[149] *West v Lazard Brothers and Company (Jersey) Limited* [1993] JLR 165 180-181; *Midland Bank Trust Company (Jersey) Limited, Establishment Committee and Day v Federated Pension Services* 1994 JLR 276 290-291.
[150] *Midland Bank Trust Company (Jersey) Limited, Establishment Committee and Day v Federated Pension Services* 1994 JLR 276.
[151] *Bartlett v Barclays Bank Trust Co Ltd* [1980] 1 All ER 139.
[152] *Midland Bank Trust Company (Jersey) Limited, Establishment Committee and Day v Federated Pension Services* 1994 JLR 276 290. The court referred to *West v Lazard Brothers and Company (Jersey) Limited* [1993] JLR 165, where reference was made to *Bartlett v Barclays Bank Trust Co Ltd* [1980] 1 All ER 139.
[153] *In the matter of the Esteem Settlement and the No. 52 Trust* [2002] JLR 53 92.
[154] See ch 3 para 5 2 1.
[155] Clarry (2014) 12 *TQR* 31.

2 2 3 Statutory duty of care

Article 21(1) of the TJL sets out the expected standard of trustee behaviour, which applies to all trustee duties and the exercise of all powers and discretions vested in a trustee. It states that a trustee shall:

> "(a) act –
>
> (i) with due diligence,
>
> (ii) as would a prudent person,
>
> (iii) to the best of the trustee's ability and skill; and
>
> (b) observe the utmost good faith."

In contrast to the English position, the trustee shall administer the trust in accordance with its terms, but always subject to the provisions of the TJL.[156] The standard set out above can therefore not be excluded by the terms of the trust deed in the way that the English law statutory duty of care can be excluded. Furthermore, the standard of care applies to the exercise of all powers and discretions of trustees, and not only to a defined list of powers such as the statutory duty of care in English law.[157]

There is no specific reference in the TJL to a paid or professional trustee being held to a higher standard of care such as that found in the Trustee Act 2000,[158] but the words "to the best of the trustee's ability and skill"[159] do inject a subjective element into the standard. The degree of care expected of a professional trustee has also been held to be higher in case law postdating the TJL.[160]

Other more specific duties are provided for as well, such as the duty to keep accurate accounts of the trustee's trusteeship,[161] and to keep trust property separate from the trustee's personal property,[162] although these are not examined here.

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[156] Trusts (Jersey) Law 1984 art 21(2).
[157] See ch 3 para 2 1 4.
[158] See ch 3 para 2 1 3 4.
[159] Trusts (Jersey) Law 1984 art 21(1).
[160] For example in *Midland Bank Trust Company (Jersey) Limited, Establishment Committee and Day v Federated Pension Services* 1994 JLR 276.
[161] Trusts (Jersey) Law 1984 art 21(5).
[162] Trusts (Jersey) Law 1984 art 21(6).

2 3 South Africa

2 3 1 The trustee as a fiduciary

As in England and Jersey, there is no doubt that a trustee occupies a fiduciary position,[163] the trustee-beneficiary relationship being but one example of fiduciary relationship under South African law. Tutors, executors, guardians and company directors are all examples of persons acting in a fiduciary role. Not all fiduciaries are therefore trustees, but all trustees are fiduciaries. However, a fiduciary obligation is only one of the elements of trusteeship.[164]

De Waal defines a fiduciary by reference to English writers, indicating that the concept has the same meaning under South African law, namely "someone who undertakes to act for or on behalf of another in some particular matter or matters". This undertaking obliges the fiduciary to act "selflessly and with undivided loyalty" in the interests of the other person.[165]

2 3 2 Fiduciary duties

The fiduciary duty of a trustee arises from the office of trustee and not from the document constituting the trust instrument.[166] In *Doyle v Board of Executors*[167] Slomowitz AJ, following de Waal's reasoning above, said the following:

> "…[I]t seems to me unquestionable that a trustee occupies a fiduciary office. By virtue of this alone he owes the utmost good faith towards all beneficiaries…"[168]

Defining fiduciary duties has, however, proven to be an elusive goal. First, there is the question of whether there is only one fiduciary duty or a number of different fiduciary duties.

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[163] Du Toit *South African Trust Law: Principles and Practice* 80-83; De Waal (2000) 117 *SALJ* 548 557; Du Toit (2007) *Stell LR* 469 471; *Doyle v Board of Executors* 1999 (2) SA 805 (C) 813.
[164] De Waal (2000) 117 *SALJ* 548 557.
[165] De Waal (2000) 117 *SALJ* 548 558 and see specifically fn 58 and 59 thereof. See ch 3 para 2 1 2 1 for the duty of loyalty under English law.
[166] De Waal (1998) *TSAR* 326 331; Du Toit (2007) *Stell LR* 469 471.
[167] *Doyle v Board of Executors* 1999 (2) SA 805 (C).
[168] *Doyle v Board of Executors* 1999 (2) SA 805 (C) 813.

Case law refers to both.[169] It has even been said that the fiduciary duty does not have a clearly defined meaning.[170]

Unlike the English position where there appears to be no doubt that the trustee stands in a fiduciary position *vis-à-vis* the beneficiaries of the trust, it has been proposed in South African law that the counterpart in the fiduciary relationship is the trust property.[171]

However, the more correct view, which corresponds with English law, must be that one party, the trustee, stands in a position of confidence and good faith towards another party, the beneficiary. The representative nature of a person's status and his duty to account for the profits he acquired in that capacity have been referred to as an "unmistakable beacon" that the person stood in a fiduciary relationship, a position of confidence and good faith, towards the other party.[172]

It is unsurprising that the English law principles of loyalty and good faith find resonance in the South African law on fiduciaries, given the context of the development of South African trust law and the vast influence of English law.[173]

The Appellate Division analysed fiduciary duties in a landmark decision in *Robinson v Randfontein Estates Gold Mining Co Ltd*.[174] The facts concerned the fiduciary relationship between a company and its director, but the judgment refers to the general concept of a fiduciary relationship and the analysis has not been challenged in nearly a century, a testament to its clarity and correctness.[175]

In *Robinson v Randfontein Estates*[176] Innes CJ said the following:

> "Where one man stands to another in a position of confidence involving a duty to protect the interests of that other, he is not allowed to make a secret profit at the

[169] Du Toit (2007) *Stell LR* 469 472, where examples are mentioned.
[170] *Hofer v Kevitt* 1996 (2) SA 402 407, where reference is made to Canadian law. See ch 3 para 2 1 2 1 where a similar uncertainty in defining fiduciary duties under English law is discussed.
[171] *Louw v Coetzee* [2003] 1 All SA 34 (SCA) 39.
[172] *Phillips v Fieldstone Africa (Pty) Ltd* 2004 (3) 465 (SCA) 477-478.
[173] See ch 2 paras 4 2 1, 4 2 2.
[174] *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168.
[175] *Phillips v Fieldstone Africa (Pty) Ltd* 2004 (3) 465 (SCA) 478.
[176] *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168.

> other's expense or place himself in a position where his interests conflict with his duty. The principle underlies an extensive field of legal relationship."[177]

He further held that although the terminology is that of English law, the principle underlying it is not foreign to South African law.

> "For it stands upon the broad doctrine that a man, who stands in a position of trust towards another, cannot, in matters affected by that position, advance his own interests (e.g., by making a profit) at that other's expense."[178]

He referred to a "breach of faith" when describing an action contrary to that which the fiduciary is obliged to do.[179] In addition, he confirmed that the English doctrine was adopted in older case law and should also be adopted by the court *in casu*.[180]

Further confirmation can be found in more recent case law. In *Jowell v Bramwell-Jones*[181] the Supreme Court of Appeal expressed the view that it is the duty of a fiduciary to avoid a conflict of interest as far as possible. The mere fact that a transaction is in favour of the trustee (who, in this case, was also one of the beneficiaries) does not necessarily mean that there was a breach of trust, but a transaction of this kind will be subject to much closer scrutiny.[182]

The concepts good faith, confidence, undivided loyalty and the idea of avoiding conflicts of interest are all found in English law.[183] It is thus clear that the principles against unauthorised profits and conflicts of interest, flowing from the requirements of undivided loyalty, good

[177] *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 177-178.
[178] *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 179.
[179] *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 179.
[180] *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 180.
[181] *Jowell v Bramwell-Jones* 2000 (3) SA 274 (SCA).
[182] *Jowell v Bramwell-Jones* 2000 (3) SA 274 (SCA) 284-288. In this case the court found that there was a breach of fiduciary duty but it was not connected to the loss claimed for, and the trustee was therefore not liable. The case is discussed later.
[183] See ch 3 paras 2 1 1, 2 1 2.

faith and confidence, [184] have made their way into South African case law as a result of a reliance on English legal principles.[185]

It has been suggested that South African case law has in fact gone further than importing English concepts and has extended the fiduciary duty beyond the English duty of loyalty, given that, as discussed below, the duty of care is considered a fiduciary duty under South African trust law.[186]

Du Toit proposes that the fiduciary duty of a trustee under South African law is a single but multi-faceted duty. [187] Different components of this duty are important in different circumstances.[188] The elements of this duty are, according to him:

(a) the duty of care;
(b) the duty of impartiality;
(c) the duty of accountability; and
(d) the duty of independence.[189]

The duty of care is examined in detail below.[190]

The duty of impartiality involves avoiding a conflict of interest between the trustee's personal interests and the interests of the beneficiaries and not making an unauthorised profit from his position as trustee. These duties are undoubtedly recognised as fiduciary by English law, falling under the umbrella of the duty of loyalty.[191]

The importance of a trustee being accountable to the beneficiaries was examined in the previous chapter – to insist on proper administration of the trust assets is a fundamental right

[184] See ch 3 para 2 1 2 2.
[185] Du Toit *South African Trust Law: Principles and Practice* 81-82; De Waal (2000) 117 *SALJ* 548 558; *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 177-180; *Phillips v Fieldstone Africa (Pty) Ltd* 2004 (3) 465 (SCA) 481.
[186] Du Toit (2007) *Stell LR* 469 472-473.
[187] See ch 3 para 2 1 2 for a similar view in English law.
[188] Du Toit *South African Trust Law: Principles and Practice* 82; Du Toit (2007) *Stell LR* 469 473.
[189] Du Toit *South African Trust Law: Principles and Practice* 82-83.
[190] See ch 3 para 2 3 3.
[191] See ch 3 para 2 1 2 2 for the English duties of no conflict and no profit.

of a beneficiary.[192] In fact, it forms part of the irreducible core of the trust (a concept that spans across jurisdictions), namely that someone must be in a position to enforce the trust and hold the trustee to account for the fulfilment of his duties.[193] As such, describing this duty as fiduciary makes sense.

The duty of independence refers to the decision-making process of the trustee and the importance of the trustee reaching an informed decision independent of the influences of the settlor and beneficiaries. This will be analysed in more detail in the following chapter in the context of settlor control over a trust. Classifying the duty of independence as fiduciary appears at least to give it more weight and supports the conclusion that, at least in certain circumstances, an abuse of the trust which results from excessive settlor control (in other words, lack of trustee independence) could in South African law be equated to a breach of fiduciary duty or a breach of trust on the part of the trustee. This issue is examined further in chapters 4 and 5.

Given that beneficiaries with discretionary or contingent as opposed to vested interests have to accept their interest in a trust in order to obtain an indefeasible right under the trust,[194] it has been argued by some that the fiduciary duty of a trustee does not extend to such beneficiaries if they have not accepted a benefit under the trust. In *Doyle v Board of Executors*[195] this was held to be wrong. Although theoretically an *inter vivos* trust under South African law is created by way of contract (a *stipulatio alteri* or contract for the benefit of a third),[196] it is widely accepted that not all aspects of the trust can be analysed by way of contractual principles or, as stated in *Doyle*,[197] the contractual analysis has "limits beyond which it cannot be pressed".[198]

It was thus held that the fiduciary duty of utmost good faith extends to all beneficiaries, whether their interests are vested or potential.[199] This reinforces the importance of the fiduciary duty of a trustee under South African law. Reference was made to *Gross v Pentz*,[200]

[192] See ch 2 para 4 3 5 5.
[193] See ch 2 para 5 1.
[194] See ch 2 para 4 3 5 5.
[195] *Doyle v Board of Executors* 1999 (2) SA 805 (C).
[196] See ch 2 para 4 3 2 1.
[197] *Doyle v Board of Executors* 1999 (2) SA 805 (C).
[198] *Doyle v Board of Executors* 1999 (2) SA 805 (C) 812.
[199] *Doyle v Board of Executors* 1999 (2) SA 805 (C) 813.
[200] *Gross v Pentz* 1996 (4) SA 617 (A) 628.

where it was stated that even contingent beneficiaries have a vested interest in the proper administration of the trust. This was confirmed by the Supreme Court of Appeal in *Jowell v Bramwell-Jones*.[201] *In casu*, the income beneficiary was also the trustee. The trust held shares in a holding company that in turn made further investments. The value of the holding company was thus dependent on the performance of the underlying investments and as a result the trustee had a duty to exercise her voting powers in a manner consistent with her fiduciary duty towards the capital beneficiaries. The court clearly indicated that the trustee had a fiduciary duty towards the capital beneficiaries even though they would only be able to benefit after her death. The trustee's duty was therefore more than mere preservation of the assets.[202]

2 3 3 The common law duty of care

Although recognised as an important trustee duty, the duty of care and skill, prudence and diligence, is not considered fiduciary in nature under English law.[203] It has been given statutory recognition, but can be excluded by the terms of the trust.

The position in South Africa is different. It has been described as the most important aspect of the fiduciary duty of a trustee[204] and as one of three main principles governing the administration of a trust, alongside the duty to give effect to the terms of the trust and to exercise an independent discretion.[205] The duty of care, although now contained in statute,[206] also existed at common law, by analogy to the responsibility of other fiduciary office holders.[207]

The common law duty of care has been linked to the Roman-Dutch concept of acting as a *bonus et diligens paterfamilias*.[208] In *Sackville West v Nourse*,[209] Kotzé JA considered Roman

[201] *Jowell v Bramwell-Jones* 2000 (3) SA 274 (SCA).
[202] *Jowell v Bramwell-Jones* 2000 (3) SA 274 (SCA) 284.
[203] *Armitage v Nurse* (1998) Ch 241 243-254; see ch 3 para 2 1 3.
[204] Du Toit *South African Trust Law: Principles and Practice* 91.
[205] Cameron *et al Honoré's South African Law of Trusts* 262. The importance of the trustee exercising an independent discretion is further examined in ch 4 in the context of excessive control by a settlor.
[206] Trust Property Control Act 57 of 1988 s 9(1).
[207] Cameron *et al Honoré's South African Law of Trusts* 262. In *Tijmstra NO v Blunt-Mackenzie NO* 2002 (1) SA 459 (T) an analogy was drawn with the relationship between a tutor and his ward.
[208] Du Toit *South African Trust Law: Principles and Practice* 90-91; Du Toit (2007) *Stell LR* 469 473; *Sackville West v Nourse* 1925 AD 516 534. See also the discussion of the duty of trustees of Guernsey trusts to act *en bon père de famille* described in ch 3 para 2 2 1. This concept seems to have certain similarities with the *bonus et*

law rules relating to a tutor dealing with the property of his ward in evaluating the responsibility of a trustee in the investment of the trust fund. No previous decisions of a South African court were available on this point, and instead he referred to various Roman law commentators and Dutch jurists.[210] He said the following:

> "The standard of care to be observed is accordingly not that which an ordinary man generally observes in the management of his own affairs, but that of the prudent and careful man; or, to use the technical expression of the Roman law, that of the *bonus et diligens paterfamilias*."[211]

The duty to act as a *bonus et diligens paterfamilias* also involves acting with the utmost good faith (a recognised element of the fiduciary duty), in the best interest of the beneficiaries and, importantly, avoiding any uncertainty or risk.[212]

Whether the actual practical standard of the South African common law duty of care is higher in practice than that under English law is debatable. The difference seems to turn on the care exercised in the management of one's own affairs as opposed to the management of the affairs of another for whom one is morally obliged to provide, and as a result the level of risk that is deemed acceptable.[213] In *Sackville-West v Nourse*[214] Solomon ACJ held:

> "…[O]ne of the circumstances to be considered by a trustee is that he is dealing not with his own money, but that of the trust. Greater care and caution are required of him in the latter case than in the former."[215]

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diligens paterfamilias concept – both entail a familial or paternalistic relationship, a sense of moral duty. Although a moral obligation is also referred to in earlier English case law in relation to the duty of care and skill, as discussed in ch 3 para 2 1 3 1, later case law refers to the prudent man of business standard, which, according to some, implies a lower standard of care. The statutory duty discussed in ch 3 para 2 1 3 4 requires reasonableness rather than prudence, another perceived lowering of standards, according to some.

[209] *Sackville West v Nourse* 1925 AD 516.

[210] *Sackville West v Nourse* 1925 AD 516 533-534.

[211] *Sackville West v Nourse* 1925 AD 516 534.

[212] Du Toit (2007) *Stell LR* 469 473; *Sackville West v Nourse* 1925 AD 516 534, where references are made to Roman-Dutch scholarly writing. The common law duty of care under English law similarly focused on the avoidance of risk. See ch 2 para 2 1 3 1.

[213] De Waal (2000) 117 *SALJ* 548 559.

[214] *Sackville West v Nourse* 1925 AD 516.

[215] *Sackville West v Nourse* 1925 AD 516 519-520 where Solomon ACJ also refers to similar dicta from 19th century English case law.

Kotzé JA held in the same case:

> "We may accordingly conclude that the rule of our law is that a person in a fiduciary position, like a trustee, is obliged, in dealing with and investing the money of the beneficiary, to observe due care and diligence, and not to expose it in any way to any business risks. In principle our law agrees with that of England."[216]

Although, as discussed below, it has been accepted that the avoidance of all risk is outdated in the modern investment world,[217] the mere observance of good faith does not excuse a trustee from liability for breach of trust – he must act with scrupulous care and prudence in making investments.[218]

Boyce NO v Bloem[219] was an example of the application of the common law duty of care by the South African courts. The case concerned a testamentary trust and the negligence of the trustees in wrongfully paying out trust money. Reference was made to English case law for the proposition that no higher degree of diligence is required when acting as trustee than where a man of ordinary prudence manages his own affairs, and the court stated that to be the law in South Africa as well.[220]

Roberts AJ found that this is not inconsistent with the writings of Roman-Dutch scholars dealing with analogous cases concerning negligence. He also confirmed the need for all the relevant circumstances to be taken into account in order to determine the exact degree of care expected of a trustee in any given scenario.[221] The judge considered English case law to aid an understanding of whether and what type of mitigating factors should excuse a trustee for not taking action to protect or recover trust assets.[222] Even if the trustees acted honestly, one must ask whether he also acted reasonably in the circumstances.[223]

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[216] *Sackville West v Nourse* 1925 AD 516 535.
[217] See ch 3 para 2 3 5.
[218] Cameron *et al Honoré's South African Law of Trusts* 263; *Sackville West v Nourse* 1925 AD 516 527-528, 535-536, where it was stated that the trustees' *bona fides* were not questioned but they were, regardless, held responsible for the loss of a risky investment; *Boyce NO v Bloem* 1960 (3) SA 855 (T) 865-866.
[219] *Boyce NO v Bloem* 1960 (3) SA 855 (T).
[220] *Boyce NO v Bloem* 1960 (3) SA 855 (T) 866.
[221] *Boyce NO v Bloem* 1960 (3) SA 855 (T) 865-867.
[222] *Boyce NO v Bloem* 1960 (3) SA 855 (T) 867-868.
[223] The requirement of reasonableness is also found in the English statutory duty of care, see ch 3 para 2 1 3 4.

In casu, the trustees had to recover a debt owed to the trust. The judge found that the trustees were negligent in not taking more active steps in recovering the debt, admitting that there may be cases where, because of a reasonable belief that payment will not be obtained despite their best efforts, the trustees would be excused for not taking action to enforce payment. In this case, however, they were found guilty of negligence and had to make good the loss.[224]

2 3 4 The statutory duty of care

Section 9(1) of the Trust Property Control Act[225] (TPCA) gives statutory recognition to the trustee's duty of care and provides as follows:

> "A trustee shall in the performance of his duties and the exercise of his powers act with the care, diligence and skill which can reasonably be expected of a person who manages the affairs of another."[226]

Section 9(2) provides that any provision in a trust deed that exempts a trustee from or indemnifies him against liability for a breach of trust brought about by a failure to observe this standard, would be void.[227] This is examined further below.[228]

The reference in section 9(1) to the affairs of another person is consistent with the common law duty of care as described above, implying a moral obligation or paternalistic element. Unlike the English statute,[229] no reference is made to a higher standard being expected of professional trustees, nor is a subjective element relating to the specific trustee included as in Jersey.[230]

Even if this were to indicate a lower standard for professional trustees, many trustees in South Africa are lay persons on whom the moral obligation of looking after another person's property should weigh heavily. On the other hand, settlors are often co-trustees, complicating

[224] *Boyce NO v Bloem* 1960 (3) SA 855 (T) 867-868.
[225] Trust Property Control Act 57 of 1988.
[226] Although the introduction of the statutory duty was in fact merely a confirmation of the existing common law duty, the prohibition on excluding the duty of care in the trust deed in Trust Property Control Act 57 of 1988 s9(2) was an innovation, as explained in ch 2 para 4 5.
[227] Trust Property Control Act 57 of 1988 s 9(2).
[228] See ch 3 para 5 3.
[229] Trustee Act 2000 s 1(1).
[230] Trusts (Jersey) Law 1984 art 21(1).

the fiduciary relationship and infringing on the required separation of control and enjoyment, as discussed in chapter 4. However, the law in South Africa appears to be less tolerant than the law in England and Jersey as far as allowing trustees to escape liability for negligent breaches of trust is concerned, indicating that the environment in which trustees operate is not necessarily more liberal.

Although not all case law after the coming into force of the TPCA and dealing with the duty of care refers to the statutory duty, some references can be found. In *Administrators, Estate Richards v Nichol*,[231] the judge referred to both the common law duty of care and section 9(1) of the TPCA as not intended to create an inflexible limitation on the investment of the trust fund.[232] In the context of the case, this is presumably intended to mean that a trustee does not have to avoid all risk in order to fulfil his duty of care, even if it was previously thought to be a requirement. This case is discussed in more detail below.

Another case where reference was made to the statutory duty of care is *Tijmstra v Blunt-Mackenzie.*[233] An application was made to remove one of the trustees of a family trust who was dealing with the trust assets as if they were his own. Section 20(1) of the TPCA allows removal of a trustee if it is in the interest of the trust and its beneficiaries. Reference was also made to section 9(1) of the TPCA. The court considered that *mala fides* was not required for the removal of a trustee.[234] The court relied on section 9(1) of the TPCA in assessing the trustee's behaviour, but also discussed the common law fiduciary duties of trustees, including the duty of care.[235] It was held that the trustee in question did not act as a *bonus et diligens paterfamilias* in selling certain trust assets and transferring trust funds to his own bank account. It appears this decision was reached on the basis that the errant trustee did not fulfil either the common law duty of care or the statutory duty of care.

2 3 5 Investment of the trust fund

Investing the trust fund is one of the most important functions of a trustee. In order to do so, trustees are given specific investment powers. No fixed list of authorised trustee investments

[231] *Administrators, Estate Richards v Nichol* 1999 (1) SA 551 (SCA).
[232] *Administrators, Estate Richards v Nichol* 1999 (1) SA 551 (SCA) 558.
[233] *Tijmstra NO v Blunt-Mackenzie NO* 2002 (1) SA 459 (T).
[234] *Tijmstra NO v Blunt-Mackenzie NO* 2002 (1) SA 459 (T) 472.
[235] *Tijmstra NO v Blunt-Mackenzie NO* 2002 (1) SA 459 (T) 472-474.

exists under South African law, but it was traditionally required of a trustee to avoid any element of risk.[236] This limitation has its origin in the trustee's fiduciary position as a *bonus et diligens paterfamilias*, someone who had to adhere to a higher standard of care than a person looking after his own affairs.[237]

As examined above, the statutory duty of care was enacted in England around the same time as trustees' powers of investment were widened.[238] As possibilities opened up for trustees to invest trust funds in a wider variety of more complicated investments carrying a higher degree of risk, it was considered that beneficiaries needed additional protection, although at common law a duty of care did already exist.

Around the same time as the liberalisation of trustees' investment powers in England, in 1999 a judgment from the Supreme Court of Appeal signalled a similar change in approach in South Africa. In *Administrators, Estate Richards v Nichol*[239] the highest court in South Africa recognised that a trustee should have more freedom in selecting trust investments. This change in thinking was brought about, as in England, by changes in the investment opportunities available, but also by the ravaging effect inflation in South Africa was having on the value of assets over time.[240]

Preserving capital in real terms, which is also the only way of ensuring sufficient income, involves some element of risk. Taking on risk was previously forbidden, unless specific provision to the contrary was made in the trust deed. Taking risks was also not always necessary in the past, as only preservation of the original capital was required. Many trustees have therefore confined themselves to very conservative investments where capital was preserved, but did not necessarily grow or produce much income.[241]

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[236] Cameron *et al Honoré's South African Law of Trusts* 298-299; Du Toit *South African Trust Law: Principles and Practice* 87-88; *Sackville West v Nourse* 1925 AD 516 519-522, 535-536; *Administrators, Estate Richards v Nichol* 1999 (1) SA 551 (SCA) 557.
[237] *Sackville West v Nourse* 1925 AD 516 533-536.
[238] See ch 3 para 2 1 3 2.
[239] *Administrators, Estate Richards v Nichol* 1999 (1) SA 551 (SCA).
[240] *Administrators, Estate Richards v Nichol* 1999 (1) SA 551 (SCA) 558. The court also referred to earlier cases, from 1965 onwards, where wider investment powers were granted by the courts.
[241] Cameron *et al Honoré's South African Law of Trusts* 300; Du Toit *South African Trust Law: Principles and Practice* 88.

The court made the point that, in the prevailing financial environment, such conservative investments were not necessarily prudent, although *prima facie* they appeared to be. Scott JA held:

> "But whether or not an investment can be said to have been prudent or made with due care and diligence is a question which can only be decided on the facts of each particular case…; and circumstances change. An investment considered prudent in earlier times may rightfully be regarded as quite imprudent in the context of modern conditions."[242]

The increased acceptance of risk brought about by this change in thinking does not mean, however, that a trustee was now free to ignore the duty of care and invest trust funds in any way he pleased. The court in the *Nichol*[243] case recognised this and added a word of caution to remind trustees of the need to exercise due diligence and care, to avoid speculative investments and to diversify and balance a portfolio of investments. Having said that, the extent to which a trustee can invest in riskier asset classes, such as shares traded on a stock exchange, and still be considered to be acting prudently would depend on the facts of each case and will include considerations such as the size of the trust fund and the needs of different classes of beneficiaries.[244]

This widening of trustees' investment powers with the concomitant reminder of the duty of care imposed on trustees is reminiscent of the development in England, although there the change was brought about by the legislator rather than the judiciary. The statutory duty of care and the widening of investment powers were both introduced in the Trustee Act 2000. In South Africa, the statutory duty of care had existed since the introduction of the TPCA in 1987, thus long before the judicial relaxation of restrictions on trustee investments. This duty cannot, unlike the English statutory duty of care, be excluded by the terms of the trust deed.

[242] *Administrators, Estate Richards v Nichol* 1999 (1) SA 551 (SCA) 557.
[243] *Administrators, Estate Richards v Nichol* 1999 (1) SA 551 (SCA).
[244] *Administrators, Estate Richards v Nichol* 1999 (1) SA 551 (SCA) 558.

2 4 Conclusion and comparison

The general content and importance of a trustee's fiduciary duties seem to be broadly similar in the jurisdictions under review and revolves around the concepts of loyalty, good faith, confidence and an avoidance of conflicts. The same can be said for the duty of care, at least as far as its practical implementation is concerned. However, theoretical differences do abound, focused on whether the duty of care denotes a paternalistic element or not, whether it requires prudence or reasonableness and whether the test is objective or subjective, thereby expecting more of paid professional trustees.

An important distinction is that the duty of care is considered a fiduciary duty under South African law, whereas it is clearly not regarded as fiduciary under English law. It is not entirely clear whether the duty of care, or the customary law concept of acting as a *bon pére de famille*, is regarded as a fiduciary duty under Jersey law, but the *bon pére* duty does appear to add to the duty of care a certain gravitas beyond the confines of statute.

Imposing onerous duties on trustees is in line with the core values referred to before.[245] A trust cannot exist if the trustee does not have certain duties towards the beneficiaries and if the beneficiaries cannot hold the trustee to account for the performance of those duties. The quality of the beneficiaries' right to do so is directly related to the quality of the performance expected of the trustee.

However, there are signs that the fiduciary obligations of a trustee, the duty of care expected of a trustee, the irreducible core of the trust – all of the special features that make the trust what it is and has been for hundreds of years – are increasingly losing importance to make way for more commerciality. This is evident in the possibility under English law of excluding the statutory duty of care (albeit that this may not be a frequent practical occurrence), the ease with which trustee liability can be excluded and the inclusion in trust deeds of provisions that allow trustees not to be involved in the business of companies they own, to name a few examples.[246]

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[245] See ch 2 para 5; ch 3 para 1.

[246] The concept of reservation of powers to the settlor or someone other than the trustee is also relevant in this context and is analysed in ch 4.

Certain fiduciary duties, such as allowing conflicts of interest or retention of profits, can also be overridden in the trust deed, particularly where the trustee is a corporate entity forming part of a bigger financial services group that offers additional services other than trusteeship. One could argue that loss to a trust fund nowadays is more likely to be caused by a lack of care and skill in investing the trust fund, but the importance of the fiduciary duties cannot be overemphasised. Hudson agrees with this and warns that the institution of the trust may become increasingly assimilated with other common law obligations such as the contract.[247]

The overriding principle of an irreducible core of obligations on which the trust is based, discussed at the end of the previous chapter,[248] seems at times to be flagrantly disregarded.

It raises questions such as whether the trust, a centuries-old legal institution, is able to cope with the fast changing social and economic environment in which we now live. The trust is undisputedly a very flexible concept, but does too much flexibility and change mean that the core of the trust, that which gives it its edge over other legal concepts, is being lost? This is also relevant in the context of an increased desire for settlor freedom and for control over the trust assets by settlors and beneficiaries alike, as examined in chapter 4. Trustees, settlors and beneficiaries all seem to want to have the best of both worlds – can the trust survive this onslaught? This question is evaluated in chapter 5.

3 Breach of trust

3 1 England

3 1 1 Definition of breach of trust

Defining a breach of trust has never been straightforward. A distinction can be made in English law between breach of trust and breach of fiduciary duties, although they are often both referred to simply as "breach of trust", and many authors, commentators and judges do not make this distinction.[249] This can lead to some confusion as there are different requirements for liability and different remedies.

[247] Hudson *Equity and Trusts* 373-376.
[248] See ch 2 para 5.
[249] Penner *The Law of Trusts* 319-320.

Although a breach of trust can take many forms, it will be either a breach of or failure to comply with an express term of the trust deed or a breach of an obligation imposed on trustees by the general law applicable to trusts, meaning the 2000 Act or the common law.[250] It is, in other words, any act or failure to act that is contrary to the trustee's duties.[251] In *Armitage v Nurse*[252] Millett LJ gave the following useful summary of the forms that a breach of trust can take:

> "Breaches of trust are of many different kinds. A breach of trust may be deliberate or inadvertent; it may consist of an actual misappropriation or misapplication of the trust property or merely of an investment or other dealing which is outside the trustees' powers; it may consist of a failure to carry out a positive obligation of the trustees or merely of a want of skill and care on their part in the management of the trust property; it may be injurious to the interests of the beneficiaries or be actually to their benefit. By consciously acting beyond their powers…the trustees may deliberately commit a breach of trust; but if they do so in good faith and in the honest belief that they are acting in the interest of the beneficiaries their conduct is not fraudulent. So a deliberate breach of trust is not necessarily fraudulent."[253]

Breaching any duty or obligation owed by the trustee will therefore result in a breach of trust. English law does not require dishonesty, negligence or wrongful intent for there to be a breach of trust.[254]

A breach of fiduciary duty is just what the term suggests – a breach by the trustee of his fiduciary duties, namely the no conflict or no profit rules. An example would be where a trustee who is authorised by the trust deed to invest in real estate, sells his own real estate to the trust. Doing so does not breach the terms of the trust, but because he is a fiduciary, he is not allowed to act when such a conflict exists, and so the act would be a breach of fiduciary duty.

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[250] Hudson *Equity and Trusts* 740-741; Tucker *et al Lewin on Trusts* 1858.
[251] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 1145-1146.
[252] *Armitage v Nurse* (1998) Ch 241.
[253] *Armitage v Nurse* (1998) Ch 241 251.
[254] Hudson *Equity and Trusts* 741-742.

Breaches of trust, strictly speaking, refer to other breaches by a trustee of duties owed to beneficiaries that are peculiar to his position as trustee, such as the duty of care and skill or duties in relation to the administration of the trust or the distribution of trust assets, but which are not fiduciary in nature. A trustee that invests the trust fund in a negligent way may be guilty of a breach of trust, but unless he acted in breach of the no conflict or no profit rule, there would be no breach of fiduciary duty.[255]

Hayton and Virgo both explain that breaches of trust (as opposed to breaches of fiduciary duty) are either (a) the result of an unauthorised, or *ultra vires*, action, such as misapplication of the trust fund or acting in conflict of interest, or (b) an inadequate action, which is doing something *intra vires*, but doing it in a suboptimal way, for instance failing to apply the required care and skill. Liability for unauthorised transactions is strict, similar to the position in relation to breaches of fiduciary duties. The beneficiaries do not have to prove a breach, loss or a causal link between the two. The trustee must restore the trust property or, if this is not possible, a money substitute. In the case of inadequate actions, fault on the part of the trustee must be proved, normally in the form of negligence, to establish liability. The trustee must pay reparation to make good the harm caused to the trust and the measure of his liability is therefore the loss actually suffered by the beneficiaries.[256]

3 1 2 Requirements for establishing liability for breach of trust

The topic of breach of trust is closely related to that of remedies, a topic that will not be examined in this dissertation. However, it is worth noting that the remedy depends on the type of breach, and that there appears to be disagreement in academic circles as to the appropriate remedy in each case. This may have to do with the difficulties in defining and categorising breaches of trust, and also as a result of the differences between equity and common law, explored in chapter 2.[257]

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[255] Penner *The Law of Trusts* 319-320; Virgo *The Principles of Equity & Trusts* 560-561.
[256] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 1047-1048; Virgo *The Principles of Equity & Trusts* 561. See also Pearce *et al Pearce & Stevens' Trusts and Equitable Obligations* 812-815, 855-857, where he explains that a trustee is always liable for a breach of fiduciary duty. Because he committed an equitable wrong, the beneficiaries can recover either restitution or equitable compensation. A trustee who acted *ultra vires*, outside the scope of his powers, is also strictly liable. However, in the case of a breach of the duty of care, a trustee would not be strictly liable, but if the trustee failed to exercise the expected standard of care, that of a prudent man of business, and this has caused a loss to the trust, he would be liable to make good the loss.
[257] See ch 2 para 2 2 2.

Despite the importance of the accountability of the trustee towards the beneficiaries, which forms part of the irreducible core of trusteeship, one can imagine situations where vexatious beneficiaries may institute proceedings against trustees who had not caused a loss to the trust fund. Therefore, modern English trust law stipulates that a trustee who committed a breach of trust falling in the *intra vires* but inadequate category is not always liable to make good his breach of trust. If there is no loss the trustee is not liable, and if there is a loss but it cannot be causally linked to the trustee's breach of trust, the trustee is not liable to make good the loss.[258] A trustee can therefore escape liability for an imprudent or improper investment that turns out to perform well, and even for investments made with the knowledge that they are unauthorised, as long as no loss is caused thereby.[259]

Nestle v National Westminster Bank plc[260] is an important case regarding liability for breach of the duty of care. It set the bar for negligent breach of trust concerning investments at imprudence or unfairness (incompetence or idleness being insufficient), and also confirmed that, apart from proving a breach of trust, the claimant must show that the breach caused a loss to the trust fund. Thus, there are three elements for liability: breach of trust, loss and causation.[261]

In casu, the trustee was a professional corporate body. It had misinterpreted the investment powers given to it under the terms of the trust and therefore reduced the trust fund's exposure to equities without taking legal advice on the point. It also failed to conduct regular reviews of the performance of the investments. The trust fund remained invested for a long period of around 60 years and although it did grow, the beneficiary claimed that if the trust fund were properly invested it would have been worth five times as much. The Court of Appeal held that the mere incompetence and idleness of the trustee was not in and of itself a breach of trust. Only if the incompetence can be shown to have caused the trustee to take decisions that caused a quantifiable loss to the trust would there be a breach of trust. The court admitted that

[258] Hudson *Equity and Trusts* 741-743.
[259] Watt *Trusts & Equity* 421. See also Hudson *Equity and Trusts* 743-745, who suggests that this was not the traditional approach that favoured strict liability for all breaches and would have meant that the beneficiaries were able to sue the trustee for a technical breach of trust, even if the result of the breach was an increase in the value of the trust fund. It is not clear whether Hudson refers here to breaches of trust or breaches of fiduciary duty, or both, but the case law he refers to, *Target Holdings v Redferns* [1995] 3 All ER 785, dealt with negligence, so presumably he refers to the *intra vires* but inadequate category of breach of trust.
[260] *Nestle v National Westminster Bank plc* [1994] 1 All ER 118 The case was also discussed in ch 2 para 2 1 3 1 in the context of the common law duty of care.
[261] Watt *Trusts & Equity* 408-409; *Nestle v National Westminster Bank plc* [1994] 1 All ER 118 133-134.

this was a heavy burden on a claimant, but still found it right to hold that the trustee did not commit a breach of trust.[262] Remarkably, the court admitted that the trustee did not act conscientiously, fairly and carefully, but found that there was no loss arising from a breach of trust for which the trustees must compensate the trust fund.[263]

It may well be argued that such incompetence on the part of a paid professional trustee should in and of itself constitute a breach of trust. Although it is said that a paid professional trustee is held to a high objective standard of prudence, this judgment negates that requirement by placing a very heavy onus on the claimant. Proving that a trustee's action or inaction caused a quantifiable loss to the trust fund is invariably very difficult when considering the uncertainties of the investment process and the performance of investments, especially company shares, over many years.

The Court of Appeal may have been trying to balance the interests of beneficiaries with the need to encourage trusteeship. Creating a more liberal environment for trustee investments and making it safer for a trustee to invest trust funds in asset classes carrying higher degrees of risk enables a trustee to generate higher returns, which benefits the beneficiaries, without having to take on increased risk of liability.[264] A similar forgiving attitude towards trustees can be found in the judgment in *Armitage v Nurse*[265] with regard to the acceptable scope of trustee exculpation clauses, discussed later.[266]

The modern approach to liability for breach of trust was confirmed by the House of Lords in *Target Holdings v Redferns*.[267] This approach requires not only that the beneficiaries must have suffered a loss, but also that there must have been a causal link between the trustee's breach of trust and the loss. Although the *Target Holdings*[268] case did not concern an express *inter vivos* trust, but rather a case of solicitors holding client money on trust in their client account, it is well recognised as setting out the accepted law on liability for breach of trust based on negligence.[269] In this case, although the solicitors did commit a breach of trust, it was

[262] *Nestle v National Westminster Bank plc* [1994] 1 All ER 118 133-134.
[263] *Nestle v National Westminster Bank plc* [1994] 1 All ER 118 139.
[264] Watt *Trusts & Equity* 410.
[265] *Armitage v Nurse* (1998) Ch 241.
[266] See ch 3 para 5 1.
[267] *Target Holdings v Redferns* [1995] 3 All ER 785.
[268] *Target Holdings v Redferns* [1995] 3 All ER 785.
[269] In other words, not relating to unauthorised transactions or breach of fiduciary duty.

not their breach of trust that led to the claimant's loss, but rather a breach of trust on the part of another party who absconded with the money and could not be found. That was the reason the claimant tried to sue the solicitors, but because its loss was not caused by the solicitors' breach of trust, it could not claim compensation from the solicitors.[270]

If no loss flows directly from the breach of trust, the trustee committing that breach can therefore not be liable for breach of trust. Moreover, the beneficiary must be able to prove the loss.[271]

When the breach of trust concerns the investment of the trust fund, as it so often does, there are particular difficulties in proving loss. The generation of a small gain may still be characterised as a loss, if the beneficiary can show that other trust funds that are subject to the same restrictions have generated higher returns. On the other hand, a reduction in the value of the trust fund during a financial crisis may not be a breach of trust, because the beneficiary cannot prove that the loss is the result of fault or breach of duty on the part of the trustee.[272]

3 2 Offshore: Jersey

3 2 1 Definition of breach of trust

Breach of trust is clearly defined in Jersey law, and it appears that the legislators were not troubled by the same doubts as English judges and commentators.

Article 1(1) of the TJL states:

> " [B]reach of trust" means a breach of any duty imposed on a trustee by this Law or by the terms of the trust[.]"[273]

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[270] Hudson *Equity and Trusts* 744-747; *Target Holdings v Redferns* [1995] 3 All ER 785 784.
[271] Hudson *Equity and Trusts* 746.
[272] Hudson *Equity and Trusts* 747. In *Nestle v National Westminster Bank plc* [1994] 1 All ER 118 the appellant had to prove that a prudent trustee, knowing of the scope of the investment power of the bank and periodically reviewing the investment, would have invested it in a way that would have made it worth more than it was in the instant case. It was held at 141-142 that this was not proved and that therefore the trustee did not commit a breach of trust that resulted in a loss. It was said that the trustee was not so much to be judged by success as by the absence of proven default.
[273] Trusts (Jersey) Law 1984 art 1(1). This is similar to the definition under English law, although there is no statutory definition under English law.

Not only is the term "breach of trust" defined by statute; many other issues are also statutorily regulated, as examined below. It appears that Jersey law would define breaches of both fiduciary duties and non-fiduciary duties as breaches of trust.

No mental element is required and a trustee can therefore act in breach of trust without knowing that he is acting wrongly.[274] It is not unusual for a trustee in an offshore jurisdiction, including Jersey, to seek directions from the court in case of uncertainty, thereby protecting himself from breach of trust claims.[275]

Not much has been written about how breaches of trust were defined under the common law, prior to the enactment of the TJL. However, the 1980 case of *Cutner v Green and Trustees of the Marc Bolan Charitable Trust*[276] provides some insight. Much of the judgment concerned procedural matters and the judgment of the lower court has not been reported. There may have been more discussion there regarding what constitutes a breach of trust. The Court of Appeal simply stated that a breach of trust occurred and that the trustee had to make it good. The trustee in this case invested trust money without the required consent. The speculative investments made by the trustee caused loss to the trust fund and the trustee conceded liability on this point. Another part of the trust fund was paid into an account unrelated to the trust, but the trustee denied knowledge about this payment. He claimed that he was not liable in respect of the interest lost on that part of the fund. The court, however, found that because he failed to account for the funds, he was liable.[277]

In fact, the trustee was liable not only for simple interest, but for what the trust fund would have earned if it was properly invested, in other words, had no breach of trust been committed. The award given was therefore for interest (or profit) lost. The court commented that it was nothing more than fair that a defaulting trustee should make good in full any loss, including any interest that would have been earned on the trust fund had he done his duty properly.[278]

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[274] Brown *The Jersey Law of Trusts* 219.
[275] Brown *The Jersey Law of Trusts* 220.
[276] *Cutner v Green and Trustees of the Marc Bolan Charitable Trust* [1980] JJ 269.
[277] *Cutner v Green and Trustees of the Marc Bolan Charitable Trust* [1980] JJ 269 276-277.
[278] Brown *The Jersey Law of Trusts* 221; *Cutner v Green and Trustees of the Marc Bolan Charitable Trust* [1980] JJ 269 278.

Despite lack of detailed arguments, the direction the court was taking is clear.

3 2 2 Requirements for establishing liability for breach of trust

Article 30 of the TJL deals with liability for breach of trust and provides:

> "30(1) Subject to this Law and the terms of the trust, a trustee shall be liable for a breach of trust committed by the trustee or in which the trustee has concurred.
>
> 30(2) A trustee who is liable for a breach of trust shall be liable for –
>
> (a) the loss or depreciation in value of the trust property resulting from such breach; and
>
> (b) the profit, if any, which would have accrued to the trust property if there had been no such breach."[279]

In *Midland Bank Trust Company (Jersey) Limited v Federated Pension Services*[280] the Royal Court said the following:

> "…[I]t seems to us that a failure to perform a duty may still lead to an action for a breach of trust even though there has not been a loss. If that is so, then the position in Jersey may be different to the position in England…"[281]

This creates the impression that Jersey law does not require loss to establish liability for breach of trust.[282] It is not clear whether that is correct. *In casu* there was a substantial loss and the court did not have to examine this issue too deeply. The trustee failed to invest the trust fund on the stock market due to the mistaken belief that it did not have the power to do so. The trustee did not take legal advice and simply placed the money on deposit, which turned out to be less profitable to the pension fund than investing it on the stock exchange would have been. These comments were therefore made in the context of whether the beneficiaries would also have complained if the stock market had fallen. The "loss" that the court said may not be required is therefore simply a failure of the benchmark to perform as it normally would

[279] Trusts (Jersey) Law 1984 art 30(1) and 30(2).
[280] *Midland Bank Trust Company (Jersey) Limited, Establishment Committee and Day v Federated Pension Services* 1994 JLR 276.
[281] *Midland Bank Trust Company (Jersey) Limited, Establishment Committee and Day v Federated Pension Services* 1994 JLR 276 290.
[282] Brown *The Jersey Law of Trusts* 220-221.

– if it did perform normally, there would have been a gap between the performance of the investment made in breach of trust and the investment in the benchmark asset, in this case the stock market.

In the *Midland Bank* case,[283] the fact that the trustee did not take professional advice was a major contributor to the conclusion that it had committed a breach of trust.[284]

Another Jersey case dealing with breach of trust is *Freeman v Ansbacher Trustees (Jersey) Limited*.[285] The case dealt, on the one hand, with the *locus standi* of a discretionary beneficiary to sue for breach of trust and, on the other hand, with the liability of a trustee for breach of trust in the shape of mismanagement of the trust fund.

The facts were that the trust fund was invested in one company that constituted the only significant asset of the trust. Employees of the trustee were also directors of the company for a substantial period of time. The company made investments, described as hazardous, in land with uncertain title and the worldwide rights to sell certain software products.[286]

It was alleged that the trustee committed a breach of trust by not exercising the duties of care and skill required of a professional trustee in managing the affairs and investments of a trust, that the trustee did not ensure it had such information about the affairs of the company as a director can be expected to have, and that as a result it failed to safeguard the trust assets and protect the interests of the beneficiaries in the way that a professional trustee should have done, thereby causing a loss to the trust fund. The original claim was for negligence. Because liability for negligence can be excluded under Jersey law (and was excluded in this case) but liability for gross negligence cannot be excluded (as discussed below), the claim was amended to one of gross negligence. The court found that whether certain behaviour can be categorised as gross negligence is a value judgment to be applied by the court – "a label to denote the degree of culpability involved".[287]

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[283] *Midland Bank Trust Company (Jersey) Limited, Establishment Committee and Day v Federated Pension Services* 1994 JLR 276.
[284] *Midland Bank Trust Company (Jersey) Limited, Establishment Committee and Day v Federated Pension Services* 1994 JLR 276 291-293. The court said at 293 "The breach was the failure of FPS to hand over the fund on an erroneous assumption of fact. The erroneous assumption of fact could have been cured by obtaining legal advice."
[285] *Freeman v Ansbacher Trustees (Jesey) Limited* [2009 JLR 1].
[286] *Freeman v Ansbacher Trustees (Jesey) Limited* [2009 JLR 1] 8-10.
[287] *Freeman v Ansbacher Trustees (Jesey) Limited* [2009 JLR 1] 25.

A more recent case of interest is *Nautilus Trustee Limited v Zedra Trustees (Jersey) Limited*.[288] The judgment dealt with preliminary issues of striking out certain parts of the plaintiff's claim (which was mostly refused) and at the time of writing the case has not progressed to trial yet, or the judgment has not been published yet. The trust fund in this case was mainly invested in structured loan notes issued by a bank connected with the trustee. The allegations of breach of trust included failure to act in the best interests of the beneficiaries, failure to preserve or enhance the value of the trust property and conflicts of interest (as the trustee belonged to the same group of companies as the bank where the trust fund was kept and invested).[289] The duty of no conflict is a fiduciary duty and thus confirms the assumption that Jersey law does not distinguish a different category of breach of fiduciary duty, but rather treats it as a breach of trust.

The defendant relied on the English case *AIB Group (UK) Plc v Redler & Co Solicitors*[290] for the assertion that there is a requirement for loss to have flowed directly from the breach of trust. The *AIB Group* judgment[291] confirmed the judgment in *Target Holdings v Redferns*,[292] discussed earlier. There was a question as to causation of the loss in this case as the regulatory notices on the bank notes, which is said to have caused the loss in their value, were only issued after the bank notes matured. It was argued that it was the financial crisis that started in 2008 that caused the loss and not regulatory findings on the banks that issued the loan notes.[293]

The judge pointed out that when the case progresses to trial, thought should be given by the plaintiff as to what its loss might be. The plaintiff received shares in another bank on maturity of the bank notes and the price of these shares have since fluctuated. Evidence would be required in respect of the losses, including whether the shares were sold or kept.[294]

[288] *Nautilus Trustee Limited v Zedra Trustees (Jersey) Limited* [2016] JRC 233.
[289] *Nautilus Trustee Limited v Zedra Trustees (Jersey) Limited* [2016] JRC 233 paras 2-8.
[290] *AIB Group (UK) Plc v Mark Redler Solicitors* [2014] UKSC 58.
[291] *AIB Group (UK) Plc v Mark Redler Solicitors* [2014] UKSC 58.
[292] *Target Holdings v Redferns* [1995] 3 All ER 785.
[293] *Nautilus Trustee Limited v Zedra Trustees (Jersey) Limited* [2016] JRC 233 paras 53-56.
[294] *Nautilus Trustee Limited v Zedra Trustees (Jersey) Limited* [2016] JRC 233 para 123.

3 3 South Africa

3 3 1 Definition of breach of trust

South African law explains breach of trust by reference to the trustee's duty of care. The duty of care is generally described as a fiduciary duty, or, stated differently, the duty of care is considered an aspect of the fiduciary duty of a trustee. It is, in fact, considered an integral part of the fiduciary duty – the trustee's performance is measured against the standard expected by the duty of care.[295] As a result, the view is that a breach of trust is equated to a breach of fiduciary duty under South African law.[296] References to breach of fiduciary duty have been found in case law, where it was also referred to as a breach of trust.[297] Breach of fiduciary duty would therefore seem to fall under the umbrella of breach of trust.

Where a trustee fails to meet the required standard of care, he is therefore considered to be breaching his fiduciary duty or committing a breach of trust.[298]

In *Gross v Pentz*,[299] a case concerned with the *locus standi* of a contingent beneficiary to sue the trustee for breach of trust, the trustee caused economic loss to the trust by negligently failing to ascertain the true value of the asset that was to be sold by the trust.[300] The trustee was authorised by the terms of the trust to sell the particular asset, but he negligently failed to apply the necessary care in determining the true market value of the asset, as a result of which it was sold for less than it was worth. Corbett CJ referred to *Sackville West v Nourse*[301] as establishing the legal foundations for the liability of a trustee for maladministration of a trust.[302] In this case the court found that the trustee acted negligently, even if no *mala fides* were present. Proof of negligence is required but not of dishonesty.

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[295] See ch 3 paras 2 3 3, 2 3 4 for the duty of care under South African law.
[296] Du Toit *South African Trust Law: Principles and Practice* 103; De Waal (1998) *TSAR* 326 330; Olivier (2001) 118 *SALJ* 224 229.
[297] *Jowell v Bramwell-Jones* 1998 (1) SA 836 (W) para 16; *Phillips v Fieldstone Africa (Pty) Ltd* 2004 (3) 465 (SCA) 478.
[298] Cameron *et al Honoré's South African Law of Trusts* 362 refers to "a breach of trust or duty", thereby implying that they are the same; Du Toit *South African Trust Law: Principles and Practice* 103. In England, a breach of the duty of care would be a breach of trust but not a breach of fiduciary duty.
[299] *Gross v Pentz* 1996 (4) SA 617 (A).
[300] *Gross v Pentz* 1996 (4) SA 617 (A) 626, where the case against the trustee was described as intentional or negligent maladministration of the trust.
[301] *Sackville West v Nourse* 1925 AD 516.
[302] *Gross v Pentz* 1996 (4) SA 617 (A) 626.

A breach of trust, however, always involves an element of wrongfulness towards one or more beneficiaries of the trust.[303] In *Jowell v Bramwell-Jones*[304] a lay trustee relied on the advice of professional financial advisors in dealing with certain investments. In this case the wrongful action was on the part of the advisors, who were the defendants, and who acted together with the trustee, who was also the income beneficiary. One of the capital beneficiaries who could benefit only after the death of the income beneficiary claimed that the sale of certain shares held by the trust was a breach of trust and caused a loss to the capital beneficiaries. The trustee herself also committed a breach of trust (a breach of fiduciary duty to be precise) in that there was a conflict between her personal interests and those of the beneficiaries. Although it was held that such a conflict would not automatically constitute a breach of trust (or fiduciary duty), such transactions will be carefully examined and in this case a breach of fiduciary duty was found to be present in addition to a breach of trust relating to the sale of the shares.[305]

The wrongful conduct in relation to the sale of the shares was held to be on the part of the professional advisers. The advisers, who were professionals advertising their skill and knowledge, either knew or should have known that their conduct would cause damage, and should have taken practical steps to prevent it. They knew that the trustee was unskilled. If the trustee could not rely on their advice, the protection afforded to the beneficiaries was jeopardised.[306]

The test to determine wrongfulness was said to revolve around whether, based on the circumstances of the specific case, the interests of the plaintiff (beneficiary) were infringed in a reasonable or unreasonable manner. Phrased differently, it depended on whether the defendant (the trustee or, in this case, the advisor to the trustee) had a legal duty to prevent the loss.[307]

Breaching the common law or statutory duty of care is unlawful. This is important as far as remedies are concerned (although remedies do not form part of the focus of this dissertation)

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[303] Cameron *et al Honoré's South African Law of Trusts* 365; *Jowell v Bramwell-Jones* 1998 (1) SA 836 (W) 877.
[304] *Jowell v Bramwell-Jones* 1998 (1) SA 836 (W) and on appeal *Jowell v Bramwell-Jones* 2000 (3) SA 274 (SCA).
[305] *Jowell v Bramwell-Jones* 2000 (3) SA 274 (SCA) para 16.
[306] *Jowell v Bramwell-Jones* 1998 (1) SA 836 (W) 878, 882.
[307] *Jowell v Bramwell-Jones* 1998 (1) SA 836 (W) 877-878.

– the main civil remedy against a trustee who committed a breach of trust is an Aquilian action[308] for pure economic loss, and in order to rely on the Aquilian action, conduct must be unlawful.[309] This includes intentional acts or omissions, but also negligent ones. However, conduct that causes loss but is not at least negligent does not constitute a breach of trust.[310] An example of this would be where a trustee invested in a diversified portfolio of shares and was properly authorised and advised to do so, but due to economic conditions outside the control of the trustee the share market suddenly crashes so that the portfolio loses value. The trustee would not be liable in this case, even though there is loss.

A wrongful act or omission can be either negligent or intentional. Examples are plentiful and include making an investment where the margin between the sum invested and the value of the security is too narrow;[311] not taking action to recover monies due to the trust;[312] the negligent failure to ascertain the true value of a trust asset before it is sold; [313] mingling trust property with the trustee's own property or allowing non-beneficiaries to occupy real property owned by the trust rent-free; lack of impartiality; and not enquiring how trust money is spent by co-trustees.[314] Some of these breaches relate to the duty of care and skill, and some relate to the duties described by English law as fiduciary, namely the no conflict and no profit rules.[315]

3 3 2 Requirements for establishing liability for breach of trust

The obvious consequence of a breach of trust is liability of the trustee. However, a trustee who committed a breach of trust is not liable towards the beneficiaries if there is no loss and if the loss was not caused by the trustee's breach of trust. For a successful Aquilian action all three requirements must therefore be fulfilled. Firstly, there must be a wrongful act on the part

[308] The Aquilian action has its roots in Roman law and is the main delictual remedy for pure economic loss, whether such loss was caused intentionally or negligently.
[309] Cameron *et al Honoré's South African Law of Trusts* 365.
[310] Cameron *et al Honoré's South African Law of Trusts* 365.
[311] *Sackville West v Nourse* 1925 AD 516 520-521, where it was found that the trustee, by taking on too much risk, acted negligently and did not fulfil the standard of care expected of a *bonus et diligens paterfamilias* and therefore had to make good the loss.
[312] *Boyce NO v Bloem* 1960 (3) SA 855 (T) 865-871. Although the trustees alleged that they were not aware of the circumstances, it was found that, because they were trustees, they had a duty to ask. Ignorance was no defence.
[313] *Gross v Pentz* 1996 (4) SA 617 (A) 626.
[314] These breaches were all found to be present in *Tijmstra NO v Blunt-Mackenzie NO* 2002 (1) SA 459 (T) 472-476.
[315] See ch 3 para 2 1 2 2. Under South African law, these duties are all considered fiduciary in nature.

of the trustee, at least negligent in nature. Secondly, the trust beneficiary must have suffered a loss. Thirdly, there must be a causal link between the breach and the loss.

The loss or damage must be actual damage sustained by the beneficiary. A beneficiary who can only benefit at a later stage, for example on the death of the income beneficiary or on the termination of the trust, cannot institute a claim before his right has vested, because it is only at this stage that he would be able to prove actual loss,[316] as confirmed on appeal by *Jowell v Bramwell-Jones*.[317]

Scott JA held that the appellant (the capital beneficiary) could not prove on a balance of probabilities that there would be a loss on termination of the trust. This is because there was no way of predicting what the share market would do in the future, and until such time as the trust terminates it would not be known whether the appellant would have suffered a loss at all. His action was therefore considered premature and the appeal was dismissed, although there clearly had been a breach of trust.[318]

The final requirement for Aquilian liability is that of causation – the trustee's breach of trust must have resulted in loss or damage. The link cannot be too remote (although it is not clear exactly what that means in practice and presumably the circumstances of each individual case will be relevant).[319]

3 4 Conclusion and comparison

The term breach of trust generally seems to encompass both breaches of fiduciary duties and other breaches of trust, the latter relating mostly to a breach of specific terms of the trust or a breach of the duty of care. English law differentiates between breaches of fiduciary duty and other breaches of trust more clearly than Jersey and South African law, possibly because the duty of care is so clearly non-fiduciary under English law.

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[316] Cameron *et al Honoré's South African Law of Trusts* 364-365; Du Toit *South African Trust Law: Principles and Practice* 104.
[317] *Jowell v Bramwell-Jones* 2000 (3) SA 274 (SCA).
[318] *Jowell v Bramwell-Jones* 2000 (3) SA 274 (SCA) 284-288.
[319] Cameron *et al Honoré's South African Law of Trusts* 364-365; Du Toit *South African Trust Law: Principles and Practice* 104.

Although the fiduciary duties of a trustee, having their origin in 18th century English law, appear broadly similar across the jurisdictions, there are differences, at least *prima facie*, in the standard of care and skill expected of a trustee, and this of course leads to a different threshold for committing a breach of trust in the different jurisdictions. A trustee of whom only a basic level of care and skill is expected will not commit a breach of trust as easily as a trustee subject to a much higher standard. There are also differences within specific jurisdictions, especially in England and also offshore, where professional trustees are clearly held to a higher standard.

In all three jurisdictions there is a requirement for loss having been caused by the breach of trust in order to attach liability to the defaulting trustee, although there is doubt about whether loss and causation are required in Jersey.

4 The rule in *Hastings Bass* and its implications for the trust industry

Before examining the extent to which a trustee can protect himself from liability for breach of trust in the jurisdictions under review, a detour will be made by looking at a particular rule of English law that allows, in appropriate circumstances, the setting aside of the exercise of certain trustee powers. The rule relates to the exercise by trustees of certain powers, but is also relevant in the context of trustee duties.[320]

The rule was perceived to have been abused by trustees and its application has now been limited by the Supreme Court on an English appeal. Arguably, in none of the cases where the previous version of the rule was applied by an English or offshore court were the beneficiaries prejudiced. The dissatisfaction with the rule was more likely based on the leniency afforded to trustees who failed to properly exercise their powers, or towards advisors who gave incorrect advice.

The development of this rule demonstrates that trustee duties are important tools in controlling and regulating the exercise of fiduciary powers. It also illustrates how the English court has taken a firm stance on a development it viewed as undesirable, and in this way has

[320] Hudson *Equity and Trusts* 335-337 explains that the rule has its origin in the duty to take account of relevant considerations when exercising discretionary powers; Tucker *et al Lewin on Trusts* 1351 discusses the rule under the topic of inadequate consideration in the exercise of trustee powers.

contributed to the further development of trust law. The reaction of the offshore world will also be examined.

4 1 England

4 1 1 The rule in Hastings-Bass

Under a rule known as the rule in *Hastings-Bass*,[321] courts in England can in certain circumstances set aside the exercise by a trustee of a discretionary dispositive power.[322] Contextually, this rule can be regarded as a technique of controlling the power held by fiduciaries,[323] and specifically the decision-making process of trustees.[324]

Making uninformed decisions could, in certain circumstances, constitute a breach of trust. It would be an example of an *intra vires* act that was performed inadequately, one of the categories of breach of trust described above.[325]

The *Hastings-Bass* rule was concerned with the duty, in exercising distributive discretions, to make properly informed decisions. A trustee needs to inform himself of matters relevant to the decision and must ignore irrelevant matters.[326] However, as described below, the rule has taken on a life of its own and has, no doubt, been used to the advantage of trustees who were not sufficiently careful.

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[321] The rule has its origins in the English Court of Appeal case *Re Hastings-Bass (Deceased), Hastings v Inland Revenue Commissioners* [1974] 2 All ER 193.

[322] Dispositive powers refer to powers authorising trustees to dispose of the trust fund, *eg* to make a distribution to a beneficiary. This must be distinguished from administrative powers allowing the trustees to manage the trust and invest the trust fund.

[323] Nolan (2009) 68 *CLJ* 293 identifies three categories of techniques to control fiduciary power. The first concerns doctrines that define and limit the scope of a power, such as construction, the requirement of good faith and the doctrine of fraud on a power, and has as a result that a purported exercise of power is void. The second category addresses the process of decision-making and includes the self-dealing rule and the *Hastings-Bass* rule. In these cases acts are voidable but not void. The third category is concerned with the degree of competence with which the power was exercised – the duty of care and skill. It constitutes an indirect control as it exposes the fiduciary to sanctions against him personally.

[324] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 925 describes that trustees must from time to time consider whether to exercise distributive or managerial discretions. They have a fiduciary duty to make informed decisions taking into account all relevant considerations, which means exercising their discretion in good faith and not passively falling in with the wishes of the settlor (as will be examined in more detail in ch 4). The exercise of the power must also be within the scope of the power and not be exercised for the trustee's own benefit and the trustees must fulfil the duty of care. If these requirements have been complied with, the exercise of discretion cannot be challenged even if a court may consider that there was a better way of exercising the power.

[325] See ch 3 para 3 1 1.

[326] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 932.

As a first step, it is necessary to look at the history of the rule and how subsequent cases have widened the application thereof.

The facts in *Hastings-Bass*[327] concerned an unauthorised exercise of a power of advancement. The power was exercised as part of a tax saving scheme, but contrary to the trustee's understanding of the law, the advancement contravened the rule against perpetuities as far as the beneficial interests in the capital were concerned (although the advancement of the interests in the income was valid). The court *a quo* decided that the exercise of the power was void and therefore the estate tax saving was not achieved.

This was reversed on appeal, where the court found that the advancement was effective to create an interest for life in the income in favour of the settlor's son, even though the exercise of the power with regard to the capital was void.[328] The Court of Appeal considered that the aim of saving estate duty would have been first and foremost in the trustee's mind, and that he would have exercised the power even if he had realised that certain indirect or contingent benefits (the advancement of the interests in capital) would not be able to take effect because they were void for perpetuity.[329]

Buckley LJ then summarised the Court's observations as follows:

> "…[W]here by the terms of a trust 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 has achieved is unauthorised by the power conferred on 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."[330]

[327] *Re Hastings-Bass (Deceased), Hastings v Inland Revenue Commissioners* [1974] 2 All ER 193.
[328] Virgo *The Principles of Equity and Trusts* 414-415.
[329] *Re Hastings-Bass (Deceased), Hastings v Inland Revenue Commissioners* [1974] 2 All ER 193 201-203, as confirmed by the Court of Appeal in *Pitt v Holt, Futter v Futter* [2011] 2 All ER 450 (combined judgment) 469.
[330] *Re Hastings-Bass (Deceased), Hastings v Inland Revenue Commissioners* [1974] 2 All ER 193 203.

As discussed below, according to the Court of Appeal in *Pitt v Holt, Futter v Futter*,[331] the above passage does not represent the *ratio decidendi* of the *Hastings-Bass*[332] decision and has in fact led to a misunderstanding of the effect of the decision.

Instead, it is suggested that the *Hastings-Bass* case turned upon whether the exercise of the power as a whole was for the benefit of the object of the power, even if certain elements thereof could not take effect because of external factors such as perpetuity.[333]

The court in *Hastings-Bass* said:

> "Had it occurred to the trustees that the ulterior trusts might all fail for perpetuity, they could not reasonably have thought that this could tip the scales in the weighing operation against the scheme. The law cannot, in our judgment, require the trustees' exercise of their discretion to be treated as a nullity on the basis of an absurd assumption that, had they realised its true legal effect, they would have reached an unreasonable conclusion as the result of the weighing operation."[334]

If it can be so regarded, the requirement that the power should be exercised for the benefit of the object is satisfied and the exercise of the power is valid, even if legally flawed. If not, the exercise of the power is outside the scope of the power (*ultra vires*) and cannot take effect. It is thus void.[335]

4 1 2 Subsequent cases and resulting perceptions surrounding the use of the rule

Although the rule was originally intended to protect beneficiaries against having to litigate against their trustees, was negatively framed and had quite a narrow field of application, it has been expanded by subsequent cases. It became very useful for trustees whose actions have led

[331] *Pitt v Holt, Futter v Futter* [2011] 2 All ER 450 (combined judgment) 468-469.
[332] *Re Hastings-Bass (Deceased), Hastings v Inland Revenue Commissioners* [1974] 2 All ER 193.
[333] *Pitt v Holt, Futter v Futter* [2011] 2 All ER 450 (combined judgment) 466-467. The question has to be objective, namely whether what was done can be regarded as beneficial to the object of the power, even if there were certain defects in the exercise of the power. In weighing up the benefits of the exercise of the power with any adverse effects it may have, the trustees can reasonably be expected to choose the option that would be most beneficial to the beneficiaries in question. It would be unreasonable to ignore the trustee's decision on the basis that, had they realised there would be some minor or indirect adverse effect in addition to achieving the purpose they had wanted (in this case a tax saving), they would not have exercised the power.
[334] *Re Hastings-Bass (Deceased), Hastings v Inland Revenue Commissioners* [1974] 2 All ER 193 202.
[335] *Pitt v Holt, Futter v Futter* [2011] 2 All ER 450 (combined judgment) 469-470, 510-511.

to unintended tax consequences, as their actions could be nullified without the need for the beneficiaries to sue them for negligence or breach of trust. It has therefore been used by trustees 'against' themselves, in circumstances where it subsequently appeared to be beneficial to the trustees (and mostly also to one or more of the beneficiaries, it must be added) to set aside one of their actions.

It is undisputed that the driving force in most of these cases was tax. Where a trustee was given incorrect tax advice and acted on it with the result that the tax objective was not achieved, such an act could be reversed using the *Hastings-Bass* rule. The same would have applied where the trustee simply never considered the tax consequences, or received correct advice that was ignored or implemented incorrectly.[336] It is not surprising that the rule became unpopular with some academics, practitioners and English judges given the relative ease with which a trustee could escape the tax consequences of his actions.[337] Furthermore, it led to the unsatisfactory position that trustees could use the rule to avoid the tax consequences of their actions while other taxpayers did not have the benefit of revisiting their decisions to the same extent.[338]

A very clear and useful exposition of the subsequent cases and the principles involved is found in the Court of Appeal's combined judgment in *Pitt v Holt, Futter v Futter*.[339]

How did this happen? More than a decade after the decision in *Hastings-Bass*,[340] the High Court in *Mettoy Pension Trustees Ltd v Evans*[341] developed and expanded the principle by holding that it was wider than mere *ultra vires* acts and included a failure to take account of relevant considerations of fact or law. It also stated the rule in positive terms rather than the original negative statement.[342] Walker J did not require a breach of trust on the part of the

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[336] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 934-935.
[337] *Breadner v Granville-Grossman* [2000] 4 All ER 705 722, where Park J commented: "It cannot be right that whenever trustees do something which they later regret and think that they ought not to have done, they can say that they never did it in the first place."; *Pitt v Holt, Futter v Futter* [2011] 2 All ER 450 (combined judgment) 510, where Longmore LJ said it was an example "of that comparatively rare instance of the law taking a seriously wrong turn, of that wrong turn being not infrequently acted on over a twenty year period but this court being able to reverse that error and put the law back on the right course."
[338] Tucker *et al Lewin on Trusts* 1351.
[339] *Pitt v Holt, Futter v Futter* [2011] 2 All ER 450 (combined judgment).
[340] *Re Hastings-Bass (Deceased), Hastings v Inland Revenue Commissioners* [1974] 2 All ER 193.
[341] *Mettoy Pension Trustees Ltd v Evans* [1991] 2 All ER 513.
[342] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 933. *Mettoy Pension Trustees Ltd v Evans* [1991] 2 All ER 513 concerned a pension fund trust and the validity of a deed made by the company and the trustees of the pension fund. It was held that the power exercised by the deed was in fact a fiduciary power,

trustee, and based the principle simply on a failure to properly take into account relevant considerations (or not take into account irrelevant considerations), however that failure may have occurred.[343]

This signalled a marked difference in approach,[344] although, ironically, the rule was not applied *in casu* as the judge found that the trustee would not have acted differently even if it had taken the relevant considerations into account.

The judgment is credited with causing judges in subsequent cases to set aside the exercise of trustee powers in a more proactive way,[345] for example in *Green v Cobham*.[346] In *Re Barr's Settlement Trusts*[347] a different approach was followed, requiring a breach of trust on the part of the trustee, and declaring that where the rule is applied, the exercise of the power is voidable, and not simply void.[348]

However, the majority of cases indicated a more lenient attitude towards trustees. *Sieff v Fox*[349] is an important example and is the case that shaped many offshore versions of the rule, as discussed below.

In this case Lloyd J identified different categories of instances where an exercise by trustees of a discretionary power may be held to be invalid. These are:

(a) a formal or procedural defect;
(b) an exercise in a way that is not authorised by the power;

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that the trustees failed to take into account considerations they ought to have taken into account, but that, in this case, they would not have acted differently had they taken those considerations into account and that therefore the deed was valid.

[343] *Mettoy Pension Trustees Ltd v Evans* [1991] 2 All ER 513 552-555. Walker J phrased the rule as follows: "…[T]he positive converse of a negative proposition enunciated by the Court of Appeal in *Re Hastings-Bass*… where a trustee acts under a discretion given to him by the terms of the trust, the court will interfere with his action if it is clear that he would not have acted as he did had he not failed to take into account considerations which he ought to have taken into account."

[344] It is described by Tucker *et al Lewin on Trusts* 1357 as a misinterpretation of the rule.

[345] Hudson *Equity and Trusts* 340.

[346] *Green v Cobham* [2002] STC 820.

[347] *Re Barr's Settlement Trusts, Abacus Trust Compay (Isle of Man) v Barr* [2003] 1 All ER 763.

[348] *Re Barr's Settlement Trusts, Abacus Trust Compay (Isle of Man) v Barr* [2003] 1 All ER 763 772-774.

[349] *Sieff v Fox* [2005] EWHC 1312 (Ch). In this case the High Court judgment was given by Lloyd J, who later sat as a judge in the Court of Appeal in the *Pitt* and *Futter* cases, and where he took a different view as to the extent of the rule. It is the formulation of the rule in this case that seems to be widely upheld by offshore jurisdictions, possibly as it is the widest formulation of all.

(c) an infringement of some general rule of law such as the rule against perpetuities; (d) an exercise for an improper purpose, including a fraud on the power; and
(e) an unawareness on the part of the trustees that they had a discretion to exercise.[350]

The judge then said that the rule in *Hastings-Bass* adds a further category, namely where the trustees have failed to have regard to some relevant consideration that they ought to have taken into account.[351]

He described the rule as follows:

> "The best formulation of the principle seems to me to be this. Where trustees act under a discretion given to them by the terms of the trust, in circumstances in which they are free to decide whether or not to exercise that discretion, but the effect of the exercise is different from that which they intended, the court will interfere with their action if it is clear that they would not have acted as they did had they not failed to take into account considerations which they ought to have taken into account, or taken into account considerations which they ought not to have taken into account."[352]

Lloyd J specifically said that he disagreed with Lightman J in the *Barr* case[353] to the extent that, for the rule to apply, there had to be a breach of duty by the trustee, and where the rule applies, the exercise of the power is voidable rather than void.[354] This set the bar for the application of the rule much lower, and meant that it had a more wide-ranging effect.

4 1 3 Judicial limitation of the rule

The recent Supreme Court decision in *Pitt v Holt, Futter v Futter*[355] (which combined two cases) has now significantly restricted a trustee's ability to rely on the rule by defining the

[350] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 933-934.
[351] *Sieff v Fox* [2005] EWHC 1312 (Ch) para 38.
[352] *Sieff v Fox* [2005] EWHC 1312 (Ch) para 119 i). The addition of "in circumstances in which they are free to decide whether or not to exercise that discretion" was intended to differentiate this type of case from those where the trustees have to act, and in which the test is said to be whether they might (not would) have acted differently.
[353] *Re Barr's Settlement Trusts, Abacus Trust Compay (Isle of Man) v Barr* [2003] 1 All ER 763.
[354] *Sieff v Fox* [2005] EWHC 1312 (Ch) para 119 iii) and iv).
[355] *Pitt v Holt, Futter v Futter* [2013] UKSC 26 (combined judgment).

field of application more narrowly.[356] In fact, the limitation was already imposed by the Court of Appeal judgment,[357] which was confirmed by the Supreme Court.

The only point on which the Supreme Court judgment differed from the Court of Appeal's, is in allowing the exercise of the power in one of the cases to be set aside on the grounds of mistake. Although this aspect will not be examined in this dissertation, it has been suggested that, in future, trustees may have greater resort to the doctrine of mistake, as the test for mistake has been slightly relaxed.

Comments were also made about the fact that the development of the rule has led to trustees asserting and relying on their own failings, or that of their advisers, in seeking to set aside their decisions. In the first instance judgment of *Futter v Futter*[358] Norris J referred to trustees acting in an "un-trustee-like fashion" and of wishing to take advantage of their failure to perform their duties in order to help beneficiaries avoid tax liabilities resulting from the trustees' actions. He described the Court of Appeal decision in *Hastings-Bass*[359] as creating a shield protecting trustees against an attack by the Inland Revenue on the validity of trustee decisions, a shield that has, however, subsequently been turned into a powerful weapon enabling trustees to attack their own flawed decisions.[360]

The principle applying where a trustee acts within the scope of a power but fails to take into account a relevant factor he should have taken into account, was restated in a more restrictive way by the Court of Appeal and subsequently confirmed by the Supreme Court.[361]

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[356] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 935; Virgo *The Principles of Equity and Trusts* 418.
[357] *Pitt v Holt, Futter v Futter* [2011] 2 All ER 450 (combined judgment).
[358] *Futter v Futter* [2010] EWHC 449 (Ch).
[359] *Re Hastings-Bass (Deceased), Hastings v Inland Revenue Commissioners* [1974] 2 All ER 193.
[360] *Futter v Futter* [2010] EWHC 449 (Ch) paras 1-2.
[361] *Pitt v Holt, Futter v Futter* [2011] 2 All ER 450 (combined judgment) 487; *Pitt v Holt, Futter v Futter* [2013] UKSC 26 (combined judgment) para 70 where the new approach was summarised as follows: "It seems to me that the principled and correct approach to these cases is that the trustees' act is not void, but that it may be voidable. It will be voidable if, and only if, it can be shown to have been done in breach of fiduciary duty on the part of the trustees. If it is voidable, then it may be capable of being set aside at the suit of a beneficiary, but this would be subject to equitable defences and to the court's discretion. The trustee's duty to take relevant matters into account is a fiduciary duty, so an act done as a result of a breach of that duty is voidable. Fiscal considerations will often be among the relevant matters that ought to be taken into account. However, if the trustees seek advice (in general or in specific terms) from apparently competent advisers as to the implications of the course they are considering taking, and follow the advice so obtained, then, in the absence of any other basis for a challenge, I would hold that the trustees are not in breach of their fiduciary duty for failure to have regard to relevant matters if the failure occurs because it turns out that the advice given to them was materially wrong.

Underhill and Hayton sets out the elements of the newly defined rule as follows:[362]

(a) a trustee acted *intra vires* but failed to take account of relevant matters when exercising a discretionary or dispositive power;
(b) the failure amounts to a breach of duty (ignoring the effect of an exoneration clause);
(c) failing to take legal advice can be a breach of duty but taking and acting on advice is not a breach of duty, even if the advice turned out to be wrong;
(d) there is no rigid causation test requiring a decision as to whether the trustee would or might have acted differently; and
(e) if the rule applies, the trustee's act would be voidable and not void.

The Supreme Court commented that the law has to balance the need to protect beneficiaries against aberrant conduct by trustees (which is the policy behind the original *Hastings-Bass* rule) against the competing interests of legal certainty and the desire not to apply too stringent a test in judging trustees' decision-making.[363] Protecting beneficiaries from having to institute proceedings against their trustees inevitably also protects those same trustees.

One may query whether this limitation of the rule will lead to increased claims against advisers for negligence. It is arguable that the benefit of advice should be available to all parties who could be prejudiced by a transaction, including beneficiaries. More pressure should be applied on advisers not to exclude liability, or at least to limit such exclusions. There is a feeling that advisers tend to charge high levels of fees commensurate with the assumption of a certain level of risk, but without a willingness to guarantee the accuracy of their advice. Legislative intervention may be required. Ironically, in the context of the *Hastings-Bass* rule, it appears that it may be better not to take advice at all as that would likely constitute breach of trust or duty, whereas following incorrect advice will not.[364]

Accordingly, in such a case I would not regard the trustees' act, done in reliance on that advice, as being vitiated by the error and therefore voidable."
[362] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 935-936.
[363] *Pitt v Holt, Futter v Futter* [2013] UKSC 26 (combined judgment) para 83.
[364] Purkis (2013) 3 *JGLR* para 38.

4 2 Jersey and other offshore jurisdictions

4 2 1 The rule in Hastings-Bass *in Jersey prior to the Supreme Court ruling*

The *Hastings-Bass* rule was confirmed to be part of the law of Jersey in a 2002 decision of the Royal Court.[365] Deputy Bailiff Birt considered various judgments of the English courts,[366] and came to the conclusion that the rule forms part of Jersey law. The court considered that the principle:

> "…is but a manifestation of the general principle that a trustee must act in good faith, responsibly and reasonably."[367]

The rule was held to be consistent with precedent and principle, Jersey law drawing substantially on English trust law principles. The court recognised that the limits of the principle still needed to be developed, so that a trustee cannot have every decision he regrets declared void, and favoured the view that the court would have to be convinced that the trustee would have acted differently, not merely that he might have acted differently, had he known the correct facts.[368]

In another Jersey case[369] that relied on the *Hastings-Bass* rule the court specifically said that there is doubt whether the principle would be invoked where *bona fide* third party purchasers for value would be prejudiced. This is an important criticism of the rule. It would lead to undesirable uncertainty in voluntary transactions and contractual dealings if transactions can be set aside because of some trustee-internal deficiency.[370] The better solution in such cases may be to let the beneficiaries sue the trustee. However, in most of the cases where the rule

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[365] *In the matter of the Green GLG Trust* [2002] JLR 571.
[366] *Re Hastings-Bass (Deceased), Hastings v Inland Revenue Commissioners* [1974] 2 All ER 193; *Mettoy Pension Trustees Ltd v Evans* [1991] 2 All ER 513; *Abacus Trust Company (Isle of Man) Ltd v NSPCC* [2001] WTLR 953; *Green v Cobham* [2002] STC 820.
[367] *In the matter of the Green GLG Trust* [2002] JLR 571 para 26.
[368] *In the matter of the Green GLG Trust* [2002] JLR 571 paras 28-29.
[369] *Seaton Trustees Limited v Morgan, in the matter of the Winton Trust* [2007] JRC 206. This case considered the acceptance of an addition of trust funds to the trust, an administrative discretion as opposed to a dispositive one. The rule was held to apply equally to administrative and dispositive discretions. An argument that successful application of the rule should render a decision voidable rather than void was also rejected, as was the idea that where incorrect tax advice has been given to trustees, they should suffer the tax consequences and pursue their remedies against the advisers. See also Brown *The Jersey Law of Trusts* 202-204.
[370] *Seaton Trustees Limited v Morgan, in the matter of the Winton Trust* [2007] JRC 206 para 12. See ch 3 para 4 3 for similar cases in South Africa, however not based on a *Hastings-Bass* type of argument.

was relied on, the transactions affected only the trustee and the beneficiaries.

The Jersey courts have generally also taken the view that fault, or a breach of duty, on the part of the trustee is not required in order to invoke the *Hastings-Bass* rule. As discussed above, the English court in *Abacus Trust Company (Isle of Man) v Barr*[371] required a breach of trust on the part of the trustee, whereas in *Sieff v Fox*[372] (and many other cases) this was not required. The Jersey courts decided to follow the latter approach, namely that a mistake on the part of the trustee is sufficient, and a breach of trust or duty is not required.[373]

A different approach was followed in *In the matter of the B Life Interest Settlement*,[374] no doubt influenced by the Court of Appeal judgment in *Pitt* and *Futter*.[375] It was submitted in the *B Life Interest Settlement* case[376] that Jersey has its own settled principles regarding *Hastings-Bass* and that the court should depart from those principles only if satisfied that they are plainly wrong. The essence of this argument was that the court had thus far focused on protecting the interests of the beneficiaries, by preventing the need for them to sue trustees or professional advisers and that changing that focus would be unfair on beneficiaries. It was thus a policy argument.

However, the Royal Court admitted that it would have followed its previous decisions was it not for the English Court of Appeal judgment in *Pitt* and *Futter*,[377] and that, in light of that decision, a departure from the line of reasoning thus far followed in the Royal Court was inevitable. The court said that if Jersey were not going to follow the new English approach, it would need to demonstrate why it was continuing to follow its historic approach.[378] At this point the appeal of the *Pitt* and *Futter* case[379] to the Supreme Court was still pending and the Royal Court said, in no uncertain terms, that it would follow that decision, whichever way it went.[380] This indicates that, although the Royal Court is not bound by decisions of English courts, apart from the Privy Council, those judgments still have a very persuasive force in

[371] *Re Barr's Settlement Trusts, Abacus Trust Compay (Isle of Man) v Barr* [2003] 1 All ER 763.
[372] *Sieff v Fox* [2005] EWHC 1312 (Ch).
[373] Brown *The Jersey Law of Trusts* 204-205.
[374] *In the matter of the B Life Interest Settlement* [2013 (1) JLR 1].
[375] *Pitt v Holt, Futter v Futter* [2011] 2 All ER 450 (combined judgment).
[376] *In the matter of the B Life Interest Settlement* [2013 (1) JLR 1] 27-28.
[377] *Pitt v Holt, Futter v Futter* [2011] 2 All ER 450 (combined judgment).
[378] *In the matter of the B Life Interest Settlement* [2013 (1) JLR 1] 29-30.
[379] *Pitt v Holt, Futter v Futter* [2011] 2 All ER 450 (combined judgment).
[380] *In the matter of the B Life Interest Settlement* [2013 (1) JLR 1] 34.

Jersey.

Aside from indicating that it would follow the Supreme Court, the Royal Court made some interesting *obiter* remarks supporting a narrower interpretation of the *Hastings-Bass* rule. These remarks include that the rule, in its wider form, encourages sloppy decision making by trustees and so runs counter to the aim of proper trust administration;[381] that the rule is only available to trustees and not to settlors or beneficiaries who partook in voluntary decisions that did not turn out as intended; that there are other remedies available to beneficiaries for breach of trust by the trustees; that if negligent advice was given it would be the trustee's duty to sue the advisers and not the beneficiaries' duty, and finally, that the Jersey law of mistake will provide equitable relief in the cases where it should.[382]

This indicates a marked departure from the approach of the Royal Court up to that point, and is all the more interesting as, subsequent to the Supreme Court decision in *Pitt* and *Futter*,[383] the legislator in Jersey did the opposite and introduced a statutory *Hastings-Bass* rule in the wide form, as set out in *Sieff v Fox*.[384] This is discussed below.

The Royal Court heard one case after the Supreme Court decision and before the coming into effect of Jersey's statutory *Hastings-Bass* rule. In this case, *In the matter of the Onorati Settlement*,[385] the beneficiaries (and significantly not the trustee) sought relief on the basis that the more stringent test, as articulated by the Court of Appeal and the Supreme Court, was satisfied. The facts were that one of the beneficiaries obtained tax advice as to an appointment to be made by the trustee, but the trustee did not ask to see this advice. This was clearly a breach of trust on the part of the trustee. Therefore, the higher threshold set by the *Pitt* and *Futter* cases[386] was reached and the Jersey court did not have to consider whether the previous, wider version of the rule would still apply in Jersey. The Royal Court did say this though:

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[381] According to Brown *The Jersey Law of Trusts* 305 there is disagreement as to whether these *obiter* remarks are always applicable. In certain cases where an application was brought on the basis of the rule, the decision-making process may have been very competent and diligent. An interpretation that the rule is only relied upon when trustees were not careful may thus be untrue.
[382] *In the matter of the B Life Interest Settlement* [2013 (1) JLR 1] 33-34.
[383] *Pitt v Holt, Futter v Futter* [2013] UKSC 26 (combined judgment).
[384] *Sieff v Fox* [2005] EWHC 1312 (Ch).
[385] *In the matter of the Onorati Settlement* [2013] (2) JLR 324
[386] *Pitt v Holt, Futter v Futter* [2013] UKSC 26 (combined judgment).

> "We propose to say nothing further on the topic, therefore, other than to say that the position remains open, although any party wishing to submit that Jersey law should continue to plough its own furrow will have to explain why the closely-reasoned judgments of Lord Walker and Lloyd, L.J. should not be applied."[387]

4 2 2 The reaction of the offshore world to Pitt v Holt *and* Re Futter[388]

The reaction of offshore jurisdictions to these judgments was eagerly awaited. Being able to rely on the wider interpretation of the rule confers, in the eyes of many offshore practitioners, a competitive edge to the relevant jurisdiction. This is a telling illustration of the importance of the trust industry in offshore jurisdictions and of different policy approaches in onshore as opposed to offshore jurisdictions. Although it is sold as a protection to settlors and beneficiaries, by saving them the cost and time investment of having to litigate against their trustees or for the trustees to litigate against their advisers, there is no doubt that the 'old' rule was very valuable for trustees and effectively protected them by eliminating unwanted litigation against them. However, this has to be balanced against the challenges posed by the current political and economic climate and the importance for offshore jurisdictions to improve how they are perceived. It is safe to say that at least some jurisdictions appear to regard the offering of additional remedies for "wrongdoing" as damaging to their reputation.[389]

4 2 2 1 Jersey

As mentioned above, Jersey pioneered the introduction of legislation to preserve the *Hastings-Bass* rule. In effect it enacted its own version of the rule and of the jurisdiction of the court based on mistake in the Trusts (Amendment No 6) (Jersey) Law 2013. The rule applies as described in *Sieff v Fox*,[390] so that the legislative provisions[391] do not require the trustee to have committed a breach of trust before the court would intervene.[392] The provisions

[387] *In the matter of the Onorati Settlement* [2013] (2) JLR 324 331.
[388] *Pitt v Holt, Futter v Futter* [2013] UKSC 26 (combined judgment).
[389] Kosky "Trustees' Taxing Mistakes – Offshore Perspectives on the Supreme Court's Decisions in *Pitt v HMRC*" *Clifford Chance Briefing Note* (accessed 09-11-2016).
[390] *Sieff v Fox* [2005] EWHC 1312 (Ch).
[391] Contained in Trusts (Jersey) Law 1984 art 47F and 47H.
[392] Trusts (Jersey) Law 1984 art 47H(4) reads: "It does not matter whether or not the circumstances set out in paragraph (3) occurred as a result of any lack of care or other fault on the part of the trustee or person exercising a power, or on the part of any person giving advice in relation to the exercise of the power."

can be invoked even if there is an alternative remedy on the basis of mistake.

This legislative confirmation[393] of a liberal application of the *Hastings-Bass* rule stands in contrast to the judicial development in England where application of the rule has been limited.

The provisions allow the court to declare the exercise of a power voidable and further to declare what the effect of the exercise of the power should be, or to declare that it is of no effect from the time of its exercise.[394] The exercise of the power is therefore not automatically void *ab initio*. Furthermore, the test of whether the trustee *would* not have exercised the power had he been aware of the true circumstances is used rather than the less stringent *might* test, referred to above in connection with the rule in England.[395] Finally, an application may be brought not only by a trustee but also by beneficiaries, enforcers, co-trustees or any other person with leave of the court.[396] This may be an attempt to indicate that the rule is not solely in the interest of trustees.

Arguments in favour of the statutory rule include the protection of trustees and, indirectly, maintaining good relationships with the beneficiaries. Regardless of how it is presented, it must have been a policy decision made in the interest of the local Jersey trust industry.[397] It is certainly not abnormal for public policy to shape the law, but in the case of offshore jurisdictions, it does sometimes appear that the policy element may be given too much weight. This is especially so in light of the *obiter* remarks of the Royal Court, in the wake of developments in England, in *In the matter of the B Life Interest Settlement*.[398]

Bearing in mind the current hostile environment within which offshore jurisdictions have to defend their every move, and the fact that the Channel Islands trust industry claims superior regulation, professional excellence and expertise, one wonders whether a different approach, sending a different signal, may not have been preferable.[399] Of course, many settlors would prefer to protect the interests of professional advisers (which is a consequence of a wide application of *Hastings-Bass* as there is no need to sue negligent advisers) above the interests

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[394] Trusts (Jersey) Law 1984 art 47H(2).
[395] Trusts (Jersey) Law 1984 art 47H(3)(b).
[396] Trusts (Jersey) Law 1984 art 47I(2).
[397] Purkis (2013) 3 *JGLR* paras 32-34.
[398] *In the matter of the B Life Interest Settlement* [2013 (1) JLR 1], as referred to above.
[399] Purkis (2013) 3 *JGLR* takes this same view.

of tax authorities. Although most reputable offshore jurisdictions, Jersey included, make much of the fact that they do not assist settlors and beneficiaries to avoid and much less to evade tax, the practical effect of the statutory rule is to allow the avoidance of an unexpected tax charge.

It is important to bear in mind though that, although the statute enables a trustee to bring an application to a Jersey court on grounds that cannot be used in England after the Supreme Court ruling, the Jersey court still has the possibility to refuse discretionary relief, for example because the claimants must have accepted that there is a tax risk, or on grounds of public policy.[400] It remains to be seen how this legislation will be applied and interpreted by the Jersey court.

4 2 2 2 Guernsey

The Guernsey courts did not have many opportunities to consider whether the *Hastings-Bass* rule formed part of Guernsey law prior to the *Pitt* and *Futter* judgment.[401] The first time an application of this type was brought before a Guernsey court was in 2009 in *Gresh v RBC Trust Company (Guernsey) Limited and H.M. Revenue & Customs*.[402] The court commented that although English decisions would form the starting point of such consideration, they would have to be considered in the light of Guernsey customary and statutory law.[403]

A recent case[404] has given the Guernsey court the opportunity to consider this rule, the application having been brought on the basis of the reformulated rule subsequent to the Supreme Court decision in *Pitt* and *Futter*.[405] Unfortunately no written judgment has been handed down, but the case has been reviewed by legal practitioners.[406]

The facts include that the trustee took no UK tax advice whatsoever. This being so, the case fell within the ambit of the newly reformulated rule, as not considering tax consequences at

[400] Purkis (2013) 3 *JGLR* para 37.
[401] *Pitt v Holt, Futter v Futter* [2011] 2 All ER 450 (combined judgment); *Pitt v Holt, Futter v Futter* [2013] UKSC 26 (combined judgment).
[402] *Gresh v RBC Trust Company (Guernsey) Limited and H.M. Revenue and Customs* 2009-10 GLR 216.
[403] Furness QC and Scott (2014) 20 *T&T* 871 878-879; *Gresh v RBC Trust Company (Guernsey) Limited and H.M. Revenue and Customs* 2009-10 GLR 216 234.
[404] *HCS Trustees Limited v Camperio Legal and Fiduciary Services Plc* (unreported).
[405] *Pitt v Holt, Futter v Futter* [2013] UKSC 26 (combined judgment).
[406] Goldstone "Analysis" *Private Client Briefing* (accessed 06-02-2017).

all (not taking advice) constitutes a breach of fiduciary duty on the part of the trustee.

Before coming to this conclusion, the court noted that the rule in *Hastings-Bass* did exist under Guernsey law, although, given the facts, the case did not require the court to consider whether the rule applied as in Jersey (not requiring a breach of trust on the part of the trustee) or whether Guernsey would follow the rule as reformulated by the English Supreme Court. It was noted, however, that although Jersey has legislated to retain the former, more widely formulated rule, Guernsey might not follow suit. Reference was made to the comments of the Jersey court in the *Onorati* judgment[407] indicating that Jersey should follow the English position, and the court felt that Guernsey would likely follow English law in this respect.

This indicates a stricter approach of the Guernsey court in setting boundaries when compared with, for example, Jersey and Bermuda.

4 2 2 3 Other offshore jurisdictions

Previous Cayman decisions[408] have followed the rule as described in *Sieff v Fox*[409] and did not require a clear breach of trust by the trustee. Although no statutory rule has been enacted, comments of the judiciary indicate that the judgments of the English Court of Appeal and Supreme Court in *Pitt* and *Futter*,[410] although being regarded as persuasive, would not restrict the Cayman courts in granting relief from unintended and unforeseen tax consequences arising from erroneous decisions of trustees.[411] Like their Jersey counterparts, the Cayman judiciary appears to consider that restricting the application of the rule and thereby reducing the remedies available to Cayman trustees would have an undesirable effect on the trust industry.[412]

Bermuda has also recently enacted a statutory *Hastings-Bass* rule in the Trustee Amendment

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[407] *In the matter of the Onorati Settlement* [2013] (2) JLR 324.
[408] *Barclays Private Bank & Trust (Cayman) Limited v Chamberlain* (2004 unreported); In *A v Rothschild Trust (Cayman) Limited* [2004-05] CILR 485, new trusts created based on incorrect tax advice caused a tax charge and the new trusts were set aside *ab initio*; *Re Ta-Ming Wang Trust* [2010] (1) CILR 541 was a case where unintended Canadian tax considerations arose because of the trustee's misunderstanding based on incorrect tax advice and where the Canadian tax authorities were given notice of the proceedings but did not oppose the proceedings.
[409] *Sieff v Fox* [2005] EWHC 1312 (Ch).
[410] *Pitt v Holt, Futter v Futter* [2013] UKSC 26 (combined judgment).
[411] Smellie (2014) 20 *T&T* 1101 1108.
[412] Furness QC and Scott (2014) 20 *T&T* 871 879-880; Smellie (2014) 20 *T&T* 1101 1109.

Act, 2014.[413] This is despite the fact that relatively few *Hastings-Bass* type applications had been heard by the Bermuda courts at the time of the Supreme Court decision in *Pitt* and *Futter*[414] and despite initial reactions in 2013 that the Bermuda courts were likely to follow the Supreme Court decision.[415]

In the matter of the F Trust and In the matter of the A Settlement[416] is the first written decision of the Supreme Court of Bermuda under the new statutory *Hastings-Bass* rule. The court granted the application in both cases so that the flawed exercises of power were set aside. The UK tax consequences in these cases were described as "financially significant factual and legal considerations".[417] The court further said that the new section 47A of the Trustee Act, 1975 gave the court an unfettered statutory discretion so that it was unnecessary to formulate a specific test for its exercise, and that the new statutory jurisdiction should be applied on the facts of each particular case.

A briefing note by a leading Bermuda law firm states that the codification of the rule demonstrates Bermuda's commitment to maintaining its position as a leading and competitive trust jurisdiction, and further that the new law offers trustees and beneficiaries of Bermuda trusts an attractive alternative to costly, time-consuming and uncertain litigation based on negligence or breach of duty claims.[418] This is certainly a noble purpose but, as discussed above, that is not the only consequence of allowing (some might say encouraging) a wide application of the rule.

4 3 South Africa

South Africa does not have a rule similar to the *Hastings-Bass* rule. Honoré[419] mentions, in the context of delegation of trustee duties and the taking of legal advice, that a trustee would not necessarily be protected from liability for breach of trust if he acted on legal advice that turned out to be wrong. Although the application of the *Hastings-Bass* rule does not require

[413] Trustee Amendment Act, 2014 inserted a new s47A into the Trustee Act, 1975.
[414] *Pitt v Holt, Futter v Futter* [2013] UKSC 26 (combined judgment).
[415] Kosky "Trustees' Taxing Mistakes – Offshore Perspectives on the Supreme Court's Decisions in *Pitt v HMRC*" *Clifford Chance Briefing Note* (accessed 09-11-2016).
[416] *In the matter of the F Trust and In the matter of the A Settlement* [2015] SC (Bda) 77 Civ.
[417] *In the matter of the F Trust and In the matter of the A Settlement* [2015] SC (Bda) 77 Civ para 22.
[418] Anderson "Statutory Hastings-Bass Enacted in Bermuda" *Conyers Dill & Pearman News & Insights* (accessed 09-11-2016).
[419] Cameron *et al Honoré's South African Law of Trusts* 326-328.

the taking of legal advice, that was often the reality. Even where a trustee delegates certain duties or takes legal advice, he retains primary responsibility towards the beneficiaries of the trust and the trustee alone can make dispositive decisions.

In *Boyce v Bloem*,[420] a case concerning a testamentary trust and the negligence of the trustees to collect money due to the trust, it was alleged that the trustee was not aware of the true position and acted on the advice of lawyers. Even if this were correct, it would not under South African law excuse the trustee for maladministration of the trust. Old authorities were referred to that require a trustee to make enquiries with the result that he cannot claim ignorance. If a trustee neglects to know what he ought to know he cannot be excused and the taking of legal advice does not protect trustees.[421] This implies that a stricter approach may have been followed in South Africa to limit the development of a rule such as the *Hastings-Bass* rule, and is in accordance with the view now held in England, namely that incorrect advice is not an excuse.

The court in *Boyce v Bloem*[422] also referred to an old Australian case[423] where it was held that a trustee might be relieved from liability for breach of trust if he has acted honestly and reasonably, but must also prove that considering all circumstances he ought fairly to be excused. The circumstances of each individual case are therefore of vital importance and simply relying on the fact that bad advice was given is not an excuse. This was held to apply equally in South Africa because a claim against a trustee in a case like the instant one is based on negligence.[424]

The above assumes that there was a breach of trust, which is now also a requirement in England for application of the *Hastings-Bass* rule.

Although there is no similar rule under South African law, there are many examples of trustees taking advantage of their own failure to comply with requirements of the trust deed in order to escape the consequences of their actions. One example would be where only two of three trustees sign binding legal documents and the trustees then assert that their action was

[420] *Boyce NO v Bloem* 1960 (3) SA 855 (T).
[421] *Boyce NO v Bloem* 1960 (3) SA 855 (T) 865.
[422] *Boyce NO v Bloem* 1960 (3) SA 855 (T).
[423] *National Trustees Co. of Australasia Ltd v General Finance Co. of Australasia Ltd* 1905 AC 373, a judgment of the Privy Council on appeal from the Supreme Court of Victoria.
[424] *Boyce NO v Bloem* 1960 (3) SA 855 (T) 865-866.

void and that they are not bound because of this breach of trust.[425] This type of argument normally arises in defence to an action against trustees by the counter party and is examined in the next chapter from the perspective of abuse of the trust and the consequences for third parties dealing with trusts. Comments have also been made by the Jersey judiciary regarding the undesirability of allowing uncertainty in dealings with third parties because of trustee-internal deficiencies, or in cases where distributions have already been made by beneficiaries (and possibly spent by them) based on incorrect documents.[426]

5 The extent of trustee exoneration clauses

5 1 England

Having considered the concept of breach of trust and when a trustee will be liable for a breach, the focus now turns to defences against such liability, and specifically clauses in trust deeds exempting a trustee from liability or limiting the extent to which a trustee is liable.

There are various defences against breach of trust. The lack of a causal link between the breach and the loss to the trust fund was already discussed. An innocent co-trustee is not vicariously liable for the actions of his co-trustee.[427] Other defences include the failure by a beneficiary to minimise his own loss and limit the trustee's liability, or where beneficiaries formally agree to release the trustee from liability. Legislation also provides a defence. Where a trustee acted honestly and reasonably and ought fairly to be excused in the circumstances, a court may relieve him from liability either wholly or partly.[428] The onus of proving that the trustee acted honestly and reasonably and ought fairly to be excused for the breach is on the trustee. It is a question of fact depending on the circumstances of each case and there is no hard and fast rule.[429]

Another method of defence, and the one that will be examined here, is exclusion or limitation of liability provided for in the trust deed itself. There is old authority for the ability of a settlor

[425] *Nieuwoudt NNO v Vrystaat Mielies (Edms) Bpk* 2004 (3) SA 486 (SCA) and *Land and Agricultural Bank of SA v Parker* 2005 (2) SA 77 (SCA) are examples of cases where the trustees alleged they were not bound to a contract because the required number of trustees were not party thereto or did not consent.
[426] See ch 3 para 4 2 1.
[427] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 1186-1187.
[428] Trustee Act 1925 s 61.
[429] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 1219-1227.

to limit the liability of his trustee, provided that the trustee had acted in good faith and that the exclusion or limitation of liability was included in the trust deed.[430] Such clauses are generally referred to as trustee exemption or trustee exoneration clauses. They curtail the consequences that would normally arise on a breach of trust and are to be distinguished from clauses that exclude or modify the underlying duty itself so that liability for breach of trust does not arise in the first place.[431]

Exoneration clauses are now standard in trust deeds governed by English law and trustees can exclude liability for everything apart from fraud or wilful wrongdoing.[432] This means that, provided that the necessary exoneration clause appears in the trust deed, a trustee need not be liable for negligence, including gross negligence. Even the new statutory duty of care in section 1 of the Trustee Act 2000 can be excluded by the trust instrument, which, some argue, has the effect of lowering the standard of care required from a trustee.[433]

Dishonest breaches of trust cannot be exempted. Dishonest breaches include fraud but also actions or omissions made in the knowledge that they are not in the best interests of the beneficiaries, or without the honest belief that they are in the best interests of the beneficiaries. It also includes the situation where a trustee recklessly does not care whether his actions or omissions are in the best interests of the beneficiaries, or where a trustee relies on the existence of an exoneration clause to justify what he is proposing to do. Finally, wilful misconduct is also a dishonest breach that cannot be excluded.[434] Negligence is not included in dishonesty.

On the other hand, one can imagine situations where a trustee acts honestly and in the best interests of the beneficiaries, but still, even deliberately, commits a breach of trust because, for example, what he is doing is against an outdated term of the trust deed. This would not be dishonest or fraudulent.[435] Whether a trustee acted fraudulently or dishonestly would therefore depend on whether the trustee purported to act in the best interests of the beneficiaries or

[430] *Wilkins v Hogg* (1861) 31 LJ Ch 41 where it was found that a clause exonerating trustees from liability for failure to perform their duties was not contrary to the idea of trusteeship.
[431] Hudson *Equity and Trusts* 365-366; Clarry (2014) 12 *TQR* 31 para 46.
[432] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 806-807.
[433] Pearce *et al The Law of Trusts and Equitable Obligations* 873.
[434] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 808; Virgo *The Principles of Equity & Trusts* 563-565; *Armitage v Nurse* (1998) Ch 241.
[435] In *Armitage v Nurse* (1998) Ch 241 251 Millet LJ repeated a well-known quote "The main duty of a trustee is to commit judicious breaches of trust."

whether he acted in his own or a third party's best interest.[436]

The leading case on this matter is the Court of Appeal decision in *Armitage v Nurse*.[437] The plaintiff was the principal beneficiary of a trust, the trustees of which committed breaches of trust in relation to the appointment of a company to farm land forming part of the trust fund, a failure to properly supervise the company's management of the land, a failure to enquire into a drastic fall in the value of the land before being sold and a failure to obtain payment of interest in respect of a loan made to the plaintiff's mother.[438] In this case the exculpation clause was drafted as follows:

> "No trustee shall be liable for any loss or damage which may happen to Paula's fund or any part thereof or the income thereof at any time or from any cause whatsoever unless such loss or damage shall be caused by his own actual fraud."[439]

Counsel for the plaintiff argued that a breach of trust committed recklessly or wilfully, such as the breach in this case, constitutes equitable fraud, even if it does not constitute actual fraud. The concept of equitable fraud is wider, referring to a misuse of a trust power but not necessarily dishonesty, and affords the court more discretion as far as remedies are concerned.[440]

Millett LJ held that the phrase "actual fraud" used in the clause quoted above means exactly that and not constructive fraud or equitable fraud. He found that the clause successfully excludes liability for breach of trust in the absence of a dishonest intention on the part of the trustee. Dishonesty or fraud requires an intention to pursue a particular course of action, either knowing or being recklessly indifferent as to whether it is contrary to the best interests of the beneficiaries. Without such an intention, there is no dishonesty and therefore no fraud.[441]

According to Millet LJ the test for dishonesty had to be a subjective one. He went on to say that the clause exempts the trustee from liability for loss or damage to the trust property:

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[436] Virgo *The Principles of Equity & Trusts* 564.
[437] *Armitage v Nurse* (1998) Ch 241.
[438] *Armitage v Nurse* (1998) Ch 241 249.
[439] *Armitage v Nurse* (1998) Ch 241 250.
[440] *Armitage v Nurse* (1998) Ch 241 250-252.
[441] *Armitage v Nurse* (1998) Ch 241 250-251.

> "…[N]o matter how indolent, imprudent, lacking in diligence, negligent or willful he may have been, so long as he has not acted dishonestly." [442]

Although this may be true on a strict interpretation of the words of the relevant clause, it seems extraordinary for a trustee, acting in a fiduciary capacity, to be held to such a low standard. This is discussed in more detail below. However, *in casu* the clause was found not be repugnant or contrary to public policy, despite academic argument to the contrary.[443]

The possibility of excluding liability for wilful default and gross negligence was also discussed. Wilful default means a deliberate breach of trust. If the trustee consciously takes the risk of loss or is recklessly indifferent about it (thereby committing a deliberate breach of trust), but he does so in good faith and in the belief that the risk should be taken in the interest of the beneficiaries (so not being dishonest), then Millet LJ held that he could still be protected by a clause that excludes liability for wilful default.[444]

As far as gross negligence is concerned, it was alleged by the plaintiff's counsel that excluding liability for gross negligence was repugnant to the concept of a trust or against public policy. Although Millett LJ agreed that there is an irreducible core of obligations owed by the trustee to the beneficiaries and that this must be enforceable by the beneficiaries against the trustee in order for a trust to exist, he did not agree that the core obligations included the duties of care and skill, prudence and diligence. The minimum duty to perform the trusts honestly and in good faith for the benefit of the beneficiaries was, in his view, sufficient.[445] This is quite a small core indeed.

He also pointed out that common law systems, as opposed to civil or mixed systems, do not distinguish between ordinary negligence and gross negligence. The difference is said to be merely one of degree.[446]

Since only negligence was alleged and not fraud, it was held that the exemption clause in this case was effective to exclude the trustees' liability for breach of trust.

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[442] *Armitage v Nurse* (1998) Ch 241 251.
[443] *Armitage v Nurse* (1998) Ch 241 253.
[444] *Armitage v Nurse* (1998) Ch 241 252.
[445] *Armitage v Nurse* (1998) Ch 241 253-254.
[446] *Armitage v Nurse* (1998) Ch 241 254.

However, Millett LJ commented *per curiam* that:

> "…it must be acknowledged that the view is widely held that these clauses have gone too far, and that trustees who charge for their services and who, as professional men, would not dream of excluding liability for ordinary professional negligence should not be able to rely on a trustee exemption clause excluding liability for gross negligence".[447]

Millet LJ referred to Jersey legislation to this effect, and said that such a change in English law would have to be brought about by Parliament and with the benefit of wide consultation with interested bodies. He therefore clearly did not feel that it was in the hands of the judiciary to make new law in this respect.[448]

There have been many judgments on the scope of trustee exemption clauses subsequent to *Armitage v Nurse*,[449] but none that changed the position fundamentally. Certain glosses have however been added, indicating that many hold the view that these clauses are too lenient towards trustees, particularly professional and paid trustees.

First, in *Bogg v Raper*,[450] which in principle approved the position in *Armitage*,[451] the trustee was sued for failing to supervise the activities of a business owned by the trust. An exoneration clause excluded his liability for any loss provided he acted in good faith. The trustee was not held liable. It was, however, held that if there were any uncertainty as to construction of such a clause, it would be construed restrictively against the trustee. It was also said that the validity of the clause (drafted by a solicitor-trustee) would depend on whether the settlor has been properly advised as to the effect of the clause.[452]

In *Wight v Olswang*,[453] the Court of Appeal similarly held that clauses exempting solicitor-trustees (who drafted the provisions) had to be interpreted restrictively. In this case there were two different exoneration clauses and it was held that, given the ambiguity, the trustee could

[447] *Armitage v Nurse* (1998) Ch 241 256.
[448] *Armitage v Nurse* (1998) Ch 241 256.
[449] *Armitage v Nurse* (1998) Ch 241.
[450] *Bogg v Raper* (1998/99) 1 ITELR 267.
[451] *Armitage v Nurse* (1998) Ch 241.
[452] Hudson *Equity and Trusts* 370; *Bogg v Raper* (1998/99) 1 ITELR 267.
[453] *Wight v Olswang (No 2)* (1999/2000) 2 ITELR 689.

not rely on either clause.[454] This may imply an attempt to mitigate an unfair advantage that professional trustees may be perceived to have in this regard.

Another important case is *Walker v Stones*,[455] where the Court of Appeal introduced an objective test for dishonesty in the case of a professional trustee. Referring to the subjective test in *Armitage*[456] of what a trustee believed to be in the interest of the beneficiaries, he disagreed with this, at least in the case of a solicitor-trustee (which may be taken as a reference to a professional trustee). In such cases the test should be qualified so that, if the trustee's so-called honest belief is so unreasonable that, objectively speaking, no reasonable trustee-solicitor could have believed that what he was doing was in the best interests of the beneficiaries, he would be regarded as having acted dishonestly. The judge accepted that the test for honesty may vary depending on the "role and calling" of the trustee. In this case, the trustees were solicitors and therefore professionals.[457]

The judge also indicated that, in his view, the fact that Millett LJ did not follow the objective test for dishonesty as set out in *Royal Brunei Airlines v Tan*,[458] did not indicate that he considered the two tests to be irreconcilable.

With regard to Millet LJ's *dictum* that a trustee is not dishonest provided that he acted in good faith and in the honest belief that it was in the best interest of the beneficiaries, the judge in *Walker v Stones*[459] made the following comment:

> "I think it most unlikely that he would have intended this *dictum* to apply in a case where a solicitor-trustee's perception of the interests of the beneficiaries was so unreasonable that no reasonable solicitor-trustee could have held such belief. Indeed in my opinion such a construction of the clause could well render it inconsistent with the

[454] Davies and Virgo *Equity & Trusts: Text, Cases, and Materials* 742; Hudson *Equity and Trusts* 370.
[455] *Walker v Stones* [2000] 4 All ER 412.
[456] *Armitage v Nurse* (1998) Ch 241.
[457] *Walker v Stones* [2000] 4 All ER 412 443-444.
[458] *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 3 All ER 97. Here the facts were that an insolvent travel agency owed money to an airline. The airline attempted to obtain a remedy from the agent's principal and shareholder. This was therefore a case of secondary or accessory liability, but the judge in *Walker v Stones* [2000] 4 All ER 412 found that the Privy Council comment applied equally to cases of primary or direct liability and to the exoneration clauses under review in that case.
[459] *Walker v Stones* [2000] 4 All ER 412.

very existence of an effective trust."[460]

Walker[461] may therefore be regarded as sending a very subtle signal that the test in *Armitage*[462] was too biased towards trustees.

The Judicial Committee of the Privy Council had the opportunity to consider the law relating to trustee exoneration clauses in *Spread Trustee Company Limited v Hutcheson*.[463] This was an appeal from the Guernsey Court of Appeal and the offshore elements thereof will be considered below. However, the Privy Council had to interpret the English law position in order to determine its effect on pre-statutory Guernsey law, and therefore the case is highly relevant from an English point of view as well.

A tight majority (three to two) held that the position is as set out in the *Armitage*[464] case, thereby endorsing the *status quo*.[465] Excluding gross negligence is not considered to be contrary to public policy.[466] There was, however, disagreement as to some of the points raised by Millet LJ. One example is the statement that English law does, in certain contexts, distinguish between ordinary negligence and gross negligence.[467]

The court considered whether Millet LJ's limitation of the irreducible core obligations to acting honestly and in good faith (and not extending it to acting without gross negligence) was correct, and made reference to the distinction he drew between the fiduciary duties of a trustee and the duty of care.[468] Under English law, the duty of care is not a fiduciary duty, unlike other jurisdictions where it is. Presumably it is the duty of care that would prevent a trustee from acting in a grossly negligent manner.[469]

The Board of the Privy Council said in no uncertain terms that, if it was desired, a public policy rule that liability for gross negligence cannot be excluded, would best be left to

[460] *Walker v Stones* [2000] 4 All ER 412 445.
[461] *Walker v Stones* [2000] 4 All ER 412.
[462] *Armitage v Nurse* (1998) Ch 241.
[463] *Spread Trustee Company Limited v Hutcheson* [2011] UKPC 13.
[464] *Armitage v Nurse* (1998) Ch 241.
[465] *Spread Trustee Company Limited v Hutcheson* [2011] UKPC 13 para 57.
[466] Pettit *Equity and the Law of Trusts* 519.
[467] *Spread Trustee Company Limited v Hutcheson* [2011] UKPC 13 paras 50-51.
[468] *Spread Trustee Company Limited v Hutcheson* [2011] UKPC 13 para 60.
[469] This may simply point to the fact that, under English law, liability for breach of fiduciary duties cannot be excluded whereas it can be excluded for non-fiduciary duties.

legislators. The court described doing so as intervening in private arrangements and affecting the freedom of trustees and settlors to arrange their relationships, something best left to legislators.[470]

There were two dissenting judgments. Lady Hale, who gave one of them, pointed out that, if the appeal succeeded, which it did, the Board would have upheld the *Armitage* decision in Guernsey law, even though the Supreme Court on an English appeal has never had an opportunity to decide whether that case was correctly decided under English law.[471] Lord Kerr, a judge from Northern Ireland, gave the other dissenting judgment and said:

> "If…the placing of reliance on a responsible person to manage property so as to promote the interests of the beneficiaries of a trust is central to the concept of trusteeship, denying trustees the opportunity to avoid liability for their gross negligence seems to be entirely in keeping with that essential aim."[472]

So much for the case law. Are trustee exoneration clauses really contrary to the irreducible core of the trust?

Although many commentators and practitioners feel that more should have been done to restrict the use of exoneration clauses, the law in England remains as set out in the *Armitage*[473] case, although in practice a higher standard of care may be required of a professional trustee.

An aptly worded clause can thus protect a trustee from liability for any breach apart from a dishonest one. This is not regarded as repugnant to the irreducible core of trusteeship and excluding liability for gross negligence is not contrary to public policy, although many would disagree and the position may in future be challenged. In *Spread*,[474] no English cases were cited that distinguished normal or ordinary negligence from gross negligence. The court, however, considered that such a distinction cannot be made and that in the modern world

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[470] *Spread Trustee Company Limited v Hutcheson* [2011] UKPC 13 para 111. Millet LJ made a similar comment in *Armitage v Nurse* (1998) Ch 241 256.
[471] *Spread Trustee Company Limited v Hutcheson* [2011] UKPC 13 para 129.
[472] *Spread Trustee Company Limited v Hutcheson* [2011] UKPC 13 para 180. See also Hudson *Equity and Trusts* 372-373, where the author agrees with this statement and describes the *Armitage* decision as an opiate on the professionalism of trustees and on their consciences.
[473] *Armitage v Nurse* (1998) Ch 241.
[474] *Spread Trustee Company Limited v Hutcheson* [2011] UKPC 13.

exemption from negligence is common both in the contractual and trust contexts.[475]

A conflict clearly exists. On the one hand there is a desire to maintain the attractiveness of the office of professional trustee by limiting liability and allowing a trustee the freedom to draft trust deeds to suit his needs. This, to some extent, assimilates the fiduciary nature of the trust relationship to a contractual relationship.[476] On the other hand there is the more traditional view of the office of trustee as someone who should exhibit the utmost good faith and be accountable for proper administration of the trust. If the standard of proper administration falls below a certain minimum, the right of beneficiaries to hold the trustee to account similarly loses meaning. [477]

The 2000 Act presented an opportunity to introduce measures to restrict the use of exemption clauses, if this was considered necessary, but this was not done.[478] There were concerns about the lack of restriction on the use of exemption clauses and the effect this would have on the protection offered to beneficiaries. As a result, the matter was referred to the Law Commission for a thorough examination. The Report entitled "Trustee Exemption Clauses" referred to an earlier consultation paper by the Trust Law Committee in 1999, which proposed that a paid trustee should not be able to rely on clauses excluding liability for negligence, at least not in circumstances where the trustee could not prove that the settlor received independent advice on the meaning of the clause.[479]

The Law Commission did recommend the adoption of a rule of practice whereby a paid trustee or trust drafter should take reasonable steps to ensure that the settlor is aware of the meaning and effect of an exoneration clause before execution of the trust deed,[480] but this is viewed by some as a "somewhat toothless proposal".[481] The Law Commission explained the difficulties of legislating against trustee exemption provisions, and also the advantage of a

[475] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 807.
[476] Hudson *Equity and Trusts* 375.
[477] Hildyard *Prudence and Vituperative Epithets* (2012) unpublished paper prepared for Chancery Bar Association Annual Conference (accessed 31-01-2017).
[478] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 809. The Trustee Act 2000 is said to have adopted a "permissive approach" to modern trusteeship by conferring wide powers on trustees and controlling their conduct through the statutory duty of care (although this can be excluded).
[479] Law Commission *Trustee Exemption Clauses* No 301 (2006) 9-10.
[480] Law Commission *Trustee Exemption Clauses* No 301 (2006) 84.
[481] Hudson *Equity and Trusts* 377.

rule of practice as an alternative, "softer" approach.[482] An analysis of the wide-ranging consultation undertaken did not clearly point in one or the other direction. The consultation indicated that a reputable trustee would usually obtain settlor consent to an exemption clause, but agreed that it is unacceptable that many settlors appear to be unaware of such a clause.[483] This undermines the settlor autonomy argument, because any exercise of autonomy works best when the settlor is well informed.

However, a statutory requirement that a trustee must disclose such a clause to the settlor prior to entering into the trust in order to be able to rely thereon was rejected.[484]

A rule of practice, which should be complied with as a matter of professional conduct, was considered a better approach to ameliorating the problem. It is stated to apply both to professionals who draft trust deeds and to paid trustees. There is no non-legislative regulation of trustees in England and no requirement for trustees to register or be licensed to act as trustee. However, the rule of practice was considered to be able to govern the majority of trustees through the adoption of the rule by regulatory bodies such as the Law Society, to which many trustees would be subject, and trust organisations such as the Society of Trust and Estate Practitioners (STEP). STEP did in fact produce a rule to this effect, but it is unclear whether any other bodies or organisations did the same. The Report also stated that voluntary compliance with the rule would assist a trustee in marketing itself, and that best practice will "seep into the consciousness of the trust industry". Given the increasing competition in this market and the importance of an untarnished reputation, it is expected that professional trustees would comply with the rule.[485]

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[482] Law Commission *Trustee Exemption Clauses* No 301 (2006) 11-13. The arguments against legislative regulation included the protection of settlor autonomy and thereby flexibility of trusts; the protection of trustees; the cost and difficulty in obtaining professional indemnity insurance; increased reluctance on the part of trustees to exercise discretionary powers; the different uses to which trusts are put, with beneficiaries of (unregulated) private family trusts being in the greatest need of protection; and that the extent of the reliance on such clauses and therefore the extent of the problem was unclear.

[483] Law Commission *Trustee Exemption Clauses* No 301 (2006) 12-14.

[484] Law Commission *Trustee Exemption Clauses* No 301 (2006) 61-67. Reasons for this included the additional time and cost for the settlor to obtain independent advice. Of course, the legislation would not have to require independent legal advice, but if trustees were not able to rely on an exemption clause if it was not brought to the settlor's attention, they would likely still insist on independent advice being obtained by the settlor. It might also be difficult to prove, many years later, that such a clause was in fact brought to the attention of the settlor prior to signing the trust deed, and in cases where trustees retired and new trustees took over, there may be uncertainty about what was done years ago.

[485] Law Commission *Trustee Exemption Clauses* No 301 (2006) 68-73, 80-81.

5 2 Offshore: Jersey and other jurisdictions

5 2 1 Jersey

The approach taken in Jersey differs from the English position as far as it concerns a trustee who acted in a grossly negligent manner. Article 30(10) of the TJL provides:

> "Nothing in the terms of a trust shall relieve, release or exonerate a trustee from liability for breach of trust arising from the trustee's own fraud, wilful misconduct or gross negligence."

When the TJL originally came into force in 1984, the relevant provision was:

> "Subject to the terms of the trust, a trustee shall not be liable…(b) for any loss to the trust property unless such loss is due to (i) his wilful default, act or concurrence, or (ii) his neglect or failure to exercise reasonable care to prevent such loss."[486]

The current article 30(10) substituted the above provision in 1989 when the TJL was first amended.[487] An explanatory note to the draft amendment confirmed that the opportunity was taken to clarify that the terms of a trust cannot relieve, release or exonerate a trustee from liability for breach of trust arising from his own fraud, wilful misconduct or gross negligence.

This indicates that the amendment did not constitute a significant change to the pre-existing law in Jersey,[488] in other words, that it was not possible to exclude liability for gross negligence under Jersey customary law either, although confirmation of the position under Jersey customary law is hard to find.

As discussed, there seems to be different opinions as to whether English law recognises the concept of gross negligence, which can be described as "a serious or flagrant degree of negligence, negligence which goes beyond ordinary negligence – something approaching

[486] The original unamended version of Trusts (Jersey) Law 1984 art 26(9).
[487] Trusts (Amendment) (Jersey) Law 1989.
[488] Clarry (2014) 12 *TQR* 31 para 15.

recklessness".[489] Liability for mere incompetence, falling short of gross negligence, can therefore lawfully be excluded by the terms of a Jersey trust deed, but nothing more.[490]

The most important Jersey case relating to the extent to which a trustee can exclude liability for breach of trust is the Jersey Court of Appeal judgment in *Midland Bank Trust Company (Jersey) Limited v Federated Pension Services*.[491] The slightly earlier case of *West v Lazard Brothers and Company (Jersey) Limited*[492] is also relevant.

Midland Bank Trust Company (Jersey) Limited v Federated Pension Services,[493] also considered earlier,[494] concerned a pension scheme set up for employees of the States of Jersey. The funds were not invested as profitably as it should have been. The trustee mistakenly believed that it did not have the power to transfer the funds to a new manager without a certain agreement in place. No advice was taken. It turned out that the agreement was not necessary and upon realising this, the trustee transferred the funds fairly quickly. However, the funds did remain on a deposit account for a period of time, during which time it was less profitable than it would have been if properly invested.

The court in the first instance judgment found that a breach of trust had been committed, but that liability of the trustee was excluded by a clause in the trust deed as the trustee did not act deliberately or in a grossly negligent manner. The appeal in 1995 concerned the validity of the exclusion clause. The court made the point that a trust deed is not a contract, and the beneficiaries, although they had no contract with the trustee, were owed fiduciary duties by the trustee that went far beyond the usual obligations found in a contract. The trustee *in casu* was a paid professional trustee holding itself out to have superior knowledge and thus the court held that a higher standard of care was expected of it. For these reasons, the court felt it had to take a very restrictive view of the trustee exoneration clause.[495]

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[489] *Midland Bank Trust Company (Jersey) Limited v Federated Pension Services Ltd* [1995] JLR 352 392-394.
[490] Brown *The Jersey Law of Trusts* 231.
[491] *Midland Bank Trust Company (Jersey) Limited v Federated Pension Services* 1995 JLR 352.
[492] *West v Lazard Brothers and Company (Jersey) Limited* [1993] JLR 165.
[493] *Midland Bank Trust Company (Jersey) Limited, Establishment Committee and Day v Federated Pension Services* 1994 JLR 276.
[494] See ch 3 para 3 2 2.
[495] *Midland Bank Trust Company (Jersey) Limited v Federated Pension Services* 1995 JLR 352 372-374, 381-385.

After a review of cases from Scotland, England, New Zealand, Australia and Canada, the court turned to Jersey law. The only Jersey case in point that was cited to the court is *West v Lazard Brothers*.[496] In this case, a clause that purported to exclude the trustee's liability in all cases except for fraud was held to be inconsistent with the TJL. The court added that it was void as being repugnant to the fundamental concept of a trust.[497] The court in *Midland Bank*[498] did not agree that a clause exempting a trustee from liability for gross negligence was void for reasons of public policy or repugnancy to the nature of a trust, despite having cited case law and authority from other jurisdictions, referred to above, that both support and contradict that view.[499]

In *Midland Bank,*[500] the court provided a summary of the principles to be applied in Jersey law. Firstly, there is no general rule under Jersey law, apart from the provisions of the TJL, that prevents a trustee from inserting provisions into a trust deed excluding liability for breach of trust, although liability for fraud cannot be excluded. This may indicate the pre-statutory position as allowing exclusion of liability for gross negligence, but is overridden, as far as the legislation is concerned, by the third point below. Secondly, the construction of such clauses must be at least as restrictive as under English law. Thirdly, such clauses are subject to the restrictions in the TJL.[501] Mention was also made of the fact that professional, paid trustees are subject to a higher standard of care, as held in *Bartlett v Barclays Bank Trust Company Limited*.[502] One could argue that article 21(1)(a)(iii) of the TJL confirms this by referring to the ability and skill of the particular trustee.

The court did not have to decide whether the tests for wilful misconduct or recklessness were satisfied *in casu*, but did find that the trustee was guilty of gross negligence, for which it ought to be liable. Thus the judgment of the court *a quo* was reversed and the trustee was held to be liable under the terms of the trust as it was not protected by the exoneration clause. Gross negligence was held, contrary to what the court *a quo* said, not to require a certain *mens rea*, intentional disregard of danger or recklessness. It simply means serious, extreme or

[496] *West v Lazard Brothers and Company (Jersey) Limited* [1993] JLR 165.
[497] *West v Lazard Brothers and Company (Jersey) Limited* [1993] JLR 165 286-292.
[498] *Midland Bank Trust Company (Jersey) Limited v Federated Pension Services* 1995 JLR 352.
[499] *Midland Bank Trust Company (Jersey) Limited v Federated Pension Services* 1995 JLR 352 374-380.
[500] *Midland Bank Trust Company (Jersey) Limited v Federated Pension Services* 1995 JLR 352.
[501] *Midland Bank Trust Company (Jersey) Limited v Federated Pension Services* 1995 JLR 352 381.
[502] *Bartlett v Barclays Bank Trust Co Ltd* [1980] 1 All ER 139 152.

flagrant negligence, a very marked departure from the standards of responsible and competent people.[503]

5 2 2 Guernsey

By virtue of article 39(7) and (8) of the Trusts (Guernsey) Law 2007 (TGL), a trustee cannot be excused for a breach of trust caused by his own fraud, wilful misconduct or gross negligence. The wording is very similar to that of the TJL. Similar to the position in Jersey, when the TGL first came into force in 1989, gross negligence was not mentioned, only fraud and wilful misconduct. In 1990, the words "or gross negligence" were added.[504]

The question of pre-TGL law in Guernsey came to the fore in *Spread Trustee Company Limited v Hutcheson*,[505] a Guernsey case that went to the Judicial Committee of the Privy Council, also discussed above in the context of English law.

Although prior to 1989 there were no decisions of a Guernsey court dealing with this issue, the Board held that it was accepted that liability for fraud or wilful misconduct could not be excluded, but that liability for negligence could lawfully be excluded. The question was whether it was also lawful in the case of gross negligence.[506]

The Board looked at the background to the coming into force of the TGL, namely a desire to confirm the validity of trusts in Guernsey and to dispel any uncertainty that may exist in relation to trusts in Guernsey (in other words, to state the law as it stood), and at the wide consultation process that preceded this.[507] The Board held that the duty of a Guernsey trustee to act *en bon père de famille*[508] was to be assimilated with a duty to act as a prudent man of business. That duty is to act as a reasonable and prudent trustee would act, with reasonable care and skill, and in the case of a professional trustee a particular type of care and skill is required.[509]

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[503] *Midland Bank Trust Company (Jersey) Limited v Federated Pension Services* 1995 JLR 352 391-395.
[504] Trusts (Amendment) (Guernsey) Law 1990 s 1(f).
[505] *Spread Trustee Company Limited v Hutcheson* [2011] UKPC 13
[506] *Spread Trustee Company Limited v Hutcheson* [2011] UKPC 13 para 12.
[507] *Spread Trustee Company Limited v Hutcheson* [2011] UKPC 13 paras 14-16.
[508] See ch 3 para 2 2 1.
[509] *Spread Trustee Company Limited v Hutcheson* [2011] UKPC 13 para 20.

The Board did not accept the argument that the omission of the words "or gross negligence" from the original TGL was a mistake. In deciding this point, the Board looked at the surrounding facts at the time of the amendment in 1990. The Trusts (Amendment) (Jersey) Law 1989 was passed only 11 months after the original TGL, and the 1990 amendment of the TGL followed quickly on the heels of the Jersey amendment in 1989. The Board concluded that the 1990 amendment was a result of the amendments made in Jersey in 1989. Furthermore, if the omission of gross negligence from the original TGL was not a mistake, it must be regarded that the original provision (allowing exclusion of liability for negligence including gross negligence) stated the position under Guernsey customary law prior to the coming into force of the TGL.[510]

Lord Kerr, the Northern Irish judge who wrote one of the dissenting judgments, felt that the fundamental obligation of a trustee under Guernsey law to act *en bon père de famille* was incompatible with exempting a trustee from gross negligence in the administration of a trust.[511]

Despite the finding in the *Spread* case[512] with regard to the customary law position, it is undisputed that Guernsey decided, shortly after the coming into force of the TGL, that the position it wanted to take as a jurisdiction is that a trustee cannot exclude liability for breach of trust which results from gross negligence, and this has been the Guernsey position ever since.

A recent Guernsey case concerning gross negligence and exoneration clauses is *Jefcoate v Spread Trustee Company Limited*.[513] The trustee sold assets at an undervalue, causing a loss of millions of pounds. It was alleged that the sale was made in breach of the trustee's fiduciary duties and amounted to gross negligence, as the trustee failed to take the proper steps to ascertain the true value of the assets and safeguard the interests of the beneficiaries. The trustee therefore did not act like a *bon père de famille*. The trustee claimed that it did not act fraudulently or in a grossly negligent manner and that it was protected by an exoneration clause. The court found that the trustee failed to carry out the duties of skill and care, but that there was no fraud, dishonesty or deliberate breach of duty. However, in the circumstances of

[510] *Spread Trustee Company Limited v Hutcheson* [2011] UKPC 13 paras 21-34.
[511] *Spread Trustee Company Limited v Hutcheson* [2011] UKPC 13 para 177.
[512] *Spread Trustee Company Limited v Hutcheson* [2011] UKPC 13.
[513] *Jefcoate v Spread Trustee Company Limited* GRC Judgment 42/2014.

the case, the failure to carry out the duties of skill and care was so serious as to amount to gross negligence and therefore the trustee could not rely on the exoneration clause or any other relief. The trustee was held liable for its gross negligence.

5 2 3 Other offshore jurisdictions

The law in Bermuda is that a trustee is liable for deliberate, reckless or negligent breaches of an equitable duty (although no definition is given in the legislation of the phrase equitable duty) and such liability cannot be excluded.[514] This means that a trustee cannot escape liability for gross negligence, and possibly not for ordinary negligence either.

In the Cayman Islands, the position is that only liability for wilful default (in England known as a deliberate breach of trust) cannot be excluded, indicating, it seems, that liability for gross negligence can be excluded.[515]

5 3 South Africa

Section 9(2) of the TPCA stipulates the following:

> "Any provision contained in a trust instrument shall be void in so far as it would have the effect of exempting a trustee from or indemnifying him against liability for breach of trust where he fails to show the degree of care, diligence and skill required in subsection (1)."[516]

This would militate even against a clause exonerating a trustee from liability for ordinary negligence.[517]

Uncertainty existed with regard to whether section 9(2) applied to trusts already in existence at the date the TPCA came into force, namely 31 March 1989. It was previously thought that it would only apply to trust deeds that took or take effect on or after this date.[518]

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[514] Trustee Act, 1975 s 22(1).
[515] Trusts Law (2011 Revision) s 47.
[516] Trust Property Control Act 57 of 1988 s 9(1) provides that "[a] trustee shall in the performance of his duties and the execution of his powers act with the care, diligence and skill which can reasonably be expected of a person who manages the affairs of another.".
[517] Du Toit *South African Trust Law: Principles and Practice* 105.

The current view is that, except in cases of a breach or omission that took place before 31 March 1989, section 9(2) applies to exemptions and indemnities in force at that date. Thus, the protection of a trustee who committed a breach of trust prior to this date is not affected, but provisions contrary to section 9(2) that were in existence when the TPCA came into force are invalidated by virtue of section 9(2).[519]

The common law position, prior to the coming into force of the TPCA, was uncertain. It would appear that it was possible to exclude liability for ordinary negligence or dubious errors of judgment by a trustee, but not for intentional wrongdoing (*dolus*). Exemption clauses were indeed used in practice prior to the coming into force of the TPCA.[520]

It appears that such clauses were also considered ineffectual with regard to gross negligence (*culpa lata*), because it was thought that different considerations should apply to trusts than to contracts.[521] Some argue that a party to a contract can validly exempt himself from gross negligence[522] and, therefore, given that under South African law the trust deed of an *inter vivos* trust is seen as a contract between the settlor and the trustee, a settlor can decide on the ambit of exemption offered to the trustee.

Although this is a rather controversial argument in conflict with the TPCA, it follows that there would be no public policy consideration against exemption clauses in trust deeds extending to gross negligence, as long as there was no dishonesty, fraud or recklessness on the part of the trustee.[523] This appears similar to the position under English law, where liability for dishonesty or fraud cannot be excluded. Although of course the trust is not considered a contract under English law, it is acknowledged that in the case of an express *inter vivos* trust, the terms are mostly agreed between the settlor and the trustee.

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[518] Cameron *et al Honoré's South African Law of Trusts* 369, where reference is made to the fourth edition of the book.
[519] Cameron *et al Honoré's South African Law of Trusts* 370.
[520] See *Coetzee v Peet Smith Trust* 2003 (5) SA 674 (T) 677, where a trust, created shortly before the coming into force of the TPCA, excluded liability save in cases of dishonesty or gross negligence.
[521] *Government of the RSA v Fibre Spinners and Weavers (Pty) Ltd* 1978 (2) SA 794 (A) 806-807.
[522] *Sasfin v Beukes* 1989 (1) SA 1 (A) 15.
[523] Cameron et al *Honoré* 371.

Honoré's view is that section 9(2) should not rule out exemption for negligence short of wilful wrongdoing as this may discourage potential trustees, especially lay persons, who may not be able to obtain insurance easily or inexpensively, from taking up the office of trustee.[524] Wunsh shares this concern. In an article[525] published shortly after the coming into force of the TPCA, he points out that trustees who accepted trusteeship before section 9(2) of the TPCA became effective, may well have done so on the basis that an exemption clause in the trust deed protected them from claims based on negligence. Such clauses would now be ineffective and in that sense the law operates retrospectively.

Furthermore, a trustee who is liable for negligence would require more substantial remuneration than was generally the case, at least with individual trustees, in South Africa, and the possibility of being exposed to vexatious claims for alleged negligence may prevent many people from taking up trusteeship in the first place. Finally, he points out that settlors and testators should be free to determine whether the trustees they appoint should be liable for negligence or not.[526]

Wunsh agrees, however, that invalidating an exemption from liability for gross negligence may be appropriate, and states that there is no doubt that liability for fraud or other intentional wrongdoing cannot be excluded.[527] His argument is therefore against liability for negligence. Such a level of liability does indeed set a high standard compared to other jurisdictions and may have other unintended consequences, as pointed out by Honoré.[528]

However, in practice the position is as set out by section 9(2) of the TPCA so that any clause exempting a trustee from liability (for breach of trust) would be void. The only protection against this would be taking out insurance against the trustee's negligence or default.[529] This certainly seems to be a stricter view than that taken in England where liability for gross

[524] Cameron et al *Honoré* 371.
[525] Wunsh (1988) *De Rebus* 547.
[526] Wunsh (1988) *De Rebus* 547 550. Similar concerns have been raised in England in the context of the duty of care and in support of allowing the exclusion of liability for gross negligence. See ch 3 para 5 1.
[527] Wunsh (1988) *De Rebus* 547 550.
[528] Cameron *et al Honoré's South African Law of Trusts* 371.
[529] Du Toit *South African Trust Law: Principles and Practice* 106 mentions that the Trust Property Control Act 57 of 1988 s 9(2) would not invalidate such insurance as it does not originate from a provision in the trust deed. However, query whether it would invalidate a provision in the trust deed in terms of which insurance premiums are to be paid out of the trust fund.

negligence can be excluded and even stricter than Jersey and Guernsey where liability for ordinary negligence (although not gross negligence) can be excluded.

5 4 Conclusion and comparison

There appears to be two camps in the argument regarding trustee exoneration clauses. On the one hand there are those, who shall be referred to as the traditionalists, who believe that a trustee, as a fiduciary, is subject to onerous obligations towards the beneficiaries and should not be able to escape liability for gross negligence, or, as in South Africa, not even for ordinary negligence. The trustee's main duty is to act in the best interest of the beneficiaries and if he does not take scrupulous care, he will be held liable for any loss suffered.

On the other hand are the more liberal modernists, who focus on the current financial and socio-economic environment in which trustees operate. Trustees are able to invest in a wide range of complex assets and beneficiaries expect returns in line with what they could have made on their personal assets. This camp argues that if a trustee was subject to such onerous duties and standards of behaviour and had no way of protecting himself against liability (particularly liability for gross negligence), the office of trustee would become unenviable indeed.

It is certainly true that a more litigious society, the perils of complex investments, volatile financial markets, and a wave of regulatory requirements are making life increasingly difficult for trustees, whether corporate or individual, offering them opportunities for wrongdoing whichever way they turn.

These two camps would have fairly divergent views of the irreducible core of the trust as referred to in *Armitage v Nurse*.[530] *In casu* it was held that the irreducible core obligations owed by trustees to beneficiaries do not include the duty of care, skill, prudence and diligence. This sets the bar very low, especially given the provenance of the trust as an institution and the fiduciary position of trustees.

[530] *Armitage v Nurse* (1998) Ch 241.

Changing political, social, economic and financial circumstances have shaped the trust into what it is today, as opposed to what it was a few centuries, or even just a hundred years, ago. Perhaps it is exactly the flexibility of the trust concept that has led to it being used for purposes it was never intended for and to the current tension between regarding the trust as a bundle of rights and obligations and regarding it as a commercial investment vehicle.

The following chapter examines the role of settlors exercising excessive control over the trust and the property held on the terms thereof. While control was traditionally the domain of the trustee on the basis that there should be a separation between ownership and control of the assets and the enjoyment thereof, the changes referred to above have led to increased involvement by settlors. The relationship between this development and the liability of trustees, specifically the level of liability trustees are willing to accept in such cases, will form part of the discussion in chapter 5.

CHAPTER 4

EXCESSIVE SETTLOR CONTROL: INVALIDITY, SHAM AND GOING BEHIND THE TRUST FORM

1 Introduction

1 1 Context and research theme

This chapter examines the phenomenon of settlor control over a trust and the consequences of excessive control. Excessive control can affect validly constituted trusts but can also, in certain circumstances, lead to the invalidity of a trust. A situation where a settlor exercises excessive control over a valid trust will be described in this chapter as an abuse of trust, although there is a range of factual scenarios that can lead to a finding that a trust has been abused, just as different circumstances can lead to invalidity of a trust. However, for the purposes of a clear comparative study, this chapter focuses only on control by the settlor (although he may in certain circumstances also wear the hat of a co-trustee.)

It is important to note at the outset that the question of invalidity of a trust (including sham trusts) should be differentiated from that of abuse of the trust. Generally speaking, where the settlor lacks the necessary intention to create a valid trust (other than a bare trust), no valid trust will come into existence. If the settlor creates the impression of setting up a trust but in reality intends to create a different relationship, and if the trustee shares this intention, the trust deed will be a simulation or sham, and a valid trust will not be created either.[1]

On the other hand, where a trust was validly constituted, but due to a shortcoming in the management of the trust and its assets, the protection offered by the trust may be lost and the ordinary consequences of the trust may be disregarded. This is what is referred to as an abuse of the trust, or a debasement of the trust, and the remedy as going behind the trust form or piercing or piercing or lifting the veneer of the trust. This means that there has to be a valid

[1] This chapter does not deal with instances where trusts or transfer into trusts are voidable, by virtue of statutory provisions, because it unfairly prejudices another party. This can be done under insolvency or matrimonial legislation, and such cases often feature a settlor wishing to retain control of trust assets. See in this regard Pettit *Equity and the Law of Trusts* 237-242.

trust to start with, as there is otherwise nothing to go behind.[2] Going behind the trust form has also been described in South Africa as ignoring the separation between the trustee's estate and that of the trust or relaxing the general principles of South African trust law.[3] Conflicting judgments in the South African context raise questions about the circumstances under which a court will go behind a trust and what the effect thereof will be.[4]

Apart from the theoretical differences between an invalid trust and a sham trust and the abuse of a valid trust, there is also a difference in the consequences – what happens to the trust assets on a successful claim of sham or invalidity as opposed to going behind the trust form. Generally speaking, if a valid trust does not come into existence, the settlor would be regarded as not having divested himself of the ownership of the trust assets and will remain the owner. An abuse of the trust, on the other hand, if it leads to a court going behind the trust or lifting the veneer of the trust, could mean that the assets are distributed to a spouse or creditor or made available to tax authorities. The court will take into account all relevant facts and circumstances and weigh up competing interests. In such a case, the purpose of trust is not fulfilled, but neither does the settlor get the assets back.[5] This equitable approach shows flexibility and pragmatism – two trademarks of the development of the trust in the first place.

This chapter focuses on the circumstances where excessive control may be found to exist. As part of this study, the theoretical basis for a successful claim of sham, invalidity or abuse of trust due to excessive settlor control will be examined. Where the controlling settlor is also a beneficiary, it can be explained as the result of a lack of separation between control and enjoyment. However, where the controlling settlor is not a beneficiary, this analysis is not satisfactory. Other explanations may be a breach of trust or a lack of independence on the part of the trustee, or a breach of the separation between the trust estate and the trustee's private estate.

The issue is approached from different angles in different jurisdictions, mainly because of the variety of roles a settlor can typically play in such jurisdictions, such as co-trustee and

[2] De Waal (2012) 76 *RabelsZ* 1078 1085-1086 prefers to refer to an abuse of the trust and going behind the trust as the remedy. Van der Linde (2012) 75 *THRHR* 371 373, 376-377 refers to the debasement of the core idea of the trust and is of the view that describing the remedy as piercing the veneer of the trust is unproblematic as long as it is kept in mind that the trust is not a separate person or entity.
[3] Shipley (2016) 3 *SA Merc LJ* 508 509.
[4] Shipley (2016) 3 *SA Merc LJ* 508 510.
[5] De Waal (2012) 76 *RabelsZ* 1078 1096-1097.

protector.[6] However, the substantive issue remains the same: can a valid trust exist if someone who is not an independent trustee, and in particular if it is the person who contributed the assets to the trust in the first place, exercises substantial control over the trust? What is required for the settlor to divest himself of the equitable interest in the trust property or, in South African terms, what is required to constitute a separate trust estate? If a valid trust comes into existence, how extensive can the control over the trust and its assets be without affecting the protection offered by the trust and altering the consequences that normally flow from a trust?

Once again, the essential characteristics and requirements of a trust referred to throughout this dissertation – the core values – are highly relevant and will assist in the examination of these issues. These core values involve the following:

(a) the advantages of analysing a trust from the perspective of obligations rather than property;
(b) there is an irreducible core of duties that must be present in order to have a valid trust;
(c) the trustee must be accountable to the beneficiaries;
(d) the trustee has an overriding fiduciary duty to act in the best interests of the beneficiaries;
(e) the importance of separation between control and enjoyment of trust property; and
(f) the separation of the trust assets from the trustee's personal estate.[7]

1 2 Practical relevance

Given the wide variety of uses to which the trust is put, and the global prevalence of this centuries old device, a study of excessive settlor control, when this leads to an invalid trust or an abuse of the trust, is highly relevant. The use (and abuse) of trusts has never been under more scrutiny than at present. This includes scrutiny by national tax authorities who seek to expand their tax base by clamping down on the advantages offered by trusts, but also by various supra-national bodies seeking to increase transparency in an attempt to prevent (or at

[6] In South African case law dealing with abuse of the trust form, trusts are sometimes referred to as the alter ego of the trustee, whereas in England such trusts are often referred to as the alter ego of the settlor. At first glance, this may seem to indicate different issues, but the reason is simply that the settlor is often a co-trustee in the South African context, but less so in the English and offshore context.
[7] See ch 2 para 5; ch 3 para 1.

least reduce) tax avoidance, money laundering and terrorist financing. This was discussed in chapter 1.[8]

Disrespect for the accepted boundaries of trust law eases the task of a party seeking access to assets held in a trust. In the examples mentioned above, that is, of course, not a bad thing.

For many years, however, trusts have been used all over the world for perfectly legitimate reasons such as succession planning, protecting wealthy families from the risk of kidnappings and state expropriation, the continuous management of family business, ring-fencing assets for different family members and looking after wealth for persons who are not able to do so themselves because of some incapacity, be it age or mental incapacity.

Typically, in these types of scenarios, there is no doubt in anyone's mind that the overriding duty of the trustee is to look after the trust property for the benefit of the beneficiaries. The settlor may or may not retain some involvement or influence, but his intention, generally speaking, is that after his death the trust will continue to be run as it was during his lifetime and that the trustee should continue to look after the beneficiaries' interests.

If, on the other hand, the settlor's main objective is to use the trust as a vehicle for his personal investments or businesses, and/or to protect his assets from a creditor or a divorcing spouse, he will often have different expectations of his role in the management of the trust and of the trustee's duty towards the beneficiaries. The position of the beneficiaries of such a trust may indeed be precarious. This is explained further below.[9]

Certain objectives, especially asset or divorce protection and tax relief, require the settlor to step back and cease control of the trust assets even more than others. The protection offered by a trust is generally much stronger if the settlor has very limited powers. However, many settlors wish to have the benefits of a trust without sacrificing control over the trust assets.

Examples of where a finding of an invalid trust or abuse of trust due to excessive settlor control may be relevant include:

[8] See ch 1 para 2 2 2.
[9] See ch 4 paras 3 1, 3 2 5.

(a) a tax authority claiming that trust assets in fact belong to the settlor, who treated the assets as his own, and not to the trustee, resulting in the assets forming part of the settlor's estate for tax purposes;

(b) a claim for redistribution of assets on divorce where one party to the divorce is either a settlor, beneficiary or trustee of a trust and can be shown to have a right to the trust assets (or own the assets beneficially) or who exercises excessive control over the assets or the trustee;[10]

(c) a creditor obtaining judgment against a debtor who claims not to beneficially own any assets as he gave them away to a trustee, but who continues to control the assets as if he is the legal owner thereof; and

(d) aggrieved beneficiaries claiming against a trustee who made investments at the direction of the settlor, without exercising his own discretion and judgment, which resulted in a loss to the trust fund.

Practical examples of these types of scenarios will be evident in the case law review later in this chapter.[11]

1 3 Structure of the chapter and content of final chapter

As a first step, a brief summary will be made across the jurisdictions under review of the traditional role of the settlor and the requirement for certainty of intention on the settlor's part. As part of this, the circumstances in which a trust will be considered a sham will also be explained.

Thereafter, the increased demand for control by settlors as well as the reasons therefor will be discussed. This is followed by an explanation of various methods available to settlors who

[10] Divorce courts in England seem to have a slightly different approach in that trust assets may be taken into account even when no control as such has been found, but it is clear that the trustee would follow the settlor's/beneficiary's wishes with regard to distributions. A distinction should, however, be made between "judicial encouragement" to trustees and "undue pressure" being exercised on them to make assets available.
[11] See ch 4 para 4.

wish to retain control, ranging from a degree of influence over investments to total control of the assets.

Logically, the important question that follows is how much control a settlor can retain without invalidating the trust, or otherwise jeopardising the effectiveness thereof. In this part of the chapter, case law and academic commentary from England, offshore jurisdictions and South Africa will be examined and an attempt will be made to distill common principles therefrom.

The question of whether the boundaries of the traditional trust are being pushed too far will also be examined, both in chapters 4 and 5. There are indications that the trust is changing from a relationship based on loyalty and trust – in which the care exercised by the trustee is of utmost importance in the furtherance of the beneficiaries' interests – into a vehicle for investment, ideally controlled, at least to some extent, by the settlor, and in which the trustee wishes to limit his liability as far as possible. The traditional common law trust is not necessarily the most suitable institution to achieve this, but is easily created and to a large degree unregulated, making it susceptible to abuse.

In chapter 5, a comparison will be drawn between the position in South Africa and the relevant foreign jurisdictions with a view to ascertaining whether any of the foreign developments in the field of settlor control and trustee liability can aid the further development of South African trust law.

2 Traditional role of the settlor and requirement of certainty of intention

2 1 Role of the settlor where a valid trust was created

2 1 1 England

The English concept of legal and equitable interests in property entails that equitable proprietary rights in property must be created specifically, for example by the creation of an express *inter vivos* trust. Once an equitable interest in property has been created, the same person cannot be the legal and equitable owner of the property.[12]

[12] See ch 2 para 2 4 3.

The settlor, having transferred the assets in question to another person as trustee, has disposed of his legal and equitable interest in the property. To the extent that he is not a beneficiary and did not reserve any powers to himself under the terms of the trust deed, he falls out of the picture at this point.[13] He can merely expect that the trustee will consider any wishes he communicates to the trustee.[14]

The settlor of an English law trust can reserve certain powers to himself, including the power to revoke the transfer of assets to the trust[15] and the power to appoint new trustees, and may even appoint himself as investment manager to the trust. If he wishes to retain any powers over the assets he has given away, he needs to provide for that in the trust deed.[16]

However, in most cases, reserving wide powers to the settlor would defeat the objective of creating a trust in the first place.[17] If it can be demonstrated that the trust assets did not in reality leave the settlor's sphere of wealth or influence, that he did not create an equitable interest in the property and divested himself of that interest, the protection offered by a trust (tax relief, asset protection, succession planning and so forth) would be lost. In any event, it is clear that English law does not know specific reserved powers legislation of the kind found in most offshore jurisdictions.[18] If the settlor does not part with the beneficial interest in the trust property, the trust is likely to be regarded as a bare trust so that the assets would remain part of the settlor's estate, including, for example, for tax or creditor purposes.[19]

[13] *Re Astor's Settlement Trusts, Astor v Scholfield* [1952] 1 All ER 1067; see also ch 2 para 2 6 4.
[14] Russen (2013) 20 *Journal of International Tax, Trust and Corporate Planning* 239 242.
[15] The power of revocation has to be an express term of the trust deed. It does not derive from the settlor's position as the person who transferred the assets to the trustee. In fact, once he has given the trust assets to the trustee, the settlor typically has no say over the way the trust is administered.
[16] Expressly reserving such powers in the trust deed is preferable to the situation where the trust deed is silent on this point, but the settlor still exercises certain powers. This may invite an allegation that the trust relationship is not what the trust deed suggests it to be, possibly leading to an argument of sham, discussed below.
[17] Thomas and Hayton in *The International Trust* 597.
[18] See ch 2 para 2 6 4.
[19] Hudson *Equity and Trusts* 214, 924; Penner *The Law of Trusts* 25-26; Tey (2009) 21 *SAcLJ* 517 518-519, 524-527. This was also illustrated in the recent High Court judgment *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch).

2 1 2 Offshore: Jersey

Jersey law recognises dual ownership of movable assets although not of immovable Jersey property.[20] Jersey statute specifically states that the trustee is the owner of the trust property, but not in his own right.[21] The position is therefore substantially similar to the English position.

An old rule of Jersey customary law known as *donner et retenir ne vaut (rien)* provided that a settlor cannot give away property and at the same time retain it. A situation where the settlor retains the power to dispose freely of the property he transferred to the trustee, or where he remains in possession of it, would have fallen foul of this rule and the disposition of property would have been void.[22] The Trusts (Jersey) Law 1984 (TJL) now provides, pursuant to a 1989 amendment,[23] that this rule does not apply to questions regarding the validity, effect or administration of a trust or the transfer of assets to a trust.[24] The TJL also provides that a settlor may be a beneficiary of a trust of which he is the settlor.[25]

Furthermore, although it was always possible under the TJL for the settlor to revoke a trust, in 2006 specific legislation was enacted allowing a settlor to reserve to himself extensive powers over the trust and its assets.[26] This is examined in more detail below. The path that Jersey and other offshore jurisdictions have followed with regard to increasing settlor powers is clearly geared towards attracting business to their vital financial service industries and plays neatly into the increased demand for settlor control discussed below.[27]

2 1 3 South Africa

South African law does not recognise the concept of dual ownership of property. In English law, conferring on beneficiaries an equitable interest in property is intended to protect and

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[20] See ch 2 para 3 3 2.
[21] Trusts (Jersey) Law 1984 art 2.
[22] Brown *The Jersey Law of Trusts* 125-126; *Abdel Rahman v Chase Bank (CI) Trust Company Limited and Others* [1991] JLR 103.
[23] Trusts (Amendment) (Jersey) Law 1989.
[24] Trusts (Jersey) Law 1984 art 9(5); see ch 2 para 3 5 4.
[25] Trusts (Jersey) Law 1984 art 10(12).
[26] Trusts (Amendment No 4) (Jersey) Law 2006; see ch 2 para 3 5 4.
[27] Hudson *Equity and Trusts* 918-920; see also ch 4 para 3 1.

enhance their position and interest *vis à vis* the trust property.[28] Not recognising split ownership does not mean that South African law does not offer protection to trust beneficiaries.

Protection for the beneficiaries flows, as examined in chapter 3, from the fiduciary position and duties of a trustee (including the duty to take possession and ownership of the trust property),[29] the separation of the trust estate from the trustee's personal estate, and the principle of separation of control and enjoyment of trust assets.[30] This principle has been held to be the essence of the trust under South African law. Although it does not prevent a settlor from being a beneficiary (as long as he is not the sole beneficiary and also the sole trustee), there should be a functional separation between the control over the trust property and the enjoyment thereof. [31]

South African law allows a settlor to vary or revoke a trust during his lifetime, unless the trust deed provides otherwise. The power to vary the trust can also be given to the trustee and limitations can be placed thereon. South African trust law, unlike its English or Jersey counterparts, requires the trustee to consent to a revocation or variation of the trust by the settlor. This is the result of how South African law views *inter vivos* trust creation, namely that it is a contract for the benefit of a third party.[32]

Moreover, revocation and variation are allowed only insofar as beneficiaries have not yet accepted benefit under the trust, unless they consent thereto.[33] Thus, the power of the settlor to revoke the trust is much curtailed in comparison to the position under English or Jersey law. South African law also does not specifically provide for the reservation of investment and other powers to a settlor in the way that offshore trust laws frequently do.

The reality is, however, that many settlors of South African law trusts act as co-trustees (or even sole trustees). This is particularly true of closely-knit family trusts, where the settlor and/or the settlor's spouse and issue are the principal beneficiaries under the trust. This, of

[28] See ch 2 para 2 4 2.
[29] Cameron *et al Honoré's South African Law of Trusts* 270-276. The *bewind* trust, where the trustee does not own the trust property, is not relevant here.
[30] See ch 2 paras 4 3 1 1, 4 3 1 2.
[31] See ch 2 para 4 3 1 2.
[32] See ch 2 para 4 3 2 1.
[33] Cameron *et al Honoré's South African Law of Trusts* 492-497; *Crookes NO v Watson* 1956 (1) SA 277 (AD).

course, offers an alternative way of exercising control over the trust assets – in the settlor's capacity as co-trustee. Clearly, this has consequences for the independence of the body of trustees. This is examined further below.

2 2 Valid trusts, invalid trusts and sham trusts

Chapter 2 also highlighted the need for certainty of intention on the part of the settlor. In order to establish a valid trust, it has to be clear (amongst other things) that the owner of the property had the intention to subject the property to a trust obligation – in other words, that he intended to create a trust and not another type of legal relationship or entity.[34] If the settlor and trustee both lacked the intention to create a trust, despite the appearance of the documentation, the trust would be a sham and therefore invalid.[35] This could be the case, for example, if both parties intended that the settlor rather than the trustee will control the trust assets, but the trust deed purports to create a normal discretionary trust.

Although certain instances of excessive settlor control would also qualify as sham trusts, not all cases would. The definition of a sham trust is a narrow one and a finding of sham requires extreme facts.[36] This does not prevent the incorrect use of the term sham trust to refer to trusts where the settlor retains influence or control, but where there is a valid trust and no common intention to create something other than a trust at the outset.

2 2 1 England

In order to find a trust deed a sham, the subjective intention of the settlor and the trustee at the time of the creation of the trust, as well their subsequent conduct, would be relevant. It is important to stress, however, that the intention at the time of creation of the trust is relevant.[37]

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[34] See ch 2 paras 2 7 1 1, 3 6 1, 4 4 1.
[35] It is submitted that if the only party who did not have the intention to create a trust is the settlor, the trust is not a sham, but a valid trust would nevertheless not come into existence, as there is no certainty of intention on the part of the settlor. If the settlor intended to create a valid trust according to the provisions of the deed, but the trustee for some reason did not share this intention, then the trust would not be a sham either, but would be valid as the settlor had the required intention. This is, however, unlikely to occur.
[36] Russen (2013) 20 *Journal of International Tax, Trust and Corporate Planning* 239 243.
[37] Hayton *et al Underhill and Hayton Law relating to Trusts and Trustees* 88-93; Virgo *The Principles of Equity and Trusts* 93-94.

The classic English case on sham is *Snook v London and West Riding Investments Ltd*.[38] Diplock LJ defined a sham as follows:

> "…[I]t means 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 rights and obligations (if any) which the parties intended to create…for acts or documents to be a 'sham', with whatever legal consequences follow from this, all the parties thereto must have a common intention that the acts or documents are not to create the legal rights or obligations which they give the appearance of creating..."[39]

Importantly, there has to be a subjective intention to deceive others – to create a false or misleading appearance – and both parties have to share this intention.[40] In the case of a trust, those parties would be the settlor and the trustee. In the case where the settlor is also the sole trustee, his intention alone is relevant.[41]

Reckless indifference (as opposed to mere indifference without a reckless attitude) as to the intention of the settlor would qualify as a shamming intention on the part of the trustee.[42] This would refer to a situation where the trustee enters into a trust deed without knowing or caring about what he signed, or without making enquiries as to the settlor's intentions.[43] Such a trustee would be considered to have the required shamming intention.

There is no requirement for dishonesty or fraud,[44] although it appears to be accepted that a sham involves a degree of dishonesty.[45] This may be because there has to be an intention to mislead and it is not difficult to see how this can be regarded as dishonest in general layman terms.

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[38] *Snook v London & West Riding Investments Ltd* [1967] 1 All ER 518 as confirmed more recently in *Hitch v Stone (Inspector of Taxes)* [2001] STC 214 and *A v A* [2007] EWHC 99 (Fam).
[39] *Snook v London & West Riding Investments Ltd* [1967] 1 All ER 518 528.
[40] Hudson *Equity and Trusts* 94; *Snook v London & West Riding Investments Ltd* [1967] 1 All ER 518 528-529 as recently affirmed in *A v A* [2007] EWHC 99 (Fam) paras 33, 43.
[41] *Midland Bank plc v Wyatt* [1995] 1 FLR 696, where a husband declared a trust of the family home in favour of his wife and children, but never told anyone about it and continued to deal with the property as if it was his own. The declaration of trust was found to be void and unenforceable and the judge considered it a pretence or a sham. See also Pearce *et al Pearce & Stevens' Trusts and Equitable Obligations* 154.
[42] *Midland Bank plc v Wyatt* [1995] 1 FLR 696; *A v A* [2007] EWHC 99 (Fam) paras 50-52.
[43] *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch) paras149-150, 435.
[44] Virgo *The Principles of Equity & Trusts* 93.
[45] *A v A* [2007] EWHC 99 (Fam) para 53.

Once a valid trust exists, it cannot be turned into a sham.[46] However, where the trustee of a validly created trust simply obeys the settlor's directions or instructions (in cases where the relevant power is not reserved to the settlor in the trust deed) without applying his mind and independently considering the interests of the beneficiaries, although not turning the trust into a sham, the trustee breaches one of his fundamental duties as trustee.[47] This is discussed further below.

2 2 2 Offshore: Jersey

The requirement of English law as to certainty of the settlor's intention applies also in Jersey.[48] Furthermore, if the settlor and trustee both had the intention to create something other than a trust, despite appearing to create a trust, so that there is a common intention to mislead, the trust would be a sham and invalid.[49] The position in Jersey with regard to sham trusts is largely the same as in England, including that recklessly going along with the settlor's intention to mislead would qualify as a subjective shamming intention on the part of the trustee.[50] However, it has been argued that the requirements for finding a sham trust may be stricter in Jersey.[51] A landmark Jersey judgment in the litigation regarding the *Esteem Settlement*[52] dealt with settlor control, sham trusts and piercing the veil, and will be examined in detail below.

2 2 3 South Africa

In order to create a valid trust, the settlor must illustrate a clear and unambiguous intention to create a trust, and not another type of legal relationship.[53] The intention to create a trust may be absent because the trustee is not sufficiently independent, for example where the settlor is also a trustee and perhaps a beneficiary of the trust. In such a case, the substance over form principle will apply so that the transaction would be construed for what it really is according

[46] Virgo *The Principles of Equity & Trusts* 93-94; *A v A* [2007] EWHC 99 (Fam) para 42.
[47] Thomas and Hayton in *The International Trust* 605.
[48] See ch 2 para 3 6 1.
[49] See ch 2 para 3 6 1.
[50] *CI Law Trustees Limited v Minwalla* [2005] JLR 359 367.
[51] See ch 2 para 3 6 1.
[52] *In the matter of the Esteem Settlement* [2003 JLR 188].
[53] See ch 2 para 4 4 1. See also Shipley (2016) 3 *SA Merc LJ* 508 519-520.

to the intention of the parties. This could be an agency relationship or a partnership, to name a few examples. A trust would therefore not come into existence in such a case.[54]

South African authority on sham trusts is scarce, most of the case law dealing with sham or simulations being in the context of tax law. A recent Supreme Court of Appeal case concerning sham or simulation is *Roshcon (Pty) Ltd v Anchor Auto Body Builders CC*.[55] Here the court summarised South African case law on simulated transactions, including the following "classic statement"[56] contained in *Zandberg v Van Zyl*:[57]

> "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 endeavor to conceal its real character. ... The Court must be satisfied that there is a real intention, definitely ascertainable, which differs from the simulated intention. … The inquiry, therefore, is in each case one of fact, for the right solution of which no general rule can be laid down."[58]

In *Roshcon*,[59] the Supreme Court of Appeal restated this general principle as follows:

> "Whether a particular transaction is a simulated transaction is therefore a question of its genuineness. If it is genuine the court will give effect to it and, if not, the court will give effect to the underlying transaction that it conceals. And whether it is genuine will depend on a consideration of all the facts and circumstances surrounding the transaction."[60]

Unlike English law, it appears that South African law may attach more weight to dishonesty.[61] However, one can argue that an intention to mislead – required under English law – is dishonest, even if not called by that name. Furthermore, both parties must have the intention

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[54] Cameron *et al Honoré's South African Law of Trusts* 137. Van der Linde (2012) 75 *THRHR* 371 388 raises the interesting question of whether, where trustee and settlor are the same person, a shamming intention on the part of that person (who may be wearing two hats but is still the same person) means the trust is a sham.
[55] *Roshcon (Pty) Ltd v Anchor Auto Body Builders CC* 2014 (4) SA 319.
[56] *Roshcon (Pty) Ltd v Anchor Auto Body Builders CC* 2014 (4) SA 319 para 23.
[57] *Zandberg v Van Zyl* 1910 AD 302.
[58] *Zandberg v Van Zyl* 1910 AD 302 309.
[59] *Roshcon (Pty) Ltd v Anchor Auto Body Builders CC* 2014 (4) SA 319.
[60] *Roshcon (Pty) Ltd v Anchor Auto Body Builders CC* 2014 (4) SA 319 para 27.
[61] Shipley (2016) 3 *SA Merc LJ* 508 516.

to mislead – it is not sufficient, as in English law, for one party to merely go along, albeit recklessly, with the shammer.[62] There is, however, no requirement that the disguised transaction must be designed to evade tax or have some other improper purpose.[63]

3 Settlor control over the trust

3 1 Reasons for and consequences of increased demand for settlor control

In a thought-provoking piece about the future of the trust, Waters gives a detailed explanation of how the use of the trust has evolved over the years.[64] Although written with reference to England and offshore jurisdictions, many of the themes are also relevant in the South African context. The writer explains that until the latter part of the 19th century, trusts were predominantly used for the holding and disposition of individual wealth within the family, such as real estate, securities, cash, works of art, jewelry, furniture and so on. These settlements were, in the opinion of Waters, very similar in nature to the trusts of mediaeval times. Towards the end of the 19th century, trusts were also used outside the family in commercial deals and to own businesses. In all these cases, the classic elements of the trust were present, namely a transfer of title to the trustee, a segregated trust estate, one or more beneficiaries and enforcement of the trust by the beneficiaries who could demand that the trustee accounts for his administration and management of the trust.[65]

These trusts typically provided for fixed successive beneficial interests, meaning that the position of beneficiaries was very secure. In fact, conferring extensive discretion upon a trustee was considered inappropriate. Trustee powers were generally much more limited than is the case with today's flexible trust deeds, as discussed below.[66]

Also relevant in this context are the profound changes in the type of investment opportunities available to investors, including trustees. This played an important part in the liberalisation of trustee investment powers, the standard of care expected of a trustee and liability issues, as

[62] Shipley (2016) 3 *SA Merc LJ* 508 519.
[63] *Commissioner of Customs and Excise v Randles Bros & Hudson Ltd* 1941 AD 369 395-396 as confirmed in *Roshcon (Pty) Ltd v Anchor Auto Body Builders CC* 2014 (4) SA 319 paras 28-32.
[64] Waters in *The International Trust* 837-889.
[65] Waters in *The International Trust* 844-845.
[66] Waters in *The International Trust* 848-849; see also ch 4 para 3 2 5 regarding the use of letters of wishes.

discussed in chapter 3.[67] Investors have been able to become more personally and directly involved with the management of their financial investments. Wealthy individuals, especially those who have built up successful businesses, are often very knowledgeable when it comes to investments and demand to be more involved in managing their wealth. If they have generated their wealth over a prolonged period, they may well be reluctant to forego this involvement even if, at the same time, they also desire the benefits offered by a trust.

Another factor in this evolution was tax. From the 1970s onwards, high levels of taxation in many mainland jurisdictions led to a desire on the part of wealth owners to mitigate or, even better, avoid taxation of gifts, income or capital gains. Tax efficiency became one of the predominant objectives when establishing a trust. This desire also affected the way trust deeds were drafted and the type of eventualities it had to cater for.[68] Many of the terms we now consider standard (at least in English and offshore trust deeds) would have been frowned upon 50 or 60 years ago. Examples of such provisions would include the following:

(a) the power to remove the trustee with or without cause, exercisable by the settlor, a beneficiary or a protector. One might ask whether this affects the trustee's attitude in discharging his duties, and who the trustee feels he needs to answer to;

(b) the ability to settle a trust with a nominal capital amount and add assets at a later point as and when it becomes possible or attractive. It is furthermore possible for someone other than the true economic settlor to contribute the initial capital and be indicated as the settlor in the trust deed;

(c) the ability to add and remove discretionary beneficiaries seemingly at will. This makes the beneficiary's position and status much more tenuous. Given that it is up to the beneficiaries of a trust to hold the trustee to account, this development clearly has an effect on the accountability of the trustee. One may ask whether the trustee is now accountable to the settlor (who can remove him), as the settlor may be the only person involved with the trust from start to finish;

[67] See ch 3 paras 2 1 3 2, 2 1 3 3, 2 3 5.
[68] Waters in *The International Trust* 849.

(d) the ability for the trustee to amend or terminate the trust or to "decant" assets from one trust to another. This creates the impression that the trust is a "neutral vehicle" to be used in future as circumstances dictate; and

(e) the reservation of extensive powers, if not by the settlor himself (for reasons discussed below) then by a protector or advisor appointed by the settlor.[69]

Another important aspect of this development is that trusts have become increasingly popular outside of common law jurisdictions. Settlors from a civil law background often have a very limited understanding of the characteristics of a trust and may feel uncomfortable with the idea of transferring ownership *and* control of their assets to a trustee in another jurisdiction. The offshore trust company, trying to sell its services to the unsuspecting settlor, may also paint a slightly different picture of how the trust will be managed in practice in the hope that this makes their trustee services more attractive than a competitor's. If this misunderstanding is never corrected for fear of losing the business, the situation only worsens over time.

It is testament to the flexibility of the trust that it was able to accommodate so many changes over time, taking account of social and economic developments in different jurisdictions. However, Waters comes to a similar conclusion as that drawn towards the end of chapter 3,[70] namely that trust practice today seems more concerned with the needs and wishes of the settlor than the position and protection of the trust beneficiaries.[71] At the same time, trustees are increasingly concerned with liability issues. Modern trust drafting takes all of this into account and aims to be everything for everybody.[72]

Two questions arise. Are practitioners and drafters conceiving a new idea of what a trust is and, if so, what exactly is that idea, both conceptually and practically? Secondly, as previously mentioned, the question is how far the boundaries of the accepted trust concept can be pushed, how far it allows settlor autonomy to go, without the trust concept "crumbling

[69] Waters in *The International Trust* 850-853.
[70] See ch 3 para 5 4.
[71] Waters in *The International Trust* 854. See also Tey (2009) 21 *SAcLJ* 517 where similar concerns are raised and where modern trusts are described at 520 as "investment tools aimed at enhancing the value of financial assets".
[72] Similar arguments regarding the modern use of the discretionary trust are made in Smith "Massively Discretionary Trusts" *Current Legal Problems* (accessed 20-11-2017).

instead into a jumble of ideas that has no convincing conceptual state"[73] or becoming assimilated with contract or agency.[74]

These are, of course, academic questions that may not be a daily concern for the trust practitioner, but over time these concerns seep into the consciousness of judges, as is already apparent in certain cases examined in this chapter. Given that trust law is to a large extent judge-made, this may have an effect on the way judges develop trust law. Alternatively, it may be argued that legislation is required to eliminate doctrinal uncertainties. This could either create a distinct vehicle, more suited to the needs discussed above, or it could take away much of the flexibility offered by the traditional common law trust.[75]

3 2 How can a settlor obtain control?

3 2 1 Reserved powers trusts

Once he has settled the trust, the settlor's ongoing role is limited, as explained above. It is, however, also clear that, for a variety of reasons, many settlors would like to have more control and some in fact insist on it. To deal with this conundrum, many offshore jurisdictions have enacted so-called reserved powers legislation over the last few decades. The Jersey legislation is examined in detail, although many other traditional offshore jurisdictions and US states[76] have introduced very similar legislation.[77] This type of legislation has two principal aims. The first is to ensure that a trust in which the settlor reserved wide powers is not invalid (or a sham) because there was no intention (or no common intention) to create a

[73] Waters in *The International Trust* 854.
[74] Waters in *The International Trust* 888; see also ch 2 para 2 4 1.
[75] Waters in *The International Trust* 888-889.
[76] One example is Nevada's directed trust legislation, allowing the trustee to be directed as to investments or distributions or both, pursuant to the Nevada Revised Statutes ch 163.553-163.556. A "trust adviser" is empowered to direct the trustee in relation to the exercise of certain powers, and the trustee becomes an "excluded fiduciary" whose liability is severely limited. Other states include Delaware, Alaska and South Dakota.
[77] Examples, apart from Jersey, include Bermuda's Trusts (Special Provisions) Amendment Act 2014 which expressly allows the reservation of any and all of the listed powers; the Cayman Islands Trusts Law (2011 Revision) s 14 which was recently amended by The Trusts (Amendment) Law, 2016 s 5 to make it clear that any or all of the powers contained in the legislation can be reserved without invalidating the trust; Guernsey's Trusts (Guernsey) Law 2007 s 15 which also provides for reservation of "all or any" of the listed powers; and Singapore's Trustees Act (Chapter 337) revised edition 2005 s90(5) which provides that a trust shall not be invalid if a settlor reserves to himself any or all powers of investment or asset management – this is more limited than other jurisdicitions as it only relates to investments.

trust in the first place, or considered testamentary because the settlor in fact wishes to control the assets during his lifetime and hand over control to the trustee only after his death.[78]

The second aim of reserved powers legislation is to limit the liability of the trustee of such a trust. A trustee who is obliged to administer the trust fund at the whim of the settlor exercising his reserved powers would not wish to be liable to the beneficiaries if it turns out that they suffered a loss as a result of such exercise.[79] Some jurisdictions, for example Singapore, have not gone as far as absolving the trustee from all liability where the power exercised was one reserved to the settlor (or someone else), but many offshore jurisdictions have made this part of their law.[80] In most cases it would thus be clear that, at least according to the governing law of the trust, the trustee will not be liable for the consequences of the exercise by the settlor of powers typically belonging to the trustee.

Nonetheless, serious questions arise with regard to such trusts. These questions mainly revolve around:

(a) whether reserved powers legislation pushes the boundaries of trust law too far, the question being whether a valid trust can exist where the trustee retains very few or virtually no fiduciary duties towards the beneficiaries;[81] and

(b) whether such a trust would be recognised as valid and effective for its purposes by a court in another jurisdiction, for example where the settlor is resident or the trust assets are located. This is important given that the residence of settlors of offshore trusts and the location of the assets are rarely in the same offshore jurisdiction.

The Jersey reserved powers legislation will be examined in detail, although the position in most of the offshore jurisdictions is very similar.

[78] Thomas and Hayton in *The International Trust* 608-614; *In the matter of the AQ Revocable Trust for Sons dated 1976 and the AQ Revocable Trust for Grandchildren dated 1976* [2010] SC (Bda) 40 Civ is an example of a finding of a testamentary intention. These trusts were set up in 1976, well before any of the offshore reserved powers legislation was enacted. The case is discussed in ch 4 para 4 2 4 1.
[79] The liability of a trustee for breach of trust was examined in ch 3 para 3.
[80] Anonymous "Reserved Powers Trusts Examined" *Collas Crill Update* (accessed 12-05-2017).
[81] An irreducible core of trustee obligations is required in order to have a trust. See ch 2 para 5 2.

3 2 1 1 Jersey reserved powers trust legislation

The Jersey reserved powers legislation was introduced by the Trusts (Amendment No. 4) (Jersey) Law 2006, which now forms part of the Trusts (Jersey) Law (TJL),[82] and provides as follows in article 9A:

> "(1) The reservation or grant by a settlor of a trust of –
> (a) any beneficial interest in the trust property; or
> (b) any of the powers mentioned in paragraph (2),
> shall not affect the validity of the trust nor delay the trust taking effect."[83]

The powers listed in article 9A(2) of the TJL are:

(a) to revoke, vary or amend the terms of the trust;
(b) to advance, appoint, pay or apply income or capital of the trust property or to give directions to do so;
(c) to act as a director or officer of a company wholly or partly owned by the trust or to give directions for the appointment or removal of such a director;
(d) to give binding directions to the trustee with regard to dealing with the trust property or the exercise of any powers or rights arising from the property;
(e) to appoint or remove a trustee, beneficiary or other person holding a power, discretion or right in connection with the trust or the trust property;
(f) to appoint or remove an investment manager or investment adviser;
(g) to change the proper law of the trust;
(h) to restrict the exercise of any powers or discretions of a trustee by requiring the consent of the settlor or another person in order to exercise such powers or discretions.

Article 9A(3) of the TJL then goes on to state that a trustee who acts in accordance with the exercise of a power so reserved or granted is not acting in breach of trust.

[82] Trusts (Jersey) Law 1984.
[83] Trusts (Jersey) Law 1984 art 9A(1).

3 2 1 2 Proposals for amendment of Jersey reserved powers trust legislation

In 2016, the States of Jersey issued a Consultation paper entitled *Proposed Amendments to the Trusts (Jersey) Law 1984*[84] (consultation paper). The responses were summarised in a Consultation Response and Policy Paper (response paper).[85] The response paper stated the Jersey Government's wish to preserve the integrity and reputation of the TJL (and presumably of Jersey as an offshore trust jurisdiction) but at the same time to develop it in view of industry demands to ensure that prospective settlors have "maximum flexibility" but "within an appropriate and legitimate framework".[86]

Not all of the proposed amendments received positive responses. One example of a proposed amendment that will not go ahead is the insertion of words in article 9A(1)(a) of the TJL enabling a settlor to reserve the whole of the beneficial interest in the trust property. As such a reservation could be seen to come close to reserving absolute ownership with the result that other jurisdictions might view the trust as illusory, this amendment was considered undesirable.[87]

However, on the other hand, the proposed amendment to article 9A(1)(b) of the TJL to make it clear that a settlor may reserve all, as opposed to just some, of the powers listed in article 9A(2) of the TJL will go ahead.[88] It has been noted that, where assets are held outside Jersey, this amendment in itself cannot prevent a challenge in the foreign jurisdiction.[89]

The issue of whether a trust deed can state whether a reserved power is personal or fiduciary received a mixed response. The point was made that if powers that are ordinarily fiduciary become exercisable by settlors without the constraints attached to fiduciary powers, it would damage Jersey's reputation as a leading trust jurisdiction. A legislative presumption was considered undesirable. The view was that it should remain possible to specify in a trust deed

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[84] States of Jersey *Proposed Amendments to the Trusts (Jersey) Law 1984* (2016).
[85] States of Jersey *Proposed Amendments to the Trusts (Jersey) Law 1984: Response and Policy Paper* (2016).
[86] States of Jersey *Proposed Amendments to the Trusts (Jersey) Law 1984: Response and Policy Paper* (2016) 2.
[87] States of Jersey *Proposed Amendments to the Trusts (Jersey) Law 1984: Response and Policy Paper* (2016) 11.
[88] This is already the case in Bermuda, the Cayman Islands and Guernsey, as explained in ch 4 fn 77. Since writing this chapter, the Trusts (Amendment No 7) (Jersey) Law 2018 has been enacted, which does indeed provide for this amendment in art 4.
[89] States of Jersey *Proposed Amendments to the Trusts (Jersey) Law 1984: Response and Policy Paper* (2016) 11.

whether a reserved power is fiduciary or personal, but that this should ultimately remain subject to determination by the court taking into account the terms of the trust deed and the circumstances of each case.[90]

Another proposed change relates to the question of whether the trustee should owe any residual duty to the beneficiaries (including the duty to observe the utmost good faith) where the settlor reserved powers to himself.[91] The consultation paper stated that the Jersey Finance Trusts Law Working Group opposed the suggested amendment on reputational grounds. Their view was that an automatic abdication of any responsibility on the part of the trustee would be unacceptable.[92]

Some respondents argued that, given the wording of article 9A(3) of the TJL, the trustee only has the duty to check that a reserved power was exercised by the correct person and that the direction was not *ultra vires*, but that the trustee has no duty to monitor what happens after the direction was implemented. However, most respondents to the consultation paper were of the view that certain residual duties exist under recognised trust law principles and that it would be inappropriate to remove these residual duties automatically (although the trust deed can still provide for their removal). This amendment will therefore not go ahead.[93]

The final proposed amendment is the insertion of a presumption that, unless specified to be a will, a trust will take effect immediately.[94] This was considered to be a welcome addition, in line with the reserved powers legislation of other offshore jurisdictions, and one that would provide greater certainty by putting beyond doubt the validity of an *inter vivos* trust containing extensive reserved powers that does not comply with the formalities applicable to the settlor for the execution of testamentary dispositions.[95]

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[90] States of Jersey *Proposed Amendments to the Trusts (Jersey) Law 1984: Response and Policy Paper* (2016) 13-14.
[91] States of Jersey *Proposed Amendments to the Trusts (Jersey) Law 1984: Response and Policy Paper* (2016) 12-15.
[92] States of Jersey *Proposed Amendments to the Trusts (Jersey) Law 1984* (2016) 23.
[93] States of Jersey *Proposed Amendments to the Trusts (Jersey) Law 1984: Response and Policy Paper* (2016) 12-15.
[94] States of Jersey *Proposed Amendments to the Trusts (Jersey) Law 1984* (2016) 46-48. This is provided for in the Trusts (Amendment No 7) (Jersey) Law 2018 art 4.
[95] States of Jersey *Proposed Amendments to the Trusts (Jersey) Law 1984: Response and Policy Paper* (2016) 23.

In summary, there appears to be a tacit admission that reserved powers trusts, whilst invaluable to an offshore jurisdiction like Jersey, can be harmful to a jurisdiction's reputation. Furthermore, concerns remain about the effectiveness of these trusts outside the governing law's jurisdiction. For these reasons, certain amendments were considered too drastic, although some of them are already in effect in other jurisdictions.

Furthermore, regulatory oversight requirements now apply in many offshore jurisdictions as a result of supra-national moves aimed at reducing money laundering and increasing tax transparency. As a result of these regulations, many offshore trustees are required to have professional oversight over assets or transactions that, according to the terms of the trust deed, are not under their control.

The efficacy of the reservation of powers by settlors will be examined below as part of the case law study as well as in chapter 5.

3 2 2 Private trust companies

Another method whereby a settlor can effectively retain a relatively high level of control is through the use of a so-called private or family trust company (PTC). A PTC is what the name says – a corporate entity, authorised to act as trustee, but acting as trustee only for members of one family or another limited group of individuals.[96] Although offshore legislation and regulation require an entity acting as trustee to be licensed as such in the relevant jurisdiction, certain exemptions from this requirement enable PTCs to exist.[97] PTCs can exist in a number of jurisdictions and the set-up and treatment of these companies differ slightly from jurisdiction to jurisdiction.

PTCs are normally owned by a purpose trust[98] or a foundation, rather than by the settlor directly, for the obvious reason that legal ownership of the trust assets would otherwise be attributed to the settlor.[99]

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[96] Anonymous "The Use of Private Trust Companies" *Ogier Publications* (accessed 19-05-2017).
[97] Examples of jurisdictions that allow PTCs include Jersey through the Financial Services (Trust Company Business (Exemptions)) (Jersey) Order 2000 as amended by the Financial Services (Trust Company Business (Exemptions)) (Jersey) Order 2009; the Cayman Islands Private Trust Companies Regulations, 2008; Bermuda, through the Trusts (Regulation of Trust Business) Act 2001. See Ytterberg and Weller (2010) 36 *ACTEC Law Journal* 501 for an interesting analysis of the use of PTCs in the United States. Similar issues are at stake there.
[98] See ch 2 para 2 7 3 1 regarding purpose trusts.

A PTC brings with it an increase in costs, but for settlors of substantial wealth the cost is not prohibitive. It can be particularly helpful where the trust assets are made up of a family business that will benefit from ongoing family involvement, but that brings with it the difficulty of not being able to diversify the trust assets. A professional trustee may be unwilling to take on such a trust.[100]

PTCs have become very popular because of the possibility of affording control to settlors. In essence, it buys the settlor, or someone close to him, a seat on the board of directors of the trustee company. It is therefore not unlike the case of a settlor acting as co-trustee, examined below in the South African context. However, the addition of a corporate layer adds protection for a settlor serving on the board.

Many jurisdictions require that a licensed trust company must carry out the administration of the PTC. Even where it is not a requirement, a PTC and the underlying trust of which it is the trustee, would normally still be administered by a professional trust company. There will usually be at least one director representing the corporate trustee that does the day-to-day administration and accounting. Advisors or other people chosen by the settlor, or the settlor himself, typically make up the other directors.

Provided the other directors can be shown not to be subservient to the settlor, the use of a PTC should not of itself jeopardise the integrity of the trust. The independence of the body of trustees must, however, be uncompromised by the involvement of the settlor.

Similar to the reserved trust situation, the corporate trustee providing a director and carrying out administrative functions would want to ensure that it is properly indemnified for its role and that the consequences of a breach of trust by the PTC are not visited upon it. Directors of the PTC would have the ordinary duties and liabilities of company directors under the laws of the jurisdiction involved.[101]

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[99] Anonymous "The Use of Private Trust Companies" *Ogier Publications* (accessed 19-05-2017).
[100] Anonymous "The Use of Private Trust Companies" *Ogier Publications* (accessed 19-05-2017).
[101] Anonymous "The Use of Private Trust Companies" *Ogier Publications* (accessed 19-05-2017).

The *Pugachev* case[102] examined below is an example of where the board of the PTC was found not to be independent of the settlor.

3 2 3 Settlor as co-trustee

Although relatively uncommon, but not unheard of, in the offshore world, it is fairly uncontroversial for a settlor of an express *inter vivos* family trust in onshore jurisdictions to act as a co-trustee. This is a regular phenomenon in South Africa, where no reserved powers legislation as found in offshore jurisdictions exists. The other trustees may be individuals – family members, friends, advisors – or corporate trustees.

A settlor acting as trustee or co-trustee is not in itself problematic under South African law.[103] As long as the other trustee or trustees bring sufficient independence to the body of trustees and the settlor cannot be said to have control over trustee decisions, there should be no question of abuse of the trust. There is, however, doubt regarding the question of how much trustee independence is required and how rigorously this requirement is enforced under South African law.[104]

A trustee is subject to strict fiduciary duties and has to act in the best interests of the beneficiaries. In order to exercise his duties properly, the trustee has to exercise his powers independently. In cases where the trustee is also the settlor or one of the beneficiaries, illustrating such independence is not a simple feat.

It also complicates fulfilment of the essential requirement of separation between ownership or control of the assets and enjoyment thereof.[105] In South Africa, this has been held to be the core idea of the trust.[106] Van der Linde and Lombard argue that where the trustees and beneficiaries are the same, there is no *de iure* separation between control and enjoyment and therefore the trust is invalid.[107] Furthermore, the existence of a separate trust estate, distinct

[102] *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch).
[103] See ch 2 para 4 3 5 4.
[104] This was discussed in ch 2 para 4 3 5 3.
[105] See ch 2 para 4 3 1 2.
[106] *Land and Agricultural Bank of SA v Parker* 2005 (2) SA 77 (SCA) paras 19, 22.
[107] Van der Linde and Lombard (2007) 2 *De Jure* 429 438.

from the trustee's personal estate,[108] can be jeopardised by this dual role of trustee and settlor. This is a theme that is evident in many of the South African cases under review later in this chapter.

3 2 4 Protectors

The popularity of protectors of offshore trusts has been on the increase for a number of years and is, in fact, now fairly common. Although protectors have been known in Scots law for centuries, in the common law world the concept was more or less unheard of until 20 or 30 years ago. There is no technical meaning to the term – a person fulfilling the typical role of a protector could also be called an advisor – and there does not seem to be much in the sense of legislation dealing with this fairly modern creation of trust practice.[109]

The main purpose of a protector is to guard the interests of the beneficiaries by providing a system of 'checks and balances' and overseeing the performance of his duties by the trustee. A protector may have trustee-like powers, but it is an office clearly separate from that of the trustee.

Absent any legislative provisions forming part of the governing law of the trust, the office of protector must be created and provided for in the trust deed. The initial protector can be appointed by the settlor or someone else, although it will most often be the settlor. Most trust deeds provide for the appointment of a successor protector, and some deeds deal with situations where no protector is in office. These types of provisions point towards the protector holding an office and strengthens the argument that he must be subject to fiduciary duties.

However, a settlor appointing himself, or a person who is subservient to the settlor, as protector and granting the protector far-reaching powers, could be seen as simply another way for a settlor to exercise influence or control over the trustee over and above acceptable levels. Such a protector would most likely protect the settlor's interests rather than the beneficiaries',

[108] See ch 2 para 4 3 1 1 for the importance of this in the South African context where there is no division of legal and equitable ownership.

[109] The Trusts (Jersey) Law 1984 does not refer to a protector by name, but art 24(3) provides as follows: "The terms of a trust may require a trustee to obtain the consent of some other person before exercising a power or a discretion." Furthermore art 24(4) reads: "A person who consents as provided in paragraph (3) shall not by virtue of so doing be deemed to be a trustee." Note that this refers only to consent powers.

and these are not necessarily aligned. A protector whose interests conflict with those of the beneficiaries may be removed from office.[110]

The powers that can be given to a protector cover a wide range. Perhaps the most common is the power to remove the trustee and appoint a new trustee in his place. Depending on the settlor's circumstances, it is a right that he could reserve to himself, but very often the reservation of any rights or powers to himself has a detrimental effect on the settlor's tax planning or asset protection purposes. In these circumstances, it can be helpful to give this power to another person so as to limit the settlor's role. Often, however, the protector is someone the settlor knows and trusts, or it can be a corporate entity indirectly controlled by the settlor. The settlor then appears not to have any influence, but in reality he does, or can, influence the trustee – through the protector.

A protector can also have the power to veto certain trustee decisions (in other words, the trustee cannot exercise the power without the consent of the protector – this is sometimes referred to as a negative power). Powers subject to veto often include the addition or removal of a beneficiary, the making of distributions (or certain types or levels of distributions) or a change in the governing law of the trust. Certain trust deeds may give the protector the right to exercise these powers himself, rather than to have a veto on the trustee's decisions.[111]

Depending on the extent and nature of the powers given to a protector, there may be a risk of the protector being considered a *quasi* trustee. This is especially true if a protector, in reality, has to consent to most trustee actions. It also unduly hampers administration of the trust by the trustee. If the powers can be described to be fiduciary in nature, the protector must have concomitant liability in order to safeguard the position of the trust's beneficiaries. Some argue that an analysis of the protector's role under English law points to a protector being a trustee.[112]

In an article analysing the nature of protector powers and whether a protector can properly be considered a fiduciary, Conaglen and Weaver argue that a definitive answer to this question is

[110] This happened in *In the matter of the V R Family Trust* [2009] JRC 109, where at paras 29-32 the Jersey Royal Court held that beneficiaries were entitled to require that a protector with fiduciary powers made decisions independent of any private interest or competing duty, just as they can expect of a trustee.
[111] Anonymous "To Protect and Serve: Understanding the Mercurial Role of a Protector" *Collas Crill Factsheets* (accessed 17-05-2017).
[112] Hudson *Equity and Trusts* 922-924.

virtually impossible.[113] The reasons are, firstly, that the concept of a fiduciary is a nebulous one and, secondly, that protectors can hold a wide range of powers and positions.

The examination of the law surrounding fiduciaries and fiduciary duties in chapter 3 [114] indicated that not all fiduciaries owe the same duties or obligations in the same type of circumstances. The range of powers that can be conferred on a protector was discussed immediately above. Because there is no settled legal description of the term protector and because a protector can have such a wide range of roles, the authors observe that, "absent specific context, it signifies little more than that a person who is not the (or a) trustee has been granted a power affecting the operation of the trust".[115]

One therefore has to ask whether a particular power held by a particular protector is held in a fiduciary capacity. Because the office and powers of a protector must be specified in the trust deed, determining whether a power is fiduciary becomes a matter of construction of the trust deed.[116] Hudson favours the view that a protector is indeed a trustee. If a protector can veto a decision of the trustee (or, in fact, make a decision regarding the trust), he must be acting with a power equivalent to that of a trustee and therefore has to act in the interest of the beneficiaries.[117]

As noted earlier, fiduciary powers (in the context of trusts) have to be exercised for the benefit of the beneficiaries of the trust, whereas a personal power can be exercised for the benefit of the power holder himself – he is not subject to a fiduciary duty when he exercises the power.[118] The importance of the question is clear: if a protector does not have to exercise a particular power for the benefit of the trust's beneficiaries, he is not accountable to them for the way the power is exercised. If the power is one that would normally be exercised by a trustee, it reduces the protection offered to beneficiaries.

[113]Conaglen and Weaver (2012) 18 *T&T* 17.
[114] See ch 3 paras 2 1 1, 2 1 2, 2 2 1, 2 2 2, 2 3 1, 2 3 2.
[115] Conaglen and Weaver (2012) 18 *T&T* 17 20.
[116] Penner *The Law of Trusts* 78; Conaglen and Weaver (2012) 18 *T&T* 17 30-35; *In the matter of the Bird Charitble Trust and the Bird Purpose Trust* [2008] JRC 013 para 82; *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch) para 167.
[117] Hudson *Equity and Trusts* 922-923.
[118] Hudson *Equity and Trusts* 135; see ch 3 para 2 1 2 1.

A number of cases have considered the nature of protector powers. There appears to be a consistent approach under offshore law with regard to the power to appoint and remove trustees, namely that it has to be exercised in good faith in the interest of the beneficiaries as a whole – it is thus a fiduciary power.[119] A power to give or withhold consent to the exercise by the trustee of his dispositive powers, or a power to amend the trust, can be personal or fiduciary. For example, where the protector is also a beneficiary, the power of veto may have been given to the protector to protect his interest as a beneficiary and thus is a personal power.[120]

It is submitted that the argument that a protector is a trustee may be correct where the protector has wide-ranging powers of a fiduciary nature, and where he is able to intervene in and overturn decisions of the trustee. However, it is difficult to defend that argument where a protector's only power is to replace the trustee, a power that could also be given to the settlor or a beneficiary in appropriate circumstances, or to veto the exercise of dispositive powers over a certain monetary limit for minor beneficiaries. Much, therefore, seems to depend on the extent and nature of the powers given to the protector. On the other hand, if the protector's powers are wide-ranging and clearly fiduciary in nature, but the trust deed states that he is not a fiduciary and exonerates him from all liability, except perhaps for fraud and wilful misconduct, this affects the quality of the protection and accountability offered to beneficiaries.

3 2 5 Letters of wishes

With the rise of the fully discretionary trust,[121] especially in offshore jurisdictions, the need arose for settlors to put in writing their actual wishes for the destination of the trust assets. Providing a letter of wishes is now a standard part of setting up an offshore discretionary trust, although some settlors prefer not to provide one for the reasons set out below.

In practice, a letter of wishes is a very useful tool for a trustee of a discretionary trust, especially after the death of the settlor. However, it is not legally binding and the trustees are

[119] *Von Knieriem v Bermuda Trust Company Limited* [1994] Bda LR 50; *In the matter of the Bird Charitble Trust and the Bird Purpose Trust* [2008] JRC 013 para 92; *In the matter of Jasmine Trustees Limited and in the matter of the Piedmont Trust* [2015] JRC 196 para 33.
[120] *Rawson Trust Co Ltd v Perlman* [1990] 1 Butterworths OCM 31.
[121] See ch 4 para 3 1.

not obliged to follow it.[122] In an article entitled *Massively Discretionary Trusts*, Smith argues that, in some extreme cases, the trustee's dispositive discretions are so wide that without a letter of wishes the trustee would not know how to exercise this discretion. Such trust deeds, mostly governed by the law of an offshore jurisdiction, may allow the trustee to remove beneficiaries and appoint additional beneficiaries, so that the beneficiaries named in the original trust deed have very little hope of receiving anything from the trust. This affects their ability to hold the trustee to account.[123]

Where trust deeds provide scant information about who should benefit, letters of wishes are imperative. Although, generally speaking, these letters are not binding, they sometimes contain the real wishes of the settlor. If these real wishes are different to what the terms of the trust provide, this may indicate that the trust is in fact a sham. If the trustee intends to administer the trust in accordance with a letter of wishes that contradicts the trust deed, a finding of sham would indeed be appropriate.[124]

Smith goes as far as saying:

> "…[M]assively discretionary trusts are a kind of deformation of the trust device."[125]

He argues that although the trust is a flexible institution, certain features need to be present – the trust needs a beneficiary and the trustee must be accountable to the beneficiary. This is trite law. Although the settlor's wishes are important, the legal relationship between the trustee and the beneficiary is, or should be, at the heart of the trust.[126] This argument comes back to the observation that a type of trust is developing where the interests of the beneficiaries are less important than the wishes and investment objectives of the settlor.[127]

Care should therefore be taken in the drafting of trust deeds and letters of wishes. If the terms of the trust are such that the trustees, or another power holder, can effectively defeat the interests of the named beneficiaries, and the letter of wishes indicates who should really

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[122] Penner *The Law of Trusts* 195.
[123] Smith "Massively Discretionary Trusts" *Current Legal Problems* (accessed 20-11-2017) 1, 19-20, 24.
[124] Smith "Massively Discretionary Trusts" *Current Legal Problems* (accessed 20-11-2017) 25.
[125] Smith "Massively Discretionary Trusts" *Current Legal Problems* (accessed 20-11-2017) 31.
[126] Smith "Massively Discretionary Trusts" *Current Legal Problems* (accessed 20-11-2017) 32.
[127] See ch 4 para 3 1.

benefit, the terms of the letter of wishes may be found to be imperative. This may support a finding of sham or, at the least, prejudice the planning objectives of the settlor.

4 Excessive settlor control and the consequences thereof: a review of case law

4 1 Introduction

The review in this part of the chapter will seek to identify the circumstances in which a court will find that a settlor exercises excessive control over a trust and to ascertain the consequences thereof.

Uncertainties abound. In determining excessive control, how much of the irreducible core of the trust must remain? To what extent should there be a separation between ownership or control of the trust assets and the enjoyment thereof? Is an abuse of trust, at least in certain circumstances, the result of a breach by the trustee of his fiduciary (and other) duties? Are there different thresholds in different jurisdictions for finding that a trust is invalid, or that a valid trust has been abused and should be ignored? Or is there a consistency to the approach of judges that overrides theoretical legal differences? How useful are company law concepts such as "piercing the veil"? What is the judicial appetite for testing the "true thickness of the veil between the settlor and his trust"[128] and, ultimately, for ignoring this veil as opposed to upholding valid trusts despite certain shortcomings?

The trust is praised as a flexible arrangement born out of equity. It is possible that this translates into more flexible remedies, aimed at fairness, being available to protect beneficiaries and third parties in the trust context than in non-trust cases.[129]

[128] Russen (2013) 20 *Journal of International Tax, Trust and Corporate Planning* 239 244.
[129] Russen (2013) 20 *Journal of International Tax, Trust and Corporate Planning* 239 241.

4 2 England and offshore jurisdictions

4 2 1 General remarks

The case law in this section includes cases heard by English judges relating to trusts governed by English law and also various offshore laws, as well as cases heard by offshore courts. These will be compared to South African judgments, analysed in the next section.

The following dictum from *Minwalla v Minwalla*,[130] where the English High Court held a Jersey trust to be a sham, sets the scene:

> "…[T]he approach which those involved should expect of the court where it appears that an off-shore trust with its professional trustees and associated companies with their sometimes cipher directors have been woven together to create a shroud that is designed to bury the husband's resources from view. Should the court respect the legal structure of that screen? Or, if it becomes apparent that the husband himself pierces the veil as and when it suits him, should the trustees and directors be surprised that a court… will strain to see through the smoke and will set the structure aside so as to treat the resources wholly his? For that is what he and they should expect where fairness to both spouses depends so crucially on an accurate understanding… of the realities of each party's economy."[131]

A reading of the case law leaves one with the impression that, although there may not be any hard-and-fast rules, the judiciary is intent on taking all the facts and circumstances of a case into account to ensure a fair outcome and to prevent the misuse of the trust concept to the detriment of others, be they beneficiaries, tax authorities or spouses or creditors of the settlor. Nevertheless, there appears to be a reluctance to ignore validly established trusts completely.

The cases discussed below were selectively identified and analysed with a view to highlighting aspects relevant to the overriding theme of this dissertation.

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[130] *Minwalla v Minwalla and DM Investments SA, Midfield Management SA and CI Law Trustees Ltd* [2004] EWHC 2823 (Fam).
[131] *Minwalla v Minwalla and DM Investments SA, Midfield Management SA and CI Law Trustees Ltd* [2004] EWHC 2823 (Fam) para 1.

4 2 2 Case law dealing with claims by third parties or creditors

4 2 2 1 *Shalson v Russo*[132]

This is an example of a case where, despite a fairly high level of settlor control, the court did not consider it appropriate to "pierce the veil" of the trust and declare that the assets actually belong to the settlor.[133] Before dealing with the piercing issue, the court dismissed the alternative claim that the trust was a sham, because the trustee was not a knowing party to the sham.[134]

Mr Russo, the settlor of the trust in question, committed fraud against various third parties who sought to challenge the trust in order to have their debts repaid.[135] The trust was created under Jersey law and had a wide class of beneficiaries, all being family members of Mr Russo. The trustee had wide powers of investment, provided that the trust fund had to be invested initially, and preferably continuously, with a specific company.[136] Nearly three quarters of the shares of this company were held in the trust although it was at all material times under the *de facto* control of Mr Russo.[137]

The court went through various transactions of the trust in great detail.[138] This illustrated that the settlor did indeed at times deal with the trust assets of his own volition.[139] However, looking at various pieces of correspondence between the settlor and the trustee, and considering the fact that the trustee reviewed documentation relating to proposed transactions and made internal notes relating thereto, the judge found that the trustee did not simply respond to every request of the settlor.[140] The evidence showed that the employees of the trustee company applied their own independent minds as to whether certain transactions were appropriate,[141] that transactions were reversed where the trustee did not agree to them,[142] and

[132] *Shalson v Russo* [2003] EWHC 1637 (Ch).
[133] *Shalson v Russo* [2003] EWHC 1637 (Ch) para 217.
[134] *Shalson v Russo* [2003] EWHC 1637 (Ch) para 215.
[135] *Shalson v Russo* [2003] EWHC 1637 (Ch) para 192.
[136] *Shalson v Russo* [2003] EWHC 1637 (Ch) para 184.
[137] *Shalson v Russo* [2003] EWHC 1637 (Ch) paras 4, 10-13.
[138] *Shalson v Russo* [2003] EWHC 1637 (Ch) paras 192-208.
[139] *Shalson v Russo* [2003] EWHC 1637 (Ch) paras 195, 204-205.
[140] *Shalson v Russo* [2003] EWHC 1637 (Ch) paras 194.
[141] *Shalson v Russo* [2003] EWHC 1637 (Ch) paras 193, 196-198.
[142] *Shalson v Russo* [2003] EWHC 1637 (Ch) paras 195.

that although Mr Russo may have been driving transactions, the trustee involved itself in what he was doing, wanting to be "kept in the picture".[143]

The court acknowledged that the settlor played a major part in the operations of the companies owned by the trust, but had to bear in mind that he was the appointed investment advisor to the trust, which gave him the authority to take the actions in question.[144] The result may have been different if he was not the appointed investment advisor. This highlights the importance of documenting an arrangement as it really is. The court found that the trust was not under his effective control and that the trustee did not allow him to run the trust. The trustee did its best to control the trust affairs, although the settlor was often "one step ahead of the trustee".[145]

This judgment appears to allow a fair amount of settlor control, but it has to be borne in mind that the settlor was officially appointed to deal with the investment of the trust fund. As long as it can be evidenced that the trustee applied independent judgement (perhaps not even all the time), it appears he would not be considered to have abdicated his fiduciary duties. Importantly, the judgment also indicates a willingness on the part of the judiciary to uphold validly constituted trusts.

4 2 2 2 The litigation surrounding the *Esteem Settlement*[146]

A well-known and much cited Jersey case dealing with reservation of powers by a settlor is the litigation surrounding the *Esteem Settlement.*[147] The settlor of the trusts in question defrauded his employer of substantial sums. The English High Court gave judgment against him for an amount of approximately US$800,000,000. Some of the funds paid into various Jersey trusts were stolen from the companies of which he was chairman. Various applications were brought in Jersey and as a result the trusts were stripped of the assets relating to the fraud.

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[143] *Shalson v Russo* [2003] EWHC 1637 (Ch) paras 198-199.
[144] A trustee who appoints the settlor as investment advisor needs to be mindful, of course, of liability issues should the investments underperform. At the very least, the settlor needs to be sufficiently qualified and experienced and the trustee needs to monitor investment performance, perhaps even more as it would have done with a professional investment advisor.
[145] *Shalson v Russo* [2003] EWHC 1637 (Ch) paras 216-217.
[146] *In the matter of the Esteem Settlement* [2003 JLR 188].
[147] *In the matter of the Esteem Settlement* [2003 JLR 188].

The judgment under consideration here concerned only the "clean" assets that were left in the trusts. The plaintiffs sought to recover these assets on the basis that either the trusts were invalid because they were shams or infringed the principle of *donner et retenir ne vaut*[148] or alternatively that they were valid initially, but should be declared invalid or unenforceable because the settlor had substantial or effective control over the trust. This is referred to as the claim to lift or pierce the veil of the trust. There were two other heads of claim, but they are not relevant in the context of this discussion.[149]

(a) Sham

The allegations of sham and breach of the maxim *donner et retenir ne vaut* were considered first. If one of these claims were successful, there was never a valid trust and the other heads of claim would be irrelevant. Only the sham claim is discussed here.

The Jersey Royal Court referred to the classic English cases defining and dealing with sham.[150] The plaintiffs did not agree that a common intention was required – this was, they said, because a trust was essentially a unilateral transaction. The court analysed Jersey and English case law and concluded that the settlor and trustee had to share the requisite intention to mislead for a trust to be considered a sham under Jersey law.[151]

There was some discussion about the nature of the intention required and specifically whether dishonesty was required to constitute a sham. The court concluded that there must be an intention to mislead and this may be regarded as dishonesty, depending on one's definition of dishonesty. The court found, with reference to earlier English case law, that the trustee must share the settlor's intention, but that simply going along with the "shammer" would qualify as the required intention if the trustee acts in a reckless manner. This would generally refer to a trustee signing a trust deed without knowing or caring about what he is signing.[152]

[148] See ch 2 para 3 5 4.
[149] *In the matter of the Esteem Settlement* [2003 JLR 188] 211.
[150] See ch 4 para 2 2 1.
[151] *In the matter of the Esteem Settlement* [2003 JLR 188] 213-221.
[152] *In the matter of the Esteem Settlement* [2003 JLR 188] 221-223.

(b) Piercing the veil of the trust

The court then continued to examine the claim that the veil of the trust should be pierced. This claim was based on the fact that the settlor had substantive and effective control over the trust. (From the judgment it appears that the terms of the trust deed did not reserve specific powers to the settlor. The control in question was *de facto*.) It was claimed that this fact, coupled with the settlor's misuse of the trust, should allow the veil of the trust and/or underlying company to be lifted and the assets of the trust treated as if they belonged to the settlor, allowing the plaintiffs to enforce the judgment against those assets.[153]

The plaintiffs argued that even though there were no previous cases where a court in Jersey (or England) had pierced the veil of a trust to enable a creditor to have recourse to assets held in a hitherto valid trust, it was a logical development of the law on piercing the veil of companies. They argued that the court should take this step.[154]

The court analysed the limited case law where the veil of a company was in fact pierced in a final (as opposed to interlocutory) decision of the court and agreed that two elements had to be present: the control over the company must be such that the controller is able to compel the company to act in the manner it did, and the act complained of must involve some illegality or impropriety. The result of these two factors is that the company's action masks or conceals the action of the controller.[155]

The plaintiffs argued that these requirements were fulfilled. The trust assets were at all relevant times under the substantial or effective control of the settlor and the requisite impropriety or misuse was present – the settlor stole funds and attempted to defeat his creditors and keep his assets out of their reach.[156]

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[153] *In the matter of the Esteem Settlement* [2003 JLR 188] 188-189.
[154] *In the matter of the Esteem Settlement* [2003 JLR 188] 227-228. The court looked briefly at the law on piercing the veil of companies and found that a distinction should be made between *piercing*, which refers to treating the rights or liabilities or activities of a company as those of its shareholders, and *lifting*, which means to look behind the veil or to have regard for the shareholding in a company for some legal purpose. What was intended in this case was therefore piercing the veil.
[155] *In the matter of the Esteem Settlement* [2003 JLR 188] 228-231.
[156] *In the matter of the Esteem Settlement* [2003 JLR 188] 232.

In the end, the court did not consider it appropriate to apply the concept of a veil to trusts.[157] In addition, it has to be borne in mind that the beneficiaries have the entire beneficial interest in the trust property (at least under English and Jersey law). There has to be a good reason why a court should decide not to enforce a trust, but to order instead that the trustees should hold the full beneficial interest in the trust assets not for the beneficiaries, but for the settlor so as to be available to his creditors.[158] Such an analysis is, of course, more complicated in circumstances where the settlor is a beneficiary or if one considers the modern drafting of trust deeds where the position of the discretionary beneficiary is, at least on the face of the trust deed, fairly tenuous.[159]

The court found it unsurprising that the plaintiffs could find no precedent for depriving the beneficiaries of their beneficial interest in circumstances where it was the trustee who did not properly fulfil the obligations imposed on him by law. Unless the trust deed provides for control being exercised by the settlor, if he does so it is unlawful and the court would not enforce such control or give effect to the breach of trust by the trustee.[160]

In this regard, the court said the following:

> "… [T]rustees who allow a third party such as a settlor to assume substantial and effective control would have abdicated their fiduciary duties and would be in breach of trust."[161]

It was thus determined that substantial and effective control coupled with misuse does not entitle a court to pierce the veil of a valid trust and ignore its terms.[162] The court referred to the fact that the TJL confirms this principle: a Jersey trust will be valid unless it falls within certain narrow exceptions.[163] The plaintiffs argued that piercing the veil and transferring the beneficial interest in the assets to the settlor was not the same as negating the validity of the trust. The court did not accept this argument and was of the view that, if a valid trust existed,

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[157] *In the matter of the Esteem Settlement* [2003 JLR 188] 236-237.
[158] *In the matter of the Esteem Settlement* [2003 JLR 188] 237-238.
[159] See ch 4 para 3 1.
[160] *In the matter of the Esteem Settlement* [2003 JLR 188] 239-240.
[161] *In the matter of the Esteem Settlement* [2003 JLR 188] 239-240.
[162] *In the matter of the Esteem Settlement* [2003 JLR 188] 240.
[163] *In the matter of the Esteem Settlement* [2003 JLR 188] 240-241. The Trusts (Jersey) Law 1984 art 10(2) stipulates the exceptions. They are concerned with unlawfulness, immorality, public policy, uncertainty and trusts created under duress, fraud and so on. The court found that none of these exceptions were present.

it would be altogether inconsistent with the recognition and enforcement of the trust to order that the assets should be transferred not to the beneficiaries but to the settlor[164] (who could, of course, also be a beneficiary, which may complicate this argument).

The court then helpfully continued to analyse the level of control that a settlor would have to exercise in order for a court to decide to pierce the veil, in case it was found that they were wrong in holding that piercing the veil of a trust is not possible in law.[165] The court found that most of the case law to which they were referred, required the level of control of a controlling shareholder. Although the phrase *substantial and effective control* was used in some of these cases, they concerned interlocutory relief and the court felt that for a final order of piercing the veil, complete control would be required.[166]

The defining question in determining complete control is not whether the trustee always goes along with the settlor's requests, but whether the trustee does so without applying his mind, without exercising a *bona fide* discretion. That does not mean that every decision of the trustee has to be the right one or a wise one, but that it has to be reached in the manner described. Such a trustee cannot be said to have abdicated his fiduciary duties and be under the control of the settlor.[167]

On a consideration of the evidence of the case, the court found that the settlor did not control the trust. The court considered a wide range of transactions in great detail. Although it was clear that the trustees *in casu* did at times feel under pressure to agree to certain actions, they were able to prove that they considered the proposed transactions in light of tax advice and that they were willing to postpone action until they had consulted with their advisers.[168] With regard to agreeing to make distributions to the settlor, the court found that although the trustees paid great attention to the settlor's views, they did not feel bound by those views.[169]

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[164] *In the matter of the Esteem Settlement* [2003 JLR 188] 241.
[165] In *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch) the court similarly examined an alternative claim of sham despite finding that the trusts were invalid for other reasons, indicating that this is a novel area of the law.
[166] *In the matter of the Esteem Settlement* [2003 JLR 188] 244-245.
[167] *In the matter of the Esteem Settlement* [2003 JLR 188] 248.
[168] *In the matter of the Esteem Settlement* [2003 JLR 188] 294-303.
[169] *In the matter of the Esteem Settlement* [2003 JLR 188] 384. The court found that the trustees only followed the wishes of the settlor without applying their mind in one of the many transactions they reviewed.

Finally, the court made some observations about the balance between the freedom to dispose of one's property, on the one hand, and the interests of creditors, on the other hand. Each jurisdiction deals with this differently, but in Jersey there are a number of remedies available to creditors. The court felt unable to invent a new cause of action that would upset this balance. Given the importance of certainty in transactions and the importance of the trust industry to Jersey as a jurisdiction, the court felt that this would be a matter requiring legislative intervention.[170]

Given that much of modern Jersey trust law is statute made, this is perhaps not a surprising stance taken by the court. However, even in England and South Africa, where trust law is mostly developed by the judiciary, judges seem to be hesitant to make new law in this respect.

4 2 2 3 *TMSF v Merrill Lynch Bank and Trust Company (Cayman) Limited*[171]

A further judgment regarding settlor's powers over offshore trusts, this time from the Privy Council, is *TMSF v Merrill Lynch Bank and Trust Company (Cayman) Limited*.[172] The issue at stake was whether the court should appoint receivers over the settlor's power of revocation in relation to trusts established by him in the Cayman Islands. Judgment was given against the settlor in Turkey for the misappropriation of funds from various banks, which TMSF was established to restructure and administer.

TMSF then discovered that the settlor has divested himself of all his assets, having transferred the same to two Cayman Islands discretionary trusts. The settlor and his wife were the beneficiaries of these trusts and he had a power of revocation that would enable him to revest in himself sufficient assets to satisfy a large portion of the judgment debt.[173] It therefore sought the appointment of a receiver over the power of revocation.

The settlor opposed the remedy sought by TMSF on the basis, generally speaking, that a receiver by way of equitable execution could only be appointed over property and the power

[170] *In the matter of the Esteem Settlement* [2003 JLR 188] 387.
[171] *Tasarruf Mevduati Sigorta Fonu v Merrill Lynch Bank and Trust Company (Cayman) Ltd* [2011] UKPC 17.
[172] *Tasarruf Mevduati Sigorta Fonu v Merrill Lynch Bank and Trust Company (Cayman) Ltd* [2011] UKPC 17.
[173] *Tasarruf Mevduati Sigorta Fonu v Merrill Lynch Bank and Trust Company (Cayman) Ltd* [2011] UKPC 17 paras 1-4.

of revocation was not property.[174] The court of first instance and the Cayman Court of Appeal both ruled in favour of the settlor and refused to afford TMSF this remedy. Treating a power of this nature as property would, according to the first judgment, "strike at the very heart of the trust concept".[175] The Court of Appeal held that it did not have jurisdiction as a matter of law to appoint receivers by way of equitable execution over a power of revocation in a trust, but even if it had, because the settlor had been made bankrupt in Turkey, the natural person to get the settlor's assets would be his trustee in bankruptcy, rather than TMSF as a single creditor.[176] It concluded that such a development, namely that a certain type of power should be considered property, has always been and must continue to be a duty of the legislature rather than the judiciary. However, it did not agree with the court *a quo*'s statement that it would strike at the very heart of the trust concept.[177]

The Privy Council's analysis highlighted the important issue of the fiduciary or personal nature of the power in question. The Council referred to instances where general powers, being powers that the power holder can exercise for his own benefit without the consent of another, have been treated as giving rise to proprietary rights. Context is important, and the fundamental distinction between power and property has not prevailed in all circumstances.[178] Another important factor is whether the power can be delegated. In this context, the distinction between fiduciary and general powers is crucial. Where the power holder does not owe a duty of trust to another, the power is so wide as to be tantamount to ownership and can thus be delegated.[179]

The Privy Council concluded that, in view of the demands of justice and because the jurisdiction to appoint receivers by way of equitable execution was open to incremental development to apply old principles to new situations, the jurisdiction should in this case be exercised. It held that the power of revocation was such that, in equity and in the

[174] *Tasarruf Mevduati Sigorta Fonu v Merrill Lynch Bank and Trust Company (Cayman) Ltd* [2011] UKPC 17 para 7.
[175] *Tasarruf Mevduati Sigorta Fonu v Merrill Lynch Bank and Trust Company (Cayman) Ltd* [2011] UKPC 17 para 21.
[176] *Tasarruf Mevduati Sigorta Fonu v Merrill Lynch Bank and Trust Company (Cayman) Ltd* [2011] UKPC 17 paras 22-23.
[177] *Tasarruf Mevduati Sigorta Fonu v Merrill Lynch Bank and Trust Company (Cayman) Ltd* [2011] UKPC 17 para 25.
[178] *Tasarruf Mevduati Sigorta Fonu v Merrill Lynch Bank and Trust Company (Cayman) Ltd* [2011] UKPC 17 paras 41-46.
[179] *Tasarruf Mevduati Sigorta Fonu v Merrill Lynch Bank and Trust Company (Cayman) Ltd* [2011] UKPC 17 paras 51-53.

circumstances of this case, the settlor's rights could be regarded as tantamount to ownership. He was, therefore, ordered to assign or delegate the power of revocation to the receivers.[180]

4 2 2 4 *Mezhprom Bank v Pugachev*[181]

In this recent landmark judgment regarding settlor control, the English High Court found that the economic settlor, Mr Pugachev, failed to set up valid trusts. By way of background, Mr Pugachev initially used a company, referred to as OPK, to hold some of his very valuable assets, including the Russian Mezhprom Bank, which he founded. Mezhprom Bank collapsed after the 2008 financial crisis and criminal investigations were opened against Mr Pugachev for misappropriation of the bank's funds. He fled to England in January 2011.

Shortly afterwards, he established five discretionary trusts. The trusts were all subject to New Zealand law, but it was not disputed that, for all relevant purposes, New Zealand law was the same as English law.

Each trust had a newly incorporated New Zealand company, therefore a private trust company,[182] as trustee. The directors of these companies were a number of individuals working for and controlled by Mr Pugachev, as well as a Mr Patterson, a New Zealand solicitor who also drafted the trust deeds, apparently based on the trust deed used in Mr Pugachev's previous OPK structure.

In July 2014, a worldwide freezing order was made against Mr Pugachev. This referred to any asset which he had the power, directly or indirectly, to dispose of or deal with as if it were his own. The effect of the judgment under discussion is that the assets held in the trusts were ruled to be subject to the freezing order, because Mr Pugachev retained sufficient powers to enable him to exercise effective control.

Mezhprom Bank and its liquidator were the claimants *in casu*, seeking an order that the assets be vested in them or alternatively in such persons or a receiver as the court thought fit. The defendants were the representatives of the minor children of Mr Pugachev and his partner.

[180] *Tasarruf Mevduati Sigorta Fonu v Merrill Lynch Bank and Trust Company (Cayman) Ltd* [2011] UKPC 17 paras 54-62.
[181] *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch).
[182] See ch 4 para 3 2 2, where private trust companies are discussed.

The claimant's case had three alternative bases: the trusts were illusory, in the sense that the terms of the trust deeds did not divest Mr Pugachev of his beneficial interest in the trust assets; the trusts were shams and therefore of no effect; and the transfers into the trusts prejudiced the interests of his creditors and therefore breached section 423 of the Insolvency Act 1986.[183]

A very important feature of the case is the terms of the five trust deeds (which were in all material respects the same). In the final analysis, the construction of the trust deeds was of vital importance and resulted in the court holding that the trust deeds were not effective to divest Mr Pugachev of his beneficial interest in the assets.

Mr Pugachev was the true economic settlor (although each trust was in the form of a declaration of trust by the trustee and thus did not name him as settlor) and was also a member of the class of discretionary beneficiaries. Crucially, he himself was the first protector of the trust. In the event of his death or disability, one of his adult sons from his first marriage would automatically become the protector. It was not disputed that this son was subservient to Mr Pugachev. Disability was defined to also include instances where he was rendered incapable of exercising his free will.[184]

The powers of the protector included veto powers over a wide range of trustee powers, including distributions of income or capital, the investment of the trust fund, the removal of beneficiaries, the variation of the trust deed and so on. The protector further had the power to appoint additional beneficiaries and, last but not least, the power to remove the trustee with or without cause and appoint a new trustee.[185] It was not specified in the trust deed whether these powers were fiduciary in nature.

[183] *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch) paras 70-73. Although it was not necessary to examine the section 423 claim, the judge said at paras 443-448 that Mr Pugachev's real and substantial purpose in setting up the trusts and transferring assets to them was to defeat his creditors. Therefore, in the absence of the other two claims, the transfers to the trusts would in any event have been liable to be set aside under the Insolvency Act 1986.
[184] *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch) para 110.
[185] *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch) para 115-117.

(a) Illusory trust argument, or the true effect of the trusts claim

The claim based on the illusory trust argument was that Mr Pugachev retained so many powers under the trust deeds that, on a proper construction of the deeds, he did not divest himself of the beneficial ownership of the assets. Birss J preferred to call this the "true effect of the trusts" claim rather than the illusory trust claim.[186]

The court remarked that the analysis of the powers a person has under the trust deed (in this case the protector's powers) is concerned with the effect of the deed, which entitles the court to construe the powers and duties as a whole in order to identify the substance of what is going on. Careful consideration of a trust deed may show that a settlor had effectively retained powers of ownership. This is not the same as an analysis of the subjective intentions of the parties in order to ascertain whether there was a sham.[187]

The judge also made an interesting analysis of the use of discretionary trusts and protectors.[188] He explained how what he referred to as an unscrupulous person would be able to use a discretionary trust to show that he does not have ownership of or a right to the trust assets, but at the same time would be able to control the assets *via* the role of a protector. The settlor of a trust who is simply a member of a class of beneficiaries knows that he has no guarantee of receiving a distribution from the trust. That is attractive to the unscrupulous person in so far that he does not want to be seen as the owner of the assets. On the other hand, what is not so attractive is that he loses control to the trustee, who may refuse to distribute the trust assets back to him.

This is where a protector may be useful, especially if the settlor himself can be the protector.[189] If the unscrupulous person becomes a protector with non-fiduciary powers – in other words, powers that can be exercised by him selfishly in his own interest, rather than in the interest of the beneficiaries as a whole – he can prevent the trustee from distributing trust assets to anyone but himself. If the trustee is uncooperative, the unscrupulous person can

[186] *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch) paras 70-71. The judge was referred to case law from Bermuda and New Zealand, examined below, in support of the illusory trust argument. This is at paras 155-169.
[187] *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch) para 167.
[188] See also ch 4 para 3 1 regarding the modern uses of discretionary trusts.
[189] See ch 4 para 3 2 4 regarding the nature of protector powers.

easily replace him with a trustee who would be more inclined to agree with him. The judge found that in such a case the discretionary trust is not really a discretionary trust.[190]

In the course of analysing the true effect of the trust deeds, the court made it clear that it was bound to consider the entire picture and all the surrounding facts and circumstances. The most important factor appears to have been Mr Pugachev's role as protector and the wide powers reserved to the protector, but it was the combination of factors, the fact that he was not only the protector but also the settlor and a beneficiary, that led to the conclusion that his powers as protector were personal and not fiduciary. Mr Pugachev, through the combination of powers and roles he held, could ensure that none of the trust assets could be distributed to anyone but himself. As a result, the judge concluded that the terms of the trust deeds did not have the effect of divesting Mr Pugachev of the beneficial ownership of the assets.[191]

(b) Sham

The judge proceeded to consider whether, in the event that his analysis regarding the true effect of the deeds was incorrect and the protector's powers were in fact fiduciary so that Mr Pugachev did divest himself of the beneficial ownership of the assets, the trusts would be shams. A finding of sham would require a common intention of Mr Pugachev and the trustee to create rights and obligations different to those borne out by the trust deeds. As far as Mr Pugachcv's intention was concerned,[192] the judge found that he may have wanted to provide for his family, but only on terms that suited him. There was no indication that he wanted to cede control of the assets placed in the trusts and it was clear that his main objective was to protect the assets from creditor claims.[193]

There was no doubt that the other individuals involved as directors and shareholders of the trustee companies were Mr Pugachev's "lieutenants" and did his bidding.[194] Mr Patterson was, however, in a different position. He was an experienced solicitor and the judge examined his conduct in minute detail. The judge considered that he had to ascertain not what Mr Patterson

[190] *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch) paras 173-182.
[191] *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch) paras 269, 272, 275, 278.
[192] Mr Pugachev did not take part in these proceedings. The judge had to make inferences from the statements and evidence of the other witnesses and the surrounding circumstances as presented to the court.
[193] *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch) paras 286-298.
[194] *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch) para 426.

thought about his role as trustee, but what Mr Patterson thought about Mr Pugachev's position as protector of the trusts.[195]

Various examples of Mr Patterson's conduct were examined as part of this process and this indicated that he accepted Mr Pugachev's role as being in control of the trust.[196] When, finally, there was resistance from Mr Patterson regarding a loan request on behalf of Mr Pugachev, the latter proceeded to exercise his protector powers to replace the trustees of all the trusts.[197]

In drawing a conclusion about the sham claim, the judge had no doubt about Mr Pugachev's intention to use the trusts as a pretence to mislead third parties.[198] To determine the trustee's intention, the conduct of Mr Patterson, the only director of the trustee companies who was not clearly one of Mr Pugachev's lieutenants, was considered vital. Asked about his own intentions, he said that he did not intend for Mr Pugachev to have complete control. The judge did not accept this, given the conduct mentioned earlier.[199] He found that Mr Patterson may not have known the settlor's true intentions, but he could not see how a person in Mr Patterson's position could reasonably infer that Mr Pugachev really wanted to relinquish control.[200] He could have asked about Mr Pugachev's intentions but he did not. The judge further said:

> "The best that can be said is that Mr Patterson prepared and signed these deeds entirely recklessly as to the settlor's true intentions."[201]

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[195] *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch) paras 304-307.
[196] *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch) paras 318-320, 338-339, 343-349, 365-373, 376-379. The conduct investigated included a lack of trustee control over the trusts' finances with Mr Pugachev being appointed a joint signatory on a bank account; Mr Patterson referring to Mr Pugachev as the ultimate beneficial owner in emails; Mr Patterson excluding a beneficiary of the trust on Mr Pugachev's instruction without making his own enquiries; and Mr Patterson's written opinion that the protector of the OPK trust deed (used as a precedent for the trust deeds in question) has ultimate control of the trust. The judge also referred to correspondence between Mr Patterson and Mr Pugachev's family office prior to the establishment of the trusts, from which it was clear that the family office was under the impression that Mr Pugachev could do what he wanted in terms of amending the provisions of the trust deed, even though the power of amendment was vested in the trustee, albeit subject to protector consent. Mr Patterson did nothing to expel this misunderstanding.
[197] *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch) paras 417-429.
[198] *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch) para 424.
[199] Specifically in relation to referring to Mr Pugachev as the ultimate beneficial owner, his opinion on the OPK trust deed, the removal of Alexander and the correspondence about the ability of Mr Pugachev to vary the trust deed.
[200] *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch) paras 427-435.
[201] *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch) para 435.

Given the judge's finding on the first leg of the claimant's claim, namely that the trust deeds fulfilled Mr Pugachev's real intention to retain control over the assets, he did not consider the trusts shams. However, given the above exposition of the intentions of the settlor and the trustee, the judge said that if he was wrong in his construction of the trust deeds and Mr Pugachev did not retain beneficial ownership of the trust assets, then the trusts were a sham, because Mr Pugachev did not intend to lose beneficial ownership of the assets.[202]

In conclusion, the judge stated:

> "However, whatever label is to be applied to this case, in my judgment the combination of circumstances here means that the court should not give effect to these instruments that would result in the assets being regarded as outside Mr Pugachev's ultimate control. The whole scheme was set up to facilitate a pretence about ownership (or rather its absence) should the need arise."[203]

The orders following this judgment were made separately, the claimant claiming that the assets be transferred to them or a receiver.[204] It remains to be seen whether the judgment will be appealed, but it appears to have opened up another route for attacking trusts under which settlors retain extensive powers.

It is unfortunate that the facts were so extreme, as it is difficult to distill general principles, but the judgment has certainly created a renewed level of awareness of settlor reserved powers. It has also emphasised the need for trustee independence, especially in the case of private trustee companies, in order to ensure that the protection offered by the trust is not lost.

4 2 3 Case law dealing with divorce

The English courts have dealt with many divorce cases involving trusts and over the last few years these have become quite noteworthy, often because of the sums involved.

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[202] *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch) paras 436-437.
[203] *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch) para 442.
[204] *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch) paras 449-450.

4 2 3 1 *A v A*[205]

In this case dealing with sham, the husband was not the settlor but a beneficiary. Although this was therefore not a classic case of settlor control, it was clear that the husband was involved in the businesses owned by the trust and had a role in their financial welfare. The wife claimed that the trusts were shams, so that the husband should be treated as owning the trust assets, and that the assets were in any event to be treated as the husband's on the basis that it was a source of wealth available to him.[206] The judgment contains a helpful and recent confirmation of the English law on sham trusts.

(a) Sham

The court concluded that the sham allegations were unfounded, as it could not be proved that the trustees were a party to the sham.[207]

The point was made that the fact that a settlor exercises control over a trust does not mean that it is a sham. Although the court will take a robust approach where settlor control is present or the trust is an alter ego of the settlor, it will not completely ignore the established principles relating to the ownership of assets by a trust, especially where third parties are involved. In other words, there has to be a proper basis for ignoring the existence of a trust.[208]

Munby J also held, by reference to *Charman v Charman*[209] (where trust assets were brought into account for purposes of a divorce order), that a settlor's access to funds does not necessarily indicate improper conduct on the part of the trustee. A trustee who properly controls a trust can quite rightly, on the request of the settlor, decide to distribute capital to the settlor or someone else, provided that all the relevant circumstances were taken into account and the decision was reached in good faith. [210]

Once a valid trust existed, the court said that the trustee cannot divest himself of his fiduciary obligations by his own improper acts. Even if a trustee subsequently agrees to treat the trust as

[205] *A v A* [2007] EWHC 99 (Fam).
[206] *A v A* [2007] EWHC 99 (Fam) paras 25-26.
[207] *A v A* [2007] EWHC 99 (Fam) paras 32-42.
[208] *A v A* [2007] EWHC 99 (Fam) paras 17-19.
[209] *Charman v Charman* [2005] EWCA Civ 1606.
[210] *A v A* [2007] EWHC 99 (Fam) para 29.

a sham, this does not turn a valid trust into a sham. It may expose the trustee to a claim for a breach of trust, but once a valid trust is created it cannot turn into a sham.[211]

(b) Financial resource

In support of the second claim that the trust assets were a resource available to the husband, the wife alleged that the husband controlled the trust assets and could do with it as he pleased. In this context, whether the spouse has immediate access to the funds has been found to be more important than whether he has effective control over it.[212]

Although a court can encourage a trustee to transfer assets to a spouse, it cannot compel or exercise improper pressure on the trustee to do so.[213] Can this be interpreted to mean that the court cannot in these circumstances go behind the trust or lift the veil of the trust? Counsel for the husband pointed out that even where a court gives judicious encouragement to trustees, the trustees should "jealously guard their independence in this respect"[214] – they must consider the interests of the beneficiaries as a whole. Munby J concluded that for the court to suggest that the trustees should advance capital from the trust to the husband to allow him to meet his obligations under a divorce order would constitute improper pressure. He therefore declined to make such an order.[215]

4 2 3 2 *Charman v Charman*[216]

This Court of Appeal judgment was heard in the same year as *A v A*.[217] At the time of the first hearing of *Charman*[218] it was the largest ever contested divorce case in England in monetary terms, the parties' assets amounting to £131 million. One of the main grounds of the appeal by the husband was that assets worth £68 million, held in a discretionary Jersey law trust set

[211] *A v A* [2007] EWHC 99 (Fam) paras 42-43.
[212] *A v A* [2007] EWHC 99 (Fam) paras 88-92. The position in English law is that, for purposes of the Matrimonial Causes Act 1973, the court can take into account assets owned or administered by third parties, if those assets are available to the relevant spouse. The question is whether the trustee would be likely, either immediately or in the foreseeable future, to accede to a request of the spouse to exercise the trustee's discretion in the spouse's favour or for his benefit.
[213] *A v A* [2007] EWHC 99 (Fam) paras 95-96.
[214] *A v A* [2007] EWHC 99 (Fam) para 97.
[215] *A v A* [2007] EWHC 99 (Fam) para 100.
[216] *Charman v Charman* [2007] EWCA Civ 503.
[217] *A v A* [2007] EWHC 99 (Fam).
[218] *Charman v Charman* [2006] EWHC 1879 (Fam).

up by the husband, of which he and his wife and children were beneficiaries, should not have been taken into account in computing their total assets.[219] At the time of creating the trust, the husband transferred a modest amount of money to fund the trust, which amount was used by the trustees to purchase shares in the husband's business. Over time, this business became hugely successful and extremely valuable.[220] Further sales and investments were made in the businesses of the husband, always at his request.[221]

Although the central question was whether, if the settlor had asked the trustees for a distribution, they were likely to agree, there were elements of settlor control. This included (apart from the fact that the trust assets were mainly the businesses run by the settlor) the fact that the settlor had the power to replace the trustee. This provision, in fact, appears to have been added in order to increase the likelihood that the trust would be administered in accordance with the settlor's letter of wishes.[222] The letter of wishes initially provided, *inter alia*, that:

> "Insofar as is consistent with the terms of the Settlement I wish to have the fullest possible access to the capital and income of the Settlement including the possibility of investing the entire Fund in business ventures undertaken by me."[223]

A later version, written after the breakdown of the marriage, still stated that he wished to be treated as the primary beneficiary.[224]

The Court of Appeal found that the court *a quo* was correct to hold that the assets of the trust should be attributed to the husband. The husband's arguments that the trust was dynastic and that he did not intend to benefit from it were rejected, given that there was no evidence to corroborate such an argument. A dynastic intention may in any event not have made much difference according to the lower court, the test being whether the assets are available as a "resource".[225] The court was of the view that, although the trust assets were not the husband's,

[219] *Charman v Charman* [2007] EWCA Civ 503 para 7.
[220] *Charman v Charman* [2007] EWCA Civ 503 para 34.
[221] *Charman v Charman* [2007] EWCA Civ 503 para 36.
[222] *Charman v Charman* [2007] EWCA Civ 503 para 55.
[223] *Charman v Charman* [2007] EWCA Civ 503 para 33.
[224] *Charman v Charman* [2007] EWCA Civ 503 para 52.
[225] *Charman v Charman* [2006] EWHC 1879 (Fam) para 79.

they could at the same time be available to him on demand and therefore it would be wrong not to include the assets in the computation.[226]

Relevant to the issue of control, the Court of Appeal further mentioned the husband's express power to replace the trustee. If the trustee refused the settlor's request for the advancement of capital, the settlor could simply replace him. The court concluded that this was another factor relevant to the likelihood of an advancement.[227]

The appeal was dismissed and the court remarked:

> "But, whenever it is necessary to conduct such an enquiry, it is essential for the court to bring to it a judicious mixture of worldly realism and of respect for the legal effects of trusts, the legal duties of trustees and, in the case of off-shore trusts, the jurisdictions of off-shore courts. In the circumstances of the present case it would have been a shameful emasculation of the court's duty to be fair if the assets which the husband built up in [the trust] during the marriage had not been attributed to him."[228]

The basis for this decision appears not to be ignoring the trust, but attributing assets to the settlor on the ground that the assets are a resource available to him. In this respect, it appears that settlor control could indeed be a factor in determining whether the trust fund is available to a spouse as a financial resource.

4 2 3 3 *Clayton v Clayton*[229]

Although not a classical offshore jurisdiction, New Zealand is part of the Commonwealth and its trust law closely follows that of England.[230] A recent case in the context of divorce has brought to the fore the question of whether there is a distinction between a sham trust and an

[226] *Charman v Charman* [2007] EWCA Civ 503 paras 45-46.
[227] *Charman v Charman* [2007] EWCA Civ 503 para 55.
[228] *Charman v Charman* [2007] EWCA Civ 503 para 57.
[229] *Clayton v Clayton* [2016] NZSC 29.
[230] Anonymous http://www.lawcom.govt.nz/our-projects/law-trusts (accessed 02-08-2018). A favourable tax regime exists for New Zealand trusts with a non-New Zealand resident settlor, even if the beneficiaries and trustees are resident in New Zealand. Such a trust is not taxable on foreign sourced income (and in that sense can be used like a classic offshore trust), although disclosure requirements were introduced recently, which have to be complied with in order to benefit from this tax regime.

illusory trust. In *Clayton v Clayton*,[231] a number of trusts established by Mr Clayton were at stake, only one of which was relevant in the context of settlor control. Both the Court of Appeal and the Supreme Court judgments are of interest.

By way of background, Mr Clayton was the settlor, the sole trustee and the principal beneficiary of the trust in question. The other beneficiaries included his children and their issue, Mrs Clayton and any person appointed as a beneficiary by Mr Clayton. Mr Clayton had normal trustee powers, including being able to distribute all the trust assets to himself as principal beneficiary, and also to deal with the trust assets as if he were the absolute owner of it and beneficially entitled to it. As principal beneficiary he had the power to appoint and remove beneficiaries as well as trustees.[232]

Mrs Clayton claimed that the relevant trust was either a sham or an illusory trust, and therefore the assets still belonged to Mr Clayton and should be taken into account in the division of the matrimonial assets. As an alternative claim, if the trust was found to be valid, Mrs Clayton claimed that the rights and powers conferred on Mr Clayton amounted to property that can be taken into account in such a division.

As the Supreme Court of Appeal found that the powers did amount to property, the part of the judgment dealing with this aspect will be examined first.

(a) Is power tantamount to property?

The Court of Appeal found that the essential requirements for the establishment of a valid trust existed and that, despite the wide powers conferred on Mr Clayton, this did not eradicate the irreducible core of obligations – to act honestly and in good faith – enforceable by the other beneficiaries.[233] Unlike the High Court,[234] the Court of Appeal therefore did not find that Mr Clayton's retained powers amounted to ownership of the trust property.[235]

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[231] *Clayton v Clayton* [2015] NZCA 30; *Clayton v Clayton* [2016] NZSC 29.
[232] *Clayton v Clayton* [2015] NZCA 30 paras 45-47. Although under New Zealand law a person can be both settlor and trustee, and both trustee and a member of a class of beneficiaries, the trustee cannot be the sole beneficiary. That would mean that the legal and equitable interests in the trust property are vested in the same person and as a result there would be no trust.
[233] *Clayton v Clayton* [2015] NZCA 30 paras 50-52 where reference is made to the English case of *Armitage v Nurse* (1998) Ch 241.
[234] *Clayton v Clayton* [2013] NZHC 301.
[235] *Clayton v Clayton* [2015] NZCA 30 para 55.

This finding was overturned by the Supreme Court. Both the Court of Appeal and the Supreme Court referred to the *TMSF*[236] case, discussed above, where a power of revocation reserved to the settlor was found to be tantamount to ownership.[237] The Supreme Court analysed the clause that allowed Mr Clayton to appoint or remove discretionary beneficiaries. They found that the power was conferred on him in his capacity as principal family member (being the principal beneficiary) and not his capacity as trustee. It meant that he had the power to remove all other beneficiaries and appoint the whole trust fund to himself.

The court did not think that this power on its own amounted to a general power of appointment or, to put it differently, to ownership of the assets.[238] The Supreme Court examined the other powers conferred on Mr Clayton and found that he could exercise these powers in his own interest and to the detriment of the other beneficiaries, without being constrained by any fiduciary duty. Even though he could not remove the final default beneficiaries, being his children, there was nothing to prevent him from appointing the whole trust fund to himself.[239] The Supreme Court therefore concluded:

> "…[T]he combination of powers and entitlements of Mr Clayton as Principal Family Member, Trustee and Discretionary Beneficiary of the [trust] amount in effect to a general power of appointment in relation to the assets of the [trust]."[240]

The court relied on the Privy Council decision in *TMSF*[241] that a general power of appointment can be treated as property in certain circumstances. *In casu* the powers and entitlements of Mr Clayton, including the general power of appointment, were regarded as property to be taken into account for the purposes of the relevant New Zealand matrimonial property legislation.[242]

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[236] *Tasarruf Mevduati Sigorta Fonu v Merrill Lynch Bank and Trust Company (Cayman) Ltd* [2011] UKPC 17.
[237] *Clayton v Clayton* [2015] NZCA 30 paras 94-114; *Clayton v Clayton* [2016] NZSC 29 paras 39-44.
[238] *Clayton v Clayton* [2016] NZSC 29 para 49.
[239] *Clayton v Clayton* [2016] NZSC 29 paras 50-67.
[240] *Clayton v Clayton* [2016] NZSC 29 para 68.
[241] *Tasarruf Mevduati Sigorta Fonu v Merrill Lynch Bank and Trust Company (Cayman) Ltd* [2011] UKPC 17.
[242] *Clayton v Clayton* [2016] NZSC 29 para 98.

(b) Sham

The lower courts, including the Court of Appeal, found that the trust was not a sham, as it was clear that Mr Clayton had a genuine intention to create a trust, albeit mainly for business purposes.[243] The Supreme Court agreed with this reasoning.[244] This is another affirmation of the difficulty to demonstrate the requisite intention for a finding that a trust is a sham.

(c) Illusory trust

This was the first time the concept of an illusory trust has been considered in New Zealand case law as a concept distinct from a sham trust. This was clear from the diverging judgments and reasoning on this point. The court of the first instance found that the trust was illusory because Mr Clayton had total control over the trust – he had no accountability towards the beneficiaries and he could revoke the trust in his favour at any time.[245]

The High Court agreed that the trust was illusory but for different reasons, namely because Mr Clayton effectively retained all powers of ownership and could in reality deal with the assets of the trust as if the trust had never been created.[246]

The Court of Appeal overturned this finding, disregarding the concept of an illusory trust and remarking that no authority was referred to for the concept of an illusory trust as distinct from a sham trust.[247]

The Supreme Court pointed out that the same factors that led them to conclude that Mr Clayton's powers amounted to a general power of appointment led the High Court to conclude that the trust was illusory.[248]

[243] *Clayton v Clayton* [2015] NZCA 30 paras 57-70.
[244] *Clayton v Clayton* [2016] NZSC 29 para 117.
[245] *Clayton v Clayton* [2015] NZCA 30 para 71-72.
[246] *Clayton v Clayton* [2015] NZCA 30 para 73.
[247] *Clayton v Clayton* [2015] NZCA 30 paras 74-85.
[248] *Clayton v Clayton* [2016] NZSC 29 para 118.

The Supreme Court concluded:

> "…[A] finding that a trust deed is not a sham does not seem to us to preclude a finding that the attempt to create a trust failed and that no valid trust came into existence… For our part we do not see any value in using the "illusory" label: if there is no valid trust, that is all that needs to be said."[249]

Because the Supreme Court found that the combination of powers and entitlements vested in Mr Clayton amounted to property to be taken into account in the division of assets, they did not have to determine whether the powers held by Mr Clayton were so broad that, although he intended to establish a trust, he failed to create a valid trust.

4 2 4 Case law dealing with claims other than from creditors or former spouses

4 2 4 1 The *A Q Revocable Trusts*[250]

An example of where a trust was found to be invalid or illusory is the Supreme Court of Bermuda's judgment in the case of the *AQ Revocable Trusts*.[251] The facts relating to this trust governed by Bermudan law were extreme in that the settlor was also the sole trustee for the first four years, after which his wife was appointed as co-trustee; the trusts were revocable by the settlor; he had the right to the entire net income and such capital as the trustee decided; and he had the power to appoint and remove trustees. The trustees were absolved from liability for investments and a further provision released them from all liability if a transaction had the written approval of the settlor.[252]

The settlor's sons brought an application declaring the trusts invalid on the basis that they were, on a true construction, testamentary, the result of which would be that the trusts were

[249] *Clayton v Clayton* [2016] NZSC 29 para 123.
[250] *In the matter of the AQ Revocable Trust for Sons dated 1976 and the AQ Revocable Trust for Grandchildren dated 1976* [2010] SC (Bda) 40 Civ.
[251] *In the matter of the AQ Revocable Trust for Sons dated 1976 and the AQ Revocable Trust for Grandchildren dated 1976* [2010] SC (Bda) 40 Civ.
[252] *In the matter of the AQ Revocable Trust for Sons dated 1976 and the AQ Revocable Trust for Grandchildren dated 1976* [2010] SC (Bda) 40 Civ paras 4-7.

revoked by the settlor's last subsequent will and the assets therefore fell into the trusts established by that will.[253]

The judge referred to Lewin's work on trusts[254] for authority that the reservation by the settlor of large beneficial powers and interests may cause an *inter vivos* trust to be considered illusory and in some cases, where a power or revocation is also reserved, considered testamentary. However, the reservation of such rights and powers would not necessarily cause a trust to be considered illusory – it would only be the case where the settlor was in all but name the equitable owner of the property during his lifetime.[255]

A crucial factor in this objective test appears to be whether the settlor retained an unrestricted power to dispose of the assets without being accountable for those assets.[256] This requirement plays into the essential requirement of accountability of a trustee towards the beneficiaries.[257] Although American law seemingly developed in such a way as to uphold *inter vivos* trusts regardless of the reservation by the settlor of extensive powers over the administration of the trust, the judge considered the general common law position, and certainly that under English law, to be that such a reservation may in certain circumstances be inconsistent with the existence of a trust.[258]

In conclusion the court held:

> "…[T]he concatenation of rights and powers in the Settlor, when coupled with the fact that he was the sole trustee at the time of the constitution of the Trusts, rendered this trust illusory during his lifetime… I accept [the] submission that the cumulative effect of the trust documents, when taken with the *de facto* situation, means that the Settlor as Trustee could not effectively be called to account during his lifetime. Crucial to this

[253] *In the matter of the AQ Revocable Trust for Sons dated 1976 and the AQ Revocable Trust for Grandchildren dated 1976* [2010] SC (Bda) 40 Civ paras 1-3.
[254] Tucker *et al Lewin on Trusts*, but note that the judge referred to the previous edition of this work.
[255] *In the matter of the AQ Revocable Trust for Sons dated 1976 and the AQ Revocable Trust for Grandchildren dated 1976* [2010] SC (Bda) 40 Civ para 9.
[256] *In the matter of the AQ Revocable Trust for Sons dated 1976 and the AQ Revocable Trust for Grandchildren dated 1976* [2010] SC (Bda) 40 Civ para 13; in para 20 reference is made to s 2(2)(a) Trusts (Special Provisions) Act 1989, where the accountability of the trustee is listed as one of the characteristics of a trust under Bermudan law.
[257] *Armitage v Nurse* (1998) Ch 241 253-254.
[258] *In the matter of the AQ Revocable Trust for Sons dated 1976 and the AQ Revocable Trust for Grandchildren dated 1976* [2010] SC (Bda) 40 Civ paras 16-17.

> conclusion is Art. VIII H, which allows the Settlor to absolve himself as Trustee from any and all breaches of trust. While it may be that I would not have come to that conclusion had Art. VIII H been coupled with a distinct and independent trustee, in this case it is the combination which pushes it over the top."[259]

The judge further found that the settlor had no intention to fetter his control and enjoyment over the trust property and had understood that he would retain such control and enjoyment when he executed the trust documents. The way the trusts were administered corroborated this – there were no trustee minutes or books of account and the settlor dealt with the assets as if they were his. Therefore, even if the court were wrong to hold that the trusts were "bad on their face", they were in fact invalid as the settlor did not have the necessary intent to create *inter vivos* trusts, but only intended the trusts to take effect upon his death. As no valid lifetime trusts were created, the assets fell into the trusts created by the settlor's subsequent will.[260]

4 2 4 2 The *A and B Trusts*[261]

The use of a protector as a means of controlling the trustee was examined in *In the matter of the A and B Trusts,*[262] a Jersey case concerning an application for the removal of a protector. Although the hearing took place in private, extracts from the judgment were published in view of the scarcity of reported judgments concerning the role of protectors. The protector in this case was of the view that one of his main duties was to ensure that the settlor's wishes were carried out by the trustee. The court, however, confirmed that his paramount duty was to the beneficiaries of the trust and that, with regard to the settlor's wishes, his duty was merely to do his best to see that the trustee had due regard to the settlor's wishes.[263]

This indicates that the settlor and his wishes are not to be ignored as soon as he signs the trust deed, but that they should not be slavishly followed without the trustee exercising

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[259] *In the matter of the AQ Revocable Trust for Sons dated 1976 and the AQ Revocable Trust for Grandchildren dated 1976* [2010] SC (Bda) 40 Civ para 29.
[260] *In the matter of the AQ Revocable Trust for Sons dated 1976 and the AQ Revocable Trust for Grandchildren dated 1976* [2010] SC (Bda) 40 Civ paras 31-31.
[261] *In the matter of the representation of C, D, E and F and in the matter of the A and B Trusts* [2012] JRC 169A.
[262] *In the matter of the representation of C, D, E and F and in the matter of the A and B Trusts* [2012] JRC 169A.
[263] *In the matter of the representation of C, D, E and F and in the matter of the A and B Trusts* [2012] JRC 169A paras 3-4.

independent discretion.[264] The interests of the beneficiaries are more important. Given the protector's "overactive" part in the management of the trusts and the breakdown of the relationship between the protector and the beneficiaries, the court decided that allowing him to continue in this role would have a serious detrimental effect on the trust relationship and he was therefore removed.[265]

4 2 5 Conclusion regarding English and offshore case law review

It is interesting to note that a number of recent cases have referred to the combination of powers and entitlements vested in the settlor as the decisive factor in deciding in favour of the party attacking the integrity of the trust. A settlor can exercise control in a number of ways, some less obvious than others. Control by someone other than the trustee does not, without more, constitute a problem. A combination of control and entitlement, however, particularly when concentrated in the settlor, indicates that there is no, or very little, accountability towards other beneficiaries. It exposes a lack of separation between ownership and enjoyment of the trust assets. It can even indicate that the settlor had no intention to divest himself of the beneficial or equitable ownership of the trust assets. Such extreme cases appear to be increasingly vulnerable to attack, and recent judgments such as *Clayton*,[266] *TMSF*[267] and *Pugachev*[268] signify the attitude of courts with regard to abuse of the trust form, particularly where the interests of creditors or divorcing spouses are concerned.

It is submitted that a distinction should be made between powers over investment of the trust fund and powers over the disposition thereof. Carving out investment powers is not unusual. Depending on the type of trust asset, it is likely that the trustee does not have the necessary expertise to manage the trust's investments and would outsource this function in any event. Where the settlor is suitably qualified, it may be perfectly acceptable for him to retain investment powers, although this should be properly documented. In such a case, the trustee would not want to retain liability to the beneficiaries for investment of the trust fund.[269]

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[264] In practice it would be very difficult for a trustee to administer a discretionary trust without consulting the settlor, a protector or the beneficiaries from time to time.
[265] *In the matter of the representation of C, D, E and F and in the matter of the A and B Trusts* [2012] JRC 169A paras 8, 10-11.
[266] *Clayton v Clayton* [2016] NZSC 29.
[267] *Tasarruf Mevduati Sigorta Fonu v Merrill Lynch Bank and Trust Company (Cayman) Ltd* [2011] UKPC 17.
[268] *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch).
[269] This interplay between control and liability is examined in the final chapter.

However, a settlor reserving power over decisions with regard to the distribution of the trust fund, especially if he is a beneficiary himself, interferes with the separation between control and enjoyment.

The drafting of trust deeds under English and, especially, offshore trust law, having evolved over years to become much more settlor focused, may have to undergo another revision if the integrity of such trusts is to be retained. Moreover, care needs to be taken not to assume that a trust deed can say one thing but the settlor can do something else. Although difficult to prove, such an intention from the outset may invite allegations of sham.

Launching a successful attack based on sham is not simple. Narrowly defined requirements must be met. However, where it is clear that the settlor did not intend to create a trust and did not want to divest himself of the beneficial ownership of the assets, a claimant may be able to prove that no valid trust came into existence in the first place, without the need to evidence a shared intention on the part of the trustee. This is because one of the three certainties required to create a valid express trust is lacking – certainty of intention.[270]

Given the way trust law, drafting practices and the use of discretionary trusts have developed, especially offshore, many settlors have over time become accustomed to being offered extensive powers over trusts settled by them. They are advised that retaining such powers would not affect the validity of those trusts, especially if governed by the law of a jurisdiction that recognises reserved power trusts.[271] Trusts are sold on this basis. Trust deeds are drafted accordingly. This reduces the risk of a sham argument, because the trust deed reflects the reality of the situation, namely that the settlor wishes to retain extensive powers (and in many cases, entitlements too).

Recent case law suggests that this may now have to be reconsidered, as such a trust deed may be construed not to create a valid trust.[272]

Although none of the cases under consideration concerned trusts governed by a legal system that specifically allows reserved powers trusts,[273] such trusts have never, to the writer's

[270] See ch 2 para 2 7 1 1 where the substantive requirement of certainty of intention is discussed.
[271] See ch 4 para 3 2 1.
[272] The most recent example of this, according to the writer's knowledge, being *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch).

knowledge, been the subject of litigation in a foreign court. In view of the trends set by the cases examined above, it is not impossible that a court in another jurisdiction (for example where trust assets are located or where the settlor is tax resident) may find that, given the lack of certainty of intention to create a trust, a valid trust never came into existence. At the most, a bare trust may be said to exist. A bare trust confers no tax, estate planning or asset protection benefits on the settlor or beneficiaries. Alternatively, such a trust may be described as illusory, although this does not appear to be a term favoured by the judiciary.

Another emerging trend can be observed in the equation of broad powers over trust property and property itself. An example is the power of revocation.[274] However, it can also be a combination of other powers and entitlements that causes the powers to be regarded as tantamount to property.[275] Although such a trust is not invalid, the normal consequences of using a trust may, in appropriate circumstances, be disregarded – this appears to be akin to the South African concept of going behind the trust form. If power is tantamount to property, it means there is no separation between control (power) and enjoyment (property).

Case law indicates that such a ruling, that power is tantamount to property, would be made only where justice and fairness demand it. The effect is also not the same as invalidity, where the assets will generally be regarded as not having left the ownership of the settlor in the first place. Where power is considered tantamount to property, a court may compel the power holder (the settlor) to exercise the power in a certain way.

It further appears that the judiciary is hesitant to ignore (the consequences of) a validly constituted trust. A trustee who abdicates his fiduciary duties by allowing a settlor to control a trust may well be liable for a breach of trust, but it is unlikely that this would lead to a valid trust being ignored, or the veil being pierced. It has been observed that such a result would be disadvantageous to the beneficiaries of a trust, as discussed below.

Even if a trustee always went along with the settlor's wishes, it seems he may be found to have abdicated his fiduciary duties to the extent required to pierce the veil of the trust only if

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[273] This legislation typically provides that a trust is not invalid, despite the retention of broad powers by the settlor. See also ch 4 para 3 2 1.
[274] As in *Tasarruf Mevduati Sigorta Fonu v Merrill Lynch Bank and Trust Company (Cayman) Ltd* [2011] UKPC 17.
[275] As in *Clayton v Clayton* [2016] NZSC 29.

he completely failed to apply an independent mind in exercising his powers. This indicates that the required standard of trustee independence is not particularly high. Such a complete failure would, moreover, be difficult to establish on the facts: Most professional trustees would be able to show that they did consider requests from the settlor independently – even if they always went along with such requests.[276]

Different reasons are advanced for the enforcement of validly constituted trusts, apart from the obvious desire to promote certainty of legal transactions. One is the protection of beneficiaries. It would indeed seem unfair if the trustee's wrongdoing prejudices the beneficiaries' interests. After all, under English law, and that of most offshore jurisdictions, beneficiaries have an equitable proprietary interest in the trust fund,[277] so that applying trust property in satisfaction of a settlor's creditors, for example, defeats that interest. On the other hand, it has been illustrated how modern discretionary trust drafting can be used in a way that confers scant protection to objects of the trustee's discretion, casting doubt on this argument.[278] Another reason is that alternative remedies exist for parties adversely affected by a settlor's retention of power or a trustee's abdication of his fiduciary duties.[279]

These conclusions will be further analysed in the final chapter.

4 3 South Africa

4 3 1 General remarks

In *Nieuwoudt v Vrystaat Mielies (Edms) Bpk*[280] the Supreme Court of Appeal made mention of a "newer type of trust",[281] where a person places assets in trust, either for estate planning reasons or because trusts are less regulated than corporate entities, but then continues to deal with the assets as if they were not held in a trust. Such cases can become problematic, especially for third parties dealing with the trust. The court in fact warned that persons dealing with a trust should take extra care.[282]

[276] See *In the matter of the Esteem Settlement* [2003 JLR 188].
[277] See ch 2 paras 2 4 2, 3 3 2.
[278] See ch 4 para 3 1.
[279] This was mentioned specifically in *In the matter of the Esteem Settlement* [2003 JLR 188].
[280] *Nieuwoudt NNO v Vrystaat Mielies (Edms) Bpk* 2004 (3) SA 486 (SCA).
[281] *Nieuwoudt NNO v Vrystaat Mielies (Edms) Bpk* 2004 (3) SA 486 (SCA) para 17.
[282] *Nieuwoudt NNO v Vrystaat Mielies (Edms) Bpk* 2004 (3) SA 486 (SCA) paras 22-24.

A fair amount has been written in South Africa with regard to the concepts of sham trusts, alter ego trusts, abuse of the trust and going behind the trust form. The topic has been particularly prevalent in relation to the division of matrimonial assets on divorce,[283] and to some extent in relation to claims by creditors and others.

In the context of divorce, it is important to note at the outset that different marital regimes are treated distinctly. A court is able to alter the default distribution on the dissolution of a marriage only in certain circumstances.[284] The first relevant circumstance is in the case of marriages out of community of property before the accrual system became available. Here the court has a wide discretion, where it would be equitable and just, taking into account relevant factors, to order a redistribution of assets from the estate of one party to the other.[285] The other order a court can make, and which is more commonly used, is that patrimonial benefits belonging to a spouse personally should be forfeited if that spouse benefits unduly in relation to the other spouse. This type of order can be made regardless of the applicable marital regime.[286]

A plethora of descriptions are found in case law and academic writing to describe the act of ignoring the fact that trust assets form a separate estate – piercing the veneer of the trust, lifting the veil of the trust, disregarding the trust, and going behind the trust form. It has been suggested that terminology from company law (such as piercing the veneer or lifting the veil of the trust) is not helpful and that, in Du Toit's words, it "clouds the conceptual clarity demanded by the still-developing South African trust law".[287] A better description may be that used by De Waal, namely "going behind the trust form".[288] The latter description is, where appropriate, used in this part of the chapter.

It is clear that invalid and sham trusts are to be distinguished from the case of valid trusts that have been abused.[289] If a trust is a sham or otherwise invalid, there is nothing to go behind. However, uncertainty remains with regard to the circumstances in which a court will find that

[283] Du Toit (2015) 8 *J Civ L Stud* 655.
[284] Shipley (2016) 3 *SA Merc LJ* 508 514-515.
[285] This is in terms of the Divorce Act 70 of 1979 s 7(3).
[286] This is provided for in the Divorce Act 70 of 1979 s 9.
[287] Du Toit (2015) 79 *Rabel Journal* 852 871.
[288] De Waal (2012) 76 *RabelsZ* 1078.
[289] De Waal (2012) 76 *RabelsZ* 1078 1085-1086; Shipley (2016) 3 *SA Merc LJ* 508 518-521.

it is appropriate to go behind the trust (or pierce the veil, as some authors[290] refer to it) and the consequences of such a finding.

The cases discussed below were selectively identified and analysed with a view to highlighting aspects relevant to the overriding theme of this dissertation. It should be borne in mind that, unlike the cases dealing with English and offshore trusts, in these cases the settlor (or at least the true economic settlor) is more often than not one of the trustees, even the dominant trustee, and quite possibly also a beneficiary.

4 3 2 Case law dealing with claims by third parties or creditors

4 3 2 1 *Land and Agricultural Bank of SA v Parker*[291]

Although not a clear incidence of settlor control, given that the trust in question was set up by the father of Mr Parker, this judgment of the Supreme Court of Appeal dealing with the use and abuse of trusts in business transactions has been very influential in the context of cases of abuse of the trust. Mr Parker himself was one of the trustees and a beneficiary of the trust.

Cameron JA stressed the importance of the separation of ownership or control over trust assets from the enjoyment of those assets as the core idea of the trust.[292] He approached the argument from the point of view of a trustee who is also a beneficiary. By itself, this is not problematic, but if the sole trustee were also the sole beneficiary, there would be no trust.[293]

Cameron JA referred to the traditional view of the trust as protecting the weak and that the trustee is essentially appointed to "exercise fiduciary responsibility over property on behalf of and in the interests of another".[294] It has been illustrated that this traditional view of the trust is not necessarily reflective of trust modern practice. However, it was not that long ago that the position of beneficiaries was much stronger.[295]

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[290] See in particular Smith (2016) 41 *JJS* 68; Smith (2017) 42 *JJS* 1.
[291] *Land and Agricultural Bank of SA v Parker* 2005 (2) SA 77 (SCA).
[292] *Land and Agricultural Bank of SA v Parker* 2005 (2) SA 77 (SCA) [19].
[293] *Land and Agricultural Bank of SA v Parker* 2005 (2) SA 77 (SCA) para 19.
[294] *Land and Agricultural Bank of SA v Parker* 2005 (2) SA 77 (SCA) para 20.
[295] See ch 4 para 3 1.

The reasons why a separation of control and enjoyment are important become clear later in the judgment: such separation explains the duty of care and the accountability and liability of a trustee; it also ensures that a trustee exercises independent judgment.[296]

The judgment further explains that although the features of a "traditional" trust typically ensure that the aforementioned requirements are met, this is not the case in many family trusts where a group of family members make up the settlor, trustees and beneficiaries. The trust form is abused because it is not used to separate control from enjoyment, but rather to confer benefit on the very same persons that exercise control over the assets.[297] In such a case, where the beneficiaries are also trustees, there is virtually no accountability. The power over trust assets is in the same hands as the beneficial interests therein. It is not hard to see how this can prejudice third parties who deal with a trust in the belief that the trust is bound to a transaction, only to find out later that, because of the trustees' non-compliance with certain formalities, it is not.

The theme of trustee independence to counter trust abuse clearly emerged in Cameron JA's judgment. In view of this, he suggested the involvement of the Master of the High Court in ensuring that every trust has an independent trustee; he also did not rule out legislative intervention.[298]

4 3 2 2 *Van Zyl v Kaye*[299]

The applicants in this case contended that the trust in question was the alter ego of Kaye, the settlor of the trust who was also a trustee before his sequestration and a member of the class of beneficiaries. They applied for the court to go behind the trust and disregard its veneer to give effect to the true situation, namely that the trust assets, two immovable properties, belonged to Kaye personally. Their allegations were based on Kaye's apparent control of the trust.[300]

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[296] *Land and Agricultural Bank of SA v Parker* 2005 (2) SA 77 (SCA) para 22.
[297] *Land and Agricultural Bank of SA v Parker* 2005 (2) SA 77 (SCA) paras 23-26.
[298] *Land and Agricultural Bank of SA v Parker* 2005 (2) SA 77 (SCA) paras 34-36. See also ch 4 para 4 3 4 where progress in this regard is discussed.
[299] *Van Zyl NNO v Kaye NO* 2014 (4) SA 452 (WCC).
[300] *Van Zyl NNO v Kaye NO* 2014 (4) SA 452 (WCC) 455-457. Kaye was the sole director of the company (owned by the trust) that owned one of the trust properties, and the accounting practices between the trust, company and his personal affairs were, to say the least, fluid.

The court found that this result – that the assets belonged to the settlor-trustee and not to the trust – could only stem from a finding that the trust is invalid, or a sham, or that the immovable property had not really been vested in the trust.[301] Binns-Ward J also made the important observation, with reference to New Zealand case law, that factual control by someone other than a trustee (or by a specific trustee if there is more than one trustee) does not in and of itself invalidate a trust.[302] Similar comments have been made in other jurisdictions.[303]

The court distinguished sham from going behind the trust form:

> "Holding that a trust is a sham is essentially a finding of fact … that the requirements for the establishment of a trust were not met, or that the appearance of having met them was in reality a dissimulation."[304]

In this case it was not even contended, much less proved, that the trust had not been legitimately founded.[305] However, not much more was said about sham trusts.

The court confirmed that, for it to make an order to go behind the trust form, there has to be a valid trust in the first place, as there would otherwise be nothing to go behind. Binns-Ward J stated:

> "Going behind the trust form … essentially represents the provision by a court of an equitable remedy to a third party affected by an unconscionable abuse of the trust form… It is a remedy that will generally be given when the trust form is used in a dishonest or unconscionable manner to evade a liability, or avoid an obligation."[306]

Parker[307] also referred to unscrupulous behaviour, which, by definition, means acting in an unprincipled or dishonest way. After *Van Zyl*,[308] unconscionability or dishonesty seem to have

[301] *Van Zyl NNO v Kaye NO* 2014 (4) SA 452 (WCC) 458, 466.
[302] *Van Zyl NNO v Kaye NO* 2014 (4) SA 452 (WCC) 464-465.
[303] See ch 4 paras 4 2 3 1, 4 2 4 1.
[304] *Van Zyl NNO v Kaye NO* 2014 (4) SA 452 (WCC) 459.
[305] *Van Zyl NNO v Kaye NO* 2014 (4) SA 452 (WCC) 459.
[306] *Van Zyl NNO v Kaye NO* 2014 (4) SA 452 (WCC) 460 para 22.
[307] *Land and Agricultural Bank of SA v Parker* 2005 (2) SA 77 (SCA) paras 29-30.

acquired the status of requirements for going behind the trust form. The judge in *Van Zyl*,[309] however, preferred to describe it as an equitable remedy, free from the strict constraints of defined principles.[310]

Binns-Ward J was not aware of any South African judgment where the veneer of a trust was pierced. He was of the view that in *Badenhorst*[311] (discussed below), on which the applicants relied, the trust was not disregarded. However, he said that if he was wrong and the court there did in fact go behind the trust form, it was on the basis of Mr Badenhorst's use of the trust in an unconscionable manner to evade his obligations on the dissolution of his marriage.

However, in this case the judge found that a sufficient basis for going behind the trust form did not exist (although this would in any event not have led to the result the applicants were hoping for). The fact that trust assets held in a validly constituted trust were administered in an objectionable way did not, according to the court, afford a legal basis to invalidate the trust or to find that the assets do not vest in the trustee (*qua* trustee).[312] (It is submitted that this is, however, different from the result of going behind the trust, at least as far as invalidity is concerned. The consequences of an invalid trust are different to those of going behind a valid trust.)

A trustee (in this case the settlor) who administers a trust without due regard to his fiduciary duties and who treats it as his alter ego cannot make the trust a sham, although it may have other consequences. This may include giving cause for his removal as trustee or the appointment of an independent co-trustee, or it may render him personally liable for transactions he concluded ostensibly on behalf of the trust, or delictually liable to the beneficiaries. It does not, however, mean that the trust assets belong to him personally.[313]

The court found that there was no evidence that the trust was used dishonestly or unconscionably to evade a liability to the applicants or Kaye's creditors.[314]

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[308] *Van Zyl NNO v Kaye NO* 2014 (4) SA 452 (WCC).
[309] *Van Zyl NNO v Kaye NO* 2014 (4) SA 452 (WCC).
[310] *Van Zyl NNO v Kaye NO* 2014 (4) SA 452 (WCC) 460.
[311] *Badenhorst v Badenhorst* 2006 (2) SA 255 (SCA).
[312] *Van Zyl NNO v Kaye NO* 2014 (4) SA 452 (WCC) 459.
[313] *Van Zyl NNO v Kaye NO* 2014 (4) SA 452 (WCC) 465.
[314] *Van Zyl NNO v Kaye NO* 2014 (4) SA 452 (WCC) 466.

It appears that, based on Binns-Ward J's *dicta* referred to above,[315] subsequent judgments regarded dishonesty or unconscionability as a requirement for going behind the trust form.

4 3 3 Case law dealing with divorce

4 3 3 1 *Jordaan v Jordaan*[316]

This case was concerned with the question whether, for purposes of a redistribution order in the context of divorce, assets transferred to a trust by one of the divorcing parties could be taken into account. The defendant, the husband in this case, averred that the assets in the trusts should be left out of reckoning in determining the value of his estate. He set up various trusts, some after divorce proceedings had commenced, and admitted, at least in the case of one trust, that it was set up with a view to frustrate a claim by his wife, the claimant in this case.[317] It appears, but it is not clear from the facts, that the defendant was a trustee of some of the trusts, but not of all of them. Traverso J held that, in deciding whether to take trust assets into account in the redistribution order, the way in which the trusts were administered was relevant.[318]

The judge referred to various instances that indicated that the defendant did not regard the trust assets as different from his own. These included the transfer of funds to himself without formal decisions by the trustee or trustees; the defendant taking actions without consulting his co-trustees; and evidence that the defendant treated the income of the trusts as his own. She considered the trust as the defendant's alter ego, used by him for his own financial advantage. In the case of the trust set up after divorce proceedings were instituted, he was considered to have had a fraudulent intent.

For these reasons, based on the settlor's control over the administration of the trust, it was considered just and fair to take the trust assets into account in valuing the defendant's estate for purpose of the redistribution order.[319] The judge nevertheless found that it was not

[315] See ch 4 fn 304, 306.
[316] *Jordaan v Jordaan* 2001 (3) SA 288 (C).
[317] *Jordaan v Jordaan* 2001 (3) SA 288 (C) para 17.
[318] *Jordaan v Jordaan* 2001 (3) SA 288 (C) paras 27-29.
[319] *Jordaan v Jordaan* 2001 (3) SA 288 (C) paras 24-25, 29-34.

necessary to consider whether to pierce the "corporate veil".[320] This may have been because of uncertainty as to the consequences of piercing, or because the defendant had sufficient assets in his own name to satisfy the court order, so that the trust assets did not have to be legally transferred to him.

4 3 3 2 *Badenhorst v Badenhorst*[321]

This decision of the Supreme Court of Appeal also concerned a redistribution order on divorce and the question of taking trust assets into account. The case is another rare instance of a South African court finding that trust assets should be taken into account in a redistribution order in the context of divorce. However, there appears to be disagreement in academic circles as to the basis on which the order was made.[322]

The facts, very briefly, were that the husband, Mr Badenhorst, was the economic settlor of the trust, that he and his brother were the trustees (although the brother did not take an active role) and that Mr Badenhorst had the power to remove his co-trustee and appoint another in his place. He was also paid for his services as trustee. The court *a quo* found that, unless it was decided that the trust was a sham, it could not order that the trust assets be taken into account in the calculation of the redistribution order and that it could not assume that the husband would be able to access trust property to satisfy the order. This is because, according to the lower court, the trust remained a separate entity and not the alter ego of the husband, who, despite wide powers being vested in him, did not abuse those powers.[323]

The Supreme Court of Appeal held, after pointing out that it is incorrect to refer to a trust as a separate legal entity,[324] that the separation of the estates of a trustee personally and in his capacity as trustee did not *per se* exclude trust assets from consideration in cases like these. In order successfully to include trust assets in the personal estate of a person (for example the settlor or trustee – in this case they were the same person), it has to be shown that the person had *de facto* control over the assets and that, were it not for the trust, the assets would have belonged to him personally.

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[320] *Jordaan v Jordaan* 2001 (3) SA 288 (C) para 34.
[321] *Badenhorst v Badenhorst* 2006 (2) SA 255 (SCA).
[322] Shipley (2016) 3 *SA Merc LJ* 508 515.
[323] *Badenhorst v Badenhorst* 2006 (2) SA 255 (SCA) para 7.
[324] *Badenhorst v Badenhorst* 2006 (2) SA 255 (SCA) para 8.

Combrinck AJA said that finding such control depended on two things: firstly, the terms of the trust deed and, secondly, the way in which the trust was administered.

The judge had no doubt that Mr Badenhorst was in full control of the trust and used it as a vehicle for his business activities. He came to this conclusion by analysing both requirements mentioned above. The terms of the trust deed included Mr Badenhorst's role as trustee together with his brother, who was not actively involved, and the fact that he could remove his brother and appoint another co-trustee should this be desired. The capital beneficiaries were the children of Mr Badenhorst, either by his first marriage or any subsequent marriage, whereas Mrs Badenhorst was only an income beneficiary. The rights of the beneficiaries would not vest until a date determined by the trustees (in other words, Mr Badenhorst). Mr Badenhorst had the power to amend the trust deed during his lifetime. The discretion of the trustees (in other words, Mr Badenhorst) in dealing with the trust assets was, therefore, unfettered. Furthermore, Mr Badenhorst was paid for his duties as trustee.[325]

An examination of the second limb of Combrinck AJA's test, the practical administration of the trust, also proved that Mr Badenhorst was in full control of the trust. He managed the trust assets without consulting or seeking the approval of his co-trustee, save in very few circumstances. He disregarded the separation of his personal estate and that of the trust, for example, by listing trust assets as his own in a personal credit application, or by insuring trust assets in his own name. The income he received from the businesses owned by the trust did not take account of the fact that the businesses were partly owned by the trust. Therefore, the judge found that, but for the trust, ownership of the assets would have vested in Mr Badenhorst.[326]

The court referred to judgments of lower courts including *Jordaan*,[327] where similar conclusions were reached, and held that the value of the trust assets should be added to the value of Mr Badenhorst's estate for purposes of the redistribution order.[328] The amount Mr Badenhorst was ordered to pay to Mrs Badenhorst did not exceed his personal assets and the

[325] *Badenhorst v Badenhorst* 2006 (2) SA 255 (SCA) para 10.
[326] *Badenhorst v Badenhorst* 2006 (2) SA 255 (SCA) para 11.
[327] *Jordaan v Jordaan* 2001 (3) SA 288 (C).
[328] *Badenhorst v Badenhorst* 2006 (2) SA 255 (SCA) paras 12-13.

judge therefore did not have to make an order to go behind the trust, or to ignore the consequences or existence of the trust by effectively awarding Mrs Badenhorst trust assets.

De Waal[329] and Shipley[330] are, however, of the view that the Supreme Court of Appeal effectively decided that the trust assets should be regarded as Mr Badenhorst's on the basis that the trust was his alter ego and that this was, therefore, a case where the court went behind the trust form. The writer is in agreement with this view.

4 3 3 3 *WT v KT*[331]

Two further relevant cases in the context of divorce are the recent judgments of the Supreme Court of Appeal in *WT v KT*[332] and *REM v VM*,[333] the latter effectively overturning the former with regard to who has *locus standi* to bring a claim for piercing the veneer of a trust. The lower court decisions[334] will be referred to briefly as they contain more detail about the abuse of the trusts in question. Although in both instances the lower court found that the trusts were the alter egos of the settlors and that the trust assets should therefore be taken into account for purposes of the division of the marital assets, no decision to go behind the trust was taken by the Supreme Court of Appeal.

WT v KT[335] involved a marriage in community of property. WT, the husband, was the economic settlor of the trust in question, although his father was named as the founder in the trust documents. He and his brother were the trustees. The beneficiaries were WT's issue. His spouse, KT, was not a beneficiary. It was clear that there was no distinction between the affairs of WT, the trust and the companies owned by the trust.[336]

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[329] De Waal (2012) 76 *RabelsZ* 1078 1079, 1090-1091.
[330] Shipley (2016) 3 *SA Merc LJ* 508 529.
[331] *WT v KT* 2015 (3) SA 574 (SCA).
[332] *WT v KT* 2015 (3) SA 574 (SCA).
[333] *REM v VM* 2017 (3) SA 371 (SCA).
[334] *T v T* [2014] ZAGPJHC 245 (19 September 2014); *M v M and Others* [2015] ZAGPPHC 66 (4 February 2015).
[335] *WT v KT* 2015 (3) SA 574 (SCA).
[336] *WT v KT* 2015 (3) SA 574 (SCA) paras 10-12, 17, 19. Examples of this include the operation by WT of his property development business through companies owned by the trust and the fact that WT used part of his inheritance from his father to repay a bank loan taken out by the trust and invested the remainder in an account in the name of one of the companies owned by the trust.

Ample evidence was provided to show that transactions entered into by the trust were very rarely properly recorded in trustee resolutions, and that WT's brother as co-trustee did not apply an independent mind in relation to any of the trust's affairs – he was in fact referred to as a "malleable trustee".[337] WT furthermore shifted funds between trust and personal bank accounts to cover his living costs, without any accounting or reconciliation in the books of the trust. The High Court judge found that, on the evidence, WT had no intention to divest himself of his wealth and instead misused the trust and its assets purely to suit himself and his objective of wealth creation. Accordingly, the court found that WT managed the trust exclusively at all relevant times[338] and, therefore, that the assets of the trust were in fact those of WT and that the assets should form part of the joint estate to be divided on divorce.[339] WT appealed against this decision.

The Supreme Court of Appeal referred *obiter* to the averment that the trust was the alter ego of WT because, amongst other reasons, he controlled the trust purely for his own financial benefit.[340] The court, however, disagreed with the order given by the trial court, not because they did not think that the settlor controlled the trust or that this should not result in taking the trust assets into account in the division, but because the court considered that KT lacked *locus standi*.[341]

Mayat AJA referred to the principles of piercing the corporate veil as a starting point in his examination of the issue of "looking behind the veneer of the trust as the alter ego of WT". He further referred to Cameron JA's judgment in *Parker*[342] where it was held that, where the trust form is debased, justice would require that the veneer of the trust be pierced in the interest of creditors. As an analogy to this but without specifically referring to *Van Zyl*,[343] (where unconscionability and dishonesty were explicitly referred to, albeit not as a requirement) Mayat AJA said that:

[337] *T v T* [2014] ZAGPJHC 245 (19 September 2014) para 19.
[338] *T v T* [2014] ZAGPJHC 245 (19 September 2014) paras 29-47.
[339] *T v T* [2014] ZAGPJHC 245 (19 September 2014) para 47.
[340] *WT v KT* 2015 (3) SA 574 (SCA) para 27.
[341] *WT v KT* 2015 (3) SA 574 (SCA) para 32.
[342] *Land and Agricultural Bank of SA v Parker* 2005 (2) SA 77 (SCA).
[343] *Van Zyl NNO v Kaye NO* 2014 (4) SA 452 (WCC).

> "…[U]nconscionable abuse of the trust form through fraud, dishonesty or an improper purpose will justify looking behind the trust form."[344]

Smith remarks that "unconscionable abuse" is not required under the common law test for piercing the veil, borrowed from company law. That test is more flexible and dependent on the facts of each case. Furthermore, it is an exceptional remedy available only if there is no alternative. According to Smith, the use of "unconscionable abuse" as a requirement for going behind the trust allows any third party affected by such an abuse to bring a claim on that basis, regardless of whether an alternative remedy is available.[345]

However, the court held that KT had no standing to challenge the management of the trust by WT because she was not a beneficiary of the trust and neither had she transacted with the trust.

According to Mayat AJA, the effect of Cameron JA's judgment in *Parker*[346] is that the separation of ownership and enjoyment of trust assets is important only to third parties who entered into transactions with the trust (and perhaps also to beneficiaries, given that Mayat AJA referred to both third parties and beneficiaries when he described KT's lack of *locus standi*).[347] The separation between control and enjoyment is, however, widely referred to as a fundamental requirement, or the core idea, of South African trust law, not only in relation to third parties, although they are most likely to be prejudiced by the lack thereof. It is submitted that the court in *Parker*[348] did not intend to confine the class of persons with standing to bring a claim to go behind the trust in this way.[349]

Finally, the court cast doubt on whether the discretion given to a court by the Divorce Act,[350] where this applied, was wide enough to order an effective transfer of assets from the trust estate to the joint estate of the parties, or whether the only possibility was to include the value of the assets in the calculation of the redistribution order.[351] That is effectively what was done

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[344] *WT v KT* 2015 (3) SA 574 (SCA) para 31.
[345] Smith (2016) 41 *JJS* 68 73-76.
[346] *Land and Agricultural Bank of SA v Parker* 2005 (2) SA 77 (SCA).
[347] *WT v KT* 2015 (3) SA 574 (SCA) paras 32-33.
[348] *Land and Agricultural Bank of SA v Parker* 2005 (2) SA 77 (SCA).
[349] Du Toit (2015) 8 *J Civ L Stud* 655 658; Shipley (2016) 3 *SA Merc LJ* 508 527.
[350] Divorce Act 70 of 1979 s 7(3).
[351] *WT v KT* 2015 (3) SA 574 (SCA) para 36.

in *Badenhorst*,[352] but possibly only because Mr Badenhorst had sufficient assets in his own name to make the required payment to Mrs Badenhorst. It is not clear what would have been ordered if Mr Badenhorst did not have sufficient assets in his own name. It is, however, submitted that it would not be logical to include trust assets in the calculation of a redistribution order if those assets cannot be accessed, particularly in cases where there is not sufficient personal assets to make the required payment.

4 3 3 4 *REM v VM*[353]

The position taken by the Supreme Court of Appeal in *WT v KT*[354] – that a person who is not a beneficiary of a trust (or did not transact with the trust) has no *locus standi* to attack that trust of which his or her spouse is the settlor and trustee – was overturned more recently by the Supreme Court of Appeal in *REM v VM*.[355] Amongst other claims made by the former spouse of REM in this case, one is relevant to this discussion, namely that a number of trusts set up by REM were his alter egos and that the assets of the trusts therefore in reality belonged to him.[356] REM's defence was that the trust assets could only be regarded as part of his own estate for purposes of the accrual if the trusts were either shams, which was not alleged, or if REM acted fraudulently in controlling the trusts.[357]

The court *a quo* examined both the terms of the trusts and the practical administration thereof, based on the two-tiered test used by Combrinck AJA in *Badenhorst*,[358] and found that the requirements for both tests were fulfilled.[359] The court found that the terms of the trusts gave REM absolute control of the trusts so that he was not able to separate his estate from that of the trusts. He could add himself as a beneficiary of the trust, had full power to deal with the trust assets and had the power to decide which beneficiaries should benefit.[360] Although the

[352] *Badenhorst v Badenhorst* 2006 (2) SA 255 (SCA).
[353] *REM v VM* 2017 (3) SA 371 (SCA).
[354] *WT v KT* 2015 (3) SA 574 (SCA).
[355] *REM v VM* 2017 (3) SA 371 (SCA).
[356] *REM v VM* 2017 (3) SA 371 (SCA) para 3(b).
[357] *REM v VM* 2017 (3) SA 371 (SCA) para 4(b).
[358] *Badenhorst v Badenhorst* 2006 (2) SA 255 (SCA).
[359] *M v M and Others* [2015] ZAGPPHC 66 (4 February 2015) paras 73-74.
[360] *M v M and Others* [2015] ZAGPPHC 66 (4 February 2015) para 76.

court did not explicitly state this, it was clear that REM was in a position to distribute all of the trust assets to himself.[361]

As to the second limb of the test, and with reference to the requirement for separation between control and enjoyment of trust assets, the court found that REM controlled and conducted the trusts as vehicles for his personal and business activities. There was thus also no separation between the trust assets and his personal and business assets.[362] This was evidenced, for example, by the indiscriminate use by REM of trust and personal funds without reconciliation and the lack of trustee minutes recording trustee decisions.[363]

The court considered the requirements for piercing the veil of a corporate entity with specific reference to improper conduct.[364] It was averred on behalf of REM that, *in casu*, there was no misuse, abuse or unfair advantage and, therefore, the veil of the trust should not be pierced. This argument was rejected by the court *a quo*. It was held that the management and administration of the trusts did constitute improper conduct, allowing the court to enquire into the separation between the trust estate and that of the trustee personally.[365] It was, therefore, decided that the assets of the trusts should be taken into account in determining the accrual of REM's estate.[366] REM appealed against this judgment.

The Supreme Court of Appeal considered VM's allegations that: (a) REM's purpose in setting up the trusts was to defeat her matrimonial claims; (b) REM did not intend to transfer ownership of his personal assets to the trusts and was dealing with the trust assets as if they were his own; (c) REM failed to perform his fiduciary duties as trustee in a proper manner, evidenced by REM's concessions that he intermingled trust and personal funds; and (d) REM transferred further assets to a trust after VM instituted divorce proceedings with the fraudulent intent to protect this asset from the divorce.[367]

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[361] This was also the conclusion of the English High Court in *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch) where, however, it was decided that the terms of the trust deed were not effective to divest the settlor of the beneficial ownership of the trust assets and therefore the trust was invalid.
[362] *M v M and Others* [2015] ZAGPPHC 66 (4 February 2015) para 77.
[363] *M v M and Others* [2015] ZAGPPHC 66 (4 February 2015) paras 78-84.
[364] *M v M and Others* [2015] ZAGPPHC 66 (4 February 2015) para 88 where the court referred to *Ebrahim v Airport Cold Storage (Pty) Ltd* 2008 (6) SA 585 (SCA).
[365] *M v M and Others* [2015] ZAGPPHC 66 (4 February 2015) paras 89-91.
[366] *M v M and Others* [2015] ZAGPPHC 66 (4 February 2015) para 92.
[367] *REM v VM* 2017 (3) SA 371 (SCA) paras 15-16.

It was not disputed that the alter ego claim accepts that there is a valid trust and that no allegations of sham were made. Swain JA also quoted from *Van Zyl v Kaye*[368] in describing the remedy of going behind a validly established trust or piercing the veneer of a validly established trust. It is described as an equitable remedy to address the consequences of an unconscionable abuse of the trust form. Furthermore, it will generally be given where "the trust form is used in a dishonest or unconscionable manner to evade a liability, or avoid an obligation".[369] However, in *Van Zyl*,[370] Binns-Ward J used this description to indicate one of the types of circumstances where the remedy might be appropriate. He specifically said that defining applicable principles would likely be a difficult task, and probably did not intend to limit or define the circumstances where such a remedy would be applicable.[371]

The Supreme Court of Appeal held that the conduct of REM referred to above in (a) to (d) was central to the determination of whether the veneer should be pierced. Where the separation of control and enjoyment is lacking, the veneer of the trust can be pierced in the interests of disadvantaged creditors and, by analogy, also where there is an unconscionable abuse through fraud, dishonesty or an improper purpose.[372]

The court, however, disagreed with *WT v KT*[373] that a spouse, who is not a beneficiary and not a third party who dealt with the trust, has no standing to attack the administration of a trust by the other spouse. The court felt that there is no basis in logic or principle to limit standing to those to whom a fiduciary responsibility is owed by the trustee (although a trustee does not owe a fiduciary responsibility, but rather a contractual duty, to a third party he contracted with) or to distinguish between a third party who transacted with the trust and a spouse with a matrimonial claim.[374] It is submitted that this is correct.[375]

The court held that a breach of fiduciary duty is not the determining factor. Instead, a claim lies against the errant trustee (who, it should be noted in this case, was also the settlor):

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[368] *Van Zyl NNO v Kaye NO* 2014 (4) SA 452 (WCC).
[369] *Van Zyl NNO v Kaye NO* 2014 (4) SA 452 (WCC) paras 20-21; *REM v VM* 2017 (3) SA 371 (SCA) para 17.
[370] *Van Zyl NNO v Kaye NO* 2014 (4) SA 452 (WCC).
[371] *Van Zyl NNO v Kaye NO* 2014 (4) SA 452 (WCC) para 22.
[372] *REM v VM* 2017 (3) SA 371 (SCA) para 19.
[373] *WT v KT* 2015 (3) SA 574 (SCA).
[374] *REM v VM* 2017 (3) SA 371 (SCA) paras 20-21.
[375] Shipley (2016) 3 *SA Merc LJ* 508 526-528 makes the same argument.

> "… on the basis that the unconscionable abuse of the trust form by the trustee, in his or her administration of the trust, through fraud, dishonesty or an improper purpose prejudices the enforcement of the obligation owed to the third party, or a spouse."[376]

In this case, a fraudulent or dishonest purpose of avoiding an obligation was, however, not established on the evidence. At most, the court felt that REM's conduct could have led to his removal as trustee or to the appointment of an independent co-trustee.[377] This indicates that extreme conduct would be required before a court will decide to go behind the trust or pierce the veil or veneer of the trust.

4 3 4 Conclusion regarding South African case law review

The cases examined above showcase the typical scenario where the settlor is also the dominant trustee and one of the beneficiaries, or at least able to appoint himself as a beneficiary.

This echoes a similar concentration of powers and entitlements as seen in some English and offshore cases, where it has led to rulings ranging from invalidity to equating power with property – something analogous to the South African remedy of going behind the trust.[378]

It has been noted before that the core idea of the trust under South African law is the separation of ownership or control over the trust assets from the enjoyment of those assets.[379]

A reading of academic contributions and case law leaves little doubt that the common denominator in finding a theoretical basis for going behind the trust is non-compliance with this core idea of the trust. Smith further explains that the duty of a trustee to maintain a separation between trust property and his personal estate is a derivative of this core idea.[380] The concept of two separate estates is, according to De Waal, vital to South African trust law

[376] *REM v VM* 2017 (3) SA 371 (SCA) para 20.
[377] *REM v VM* 2017 (3) SA 371 (SCA) para 20.
[378] See ch 4 para 4 2 5.
[379] See ch 2 para 4 3 1 2; ch 4 para 4 3 2 1.
[380] Smith (2016) 41 *JJS* 68 69.

and explains why the common law trust can function in civil law jurisdictions where there is no dichotomy of legal and equitable ownership that protects the interests of beneficiaries.[381]

In the type of circumstances found in the cases examined above, there is evidently no functional separation between control of the trust assets and enjoyment thereof. There is also no trustee independence. The settlor is also a trustee and one of the beneficiaries. His family members, the other beneficiaries, are unlikely to hold him to account. Where the core idea of the trust is debased to such an extent, it would be logical if the result of such a lack of separation had a profound effect and it would be entirely understandable for a divorcing spouse to request that trust assets are taken into account in the division of matrimonial assets.[382]

The availability of the remedy of going behind the trust is now fairly undisputed in South African law. De Waal describes going behind the trust as a situation where the court ignores the separation of the trustee's personal estate and that of the trust.[383] Smith describes it as an equitable remedy, available where a valid trust has been abused as the result of a failure on the part of the trustees to adhere to their duties and where the core idea of the trust has thus been breached.[384] Where there is no separation between control and enjoyment, why should its derivative, the separation of estates, be respected?

Despite the availability of the remedy being undisputed, the exact requirements for a decision to go behind the trust and the consequences of such a finding are not entirely clear. It can only be hoped that, as more cases are considered by the courts, the law in this regard will become more certain.

In all this, the importance of trustee independence – a corollary of the separation of control from enjoyment – cannot be overstated.[385] This issue has particular relevance where the settlor is one of the trustees, in other words, where the person with control is also the one enjoying the trust property, as is often the case with South African trusts. De Waal points out that this

[381] De Waal (2012) 76 *RabelsZ* 1078 1088.
[382] Du Toit (2015) 8 *J Civ L Stud* 655 657-658; Van der Linde (2012) 75 *THRHR* 371 379-380.
[383] De Waal (2012) 76 *RabelsZ* 1078 1079; Shipley (2016) 3 *SA Merc LJ* 508 509.
[384] Smith (2016) 41 *JJS* 68 76-77.
[385] De Waal (2012) 76 *RabelsZ* 1078 1079, 1090-1093; Du Toit (2015) 8 *J Civ L Stud* 655 658, 665-666; Shipley (2016) 3 *SA Merc LJ* 508 509; Van der Linde (2012) 75 *THRHR* 371 379-380.

multi-faceted role – settlor, trustee and beneficiary – has contributed greatly to this problem.[386] It is submitted that this is correct.

This is not to say that settlors of trusts elsewhere have no desire for control. It was illustrated in the previous section that there are various alternative measures allowing the settlor of an English or offshore trust to exercise control over the trust. This may impact on trustee independence in a similar way. In fact, trustee independence emerges as a crucial component in the countering of settlor control.

The need for such a balancing act was also illustrated in the examination of English and offshore cases above.[387] A settlor may attempt to exercise control, but as long as the trustee exercised an independent mind in considering whether to execute the settlor's wishes or instructions, the trustee would not be considered by a court to have abdicated his fiduciary duties. In light of this, one may argue that the level of trustee independence required is not particularly high and that more should be expected from a trustee in this regard. However, this appears to be the current state of affairs.

In the South African context, where the settlor is a co-trustee, especially where he is also one of the beneficiaries, this requires even more rigorous independence on the part of the other trustees – but typically they do not display this characteristic, as they are lay persons without knowledge of trusts, and, furthermore, close family members of the dominant settlor-trustee.

Cameron JA's suggestion in *Parker*[388] with regard to the need for an independent trustee was instrumental in the recent issuing of a Chief Master's Directive[389] (directive) dealing, amongst other things, with the appointment of an independent trustee. It appears to be required only where the trust is a so-called 'family business trust'. This is described as a trust where the trustees have power to enter into transactions with third party creditors, the trustees are all beneficiaries and the beneficiaries are all related to one another.[390]

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[386] De Waal (2012) 76 *RabelsZ* 1078 1090.
[387] See ch 4 para 4 2.
[388] *Land and Agricultural Bank of SA v Parker* 2005 (2) SA 77 (SCA) paras 34-36.
[389] Department: Justice and Constitutional Development *Trusts: Dealing with Various Trust Matters* (Chief Master's Directive 2 of 2017) 13-16.
[390] See ch 2 para 4 3 4 2 where this type of arrangement is also mentioned.

The directive requires the Master to consider the appointment of an independent trustee where such a family business trust is registered with the Master for the first time.[391] It is submitted that the scope for abuse of the trust is higher in such cases and the appointment of a truly independent trustee should aid in reducing such abuse. The directive does not apply to existing trusts and affords the Master some discretion, depending on the circumstances of the case, as to whether an independent trustee must in fact be appointed or not.[392]

A description is provided of what constitutes an independent trustee. Crucially, the independent trustee must not have any family relationship with any of the other trustees, the settlor or the beneficiaries nor can he have an interest in the trust assets. Although there is no requirement for the independent trustee to be a professional person, he must be competent to review the conduct of non-independent trustees, he must be knowledgeable about the law of trusts, he must have knowledge and experience of the business field in which the trust operates and he must also be aware that he may be liable for breach of trust should he fail to act as an independent trustee.[393]

It is submitted that only certain professional individuals or corporate entities active in the field of trust administration would be able to fulfill these requirements. Even for them, having knowledge of the field of business in which the trust is active may be difficult if this is, for example, an agricultural business. This may admittedly not be a strictly necessary requirement, as the trustees may appoint an expert in the field to advise them where required, just as they would do with investment advice.

The directive also contains provisions relating to the nomination, resignation and remuneration of the independent trustee.

The directive can be considered a vital step in the right direction, although the practical affect is, of course, still unknown. The review of South African case law leaves no doubt that an increase in the proportion of trusts, particularly family business trusts, with an independent trustee should contribute greatly to the prevention of abuse of the trust form.

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[391] Department: Justice and Constitutional Development *Trusts: Dealing with Various Trust Matters* (Chief Master's Directive 2 of 2017) 13.
[392] Department: Justice and Constitutional Development *Trusts: Dealing with Various Trust Matters* (Chief Master's Directive 2 of 2017) 14.
[393] Department: Justice and Constitutional Development *Trusts: Dealing with Various Trust Matters* (Chief Master's Directive 2 of 2017) 13-14.

As in England and offshore jurisdictions, South African courts do not easily decide to go behind a validly constituted trust, precisely because it goes against well-established principles of trust law holding that trust assets do not form part of the estate of either the settlor or the trustee personally. It ignores the normal consequences of a valid trust.

The consequences of going behind the trust should be differentiated from the consequences of a sham trust.[394] Where no valid trust came into existence (either because the settlor lacked the necessary intention to create a trust or because the settlor and the trustee shared the intention to create something other than a trust, despite giving the appearance of intending to create a trust), the assets are deemed to belong to the settlor because he did not properly divest himself of the ownership thereof. Where, on the other hand, a valid trust comes into existence, the beneficiaries acquire certain rights in respect of the trust assets. A court cannot simply ignore the consequences of the trust and the existence of these rights by ruling that the assets still belong to the settlor.[395]

Smith argues that this may go some way to explain the uncertainty regarding going behind the trust in divorce proceedings (although there is not necessarily more clarity in other scenarios, such as creditor claims). Is a decision to take trust assets into account in determining the value of a trustee-spouse's estate the result of going behind the trust form, or is it the result of a judicial discretion to redistribute assets in terms of the Divorce Act?[396] If the latter, does that mean that trust assets cannot be taken into account in matrimonial regimes not governed by that legislation?[397]

Badenhorst[398] may well be interpreted as an example of a court going behind the trust as a result of the effective control exercised by the settlor (based on the provisions of the trust deed and the practical administration of the trust), but recent judgments[399] have cast doubt on the basis for the order made in *Badenhorst*.[400]

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[394] De Waal (2012) 76 *RabelsZ* 1078 1079; Smith (2016) 41 *JJS* 68 77.
[395] Similar comments were made in *In the matter of the Esteem Settlement* [2003 JLR 188] 421; see also ch 4 para 4 2 2 2 where this case is discussed.
[396] Divorce Act 70 of 1979.
[397] Smith (2016) 41 *JJS* 68 77.
[398] *Badenhorst v Badenhorst* 2006 (2) SA 255 (SCA).
[399] *WT v KT* 2015 (3) SA 574 (SCA); *REM v VM* 2017 (3) SA 371 (SCA).
[400] *Badenhorst v Badenhorst* 2006 (2) SA 255 (SCA).

The writer is not aware of instances where trusts were found to be shams or invalid due to excessive control by the settlor. Much of the focus in South African law is on the issue of going behind the trust, or piercing the veil, and the requirements for and consequences of such a decision.

It does indeed appear that it is more difficult under South African law to establish a case of abuse of trust that justifies a court to ignore the consequences of the trust. As mentioned above, recent case law[401] indicates that fraud or dishonesty and avoiding an obligation or evading a duty may now be required before a court would go behind the trust, even if it were clear that the settlor treated the trust as his alter ego. However, this requirement appears to be premised on the party bringing the claim not being owed a fiduciary duty by the trustee. It is not clear whether these elements would also be required if a claim was made by a beneficiary, to whom the trustee does, in fact, owe a fiduciary duty. It is, however, unlikely that beneficiaries would bring an action for going behind the trust – this would most likely prejudice their interests – and a claim against the trustee for a breach of trust may be more appropriate.

5 Conclusion and next steps

From a comparative perspective, the issue of settlor control illustrates interesting similarities as well as divergences. Settlors' desire for more control is common across the jurisdictions under review. Retaining control over assets transferred to a trust can be achieved in a variety of ways. Although it does not necessarily affect the validity or effectiveness of a trust, in many cases it does. Judging the acceptable level of control that a settlor can retain appears to be more of an art than a science.

Validity is at stake where the settlor did not have the required intention to transfer beneficial or equitable ownership of the trust assets to the trustee. In addition, a trust will also be invalid if it is found to be a sham, namely where the settlor and trustee both intended to dress another type of legal relationship up as a trust. Recent case law suggests that this result is more than a theoretical possibility.

[401] *Van Zyl NNO v Kaye NO* 2014 (4) SA 452 (WCC); *REM v VM* 2017 (3) SA 371 (SCA).

In other cases, a valid trust may come into existence, but its effectiveness and consequences may be compromised if the settlor exercises too much control over the trust. How much control is too much?

In the context of English and offshore law, it appears the answer to this question depends on the quantity and quality of control exercised by the trustee. Settlor control is typically achieved by reserving certain powers, normally exercised by the trustee, to the settlor or to a protector controlled by the settlor. Only if the trustee were to abdicate all fiduciary responsibility and fail to exercise an independent mind would a court decide to pierce the veneer of the trust and to ignore the fact that the trust assets belong to the trustee *qua* trustee, and not to the settlor. The result is that trust assets may be made available to meet the demands of creditors, tax authorities or divorcing spouses. Thus, trustee independence is paramount, but the standard required does not appear to be very rigorous.

From a South African perspective, settlor control is often achieved by the settlor acting as a co-trustee, frequently being the dominant trustee in an environment where the other trustees are family members. As one would expect the trustee to exercise control over the trust assets, it is not a straightforward question of the settlor (who is also the trustee) having too much control. The pertinent question is whether the settlor-trustee exercises his powers in the best interests of the beneficiaries as a whole, or whether he treats the trust as an extension of his personal or business assets and exercises those powers to further his own interests. One should ask whether the co-trustees are actively and independently involved in decisions relating to the trust, or whether the settlor-trustee effectively takes all decisions alone. Again, trustee independence is crucial in determining the integrity of the trust.

In neither of the jurisdictions under review is it entirely clear when a court will decide to look behind a trust, or pierce the veneer of the trust. It is, however, evident that trusts and the legal consequences following from trusts are well respected and such a decision will not be taken lightly.

Where trustee independence is compromised, the essence of the trust is compromised. The core values referred to earlier in this dissertation [402] are the embodiment of essential requirements that are conspicuously absent in the type of circumstances described above.

To follow on these conclusions, the next, final, chapter will look, amongst other things, at the interrelationship between settlor control and trustee liability. To what extent can a trustee who allows a settlor too much control over a validly constituted trust be liable towards beneficiaries who were disadvantaged by the ineffectiveness of the trust? Can such a trustee be guilty of a breach of trust? Should an exoneration clause relieve the trustee from liability? Furthermore, the final chapter will look at what the rise in settlor control and limitation of trustee liability may mean for the traditional concept of the trust and for the trust industry as such. Is a trust still a trust if the settlor exercises broad powers and the trustee is only accountable to a very limited extent? Finally, can South African law benefit from the developments seen in other jurisdictions?

[402] See ch 2 para 5; ch 3 para 1; ch 4 para 1 1.

CHAPTER 5

CONCLUSION

1 Introduction

The phenomena examined in the previous chapters – settlor control and exclusion of trustee liability for breach of trust – are both fairly contemporary developments of the traditional trust concept. They are often, but not always, simultaneously present. Chapter 4 has illustrated that settlor control can, in certain circumstances, lead to the invalidity of a trust, or to a court going behind the trust, although the requirements that lead to such a result are strict and, to some extent, unclear. Trustee behaviour, and the need for trustee independence (especially in the South African context), emerged as crucial factors in such cases.[1]

This chapter concludes the study of these topics. It looks at whether a trustee can be liable for breach of trust in cases where excessive settlor control is present (whether or not a court may decide to go behind the trust). If that is the case, can and should the trustee escape liability for such breach of trust as a result of provisions in the trust deed? It asks whether such an arrangement can still be called a trust or whether it pushes the boundaries of the trust too far. Possible consequences of these developments for the trust industry and potential alternative solutions are touched upon, as well as whether South African trust law can benefit from developments seen elsewhere.

It may be helpful at this juncture to refer back to the core values identified at the end of chapter 2[2] and referred to throughout this dissertation. These pan-jurisdictional themes may be useful as a framework against which to evaluate the questions raised in this chapter. The core values that have been identified are the following:

(a) although trusts can be analysed both in terms of obligation or property, and both dimensions need to be present in order to have a trust, an analysis focusing on

[1] See ch 4 para 5.
[2] See ch 2 para 5.

obligation may have certain benefits, particularly in view of the discussion in this chapter;

(b) an irreducible core of duties owed by the trustee to the beneficiaries must be present for a valid trust to exist – this can be referred to as the irreducible core of the trust;

(c) flowing from this is the fact that the beneficiaries must be able to enforce the trust and hold the trustee to account for the fulfilment of his duties;

(d) the trustee has an overarching duty to act in the best interests of the beneficiaries, and not in furtherance of his own interest. This flows from his position as a fiduciary;

(e) there must be a functional separation between ownership or control over trust assets and the enjoyment of the assets; and

(f) as a derivative of this separation, some jurisdictions recognise a separate estate of trust assets, distinct from the personal assets of the trustee.

The following conclusions have already been drawn. As a result of changing social and economic conditions, the increased use of the trust by settlors from civil law countries (who may not understand the nature of a trust), and the flexible and unregulated nature of the trust, the common law trust has undergone a remarkable metamorphosis over the last few decades: from an arrangement aimed at protecting and providing for beneficiaries, into an investment vehicle at the behest of the settlor. It is clear that this may be putting the interests of the trust beneficiaries at risk. At the same time, it has been noted that, as a result of the way in which modern trust deeds are used and drafted, the rights of beneficiaries are in any event becoming increasingly tenuous.[3]

It may even be argued that the reluctance to go behind the trust has its roots in a desire to respect the trust as a legal institution and to promote certainty in relation to the use of trusts,

[3] See ch 4 para 3 1.

rather than with protecting the interests of beneficiaries who, in many cases, only have a very remote chance of benefitting.

If the beneficiaries named in the trust deed are unlikely to remain beneficiaries in the long run and ultimately benefit from the trust, it is hard to quantify their interest and it may not matter if that interest is exposed to high levels of risk. However, should such an arrangement take the form of a family trust, which was conceived as an arrangement to protect beneficiaries?

The questions raised above will now be examined in more detail.

2 Settlor control, breach of trust and exclusion of trustee liability towards beneficiaries: do the core values remain?

2 1 Introductory remarks

2 1 1 Settlor control and breach of trust

Attempts to go behind the trust on the basis of settlor control are typically made, not by beneficiaries, but by creditors, tax authorities or divorcing spouses. In the case of a creditor, it would usually be where the settlor does not own sufficient assets in his own name to satisfy his debt to that creditor. In the case of divorce, the settlor's spouse would normally allege that the trust assets should be taken into account in determining the pot that should be divided. The spouse may or may not be a beneficiary of the trust. In these cases, settlor control indicates a reluctance of the settlor to divest himself of beneficial ownership of the trust assets, or, in the South African context, disrespect for the separation between control and enjoyment of trust assets. This makes the trust more vulnerable to being attacked by third parties.

Whether or not the third party is successful, what is the position of beneficiaries of the trust who suffered loss as a result of the trustee allowing the settlor too much control? It is submitted that such behaviour can, in certain circumstances, constitute a breach of trust on the part of the trustee.

It is clear that if the trustee allows, for example, decisions regarding the investment of the trust assets to be made by a settlor or protector who is not suitably qualified and, as a result, there is a financial loss to the trust fund, the beneficiaries would be able to bring a claim for breach of trust against the trustee.

Arguably, beneficiaries can also suffer financial loss if a court decides to go behind the trust and the trust fund or a part thereof is applied towards, for example, the satisfaction of the settlor's debt. Can beneficiaries in such a scenario claim that the trustee committed a breach of trust and should therefore make good their loss?

If one takes the view that abdicating fiduciary responsibility and not applying an independent mind are breaches of trust,[4] and if there was a loss to the trust fund occasioned by that breach, then, under the principles examined in chapter 3, the trustee should be held liable. This may not be the case where the settlor has a power of revocation, as the exercise of that power would have meant that the beneficiaries do not benefit at all. The case of an irrevocable trust would, however, be different.

It has been shown that trustee duties generally extend to all beneficiaries, even discretionary or contingent beneficiaries. If, however, the terms of the trust deed imply that the beneficiary's interest is nothing more than nebulous,[5] it would be difficult to hold the trustee to account in the way suggested above – the core value of accountability would be lacking.

2 1 2 Exclusion of liability for breach of trust

However, in all these cases, if one assumes that there is an actionable breach of trust, to what extent can – and should – trustee exoneration or exculpation clauses[6] protect the trustee? What is the core of trustee duties and accountability that remains in such a case?

[4] Examples of case law where this statement was made include *In the matter of the Esteem Settlement* [2003 JLR 188] 239-240; *A v A* [2007] EWHC 99 (Fam) paras 42-43; *Van Zyl NNO v Kaye NO* 2014 (4) SA 452 (WCC) 465.
[5] Some offshore trust deeds, known as "Red Cross trusts" or "blind trusts", name only a charity as beneficiary in the trust deed, with a power for the trustees, settlor or protector to add and remove beneficiaries as is deemed suitable in the circumstances. See ch 2 para 3 6 3.
[6] See ch 3 para 5.

When a trustee (who is not the settlor) is faced with a settlor who wishes to exercise powers over the trust in one of the ways described in chapter 4,[7] it is natural for the trustee to be concerned about his liability towards the beneficiaries. The accountability of a trustee towards the beneficiaries is crucial to the existence of a trust, but equally, if the trustee is not able to exercise a certain power, why should he be liable if the exercise of that power by someone else causes loss?

Different jurisdictions have different thresholds for the exclusion of trustee liability in trust deeds. In addition, some methods of affording the settlor more control automatically reduce the accountability of the trustee towards the beneficiaries by excluding trustee liability for breach of trust. Unless someone else becomes accountable to the beneficiaries, it is submitted that in these cases the irreducible core of the trust is most at risk.

The following constitutes a brief comparative summary of the findings so far and how they relate to these questions.

2 2 England

2 2 1 Fiduciary position of the trustee

The fiduciary duty of a trustee under English law generally relates to avoiding conflicts between his personal interests and those of the beneficiaries of the trust, and not making an unauthorised profit from his position as trustee. It requires the trustee to be loyal and faithful.[8]

Beneficiaries of the trust can hold the trustee to account for the proper administration of the trust and can bring a claim for a loss caused by a breach of trust.[9] In fact, so important is the accountability of a trustee to the beneficiaries that it has been held that:

> "If the beneficiaries have no rights enforceable against the trustees, there are no trusts."[10]

[7] See ch 4 para 3 2.
[8] See ch 3 para 2 1 2.
[9] See ch 2 paras 2 4 2, 2 6 5, 3 5 5, 4 3 5 5.
[10] *Armitage v Nurse* (1998) Ch 241 253.

2 2 2 Duty of care

Although the above is quite a powerful statement, the same judge went on to state that honesty and good faith are sufficient to give substance to a trust, and that the core obligation of a trustee under English law does not include the duties of skill, care, prudence and diligence.[11] It is also the case that the duty of care is not regarded a fiduciary duty under English trust law.[12]

The English duty of care and skill evolved out of the 20th century prudent man of business rule and was codified in the Trustee Act 2000.[13] As explained below, the prudent man of business test may in theory be argued to imply a less rigorous standard than the more paternalistic rules out of which the duty of care evolved in Jersey and South Africa.

In mitigation of this, it is now generally accepted that a higher standard of care is expected of a professional trustee who holds himself out as having specialist skills and expertise, than of a layperson who acts out of a sense of moral or family duty.[14] However, in response to the introduction of this higher standard, it is now also common practice to include a clause in the trust deed that excludes the duty of a trustee to interfere in the management of a company owned by it, unless the trustee has actual knowledge of dishonesty by the managers of the company.[15] Furthermore, it is possible to exclude the duty of care altogether. Although this may not occur frequently in practice, particularly where a professional trustee is involved, it remains the case that the core obligation of a trustee under English law does not include the duties of skill, care, prudence and diligence.[16]

2 2 3 Settlor control

The settlor of an English law trust can reserve certain powers to himself or to a protector. However, extensive reservation of powers may defeat the objective for which the trust was set up, be it tax mitigation or asset protection, and therefore this is not a common occurrence. There is no specific legislation allowing the reservation of broad powers to the settlor, as

[11] *Armitage v Nurse* (1998) Ch 241 253-254; ch 2 para 2 6 3.
[12] See ch 3 paras 2 1 2, 2 1 3.
[13] See ch 3 para 2 1 3.
[14] The landmark case in this regard is *Bartlett v Barclays Bank Trust Co Ltd* [1980] 1 All ER 139.
[15] See ch 3 para 2 1 3 1.
[16] *Armitage v Nurse* (1998) Ch 241 253-254.

found in many offshore jurisdictions.[17] A settlor who wishes to reserve wide powers will presumably choose the law of one of these offshore jurisdictions to govern the trust, rather than English law.

Recent case law in England and other onshore common law jurisdictions, such as New Zealand, substantiates the premise that a settlor (or a protector who acts in accordance with his wishes) cannot reserve extensive powers to himself or a protector without jeopardising the validity of the trust. This can be either because the settlor had no intention to part with the beneficial ownership of the assets, or because the trust was a sham.[18] Alternatively, as was decided in New Zealand recently, a concentration of powers and entitlements in the settlor could result in the powers being equated to ownership of the trust assets, with the result that the trust assets are exposed to claims made against the settlor personally.[19] In such cases it is clear that there is no, or extremely little, accountability of the trustee towards the beneficiaries, and no separation of control and enjoyment of trust assets. Thus, the core values are being threatened.

English courts appear hesitant to ignore validly constituted trusts, although in the context of divorce it is not unheard of that trust assets are attributed to a settlor on the basis that the assets are a resource available to him, and control exercised by the settlor could be a contributing factor in this regard.[20] In practice, one may argue that this has the same effect as "piercing the veil" of the trust.

2 2 4 Breach of trust

In other divorce cases, the English High Court has indicated that where a trustee allows a settlor to exercise control over a validly constituted trust, this does not affect the validity of the trust (or, at least, it cannot turn the trust into a sham), but may expose the trustee to a claim for breach of trust.[21]

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[17] See ch 4 para 2 1 1.
[18] *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch) discussed in ch 4 para 4 2 2 4.
[19] *Clayton v Clayton* [2016] NZSC 29 discussed in ch 4 para 4 2 3 3.
[20] *Charman v Charman* [2007] EWCA Civ 503.
[21] *A v A* [2007] EWHC 99 (Fam). In this case, the court said that it cannot compel a trustee to transfer trust assets to a spouse to fulfil his financial obligations on divorce. However, the spouse did not exercise control over trust assets to the same extent as in other cases, which may explain the different result.

English law distinguishes between breach of trust (an unauthorised or inadequate action of the trustee) and breach of fiduciary duty (which is what the phrase implies).[22]

Liability for an unauthorised action or breach of fiduciary duty is strict. However, in the case of an authorised but inadequate action of the trustee, loss and a causal link between the breach of trust and the loss are required in order to succeed with a breach of trust claim.[23]

The writer has not been able to find clear authority on whether allowing excessive settlor control is a breach of fiduciary duty, an unauthorised action or an authorised but inadequate action. It is submitted that much may depend on the factual circumstances of each case. However, an argument that allowing the settlor too much control is a breach of fiduciary duty is not untenable. In any event, if there was loss and a causal link, the trustee could be guilty of a breach of trust either way.

Although objects of a discretionary trust do not have proprietary rights under English law, they do have personal rights and can enforce the obligations owed to them by the trustee.[24] It would, therefore, appear that a breach of trust claim can be brought by beneficiaries with fixed or vested interests as well as those with a mere hope of benefitting. However, if a beneficiary were to be removed from the class of beneficiaries, he can no longer bring such a claim, and herein lies a weakening of his position.

2 2 5 Exoneration clauses

As far as the exclusion or limitation of liability for breach of trust is concerned, it is possible under English law to exclude liability for all but dishonest breaches of trust, namely fraud or wilful wrongdoing. A trustee of a trust governed by English law is thus able to exclude liability for negligence and even gross negligence.[25] The background to and operation of these clauses were discussed in chapter 3. Although there is no statutory requirement for a trustee to

[22] See ch 3 para 3 1 1.
[23] See ch 3 para 3 1 2.
[24] See ch 2 para 2 6 5.
[25] *Spread Trustee Company Limited v Hutcheson* [2011] UKPC 13. The irreducible core of the trust is not regarded under English law as including the duty to act with care and skill (which duty can, in fact, be excluded from a trust deed altogether), which may go some way towards explaining the ability of a trustee to exclude liability for gross negligence. See ch 3 para 5 1.

make a settlor aware of such a clause in a trust deed, it is generally expected that a professional trustee would do so.[26]

If one assumes that a trustee may be exposed to a claim for breach of trust by allowing the settlor to control the trust, the question is whether an exoneration clause excluding liability for gross negligence can (and should) relieve the trustee from such liability.

If allowing the settlor too much control was a fraudulent or wilful act on the part of the trustee, the trustee cannot be protected in this way. However, in cases of negligence or even gross negligence, it would be possible for the trustee to escape liability.

2 2 6 Do the core values remain?

The diverging views regarding the acceptability of exoneration clauses were discussed in chapter 3.[27] Using the core values identified in chapter 2[28] as a benchmark, it can at least be argued that a trust deed that excludes the duty of care or liability for gross negligence falls short of those requirements and is leaning towards a contractual arrangement. Where a trustee, acting in a grossly negligent way, allows a settlor too much control and in the process abdicates his fiduciary responsibility towards the beneficiaries, it would indeed seem contrary to the core values identified earlier to allow such a trustee to escape liability for his breach of fiduciary duty on the basis of an exoneration clause in the trust deed.

Although many hold the view that the current position falls short of safeguarding the irreducible core of the trust, neither the judiciary nor the legislature has yet taken a firmer stance on this point.

[26] See ch 3 para 5 1.
[27] See ch 3 para 5 4.
[28] See ch 2 para 5.

2 3 Jersey and other offshore jurisdictions

2 3 1 Fiduciary position of the trustee

The position of the trustee as fiduciary under Jersey law bears a close resemblance to the position under English law and does not require further elaboration at this point.[29]

2 3 2 Duty of care

Although it is not entirely clear whether the duty of care is considered a fiduciary duty, it does appear to be the case, differentiating Jersey law from English law in this respect.[30]

The duty for a trustee under Guernsey customary law to act *en bon père de famille* likely applies in Jersey as well, and requires the trustee to exhibit utmost care.[31] It may be argued that this duty implies a higher standard than the prudent man of business test of English law. It may also explain why under Jersey and Guernsey law it is not possible to exclude either the duty of care or liability for gross negligence, as is the case in England.[32]

On the other hand, as in English trust deeds, it is common practice in offshore trust deeds to include a clause allowing the trustee not to interfere with the management of a company owned by it unless it has actual knowledge of misconduct of the directors or officers of that company.

2 3 3 Settlor control

The most popular methods of ensuring settlor control, from an offshore perspective, revolve round the reservation of certain powers – traditionally exercised by the trustee – to the settlor. The appointment of a protector, who could be the settlor himself or someone he knows and trusts and who has specific powers over the trust, is another widely accepted method of securing an enduring influence over the trust,[33] as is the use of a private trust company where

[29] See ch 3 para 2 2 1.
[30] See ch 3 para 2 4.
[31] Clarry (2014) 1 *JGLR* paras 15-16.
[32] See ch 3 paras 2 2 2 , 2 2 3, 5 2 1, 5 2 2.
[33] See ch 4 para 3 2 4.

the settlor or his representative can have a seat on the board of the trust company.[34] This dissertation has, however, focused on reserved powers trusts, particularly as such trusts also allow a trustee to escape liability for breach of trust, and therefore are in stark contrast with the traditional trust concept.

Many offshore jurisdictions have introduced legislation specifically designed for this purpose. It is widely accepted that the introduction of reserved powers legislation was aimed at attracting more business to the relevant offshore centres, in the same way as the innovative legislation regarding non-charitable purpose trusts[35] and a statutory *Hastings-Bass* rule.[36] The reserved powers legislation is aimed, firstly, at ensuring the validity of a trust in which the trustee may retain very little power, and, secondly, at exonerating the trustee from liability if he acts in accordance with the powers exercised by the settlor.[37]

This demonstrates the inherent defect of reserved powers trusts: without this special legislation they would not be valid common law trusts and it would be virtually impossible to find a willing trustee.

2 3 4 Breach of trust

Jersey law defines breach of trust as a breach of any duty imposed on the trustee by law or the terms of the trust.[38]

Case law has established that a trustee who abdicates all fiduciary responsibility could be held liable for breach of trust (rather than allow a court to pierce the veil of the trust and expose trust assets – held for the benefit of the beneficiaries – to claims by creditors of the settlor, which courts appear reluctant to do).[39] It is not entirely clear whether it is required to prove loss and causation in order to succeed with a breach of trust claim under Jersey law, but there would have to be at least evidence that a profit would have accrued to the trust in the absence of the breach.[40]

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[34] See ch 4 para 3 2 2.
[35] See ch 2 para 3 4 3.
[36] See ch 3 para 4 2 2 1.
[37] See ch 4 para 3 2 1.
[38] See ch 3 para 3 2 1.
[39] *In the matter of the Esteem Settlement* [2003 JLR 188] 239-240.
[40] See ch 3 para 3 2 2.

It has been established that, under Jersey law, objects of discretionary trusts have the same standing to seek relief for the protection of their rights as beneficiaries with fixed and transmissible interests.[41] The relief granted will, of course, depend on the court's discretion. However, a breach of trust claim can in principle be brought by a beneficiary who merely forms part of a discretionary class, provided, needless to say, that the person forms part of that class at the relevant time.

2 3 5 Exoneration clauses

Given the importance of the duty of care, and the fact that liability for gross negligence cannot be excluded, it appears *prima facie* that the Jersey law approach to trustee liability may be stricter than in England.[42] This would be the case for trusts that do not reserve extensive powers to the settlor, but because the Jersey trust law[43] allows such reservation of powers and at the same time excludes trustee liability for breach of trust, this position is effectively nullified.

From the point of view of the trustee, it is understandable that he would not want to be liable for a breach of trust caused by a party other than himself. This explains why the most important feature of offshore reserved powers trusts, from the trustee's perspective, is the statutory limitation of trustee liability. Provided that the power exercised by the settlor is one reserved to him, under the designer legislation of offshore jurisdictions, a trustee who acts in accordance with this is not acting in breach of trust.[44]

However, in such a scenario, the accountability of the trustee towards the beneficiaries is severely limited. The overriding fiduciary duty of the trustee to act in the best interests of the beneficiaries has no substance, as his function becomes more closely assimilated with that of a mere administrator. Can there still be a trust, especially if the person to whom extensive powers are reserved can exercise those powers in a personal, rather than fiduciary, capacity?[45]

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[41] Brown *The Jersey Law of Trusts* 116-117; *Freeman v Ansbacher Trustees (Jesey) Limited* [2009 JLR 1].
[42] See ch 3 para 5 2 1.
[43] Trusts (Amendment No 4) (Jersey) Law 2006.
[44] See ch 4 para 3 2 1 1.
[45] See ch 4 para 3 2 1 2.

The reserved powers trust may at first sight appear to be a clever invention – and is certainly very much in demand with settlors who use a trust more as a tax-efficient, confidential investment vehicle than a succession planning arrangement. It is, however, not clear whether, if a foreign court is faced with a claim that such a trust is invalid, or that the trustee should be held liable for breach of trust, these statutory protections would prevail. A foreign court may find that the trust is invalid on the basis that the settlor did not divest himself of the beneficial ownership of the assets, or the trustee could be held liable for a breach of trust notwithstanding the provisions of the offshore legislation on the basis that he abdicated his fiduciary responsibilities.

To the writer's knowledge, offshore reserved powers trusts have not yet been subjected to the scrutiny of a foreign court. This constitutes one of the fundamental limitations of such trusts, particularly where assets are kept outside the jurisdiction of the governing law. As trusts governed by the law of a particular offshore jurisdiction are very rarely created by settlors resident in that jurisdiction, and the trust assets would often be located elsewhere, it is submitted that this constitutes a serious disadvantage.

In addition, many offshore jurisdictions, not least Jersey and Guernsey as British Crown Dependencies, are increasingly imposing regulatory requirements on professional trustees.[46] The effect of this is that a trustee subject to these requirements must have professional oversight of the trust assets and activities undertaken in relation to the assets, regardless of whether his powers in relation to those assets have been restricted.[47] The trustee cannot stand back when the trust or the assets are managed in a way that is detrimental to the beneficiaries of the trust.[48] This means that even if, on paper, all trustee liability is excluded, in practice that may not be the case. This leads to increasing uncertainty in relation to the use of these trusts, as described below.

[46] A person carrying on trust business in or from within Jersey, or holding himself out as doing so, must be registered under the Financial Services (Jersey) Law 1998 and is subject to ongoing regulatory oversight. The regulator, the Jersey Financial Services Commission is responsible for the licensing, regulation and ongoing supervision of the financial services industry (Anonymous http://jerseyfsc.org (accessed 29-06-2018)).

[47] Of course, it should be noted that a reserved powers trust governed by Jersey law does not have to have a Jersey-resident trustee, and the jurisdiction where the trustee is resident may not always impose regulatory oversight requirements of the type described here.

[48] Careful drafting of such trust deeds is, in fact, required to ensure that the trustee is able to take action when necessary, in order to avoid the trustee having to apply to court in order to be able to intervene.

2 3 6 Do the core values remain?

Arguably, a trust with the characteristics mentioned above resembles a contract between the settlor and trustee more than a trust arrangement characterised by the core values referred to above. In such a scenario the settlor and trustee agree on the parameters of their relationship with very little constraint.[49] Adding to that the ease with which beneficiaries of offshore trusts can usually be removed or added, the trust appears to be a vehicle not for their benefit, but to make it possible for the settlor to make and control investments with the additional benefits of tax mitigation and confidentiality.

It is submitted that in such situations there remains very little, if any, of the irreducible core of the trust, and neither is there much separation between control and enjoyment of the trust assets, particularly if the settlor is a beneficiary. The overriding duty of a trustee to act in the best interests of the beneficiaries all but disappears.

That does not mean that, in practice, a trustee of such a trust necessarily abdicates all fiduciary responsibility even if he is allowed to do so under the applicable offshore trust law. This may be because there is doubt regarding the extra-jurisdictional recognition of such trusts, because regulatory stipulations may require the trustee to have more oversight than the law requires of him, because he may expose himself to a claim for breach of trust, or because of reputational concerns. It is, however, the legal position.

In those circumstances where the English courts have had to deal with discretionary trusts governed by offshore law (albeit that a reserved powers trust has not yet been the subject of such litigation), it is clear from the judges' comments, many of them *obiter*, that there is very little appetite for allowing settlors to use offshore trusts for improper purposes, be that tax evasion or hiding assets from creditors or spouses.[50] One can expect this trend to continue given the hostile attitude towards trusts explained in chapter 1.[51]

[49] As illustrated in ch 4 para 3 2 1, the list of powers that can be reserved is extensive.
[50] Hudson *Equity and Trusts* 919; *Schmidt v Rosewood Trust Ltd* [2003] 2 AC 709 para 1; *Minwalla v Minwalla and DM Investments SA, Midfield Management SA and CI Law Trustees Ltd* [2004] EWHC 2823 (Fam) para 1.
[51] See ch 1 para 2 2 2.

2 4 South Africa

2 4 1 Fiduciary position of the trustee

South African trust law follows its English counterpart as far as the fiduciary position of a trustee is concerned. The duties of loyalty and good faith find resonance in South African case law. It has, in fact, been argued that, because the duty of care is so clearly described as fiduciary under South African law, it goes even further than English law.[52]

2 4 2 Duty of care

The duty of care appears to have evolved from the Roman-Dutch concept of acting as *bonus et diligens paterfamilias*.[53] This seems more closely linked to the duty to act *en bon père de famille* found in Guernsey and Jersey customary law,[54] as it clearly concerns the management of the affairs of someone with whom the trustee stands in a relationship of trust, rather than the English law prudent man of business[55] who looks after his own affairs.

The duty of care, regarded a fiduciary duty, is also entrenched in statute.[56] The non-fulfilment of this duty has been held to be sufficient to remove trustees from their office where they were dealing with trust assets as if the assets were their own, co-mingling trust and personal assets, unnecessarily exposing trust assets to risk, and failing to act in the interests of the beneficiaries as a whole. It was held not to be necessary to prove *mala fides* in order to remove a trustee from office.[57]

The removal of a settlor-trustee who is guilty of this type of misconduct and maladministration may be a way of ensuring that an independent trustee is appointed in his place. Where no loss has been proved so that a breach of trust claim would not succeed, because the duty of care is so entrenched in South African law, this could be a useful remedy for aggrieved beneficiaries and may avoid future loss.

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[52] See ch 3 paras 2 3 1, 2 3 2.
[53] See ch 3 para 2 3 3.
[54] See ch 3 para 2 2 2.
[55] See ch 3 para 2 1 3 1.
[56] Trust Property Control Act 57 of 1988 s 9(2).
[57] *Tijmstra NO v Blunt-Mackenzie NO* 2002 (1) SA 459 (T) discussed in ch 3 para 2 3 4.

2 4 3 Settlor control

In the South African context, although a settlor can revoke or vary a trust under certain circumstances, it is not possible to reserve to the settlor or a protector the same wide powers as under offshore reserved powers legislation.[58] However, the settlor, more often than not, exercises power by acting as a co-trustee, and may in addition be the dominant trustee. This can be problematic if the co-trustees are not sufficiently independent, and particularly so if the class of beneficiaries comprises the settlor and his immediate family members.[59] Unless there were to be a rigorously independent co-trustee, this may be argued to be a more direct and effective way for the settlor to exercise control than merely reserving certain powers under the trust deed.

However, if there is a truly independent co-trustee acting alongside the settlor, it is submitted that this may, in an ideal world, constitute a workable model of acceptable settlor control. The settlor who acts as co-trustee would remain liable (to a higher degree than under English or Jersey law) and must therefore at all times act in a fiduciary capacity. Thus, the core values, such as an irreducible core of trustee duties, and a separation of control and enjoyment, would remain. It is, however, doubtful whether one can realistically expect such a level of independence from an unregulated co-trustee whose activities may, to a large extent, go unchecked.

2 4 4 Breach of trust

Under South African law, breach of trust is explained by reference to the duty of care (which is considered a fiduciary duty). If this duty is breached, there is a breach of trust.[60]

In case law reference has been made to the possibility of a breach of trust claim where a trustee allows a settlor too much control and disregards his fiduciary duties.[61]

If the settlor's control is a result of him acting as co-trustee, he is entitled to such control in his capacity as trustee, but has to exercise his powers in a fiduciary manner – independent and

[58] See ch 4 para 2 1 3.
[59] See ch 4 para 4 3 4.
[60] See ch 3 para 3 3 1.
[61] *Van Zyl NNO v Kaye NO* 2014 (4) SA 452 (WCC) discussed in ch 4 para 4 3 2 2.

in the best interests of the beneficiaries as a whole (and not simply for his own benefit). Failing to act in this way could expose the settlor-trustee to a breach of trust claim. Similarly, where a trustee, who is not also the settlor, allows the settlor to control the trust, a breach of trust claim may be possible on the basis that allowing such control is at least negligent.

However, it has to be borne in mind that, in order to succeed with a breach of trust claim under South African law, there must be a wrongful act on the part of the trustee, loss to the beneficiary and a causal link between the breach of trust and such loss.[62] Allowing a settlor to effectively control the trust, or failing to exercise trustee powers for the benefit of the beneficiaries, would not without fulfilling the requirements of loss and causation enable the beneficiaries to succeed with a breach of trust claim. (If there is no loss, it may, however, still be possible to have the trustee removed from office, as mentioned above.)

If a court decides to go behind the trust and ignore the separation between the trustee's personal estate and the trust estate, so that trust assets can be used to satisfy personal debts of the settlor-trustee, the beneficiaries (who will likely be the settlor's close family members) may well have a claim against the trustee or co-trustees for breach of trust. This would be on the basis that there is a loss to the trust fund, caused by the trustee's failure to comply with his duty of care. The position under South African law is that the fiduciary duty of a trustee extends to all beneficiaries, whether their interests are vested or potential, and whether they have accepted benefits or not.[63]

2 4 5 Exoneration clauses

South African trust law prevents any exemption from liability for breach of trust.[64] This means that a trustee is liable for breaches of trust caused by either negligence or gross negligence. The South African position therefore appears the strictest, with beneficiaries being afforded greater protection than under English trust law.[65]

[62] See ch 3 para 3 3 2.
[63] *Doyle v Board of Executors* 1999 (2) SA 805 (C) 813; see discussion in ch 3 para 2 3 2.
[64] See ch 3 para 5 3.
[65] Clarry (2014) 1 *JGLR* para 29.

2 4 6 Do the core values remain?

Of the core values referred to above, the separation of control and enjoyment of trust assets is possibly the most frequently referred to in South African academic writing and it has been referred to as the "core idea" of the trust.[66] However, the other core values, including the overriding duty to act in the best interests of the beneficiaries and the accountability of the trustee, are certainly deemed essential to the trust relationship.

If a trustee is found to be in breach of trust for allowing settlor control or for furthering his own interests rather than acting in the best interests of the beneficiaries, it is not possible for the trustee to escape liability – whether for negligence or gross negligence – on the basis of a trustee exoneration clause. From this perspective it would appear that the irreducible core of the trust is therefore better protected than in the other jurisdictions under review. However, the issue of abuse of the trust through excessive settlor control is highly relevant and much debated.

Traditionally, South African law does not require rigorous trustee independence, and thus, combined with the ease and flexibility with which a trust can be used, a state of affairs has developed where it is common to transfer assets to a trust, but to continue to deal with the assets as if nothing has changed.[67] This clearly violates the principle of separation of control and enjoyment and the presence of an irreducible core may be questioned in these circumstances. As discussed below, there are clear indications that the legislature and the judiciary are growing intolerant of this abuse.

3 Alternative solutions

Throughout this dissertation it has been shown that legislation and the judiciary have both played a crucial role in developing trust law. In the offshore jurisdictions, frequent new legislation is the norm – it seems to be the way in which these jurisdictions attempt to keep their competitive edge.[68] Case law plays a much bigger role in both England and South

[66] See ch 2 para 4 3 1 2.
[67] *Nieuwoudt NNO v Vrystaat Mielies (Edms) Bpk* 2004 (3) SA 486 (SCA) para 17; see ch 4 para 4 3 1.
[68] See ch 2 para 3 7.

Africa.[69] Although there have been amendments to the legislation affecting trusts over the years, this has been quite limited compared to their offshore counterparts.

It is, therefore, not surprising that offshore jurisdictions are inventing new structures that have some characteristics of a trust and some that more closely resemble a separate incorporated legal entity. In Jersey this took the form of the Foundations (Jersey) Law 2009. These foundations are intended as private succession planning and wealth management structures, and are said to be highly flexible;[70] in this respect it resembles a trust. However, foundations have legal personality and may contract in their own name, thus making them more accessible and understandable for founders from a civil law background. There is also no separation of legal and beneficial or equitable title to the foundation property, as there is with a trust.[71] Beneficiaries under foundations have no interest, legal or beneficial, in the foundation's assets, unless the beneficiary has become entitled to receive a benefit under the foundation's constitutive documents.

A council administers the foundation and carries out its objects. Importantly, council members do not owe any form of fiduciary duty to the foundation's beneficiaries (should it have beneficiaries). They do have to act honestly and in good faith with a view to the best interests of the foundation (not the beneficiaries) and they need to exercise the care, diligence and skill that a reasonable, prudent person would exercise in comparable circumstances. However, compared to the statutory duty of care under trust law,[72] this is a much-reduced standard.

It is clear that the foundation law described above is intended to offer the same advantages as a trust, but without some of the constraints, in a way that makes the foundation more appealing than the trust, both for the founder and for the council members.

The Cayman Islands have taken the foundation idea one step further by introducing the foundation company as a new vehicle for wealth planning and for use in commercial

[69] See ch 2 paras 2 10, 4 7.
[70] Anonymous "Jersey Foundations" *Carey Olsen Briefings* (accessed 25-07-2018).
[71] It is also possible to establish a non-charitable purpose foundation, as is the case with trusts under the Trusts (Amendment No 3) (Jersey) Law 1996 discussed in ch 2 para 3 4 3.
[72] Trusts (Jersey) Law 1984 s 21(1) discussed in ch 3 para 2 2 3.

transactions.[73] Although it appears very similar to the Jersey foundation described above, the new vehicle has its origins in the traditional limited liability company, to which certain features have been added (or taken away). As a result, it is expected that this new vehicle will be able to benefit from the extensive Cayman case law on companies, adding to the certainty as to how courts will treat this vehicle (although this remains to be seen). In any event, what is evident is that the Cayman Islands have drafted this legislation with the main objective of "adding another string to the bow of options for the wealth planning industry, while keeping an eye on other, wider commercial strategies".[74]

It is probably fair to say that the offshore jurisdictions will continue to legislate in order to keep their competitive advantage. Provided that these new vehicles fulfil the requirements of the wealth owners who wish to use them and are accepted and respected for what they are in a foreign court (because inevitably there will be an international element to the use of these vehicles), it would seem preferable to use such a vehicle rather than using a trust but violating many of the core principles thereof.

Other relatively new inventions are the trust laws enacted by certain civil law jurisdictions, notably China, whose trust law dates from 2001. There are clear divergences from the common law trust as developed by English law. It appears that certain characteristics of this trust law were specifically moulded to be compatible with the requirements of modern wealth owners who wish to have the benefits of a common law trust but without the restrictions thereof.

The settlor can continue to own the trust property and as a result has a continuing role in the trust. The rights of beneficiaries are not clear; exclusion of trustee liability for wilful misconduct and gross negligence is not possible where the trust takes the form of a contract but not otherwise, leaving the position of, say, testamentary trusts unclear. Much of the required clarity will have to be provided by case law, but there is no certainty as to how the Chinese judiciary, presumably unschooled in trust law, would interpret the trust, especially in a private wealth, as opposed to commercial, context.[75]

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[73] Foundation Companies Law, 2017; Partridge "Another String to the Bow – The Cayman Islands New Foundation Company Legislation" *Ogier Publications* (accessed 25-07-2018).
[74] Foundation Companies Law, 2017; Partridge "Another String to the Bow – The Cayman Islands New Foundation Company Legislation" *Ogier Publications* (accessed 25-07-2018).
[75] Graham and Steen (2012) 18 *T&T* 36.

Returning to the jurisdictions under review in this dissertation, the South African judiciary has always played a central role in developing the relatively young South African trust law. It is no different when it comes to issues such as abuse of the trust through excessive settlor control. South African courts now recognise the remedy of going behind the trust in instances where the trust is abused in this way, with the judiciary referring to this remedy on numerous occasions. There have not been many instances of a final decision to go behind a trust and the exact requirements for doing so have not yet fully crystallised, but future judgments and academic discourse will hopefully bring more clarity on the subject.

Although a settlor acting as co-trustee can exercise fairly direct control over a trust, an independent co-trustee may prevent flagrant abuse of the trust in such circumstances. The need for an independent trustee in circumstances where the settlor, trustees and beneficiaries all form part of the same family group has long been recognised by the judiciary[76] and has now been acknowledged in the form of a Chief Master's Directive.[77] This move is a step in the right direction and should help to avoid the abuse of trust that is common in such situations, although it may be that a legislative change is required if the directive is not satisfactorily implemented.

4 Final conclusions

4 1 England and offshore jurisdictions whose trust laws are closely aligned with that of England

Earlier in this dissertation it has been explained that certain developments in trust law and practice are contributing to a situation where the common law trust concept is losing its unique characteristics and becoming increasingly assimilated with the concepts of legal personification, contract or even agency. It is doubtful whether, in some arrangements labelled a trust, the core values referred to above are present.[78]

[76] *Land and Agricultural Bank of SA v Parker* 2005 (2) SA 77 (SCA).
[77] See ch 2 para 4 5 for the role of the Master of the High Court with regard to trusts; see ch 4 para 4 3 4 for the directive.
[78] See the discussions in ch 3 paras 2 4, 5 4; ch 4 para 3 1.

This creates uncertainty, as the boundaries of what can be achieved with a trust are becoming increasingly blurred. One example of this uncertainty is whether the validity and effectiveness of offshore reserved powers trusts would be respected in a foreign (onshore) court.[79] Another example is the diverging opinions on the acceptability of trustee exoneration clauses in England.[80] In similar vein, judges and academic scholars grapple with the issue of going behind the trust. It appears to be a suitable remedy in cases of abuse of the trust, but ignores the consequences of a trust and, in the South African context, the separation of the trustee's personal estate from the trust estate.[81]

Waters[82] is of the view that common law jurisdictions have arrived at a point where they need to decide whether to retain the trust concept that developed to a large extent over the last two centuries, or whether to be open to other possible conceptions regarding the nature of the trust. If no decision is made, he fears that the trust will cease to be distinguishable from other legal concepts, and the uncertainty surrounding what constitutes a trust – how far the boundaries can be pushed – will substantially curtail its use across borders.[83] The uncertainty also impacts negatively on the use of trusts in other sectors, such as pension fund trusts, unit trusts and other collective investment trusts, which generally are regulated to a much larger extent, but have their foundation in the common law trust.[84]

The classic private trust arrangement sits, according to Waters, in the middle of the spectrum between legal personification and contract. Even further out on the spectrum is agency.[85]

If a trust were a legal entity, it would burden the trustee with limited liability similar to that of a director of a company and prevent personal liability (apart from cases of wilful wrongdoing), without the need for exculpation clauses in trust deeds.[86] However, such a change would irrevocably alter the relationship between the trustee and the beneficiary, to whom the trustee is accountable. The trust would also lose much of its flexibility, insofar as legislation and regulation would largely replace the pragmatic judicial development of the

[79] See ch 4 para 3 2 1.
[80] See ch 3 para 5 1.
[81] See ch 4 paras 4 3 1, 4 3 4.
[82] Waters in *The International Trust*.
[83] Waters in *The International Trust* 838.
[84] Kulms (2016) 24 *European Review of Private Law* 1091.
[85] Waters in *The International Trust* 875-880.
[86] Waters in *The International Trust* 880-882.

concept. It would presumably also cease to offer advantages such as tax mitigation and succession planning, as the settlor or beneficiaries would own the "trust entity" or a part thereof.

As far as settlor autonomy goes, characterising the trust as a contract would enable the settlor to agree to any level of control with the trustee. The settlor would also be able to replace the trustee at his discretion. Again, the position of the beneficiary and its relationship with the trustee is at risk if this route is followed. Contemporary trust drafting, especially offshore, means that beneficiaries can be added and removed with ease and their right to information may to a certain extent be curtailed. This puts the beneficiary in a very weak position, particularly when compared with standard trust deeds of 40 or 50 years ago, where the beneficiaries were clearly named and it was not possible to make changes to the beneficiary class at will.

These observations accord with what was said earlier: the trust appears to have evolved from a relationship where the trustee administered the trust property in the best interest of the trust beneficiary, into an investment holding vehicle where the settlor uses the trust not in order to benefit someone else, but in order to gain advantages related to tax, asset protection or confidentiality. In some cases of extreme settlor control and very limited trustee accountability, the arrangement between the settlor and trustee may come uncomfortably close to agency. These are, of course, the extreme ends of the spectrum and it is likely that a vast majority of personal family trusts fall somewhere in-between these two extremes.

In addition to the changes highlighted in chapter 4 (new opportunities for wealth creation, taxation developments and an increasing use of the trust by settlors from civil law countries),[87] it is submitted that the financial importance of the trust industry to the offshore jurisdictions and the prevalence of corporate trustees that charge for their services are major contributors to the state of affairs described above. These corporate bodies, and the legal and tax advisors of would-be settlors, depend on a steady flow of new and continuing trusts for their survival. Trusts are often mis-sold to settlors insofar as settlors are led to believe that they can retain a fair degree of control over the assets, or, alternatively, the trust is established under the law of a jurisdiction that allows a wide reservation of powers to the settlor. The

[87] See ch 4 para 3 1.

latter course of action is preferable from the trustee's point of view, as his liability for acting in accordance with the settlor's instructions is either excluded or severely curtailed.

Because the concepts of settlor control and exclusion of trustee liability conflict with the traditional view of the trust, settlors, trustees and advisers, from both common law and civil law jurisdictions, are left in an uncertain state as to how far these concepts can be pushed before it becomes unacceptable.

Waters, who writes from the perspective of the international use of the trust, argues that the trust may become unrecognisable (or, as he phrases it, a "jumble of ideas without focus")[88] if the common law jurisdictions, where the trust is argued by some to be most at home, do not set clear boundaries for the use of the trust, not only within the confines of common law jurisdictions, but also elsewhere.

4 2 South Africa

South African trust law is not free from uncertainty either. The trajectory of the development of trust law in South Africa was, and still is, unique, although it is very similar indeed in most respects to the Scottish trust.[89] The trust law that has developed on South African soil shows many fundamental similarities with English trust law and, as a result, it can safely be argued that a South African trust is a real trust.[90] However, as a result of this unique, and more modern, path of development, there are subtle differences *vis a vis* English law, some of which may have the result that South African trust law is better able to deal with the issues raised in this dissertation. Examples of these differences are in relation to the trust as a legal entity and the trust as a contract, as explained below.

It has been noted that, although a trust is not regarded as a separate legal entity under South African law, the recognition of separate estates – the trustee's personal estate and the trust estate – may come close to recognising the trust as a legal entity.[91] Du Toit refers to the

[88] Waters in *The International Trust* 886.
[89] See ch 2 para 4 2 3.
[90] See ch 2 para 4 3 1 1.
[91] See ch 2 para 4 3 2 2.

"gravitational pull of the law of persons", illustrated by incorrect and confusing references by legal scholars, as well as the judiciary, to the trust as an entity.[92]

Furthermore, elements of the law of contract are visible in South African trust law, insofar as it is accepted that *inter vivos* trusts are created by way of contract or, to be more precise, a contract for the benefit of a third party. However, the contractual analogy does not permeate all aspects of a South African trust, and appears to be limited to the creation, variation and revocation of trusts.[93]

Despite accepting that the *inter vivos* trust deed is a contract between the settlor and the trustee, settlor autonomy does not go as far as it does in other jurisdictions, particularly offshore jurisdictions such as Jersey. Of course, the reservation of powers to the settlor or a protector is not necessary if the settlor acts as co-trustee. In addition, the trustee is less able to protect himself against liability, as the Trust Property Control Act[94] prohibits any exclusion of liability for breach of trust – even in cases of simple negligence. In theory, this applies to settlor-trustees as well, but, as explained below, in many of these cases there is no trustee accountability or independence, so this limitation may not concern a settlor-trustee, at least, not until something goes wrong.

Although one may argue that the impossibility of excluding liability for negligence is unfair and may discourage potential trustees from accepting the office of trustee (and could be a reason why there is a scarcity of independent trustees), this is the current position.[95]

As is the case in the other jurisdictions under review, abuse of the trust concept occurs most frequently where the benefits of using a trust are desired, without a willingness to accept the reality of having to hand over control of the trust assets. In South Africa, this manifests itself particularly where business or commercial trusts are fused with family trusts.[96] In such a case, the trust is used for commercial purposes, typically the ownership and running of a business operation, or the holding of more passive investments, but the settlor, trustees and beneficiaries all form part of the same family. As a result, there is no substance to the

[92] Du Toit (2015) 79 *Rabel Journal* 852 859.
[93] See ch 2 para 4 3 2 1.
[94] Trust Property Control Act 57 of 1988 s 9(2).
[95] See ch 3 para 5 3.
[96] Du Toit (2015) 79 *Rabel Journal* 852 870.

accountability of the trustee. The beneficiaries are his close family members and may not even be aware of the existence of the trust. There is no separation between control over the trust assets by the trustee and enjoyment thereof by the beneficiaries. Evidently this is not an acceptable state of affairs, and the core values referred to before are conspicuously absent.

Reference was first made to the possibility of piercing the veneer of the trust in the interest of third parties in *Land and Agricultural Bank of South Africa v Parker*.[97] The notion of piercing a corporate veil in the context of trust law has, however, been said to cloud the "conceptual clarity demanded by the still-developing South African trust law".[98] Therefore, the description "going behind the trust" is preferred.[99]

Another aspect of the South African development of the trust that may have led to some of the differences in comparison to the English trust, is that South African law engages with the trust in a realistic and pragmatic manner. It is less constricted than its English counterpart by abstract (and some may say antiquated) legal concepts, but at the same time not devoid of academic rigour. Du Toit is of the view that this model may provide valuable lessons with regard to the introduction of the trust into new contexts.[100]

Despite this flexible and pragmatic approach, or perhaps because of it, uncertainties remain when it comes to abuse of the trust through settlor control. It may be that, in addition to the recent Chief Master's Directive,[101] legislation is required to ensure that an independent trustee is present in those circumstances where there are abundant opportunities for abuse, such as the fused business and family trust referred to above. This may take away some flexibility for settlors, but the benefits in terms of certainty and respect for the trust as an institution would far outweigh that.

4 3 Closing remarks: lessons for South African trust law?

It cannot be disputed that trusts, and particularly express *inter vivos* trusts used in a family context, are regarded, often undeservedly, with skepticism by tax authorities. It can also not

[97] *Land and Agricultural Bank of SA v Parker* 2005 (2) SA 77 (SCA).
[98] Du Toit (2015) 79 *Rabel Journal* 852 871.
[99] See ch 4 para 4 3 1.
[100] Du Toit (2015) 79 *Rabel Journal* 852 877.
[101] See ch 4 para 4 3 4.

be disputed that there is a global drive towards greater tax transparency and compliance, and a rise in populist movements opposed to capitalism and wealth creation. Some of the classic advantages of using a trust – tax mitigation and confidentiality – have already been curtailed by these developments in onshore, high tax jurisdictions such as England and South Africa.

The judiciary, across the jurisdictions under review, has already signalled that it may be time for a change. The alternatives are increased regulation and legislation, which could lead to less flexibility for those who wish to use the express *inter vivos* trust for the purposes it was intended to achieve.

Although a situation where all trusts are strictly regulated may not be desirable, this chapter explained the positive aspect of the regulation of licensed trustees in certain offshore jurisdictions, such as Jersey. The requirement of professional oversight over trust assets makes it very hard for a professional trustee to abdicate his fiduciary responsibilities without exposing himself to liability for breach of trust. Unfortunately, in the offshore context, this regulation is in stark contrast with what the applicable trust law allows, and therefore does not result in increased certainty regarding the effectiveness of these trusts in other jurisdictions. In fact, it may be adding to the uncertainty that surrounds the question of how far settlor control and exclusion of trustee liability can go.

In a purely South African context, it is submitted that, when it comes to the abuse of the trust, the principal area for improvement is trustee independence.[102] A trustee of a South African trust cannot, as the law currently stands, be relieved from liability for gross negligence, or even negligence. This position, although in line with many of the core values identified before, may be too strict if there is a desire to increase the prevalence of independent (and professional) trustees. The English position, on the other hand, where liability for gross negligence can be excluded in the trust deed, may be a step too far in the opposite direction and raises questions about whether the irreducible core of trustee obligations remains. The position adopted in Jersey, Guernsey and many other offshore jurisdictions, namely that liability for negligence, but not gross negligence, can be excluded, may potentially be a sensible and prudent middle ground, and would take cognisance of changing circumstances

[102] This conclusion was drawn in ch 4 para 4 3 4.

and the need for pragmatic solutions. This is an aspect that may require further evaluation and qualification.

As far as the requirement to have an independent trustee is concerned, the Chief Master's Directive,[103] which resulted from the *Parker*[104] decision, is a crucial step. It may be, however, that an amendment to the Trust Property Control Act[105] is required to ensure that the spirit of this directive is complied with. It is submitted that the requirement to appoint an independent trustee should be applicable to all trusts where the settlor, beneficiaries and trustees (apart from the independent trustee) are members of the same family, and not only to so-called 'family business trusts' as suggested by the Chief Master's Directive.[106]

Well drafted legislative change typically has the benefit of affording certainty. It has been illustrated that the uncertainty regarding the efficacy of offshore reserved powers trust legislation is one of its major flaws. This appears to be because the principles of excessive settlor control combined with lack of trustee accountability present an unacceptable abuse of the traditional trust concept. It is submitted that legislation of the sort described in the previous paragraphs – allowing a trustee, at least in certain circumstances, to escape liability for negligence (but not gross negligence) and allowing a settlor to act as co-trustee and therefore exercise control, but, at the same time, requiring an independent trustee who needs to fulfil a list of clearly defined requirements – would not violate the South African trust concept. Bearing in mind the significance of the separation between control over trust property and enjoyment of the trust property, regarded as the core idea of the South African trust,[107] one may argue that the requirement for an independent trustee is indispensable.

It is submitted that, in order to continue to benefit from the flexibility and advantages offered by the trust concept, wealth owners and the trust industry that serves them, both within and outside of the confines of common law jurisdictions, have no choice but to accept that those benefits come at a price: for the settlor, a separation between the control and enjoyment of the trust assets; for the trustee, the accountability that comes with acting as a fiduciary. Only if the correct balance can be maintained will the trust survive for generations to come.

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[103] See ch 4 para 4 3 4.
[104] *Land and Agricultural Bank of SA v Parker* 2005 (2) SA 77 (SCA) para 35.
[105] Trust Property Control Act 57 of 1988.
[106] See ch 4 para 4 3 4 where this is discussed.
[107] See ch 2 para 4 3 1 2; ch 4 para 4 3 2 1.

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