Equity & Trusts

Private Law Tutor Publishing

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Welcome/Introduction/Overview

This book provides you with basic information as a basis for you to form your own critical opinions on this area of law. Once you have mastered the basics, you will be inspired to question contract principles in your essays and apply them in mock client advisory scenarios. Again, for your convenience, we have also published a book which provides you with examples of how to answer such questions and how to apply your knowledge as effectively as possible to help you get the best possible marks.

This aid is a fully-fledged source of basic information, which tries to give the student comprehensive understanding for this module. However, it is recommended that you compliment it with the further reading suggestions provided at the end of each topic, as well as read the cases themselves for more in-depth information. This book provides an analysis of the basic principles of the law of Equity and Trusts. The following is a summary of the Book content:

- An introduction to Equity Law;
- An introduction to Trusts Law;
- What these areas of English Law seeks to achieve; and
- The legal-philosophical development of this area of law.

The aim of this Book is to:

- Provide an introduction to anyone studying or interested in studying Law to the key principles and concepts that exist in the Law of Equity and Trusts.
- To provide a framework to consider Equity and Trusts Law within the context of examinations.
- Provide a detailed learning resource in order for legal written examination skills to be developed.
- Facilitate the development of written and independent critical thinking skills.
- Promote the practice of problem solving skills.
- To establish a platform for students to gain a solid understanding of the basic principles and concepts of Equity and Trusts, which can then be expanded upon.

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Through this Book, students will be able to demonstrate the ability to:

- Demonstrate an awareness of the core principles of Equity and Trusts.
- Critically assess challenging mock factual scenarios and be able to pick out legal issues in the various areas of the law.
- Apply their knowledge when writing a formal assessment.
- Present a reasoned argument and make a judgment on competing viewpoints.
- Make use of technical legalistic vocabulary in the appropriate manner.
- Be responsible for their learning process and work in an adaptable and flexible way.

STUDYING EQUITY & TRUSTS LAW

Equity & Trusts is one of the seven core subjects that the Law Society and the Bar Council deem essential in a qualifying law degree. Therefore, it is vital that a student successfully pass this subject to become a lawyer. Additionally, a knowledge and understanding of the principles in these areas is needed in order to study other law subjects such as land, probate and Wills.

The primary method by which your understanding of the law of Trusts will develop is by understanding how to solve problem questions. You will also be given essay questions in your examinations. The methods by which these types of question should be approached are somewhat different.

TACKLING PROBLEMS AND ESSAY QUESTIONS

There are various ways of approaching problem questions and essay questions. We have provided students with an in-depth analysis in the question and answer series of books.

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Chapter 1 - Introduction to Equity

INTRODUCTION

Equity represents one of the two main ramifications of the UK law system. On one side there is Common law, such as the law made by the judges in the Common Law courts. On the other side there is Equity, the law made by the judges in the Chancery courts. A clear understanding of the origins of Equity is essential in order to comprehend the principles on which it is based and the way those are applied. Concepts such as 'trust' must be illustrated in the light of the historical development of the subject.

WHAT HAPPENED IN THE VERY BEGINNING?

The origins of Equity lie in the Middle age. At the time in order to go to court an individual needed to be a 'free man' (Sir and Lord) and make sure that the case fitted into a particular range of claims, called 'writs'. Writs were templates that encompassed those claims considered deserving to reach the court. The purpose of creating writs was to prevent the courts to be flooded by undeserving cases. Furthermore, in 1258 the Proclamation of Oxford came into force with the aim to prevent the creation of further writs. Less potential claims were allowed to go to court. The society kept developing while the law fossilised.

Only one option was left to those not able to take their cases to court: The King. The King, as fount of all justice, had the power to override the writs and declare fair the consideration of a case even though it did not fall within the required categories. At some point due to the volume of claims, the King appointed someone to deal with this burden in his place, the Chancellor, traditionally the Senior Advisor of the King (someone that may be seen as the current Prime Minister). The Chancellor was usually a cleric, a religious person whose approach to the cases based on theoretical concepts such as justice, fairness and equity. The Claimant used to send his petition to the King in Council. The petition was addressed to the Lord Chancellor that examined the case. In time the Chancellor started building up a body of rules and Equity

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commenced to be more formalised. In order to balance the high degree of flexibility applied to the cases and guarantee more certainty, the Court of Chancery built up a proper legal system called Equity.

Equity has been created in order to mitigate the harshness of the Common Law. Initially it was a second option for those cases not able to have a cause of action before Common law courts under the writs. Afterwards it became an option to reach a more suitable remedy upon the facts of the case that Common Law would have not provided and a way to fill the gaps, internal to the Common Law system. The purpose of Equity was to achieve justice and fairness *ad hoc*, by looking at each case on its own.

As separated bodies of law, Equity and Common Law may reach different outcomes so that a conflict may arise. How could conflicts be resolved?

General Principle: Where there is a conflict between common law and equity, equity shall prevail (per Coke CJ).

Earl of Oxford's Case
Facts: Magdalene College sold a piece of land to Queen Elisabeth I. The land was later on sold to Mr Spinola. A statute, 13 Eliz c 10, provided that conveyances of estates by the masters, fellows*, any college dean to anyone for anything other than a term of 21 years, or three lives, 'shall be utterly void'.* It was thought transfer to the Queen would grant unimpeachable title. Spinola thought this, and so did Edward de Vere, the Earl of Oxford, who bought the land in 1580 and built 130 houses. John Warren leased a house through intermediaries. Then, Barnabas Gooch, Master of Magdalene College, claimed that he was able to lease the land to John Smith. Warren brought an action of ejection against Smith, but his lease expired before it was heard by court. Warren asked the question to be decided anyway. **Ratio: Equity is a modifier of the Common Law therefore whether a principle is established in Equity it has to be followed in Common Law. Per Lord Ellesmere LC "The office of the Chancellor is to correct man's consciences for frauds, breach of trusts, wrongs and oppressions of whatsoever nature and to soften and mollify the extremity of**

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the law (…) When judgment is obtained by oppression, wrong and a hard conscience, the Chancellor will frustrate and set it aside, not for any error or defect in the judgement but for the hard conscience of the party." Application: The Court of Equity decided in favour of the Defendant, holding that he was entitled to relief.

The fundamental role exercised by both ramifications of the law and the potential conflict between the two have led to the introduction of the Judicature Acts 1873-1875. The Act has unified the civilian legal structure by creating one set of courts including both the court of Equity and the court of Common Law. Nevertheless, it is not that simple to transplant Equity and Common Law within one single system since they have been separated for several centuries. Two separate bodies of rules have been built up for years until the point that equity has, for instance, built a more sophisticated body of rules in relation to property rights with the introduction of trusts. Trusts are a property regime that is strictly related to the Equity system. They have developed out of the division of law and equity.

THE SIGNIFICANCE OF THE NINETEENTH CENTURY IN THE DEVELOPMENT OF EQUITY

During the Nineteenth century several important reforms were introduced in order to balance the presence of the two parallel law systems of Common law and Equity. The introduction of the Common Law Procedure Act 1854 permitted Common law courts to adopt equitable remedies next to the usual damages. The

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Chancery Amendment Act 1858 allowed the Court of Chancery to award the Common law remedy of damages next to the usual equitable remedies. The Judiciary Act 1873 and 1875 fused the two systems of Common law and Equity in one single administrative structure. More specifically, the purpose of the Act was '*the vesting in one tribunal the administration of Law and Equity in every cause, action or dispute which should come before that tribunal'* as Jessel MR stated in **Salt v Cooper** [1880] 16 Ch D 544 In order to prevent situations where courts might face conflicts between the two systems, Section 25 of the Judiciary Act 1873 established:

> *'Generally, in all matters not hereinbefore mentioned in which there is a conflict or variance between the rules of equity and the rules of common law with reference to the same matter, the rules of equity shall prevail.'*

General Principle: '*There is only one court and the equity rules prevail in it'* (Jessel MR)(On the front cover of this book).

Walsh v Lonsdale [1882] 21 Ch D 9
Facts: The parties stipulated an agreement for the lease of a mill for seven years. The Claimant was let into possession. The agreement was stipulated without the adoption of a deed. In the agreement there was a clause establishing that rent would have been paid one year in advance whether the Defendant demanded. When Lonsdale asked the Claimant the payment in advance, he refused it and the Defendant distrained for the amount. The Claimant sued the Defendant on the ground of illegal distress and specific performance of the contract for the lease. **Ratio: The equity rules prevail and the maxim applied by the court Lord Jessel MR was equity looks on that as done that which ought to be done. Application:** Since Equity does not require compliance with particular formalities such as the use of a deed, the court held in favour of the Defendant on the ground that he was entitled of the payment in law and in equity. The agreement between the parties had to be treated as equivalent to a contract for a lease under a deed.

General Principle: The purpose of the law is to reach fairness in the best interest of the parties, unhindered by the constraints of law or equity.

Federal Commerce and Navigation Ltd v Molena Alpha inc [1878] QB 927
Facts: Three ships got let to charterers for about six years. The agreement included the following clauses: i) the rent had to be paid twice monthly in advance. In default of payment the owners had the right to withdraw the vessel after notice; ii) deductions from hire were admitted. The charterers made deductions from hire without prior agreement with the owners. The ship-owners withdrew the charter by instructing the master not to sign any bills with the charterers. The latter read the owners' action as a repudiation of the charter and they sued them. **Ratio: 'During that time the streams of common law and equity have flown together and combined so as to be indistinguishable the one from the other. We have no longer to ask ourselves: what would the courts of common law or the courts of equity have done before the Judicature Act? We have to ask ourselves: what should we do now so as to ensure fair dealing between the parties?' as Lord Denning stated. Application:** The House of Lords held in favour of the charterers. The breach of the term of the contract made by the owners went to the root of the contract by depriving the charterers of their main benefit such as the issue of the bills which was essential to the charterers' trade. The Defendant's conduct was held to be a wrongful repudiation of the contract.

HISTORICAL AND CONCEPTUAL BACKGROUND

1. What is Equity?

The key points in relation to introduction of Equity can be encompassed in four categories:

- Until 1875 Equity was regulated by a different court such as the Court of Chancery.
- The main reason why Equity has been created was to mitigate the harshness of common law.

- Equity represents a distinct legal system
- Equity is based on an exclusive and a supplementary jurisdiction.

2. Development of Equity to the Judicature Acts

KEY DATES

1066 Norman Conquest

1154 Centralisation of Legal System under Henry II - Common Law Courts

1258 Expansion of Writ System restricted by Provisions of Oxford

14C Petitions to King as "fountain of justice".

1473 Lord Chancellor issues decrees in his own name

c. 1500 Greater part of land in England held under uses

1529 Rules of Equity begin to develop leading to formality

1535 Statute of Uses – attempt to abolish 'uses' (early trusts)

1540 Statute of Wills – land could be left by will

1560 Lord Chancellor enforces "Use upon a Use" (see slide 11)

1615 Earl of Oxford's case: Dispute over common injunctions.

1616 James I resolves it in favour of Court of Chancery.

18C/19C Increasing rigidity of Equity. Delays become a scandal.

1854 Common Law Procedure Act

1858 Chancery Amendment Act ("Lord Cairns' Act")

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1873/1875 Judicature Acts – common law and equity administered by single High Court and Court of Appeal

1882 Walsh v. Lonsdale - fusion applied in practice - the rules of Equity prevail

1925 Modern Trust replaces the "Use upon a Use"

Comprehensive Property Law Reform: "The 1925 Legislation"

EQUITY'S MOST CHARACTERISTIC INSTITUTION: THE TRUST

One of the main reason why Equity has been created lies in the institution of trust as a supplement of common law. During the 13th century, owners of lands left their properties to relatives or friends while abroad. The use of the lands by these individuals was identified by common law as legal ownership. Equity introduced a new way to look at this title. Lands were hold for the benefit of the real owner. Trust can be looked at as a modern version of the 'use'. Later on, the **Lord Chancellor applied the same institution to those circumstances where a person held a property for the benefit of a third party appointed by the first owner.** The adoption of the device was extended to new situations. Holding land under a 'use' also had other advantages: typically to allow it to be inherited by persons other than one's heirs, and to avoid various incidents of feudal tenure.

EQUITY ACTS *IN PERSONAM* (AGAINST THE PERSON)

'Equity acts *in personam'* represents one of the leading maxims. By describing property rights as rights *in personam* the law means that the right can be exercised against the entire world. Those entitled of the right cannot be deprived by anyone. In the presence of a trust, the interest of the beneficiary (such as the person for whom the property is hold) cannot be compromised by anyone. No one but the beneficiary can claim the right over the property. According to Equity rules, there

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is only one person that may steal the right of the beneficiary over a property. This person is the so-called 'bona fide purchaser for value without notice' or 'Equity's darling'. Equitable interest may be lost in the presence of a persona falling into this definition.

The position was recently summed up well by Lord Millett, in [2012] CLJ 583 at 587-8:

> "*Equity creates proprietary interests in the beneficiaries by its ability to enforce the trustee's obligation to manage the trust property for their benefit, and to enforce the duty not only against the trustee himself but against his successors in title other than a bona fide purchaser for value without notice*".

EQUITY AS A SUPPLEMENTARY JURISDICTION

It is fundamental to understand that Equity is not a completely separated system. It works arm in arm with the Common law system. For instance, when answering to the question 'who has legal title?', you will look at the Common law rules, since the beneficiary owns the trust property in equity and the trustee in law.

This appears clear when looking at the equitable remedy of injunction.

Example:_A person keeps trespassing the land of Mr X. Prior to 1854, Common law courts would have dealt with the issue by awarding Mr X with damages. In order to obtain a different remedy, Mr X would have had to go through two separated processes: one at Common law courts, one at the Chancery court. What Mr X really wants is to prevent that person from trespassing. The remedy that would come from the Court of Chancery is the so-called injunction. The court would directly order the trespasser to stop.

NATURE OF EQUITABLE RIGHTS

Equitable rights are shaped on the basis of legal rights. This is well-illustrated by the following examples from the law of real property:

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Legal	Equitable
Fee simple	Equitable fee simple
Legal lease	Equitable lease
Legal charge (mortgage)	Equitable charge
Easement	Equitable easement

THE EQUITABLE DOCTRINE OF NOTICE

Historically, the equitable doctrine of notice was extremely important, and applied both to land and personalty. By looking at its application in Land the doctrine is better illustrated. A person that buys a land subjected to a legal mortgage will still be bound by the legal mortgage. It does not matter whether he was aware or not of the existence of the legal mortgage over the land. Things are different in the presence of an equitable mortgage. A person that buys a land subjected to an equitable mortgage will not be bound by it if he was unaware of its existence. The theory is simple, but the doctrine became more elaborate.

General Principle: If the purchaser meets each element required by the doctrine of notice (legal estate, valuable consideration, lack of notice and good faith) then they can ignore a prior equitable right, in that case a trust, even though the beneficiaries had been swindled by the (seller) trustees.

Pilcher v Rawlins (1871-72) L.R. 7 Ch. App. 259
Facts: Jeremiah Pilcher made a settlement under which three members of Pilcher's family were to stand possessed of about £8000 in trust for Jeremiah Pilcher during his life and after his death for his children. With the consent of Jeremiah Pilcher, the trustees were allowed to vary the investments and appoint new trustees. The Defendant was a solicitor appointed as trustee in relation to the £8000. The money represented a security of a mortgage deed. **Ratio: Equity has an interest in and a power over a purchaser's conscience. The bona fide transferee of the legal estate for value without notice of the equitable interest acquires the legal title in priority over the beneficiary. Application:** Three are the main types of notice available:

- *Actual Notice*

The purchaser was aware of the equitable interest before buying the property. Actual notice occurs even though a person forgets about a notice or is in possession of a document that notifies the equitable interest but he does not read it.

- *Imputed Notice*

Imputed notice occurs where the buyer was not personally aware of the equitable interest, but his agent (typically the solicitor) was. The buyer will be considered bound by the equitable interest.

- *Constructive notice*

A constructive notice comes into place when a purchaser did not actually know of the equitable interest, but either the legal estate purchaser fails to make any inquiries as to prior equitable interests, or where although he makes inquiries, these are taken to be insufficient.

General Principle: There are circumstances in which a high standard of inspection is expected. If this fails, constructive notice may be implied.

Kingsnorth Finance Co Ltd v Tizard [1986] 1 WLR 783
Facts: The Defendant was the sole owner of the matrimonial home. Mrs Tizard was granted with a beneficial interest. The couple started having problems and they got separated. Mrs Tizard left the house. She was at home every day to look after the two children. When required, she spent the night at the house since the husband was away to stay with the children. One day Mr Tizard mortgaged the property. When he applied for the mortgage he defined himself as a single man. The surveyor did the inspection of the house when wife and children were out. The inspector noticed signs of children, but he did not find anything in relation to the wife. Mr Tizard said that the ex-wife moved out months before. The Claimant made a loan offer and the Defendant accepted. When the Claimant tried to enforce their charge, the issue was whether the Claimant's legal mortgage was subject to the equitable

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interest of the wife. **Ratio: Physical presence becomes actual occupation even though a person has not exclusive or continuous and uninterrupted occupation of the property. It is surveyor's duty to properly verify how the house is used when informed of a marriage. Application:** The court found the Defendant not liable on the ground that the surveyor was under a duty to do more investigations once finding out about the presence of children.

Land Law today

Thanks to the introduction of the registration of lands, cases involving the doctrine of notice are fewer. The doctrine only applies in those circumstances involving pre 1925 restrictive covenants or equitable shares on unregistered land. The Land Registration Act 2002 protects equitable interests since registration represents a notification to the world. By consulting the land registry, a purchaser can find all the information in relation to a land.

MAXIMS OF EQUITY

Maxims represent a group of mottoes that encompass the principles on which Equity is based on.

- **Equity will not suffer a wrong to be without a remedy -** Where statute or common law does not provide for the remedying of a wrong; it is equity which intercedes to ensure that a fair result is reached.

- **Equity follows the law** -The principle is that statute will be obeyed.

- **Where there is equal equity, the law prevails** - Where there is no clear distinction to be drawn between parties as to which of them has the better claim in equity, the common law principle which best fits the case will be applied.

- **Where equities are equal, the law prevail -** Equity will favour whoever created their rights first. A mortgagee

would be given priority over another mortgagee if he created his mortgage before the other.

- **He who seeks equity must do equity -** Whoever seeks equity must have acted entirely fairly themselves. A Court of Equity will not act in favour of someone who has, for example, committed an illegal act.

- **He who comes to equity must come with clean hands** - A person claiming rights under an agreement to which they are not complying with will not be assisted by equity.

- **Delay defeats equity** - Equity aids the vigilant and not the indolent. If a claimant allows too much time to elapse between the facts giving rise to her claim and the service of proceedings to protect that claim, the court will not protect her rights. The doctrine of not allowing an equitable remedy where there has been unconscionable delay is known as 'laches' (**Partridge v Partridge** [1894] 1 Ch 351).

- **Equality is equity -** It is ancient principle that *'equity did delight in equality'*.

- **Equity looks at the intent rather than the form -** Equity will give effect to the substance of any transaction rather than merely to its surface appearance **(Parkin v Thorold** (1852) 16 Beav. 59).

- **Equity imputes an intention to fulfil an obligation -** The principle assumes an intention in a person bound by an obligation to carry out that obligation.

- **Equity regards as done that which ought to be done -** Equity will consider that something has been done if the court believes that it ought to have been done. In **Walsh v Lonsdale** (1882) 21 Ch D 9, a binding contract to grant a lease was deemed to create an equitable lease even though the formal requirements to create a valid common lease had not been observed.

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- **Equity acts *in personam.***
- **Equity will not assist a volunteer -** A trust operates on the conscience of the legal owner of the property.
- **Equity will not allow a statute to be used as an engine of fraud.**
- **Equity abhors a vacuum** - Equity will not allow there to be proprietary rights which are not owned by some identifiable person **(Vandervell v IRC** [1967] 2 AC 291).
- **Equity will not permit a person who is trustee of property to take a benefit from that property qua trustee.**
- **A trust operates on the conscience of the legal owner of the property -** The legal owner of a property will be obliged to hold it on trust for any persons beneficially entitled to it where good conscience so requires.

HOW THE LEGAL TITLE IS GOING TO BE USED?

The trustee plays two important roles thanks to the legal title received. First, he has to follow the trust fund itself by running, administering it in accordance with what has been dictated by the trust document. If there are multiple trustees, they all hold the property as joint tenants; they will hold the property together. Second, the trustee has to transfer the legal title to the beneficiary that will become the absolute owner of the property.

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Summary

- Equity represents one of the two main ramifications of the UK law system. On one side there is Common law, such as the law made by the judges in the Common Law courts, on the other side there is Equity, the law made by the judges in the Chancery courts.
- The origins of Equity lie in the Middle age.
- The Claimant used to send his petition to the King in Council. The petition was addressed to the Lord Chancellor that examined the case. In time the Chancellor started building up a body of rule and Equity commenced to be more formalised.
- Equity has been created in order to mitigate the harshness of the Common Law.

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Chapter 2 – Introduction to Trusts

Introduction

A trust is an equitable device created by Equity in order to transfer a property under the control of a trustee for the benefit of a beneficiary. The most common definition of trust has been given by A Underhill and D Hayton in the *Law of Trusts and Trustees* (16th Edition, Butterworths, 2002):

'A trust is an equitable obligation, binding a person (called a trustee) to deal with property over which he has control (which is called the trust property) for the benefit of persons (who are called the beneficiaries or cestuis que trust) of whom he may himself be one, and any one of whom may enforce the obligation.'

The definition refers to the most commonly used private trusts. Nevertheless, it is important to mention at an early stage that charitable and private purpose trusts also exist. According to Section 1 of the Recognition of Trusts Act 1987, *'For the purposes of this Convention, the term trust refers 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.'*

The development of the trust

Trusts have developed out of the division of law and equity. **The settlor of property wishes to transfer this property to a friend for the benefit of a third party namely his children or wife (up to a hundred years ago women were not permitted to have property).** The original owner can execute a document of transfer, transferring the property to his friend the trustee, for his children. The dispute that would arise is whom the property belonged too? The document of transfer makes the friend the legal owner, but the original intentions of the settlor was that the friend nominally own and control the property for his children, the rightful owner. The common law courts would examine the transfer document and hold the friend is the legal owner for all purposes, although the original

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intention of the settlor was the property is given for the benefit of the third party. The Equity/Chancery courts recognised this arrangement, that the property was not owned by the trustee but by the third party. Eventually the position of the chancery courts prevailed, the equity courts would enforce the trustee to act in the benefit of the third party and not for his own purposes. The beneficiary's right under the trust became known as the equitable and beneficial interest. The trustee is said to have legal title; this was seen through the common law courts that believed the trustee to be the legal owner of the property.

The nature of the trust

The trust involves an equitable obligation, which is imperative in nature.

"*Stated in its simplest terms, a trust is a relationship which exists when one party holds property on behalf of another."* Per Lord Nicholls, **Royal Brunei Airlines v. Tan** [1995] 3 All ER 97, at 103.

"*A trust exists whenever the legal title is in one party and the equitable title in another. The legal owner is said to hold the property in trust for the equitable owner."* Per Lord Millett, *Restitution and Constructive Trusts* (1998) 114 LQR 399, at 403.

"*A trust is an arrangement in which one person, who is called the settlor, transfers property to another person, who is called the trustee. In so doing, the settlor directs the trustee to hold the property either for the benefit of certain persons or for the promotion of some purpose. If the trustee undertakes to carry out the direction, he becomes subject to a binding obligation which Equity will enforce*." Professor Everton, *What is Equity About?* (London, Butterworths, 1970), at pp. 22-23.

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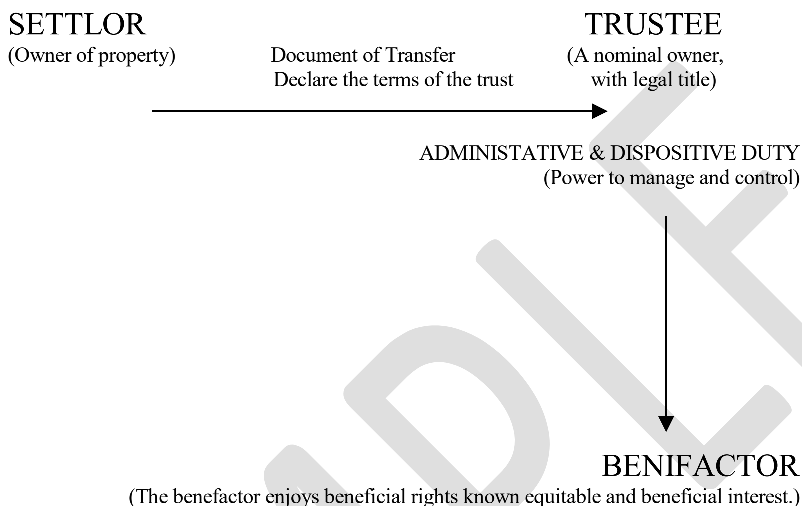
Figure 1: this is a diagram showing the relationship of parties in a trust.



The settlor when establishing a trust of his property will transfer the property to a trustee. The transfer document will stipulate the trustee is the nominal or ostensible owner of the property, but the terms of the trust will state the trustee must hold the property for the benefit of the third party the beneficiary. The beneficiary is entitled to enforce his right under the trust against the trustee, this right is called equitable interest because it was originally the Chancery courts that recognised the third party's right.

The practical function of a trust

The crucial quality of a trust is a means of separating management and the right to benefit of property. Thus, a trust is a means for creating a separation of management and benefit to property. Contrastingly, Absolute ownership involves both these elements an absolute owner enjoys control and benefit.

General Principle: The creation of a trust can allow for the legal ownership and equitable benefit to be divided.

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Vandervell v IRC [1967] 2 AC 291
Facts: Mr Vandervall was a rich businessman who wanted to save paying tax and attempted to create tax avoiding schemes. In 1958 Mr Vandervell instructed his trustees to transfer some shares they held for him to the Royal College of Surgeons ("RCofS") which was a charity. With an option in the transfer he could buy back the shares in the future for £5000. In 1961 the RCS had received more than £150,000 in dividends from the shares and Vandervell's trustees exercised the option to repurchase. The Inland Revenue claimed tax from Vandervell on the basis that he had not disposed of his interest in the shares for the period 1958 – 1961 because there was no writing. **Ratio: The House of Lords found that the option had created an automatic resulting trust for Vandervall and that therefore he retained an interest in the shares and had to pay tax on them. The RCofS could not have been taxed because it is a charity and was exempt from that taxation. House of Lords also stated obiter that where the legal and the equitable interest are intended to be transferred together there is no need for a separate written disposition of the equitable interest. Application:** Although the tax avoidance scheme failed and Vandervall was made to pay tax on the shares of the company, the case demonstrates the attempted splitting of ownership and benefit.

General Principle: There are four fundamental propositions that well illustrate the law of Trusts.

Westdeutsche Landesbank Girozentrale v Islington BC [1996] AC 669, HL
Facts: The case was in regard of an interest rate swap, a transaction where one party agreed to pay the other over a certain period interest at a fixed rate on a notional capital sum. The other party agreed to pay over the same period interest at a market rate on the same notional sum. Few years earlier the House of Lords held interest rate swap agreements void in the light of the Local Government Act 1972. The argument between the parties arose when the Claimant sued the Council in order to recover £1,145,525 (including compound interest). The Council accepted to pay the money back under the void contract, but only including simple interest. The issue for the court was whether an equitable

proprietary claim was available to the Westdeutsche bank in the present case. **Ratio: Lord Browne-Wilkinson listed four leading principles of trust law which are: (i) Equity operates on the conscience of the owner of the legal interest; (ii) A person cannot be a trustee of the property if and so long as he is ignorant of the facts alleged to affect his conscience; (iii) There must be identifiable trust property; and (iv) Once a trust is established, a beneficiary has a proprietary interest in the trust property, enforceable in equity against any subsequent holder of the property other than a purchaser for value of the legal interest without notice. Application:** The House of Lords held that there was no resulting trust so that the Council could only recover its money with simple interests since there was only a claim for recovery in common law.

Advantages of Trusts

- **Separation of income and capital -** The use of Trusts enables assets to be segregated from what belongs to the settlor. Trusts protect the so-called beneficiaries from the consequences of the settlor's insolvency. Whether the settlor becomes insolvent, creditors will not be able to access the properties of the Trust. Therefore, the trust is used for asset protection. These types of trusts allow large amounts of money to be held on trust, which accumulate substantial interest payments, which are to be paid to the benefactor. For example, money can be left to my friend on trust, to hold for my wife for life and then for my children. (This means the wife will receive the interest for life and then the children will get the money, when she dies). The separation of money and capital also allows future gifts – The mechanics of a trust allows a gift to be made which will continue on in the future over time.

- **Joint and collective ownership -** Trusts can be used to create concurrent or subsequent interests in land. Thanks to the use of Trusts the settlor may partition the asset for the benefit of several people. For instance, the settlor may leave a property to A for life with reminder to B. This

means the property belongs to A for the duration of his life and then B will benefit from the property at the death of A.

Collective investment - Investment on the stock market in an efficient way requires large amounts of money far beyond what is available to most individuals. Thus a trust allows collective investment, which is managed by professional investment managers on trust. These managers are in control of the money they invest it and act in the best interests of the third parties, who in this type of situation may also be the settlor**.** The same works for investment and pensions, which works through the law of trusts.

Administrative convenience - The administration and management of a property by the trustee may be useful in those circumstances whether the beneficiaries have not a high level of financial and investment knowledge or whether the beneficiaries are young.

Tax avoidance - Trusts allow those using it to avoid or mitigate tax liability.

Rights relating to Trusts

- **Settlor's position**

The settlor is the person that creates the Trust and sets its content. The settlor decides the form of the trust, the beneficiaries and their interests and the trustee and their obligations. Before the creation of the Trust, the settlor must be the absolute owner of the property in question. He must hold the legal and beneficial ownership of the property. Once the Trust has been created, the settlor loses both the legal title and the beneficial interest. Once the settlor has determined the terms of the trust and transferred the property, he is unable to revoke the trust. He no longer enjoys any rights unless he has made provision.

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- **Trustee’s position**

The Trustee receives the burden of managing and administering the property under the trust for the benefit of the beneficiaries. Between the trustee and the beneficiaries there is a fiduciary relationship that basis on confidence, trustworthiness to act for the benefit of the beneficiaries and not for its own benefit. The trustee’s administrative functions are really concerned with looking after the money. If it were a fund, this would include investing and re-investing the money. If it is a single item, the trustee must ensure proper state of repair and so forth. The trustee’s dispositive responsibilities refer to making transfers and payments to the beneficiaries.

- **Beneficiaries’ position**

Beneficiaries have equitable rights in the property and a beneficial interest in it. Beneficiaries may sue the trustee and any third party for damages for breach of Trust. They can get the property itself back or whatever has been substituted for, even if given to somebody else. Beneficiaries are entitled to assign the whole property or part of it to third parties. They may also terminate the trust by requiring the trustee to transfer the legal title of the property to them.

The nature of the beneficiary’s rights

Personal and proprietary interests: In an example of the simplest type of trust a bear trust, where there is one beneficiary. Here the trustee function is to look after the trust property until it is ready to be transferred to the beneficiary in accordance with the trust instrument. In this type of case the nature of the beneficiaries’ interest is one which is a form of ownership of the trust property. The beneficiary is said to have a propriety interest in the trust property.

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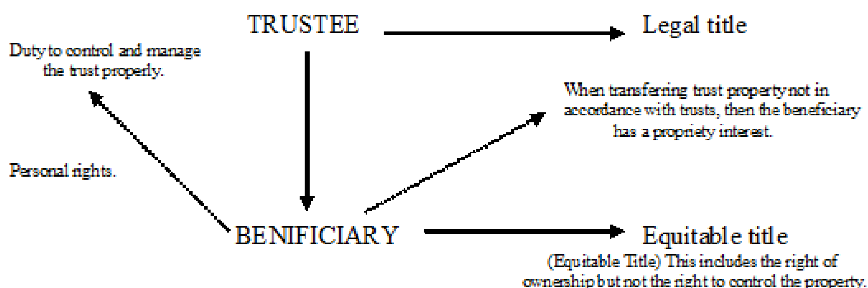
Figure 2: a diagram demonstrating the distinction between a beneficiary's propriety interest and person right



General Principle: The beneficiaries' interest is one which is a form of ownership of the trust property.

Vadim Schmidt v Rosewood Trust [2003] 2 AC 709

Facts: The settlor established two trusts in the Isle of Man with an Isle of Man company acting as trustee. The settlor died unexpectedly and intestate. The applicant sought access in both his personal capacity as heir to settlor and in his capacity as executor of the settlor's estate to documents in the possession of the trustee. The Court was unable to determine the proper construction of the gifts contained in the trust documents and hence was unable to determine whether the applicant had a proprietary interest in the trust property such as to entitle him to access the documents sought on the basis of the rule in **O'Rourke v Darbishire** [1920] AC 581. **Ratio: the court held that persons with a non-proprietary interest in a trust, such as the object of a trust power, may now seek access to trust documents, with such access now to be treated as a discretionary question for the court in the exercise of its inherent jurisdiction to supervise the administration of trusts. Application:** The Privy Council reformulated the basis upon which a person interested in a trust may seek access to trust documents; abandoning the rule previously thought to have been established in **O'Rourke v Darbishire** [1920] AC 581 that access is available to persons with a "proprietary interest" in the trust property.

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The trustee has legal title of property while the beneficiary has equitable title. The equitable title is a form of ownership, referred to as beneficial ownership. The difference between beneficial ownership and absolute ownership is the absolute element of management and control of the property. The nature of ownership is that it gives rights, which are good against everyone, whereas a propriety right is only good against the other person involved. The trustee is under a duty to control and manage the trust properly this gives rise to a personal right to the beneficiary. Moreover, if the trustee transfers the trust property to a third party not in accordance with the trust instrument this then entitles the beneficiary to a claim to reclaim this property from the third party; this can be described as a propriety right. Thus the beneficiary owns the property but a beneficial ownership as opposed to absolute ownership.

General Principle: Beneficiaries are entitled to terminate the trust if they have attained the age of majority (over 18), if they have full mental capacity and if they are absolutely entitled to the trust property.

Saunders v Vautier [1841] 41 E.R. 482, Ct of Chancery
Facts: A testator, by his will, bequeathed to his executors and trustees all the East India stock upon trust to accumulate the dividends until the beneficiary should attain twenty-five. Once reached this age, the trustee was required to transfer capital and accumulated income to the beneficiary. At the age of 21, Vautier claimed the fund. **Ratio: The issue for the court was whether the trustees should transfer trust. Wherever a beneficiary with an absolute interest under a trust is *sui juris,* i.e. of full age and not a lunatic, he may call for the trust property which represents that interest, and the trustees are obliged to transfer the legal title of it to him; if he is a sole beneficiary, this will result in the complete collapse of the trust. When the beneficiary has an absolute indefeasible interest in the legacy, it is not bound to wait until the expiration of the period.** **Application:** The Defendant was held entitled to terminate the trust since he had the full beneficial interest.

The rule in **Saunders v Vautier** [1841] 41 E.R. 482 represents a significant limitation upon the settlor's 'freedom of trust', but it can be justified in two ways:

There might be something of an 'anti-trust' justification, as follows: while it is fine to empower owners to created structured gifts of property where this is essentially the only means of giving the benefits of property, as for example when money is provided for minor children, this power should not be used to allow an owner to control his beneficiaries when they are fully competent to look after themselves. If you give property to someone, you naturally take the risk that they will use that property in ways which are foolish or which otherwise might defeat your hopes. But that is the price of treating people, including donees of property, as autonomous individuals. The law of trusts should not, therefore, allow settlors to treat sane adults as children, and so the principle of **Saunders v Vautier** reflects the law's desire that all individuals, once *sui juris,* should be treated as capable of running their own affairs, including their rights over property.

The second justification is related, and concerns the idea of equitable ownership. In the eyes of equity, the beneficiaries are the owners of the trust property, not the settlor. They have the rights against the trustee, and must enforce the trust themselves. When they reach full age, in essence the trust is in their hands. They can enforce their rights against the trustee or not, may consent to the trustees acting outside the terms of the trust, i.e. doing what would otherwise be a breach of trust, and may vary the terms of the trust as they wish. The settlor has no say in any of this. Thus they are (in theory) in full control of the property via the office of the trustee. But if that is so, why cannot they do with their property what they like, as can any other full owners, and in particular, take the property out of the trust completely if they so desire?

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Doctrine of notice - ‘Equity’s Darling’

It is important to pinpoint that beneficiaries’ rights are not absolute rights. There is one person called ‘Equity’s Darling’ whose right may prevail over the beneficiaries’ ones. The doctrine of notice is an equitable doctrine that dictates where certain conditions are fulfilled equity will regard a bona fide purchaser for value without notice as “Equity’s Darling”. It is a good faith party that gives money without knowledge of the trust. Equity’s Darling takes the property free of any rights of the beneficiary. Therefore, if the purchaser of the property is Equity’s Darling, the beneficiary will not be able to have the property itself back, but only a substitute of the property.

General Principle: The bona fide transferee of the property trust for value without notice acquires good title over the property.

MCC Proceeds Inc v Lehman Bros International (Europe), The Times, 14 January 1998
Facts: The Claimant was a company controlled by Mr Maxwell and members of his family that took over Macmillan Incorporated. Macmillan Inc placed shares in a subsidiary in the name of a nominee company controlled by Mr Maxwell, called Bishopsgate Investment Trust plc. Bishopsgate held the legal title while Macmillan retained the beneficial interest in the shares. Later on Bishopsgate pledged the shares with the Defendant, without notifying Macmillan. The Defendant subsequently sold the shares to another company. MCC sued the Defendant on the ground that they had beneficial interest in the shares so that to be entitle of recovery them. **Ratio: Whether the Defendant falls within the category of the so-called bona fide purchaser that has gotten a legal interest in a property without notice of any breach of Trust, he cannot be held liable. Application:** The Court of Appeal found in favour of the Defendant on the ground that the company acquired good title to the shares, free from any claims.

Types of Trusts

Inter vivos – Created by the settlor when he is alive.

A. **Public Trust –** Trusts created for the benefit of the public are public trusts. These include:

- **Purpose Trust -** A purpose trust is a type of trust that has not beneficiaries, but instead exists for advancing non-charitable purpose of some kind. Trusts for charitable purposes are also technically purpose trusts, but they are usually referred to simply as charitable trusts.

- **Charitable trust -** A charitable trust is a type of public trust, created exclusively for charitable purposes. The trust is established for the benefit of the public. The trust must benefit the society or a large part of the community.

B. **Private Express Trust –** Those trusts created for the benefit of people are private trusts. It is a Trust expressly created by the parties, not inferred by the law from the conduct of the parties. Under this category there are two possible types of Trust: Fixed Trust and Discretionary Trust.

- **Fixed Trust** - A fixed trust is one where the terms of the trust are determined and stipulated exhaustively at the outset by the settlor. These include who is a beneficiary, what is he or she to get, when they are to get it and on what conditions if anything. If the trust instrument stipulates all of these matters then the trustee's dispositive function becomes mechanical, in that he does not have to exercise judgment just follow what is set out in the instrument. This is the traditional type of trust. A trustee holds a property for multiple beneficiary or a single one. The important aspect of a fixed trust is that the trust fund itself dictates what the beneficiaries are going to get. It is the trust that states what each beneficiary will receive. It is not compulsory to attribute equal share to the parties. A settlor may decide to give 1 per cent to one beneficiary and

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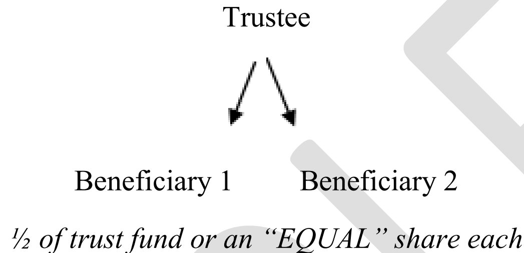
99 per cent to the second beneficiary. The trust itself stipulates what each beneficiary will receive.

Figure 3: A diagram showing equal distribution under a fixed trust.



Two are the main problems that arise with fixed trust. First, trusts were often created as a way to be fiscally efficient in order to reduce tax liability. Whether the beneficiary's share is fixed, the interest will be easily taxable. Second, fixed trusts may be seen a bit too inflexible since they cannot be changed in the light of possible future needs of the beneficiaries. For these reasons, fixed trusts have become obsolete to a certain extent.

- **Discretionary Trust** (it can be either *inter vivos* or testamentary) – The settlor does not determine on the trust document how much property each beneficiary will get. It will be discretion of the trustee to decide. Since tax cannot be applied until the property has been received, discretionary trusts play a better role in the fiscal life of a person. How does the trustee exercise discretion? The trustee acts in the best interest of the beneficiary as a whole. He will look at all beneficiaries and at all their needs in deciding who is going to get what. However, if the trust is a discretionary one, this refers to a dispositive discretion, where the trustee will have to exercise a discretion in determining what property to pay to a beneficiary. For example, Y leaves all my money to friend

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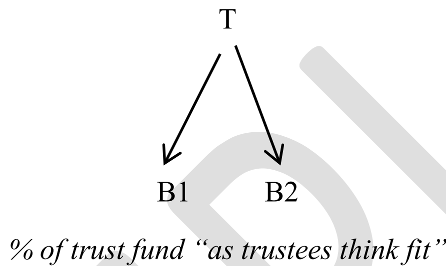
X to be divided at his discretion amongst my children in such proportions that he may think appropriate.

Figure 4: A diagram showing distribution under a discretionary trust.



% of trust fund "as trustees think fit"

Advantages of a discretionary trust

A discretionary trust may be used in avoiding loss in Bankruptcy. For example, if X leaves all his money to his sons, A and B. If B becomes bankrupt the trustee will have to pay B his share of the property, even though this will become payable to creditors. If the trustee is given some discretion as to how to distribute the share of property between A and B, the trustee could simply not pay any money to B if the money was used to go to creditors. He would simply withhold payment until such time as bankruptcy proceeding had been concluded and free of debt.

The dispositive discretion

Where there is a discretionary trust, the trustees are subject to certain duties in relation to the exercise of discretion. First, clearly they have to stay within the terms of the discretion. If the trust instrument says *"the trustee must divide the money at their discretion amongst A, B and C"*, there is no discretion to give money to D. Secondly, the discretion must be exercised by the person who is given the discretion, you can't delegate discretion, the trustee must decide the appropriate course.

General Principle: Trustees who exercise a power of appointment, under a discretionary trust, without exercising their discretion because they did not realise that it existed, are in breach of their duty to consider the appropriateness of the appointment, and the appointment will be invalid.

Turner v Turner [1984] Ch 100
Facts: The settlor created a trust for the benefit of his wife and children. The trust contained a discretionary power to distribute capital or income out of the trust fund to all or any of the beneficiaries. The settlor appointed as trustees his father, sister-in-law and her husband. None of them had understanding of trust matters. In exercising the power of appointment the trustees divided the trust in favour of the four children. By a deed, the trustees revoked the appointment of the settlor's eldest son and appointed the remaining three children as the sole beneficiaries of the trust fund. **Ratio: it was held what might first appear to have been a decision of trustees may prove on questioning not to have been a decision. Where a power is exercised in form but not in substance then the appointment will be declared void. Application:** The purported appointments must be set aside. The trustees had not exercised their discretion in making the appointments and were in breach of that duty.

General Principle: Sometimes the trust instrument will stipulate steps to be followed by the trustee when exercising discretion. It might just state as the trustee thinks fit, in this event the trustees have to consider what appropriate criteria they must use, these criteria must be rationally exercised.

R v District Auditor ex p West Yorkshire MCC (1986) 26 RVR 24
Facts: Application by local authority for a declaration that payment to the West Yorkshire Trust was ultra vires and was not rendered unlawful by applicant's motives and did not require consent by the secretary of state. **Ratio: A settlor stated in the trust instrument the criteria that had to be taken account off when exercising discretion. Application:** It was doubtful whether review was appropriate as the auditor had not yet determined the

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matter. Without creating a procedural precedent however, it was clear the trust neither could neither take effect as a valid charitable trust nor as private trust as there was no certainty as to beneficiaries.

The trustees will have to ensure they are properly acquainted with every factual fact and information which is necessary, in order to exercise discretion. First for example if there is a small family and they have to pay money amongst the three children, then the trustee's must find out about the three children. What are their circumstances? Does one have a disability, which may justify a larger proportion of the pay out? They cannot exercise discretion without facts. There is no use of criteria when there is no fact to which applies the criteria.

Second, another type of discretionary trusts is large discretionary trusts, which involve paying out employees or members within a large group such as a company or society. In this type of situation trustees cannot get the same type of information about thousands of beneficiaries as in the small family discretionary trust. Thus the trustee is expected to survey the field. This involves discovering information relevant to exercising the discretion, putting up posters, asking people to apply.

Exhaustive and non-exhaustive discretionary trusts

There are many subdivisions of discretionary trusts but the overall concept binding them all together is that the trustees must exercise discretions vested in them before any potential beneficiary becomes entitled to income of the trust. A discretionary trust may be either exhaustive or non-exhaustive in nature.

- **Exhaustive trust**

Exhaustive trusts require the distribution of all the income but grant the trustees discretion to determine how that income is applied between the beneficiaries. For example, if X leaves all his money on trust to Y (trustee) for 21 years, but he must allocate the income generated by the trust property, as they think fit among his children each year, this type of trust would be exhaustive.

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- **Non-exhaustive trust**

This grants the trustee's discretion over how much of the income is distributed as well, perhaps, as over the identity of the beneficiaries who were to receive that income. A non-exhaustive discretionary trust provides the power to accumulate income vested in the trustees for the beneficiaries.

A non-exhaustive discretionary trust can be stated in two ways:

- There is a discretionary trust to distribute the income (mandatory) subject to a power to hold any part of the income and accumulation.

- There is a trust to accumulate income subject to a power to pay out to the children.

The way in which the trust is stated in practice makes no difference. However, in theory it makes a difference. In one case prima facia there is a duty to distribute and consciously exercise a power to withhold. Conversely, in another case they have prima facia obliged to accumulate the money and consciously exercise a power to distribute. It can make some difference to how they approach the question. The reason this is important is because the test for certainty (in **Re Baden's Deed Trusts** (No. 1), **McPhail v Doulton** [1971] AC 424) to be applied in ascertaining the validity of a trust would depend on whether it was a discretionary trust or a power. On the terms of trust in **McPhail v Doulton** the trust would have been invalid if it was one interpretation and valid on the other interpretation, this is why it is important to establish which formulation it was.

Trusts arising from the operation of the law

- **Resulting Trust**

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Whether an express Trust fails (for instance, when the beneficiary dies or when there is a surplus of trust funds left over after the trust purpose has been achieved.), the trustee hold the property in resulting trust for the settlor. Here, for example, a settlor attempts to set up a trust but the beneficial interest either wholly or in part "results" or returns to the settlor. This may happen in various situations, such as where the property is conveyed to trustees upon certain trusts which fail or which do not exhaust the beneficial interest. The part that is undisposed of results back to the settlor. For example, if there is a gift on trust for A for life, and then on trust for X if X attains the age of 21, but X dies before the age of 21 within A's lifetime, the property will result or return on A's death to the settlor.

- **Constructive Trust**

The court creates constructive trusts whether necessary in the interests of justice and conscience. For instance, whether the trustee makes a profit derived due to his position, abusing his role, that profit is held on constructive trust for the beneficiaries. These trusts are normally imposed by the courts in order to remedy fraudulent or unconscionable conduct. A constructive trust thus is remedial in effect and might arise where the trustees in breach of trust sell the property to another who, for some reason or another, is not a bona fide purchaser for value without notice ~ he or she may have knowingly received or assisted in disposing of trust property in breach of trust. In such circumstances the courts may impose a constructive trust on the third party, who then holds the property on a constructive trust for the person from whom it was obtained. Equity says that in certain circumstances the legal owner of property must hold it on trust for others. Constructive trusts are imposed by the law irrespective of the intention of the trustee and in fact may be the very last thing the new constructive trustee wants.

There is an academic argument as to the exact status of constructive trusts in this country. Some think of it as simply another form of an institutional trust in much the same way as other trusts in that they are imposed only within the limits

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described by precedent. Others, particularly the late Lord Denning, favour the American idea of using the constructive trust as a remedy. In **Hussey v. Palmer** [1972] 3 All ER 744 Lord Denning said that constructive trusts can be imposed "whenever justice and good conscience require it." The views of Denning have been attacked on the basis that it would create uncertainty in the law. No one would know in what circumstances a constructive trust might be imposed and that imposing a constructive trust might be accompanied by unforeseen and unconsidered consequences. However, it could be argued that the whole controversy is really rather sterile since historically all trusts were remedies.

- **Statutory Trust**

In particular circumstances the Parliament may create statutory trust. For instance, according to Section 33 of the Trustee Act 1925 a protective trust exists as life interest in favour of the principal beneficiary coupled with a discretionary trust in favour of a specified class of objects, including the principal beneficiary, on the occurrence of the determining event.

A number of statutes impose trusts, so even where there is no express declaration of a trust, they may arise under several different statutes. Probably the most significant for our purposes here arises in the context of the 1925 property legislation. The *Law of Property Act* 1925 sections 34-36 impose a statutory trust for sale whenever land is co-owned, converted into trusts of land by the *Trustees of Land and Appointment of Trustees Act* 1996. The *Administration of Estates Act* 1925 s. 33, as amended by the *Trustees of Land and Appointment of Trustees Act* 1996, imposes a statutory trust for sale on the property of people dying intestate (without a will), which directs their personal representatives to hold their real and personal property on trust with a power to sell it and hold the purchase money on trust as directed.

Other types of trust

- **Bare Trust –** Under this type of Trust the beneficiary has absolute right to the capital and assets of the Trust while the trustee has no discretion as to its management and

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disposal. The trustee strictly needs to comply with the instructions given by the beneficiary.

- **Protective Trust –** It is a particular type of Trust that protects beneficiaries from bankruptcy or other kinds of misfortune. Under this type of Trust, the beneficiary receives a life interest determinable on the occurrence of a particular event. Whether the event occurs (such as bankruptcy) the life interest is forfeited and the property will fall under a discretionary Trust where the beneficiary will still be part of those that may benefit under the discretion of the trustee.

- **Pension funds Trust –** The Trust property is represented by the work and remuneration of the employee.

- **Successive Interests trust**

Where the settlor has made himself trustee for the benefit of others (children), there are two different types of beneficiary:

- **Life Tenant -** person who receives a life interest. This person gets rights to the trust property immediately. He is not going to be entitled to all the property. He is only entitled to something called 'income', not the property itself, but the profit that derives from the trust asset (dividends in case of share; rent in case of property; interests in case of money). It lasts as long as the person with the life interest is alive. When the life tenant dies, the trust asset will go to the person called remainder man.

- **Remainderman** – he is not entitled to anything until the life tenant dies, but he then gets everything. He will not get only the income, but the entire property, called 'capital'.

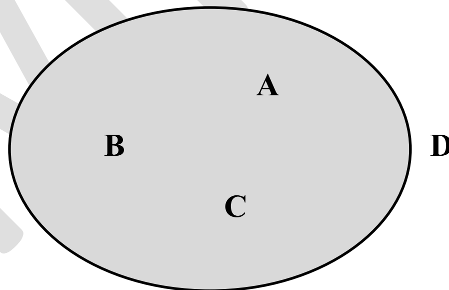
Example: Portfolio of shares, you create a trust appointing yourself as life tenant so that you will keep receiving the dividends. Once you die, you can leave it to your kids.

- **Testamentary** – you can create a trust under your will when you are dead.

No matter what type of trust you use, beneficiaries do not only have personal rights against the trustee but also proprietary rights in trust assets themselves in Equity. This means that if, for instance, the trustee steals the property, the beneficiary can get the property itself back, even if given to somebody else.

What is a power?

If you give someone a power, you are giving him an authority. You are allowing someone to deal with your property. For example a power of appointment: *'I leave my estate to my husband with a power to appoint between our children A, B and C (called the objects of the power)'*. The power of appointment does not confer **Saunders v Vautier** rights so that A, B and C cannot end the power received by the husband, take the estate and divide it on their own. They have no proprietary right. The only thing A, B, C can do is restraining improper exercise of power (for instance, any attempt to appoint outside the class).



How Trusts and Powers differ?

- Fixed Trust
- Discretionary Trust + £300 to each X, Y and Z
- Power of appointment

Fixed trust - £300 to X, Y and Z in equal shares (each £100) settlor fixes who benefits and the size of each share.

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Discretionary trust - £300 to such X, Y and Z as T *shall* select (£100 to X, £170 to Y and £30 to Z). The settlor defines the class and directs T to choose shares.

Power of appointment - £300 to such of X, Y and Z as D *may* select and, if no selection is made, to A.

By using *may* instead of *shall* as per discretionary trust, the purpose is to remove the obligation. Whether the settlor gives power of appointment to someone, there usually are instructions in case that person does not exercise the power. In the example, whether D does not select in the defined class, A will receive a gift over in default.

Enforcement of a trust or power

In the case of a fixed trust if a trustee fails or chose not to carry out the trust, they do not have a choice. They are legally obliged to carry out a trust in accordance with its terms and if they fail to do that the beneficiaries can go to court and the trust instrument will stipulate what should happen with the money, thus the court will simply enforce this, and order the trustee to pay. In the case of a power of appointment, if the trustee fails or chose not to carry out the power, the court cannot force the trustee to exercise the power because the trust instrument will state the trustee is not obliged to exercise a power, the court would have no reason to intervene. A difficultly that may arise, is when the object of a power complains, the trustees have not properly considered whether to use that power. This is quite a cumbersome task, because the court cannot force the trustees to use the power, they can however replace the trustees if they feel they are not properly considering using their powers. In a discretionary trust, the trustee will have to make a distribution and they have to exercise the discretion of how to make the distribution.

General Principle: If the trust has not been exercised and there has been no distribution, it will not be a breach of trust. It may well be the case the trustee is unaware of his duty to make a distribution and when prompted by the court the trustee would conform to the trust instrument.

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Re Locker's ST [1977] 1 WLR 1323
Facts: Trustees of a settlement created in 1963 were given an absolute and uncontrolled discretion in applying the income of the trust fund amongst the beneficiaries. They failed to distribute such income, initially adding it to capital; but the income from 1965 to 1968 remained undistributed and was not so applied. The trustees applied for directions. **Ratio: Trustees with an "absolute and uncontrolled" discretion who fail to distribute trust income as required by the settlement may, notwithstanding their delay, still be permitted, and encouraged, by the court to distribute such accrued income amongst the beneficiaries as they see fit.** **Application:** The trustees remained at liberty to distribute the arrears of income within their discretion, but should not exercise their discretion in favour of beneficiaries who became objects a reasonable time after the income to be distributed.

General Principle: Another type of discretionary trusts is the more modern type of large discretionary trusts, which involve paying out employees or members within a large group such as a company or society.

McPhail v Doulton [1971] AC 424
Facts: The settlor transferred a property to trustees to apply to net income, in their absolute discretion, to the officers, ex-officers, employees and ex-employees of a company or their relatives or dependants. The question in issue was whether the trust was valid as satisfying the test for certainty of objects. **Ratio: Lord Willberforce stated – "First the court will authorise the appointment of new trustees (new trustees would then exercise their discretion). Secondly the court would authorise representatives of the beneficiaries to prepare a scheme of distribution, for approval of the court (the representatives would be the head of department of the company whom could make appropriate suggestions as to beneficiaries). The test that must be applied to discretionary trusts is whether the trustees may say with certainty that any given postulant "is or is not a member of a class of objects", and there is no need to draw up a list of objects.** **Application:** The House of Lords decided that

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the trust was valid and changed the test for certainty in respect of discretionary trusts, making in line with the test for powers.

Powers of appointment

Power of appointment allows the trustee to dispose of the property in favour of the object of that power. For example, if X leave his friend Y all his money to be distributed among all his children and up to £5 to the RSPCA. This means the trustee has a power to leave £5 to the RSPCA, but the important thing about the power is the trustee is not obliged to do it. The trustee has discretion not only as to how to distribute the property (how much of £5), but also as to whether to distribute the property at all (whether the RSPCA should get anything at all).

Thus there are three trust arrangements:

- Fixed trust, is a mandatory trust, trustee should follow the trust instrument.
- Discretionary trust is a mandatory trust but the trustees have discretion as to how to exercise his duty.
- Powers of appointment trust, the trustee does not have to exercise his power.

The distinction between these powers is important. For example, if a case arises where the instrument stated the trustees *may* exercise discretion to divide my money among my children. The answer is not entirely clear from that wording. If they don't have to pay the children, it is a power. But it could be a discretionary trust where the money has to be paid; the trustee will have to make the distribution, although the trustees have discretion as to the division of property among the three children.

A power does not necessarily have to be exercised by a trustee. For example, X may leave all of his money to Joe on trust to be distributed equally among his 3 children, subject to the power that my wife can appoint up to £10,000 to the RSPCA. In this situation the power is not exercised by a trustee, this is a possible arrangement. In this type of circumstances, the person exercising

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the power is called the donee. The donee of the power is usually the trustee then he has certain responsibilities on how to exercise the power, if he is not a donee then these responsibilities are not inherent.

How to categorise powers of appointment

There are several ways to categorise powers.

1) The first distinction depends on the person that exercises the power.

- Fiduciary Power – whether the power is exercised by a trustee (solicitor; agent etc.)
- Personal Power – whether the power is exercised by someone else who is not a trustee, called donee.

The nature of the power dictates the obligations that the person with that power owes. Example of Fiduciary power:

General Principle: The obligation deriving from fiduciary powers is set out by the court in the following case.

Re Hay's Settlement Trust [1981] 3 All ER 786
Facts: In the case the trustee was directed to hold the trust fund appointing anyone except the settlor, the settlor's husband and the trustee himself. The issue was related with the validity with that power. **Ratio: The House of Lords set out the three main steps in which a fiduciary power must be exercised: (i) The trustee has a choice to exercise or not. The trustee must periodically consider whether to exercise the power received or not. (ii) Because of the responsibilities a trustee has, he has to act responsibly, properly considering the size of the class entitled to benefit, carefully analysing the range of the objects. (iii) He has to appoint appropriate individuals to benefit, deserving individuals. Application:** The court held that the power was valid. The trustee was under a duty to ensure that any appointment was within the power and to periodically consider exercising it. The power could not have been delegated.

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2) The second way to categorise powers is based on the person that benefits from it.

General power – when the power is choosing from anyone in the world

Special power – power to choose from a defined class of individuals

Hybrid power – anyone, except a defined class of individuals (as in the case of Re Hay's ST)

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Summary

- A trust is an equitable device created by Equity in order to transfer a property under the control of a trustee for the benefit of a beneficiary.
- The trust involves an equitable obligation, which is imperative in nature.
- Thanks to the use of Trusts the settlor may partition the asset for the benefit of several people.
- The settlor is the person that creates the Trust and set its content.
- The Trustee receives the burden of managing and administering the property under the Trust for the benefit of the beneficiaries.
- Beneficiaries have equitable rights in the property and a beneficial interest in it.
- It is important to pinpoint that beneficiaries' rights are not absolute rights. There is one person called 'Equity's Darling' whose right may prevail over the beneficiaries' ones.
- **Section 1** of the Recognition of Trusts Act 1987 states that 'For the purposes of this Convention, the term trust refers 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.'
- Creation of Trusts gives rise to a lot of advantages such as mitigation of tax pressure, protection of beneficiaries' interests etc.
- Trusts give rise to specific rights and duties attributed to settlor, trustee and beneficiary.
- Several are the types of trusts that may be created.
- It is important to distinguish a trust from a power.

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Endnote

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