CURRENT DEVELOPMENTS IN TRUST LAW AND PRACTICE

[STEP, Nassau, 4TH October 2011]

Hon Mr Justice David Hayton, Caribbean Court of Justice

1. SETTING ASIDE EXERCISES OF DISTRIBUTIVE POWERS

According to first instance courts' interpretations of *Re Hastings-Bass*[1], where trustees had exercised a discretionary power to distribute trust property to an object of the power, but the effect or consequences of the exercise had turned out to be different from that intended, the court would interfere with the trustees' action if they would not have acted as they did but for failing to take into account considerations which they ought to have taken into account or but for taking into account considerations which they ought not to have taken into account: *Sieff v Fox*[2].

In the conjoined appeals[3] in *Pitt v Holt* and *Futter v Futter* the Court of Appeal explained the narrow ratio of *Re Hastings-Bass* where trustees had exercised their power of advancement to create a sub-settlement for the benefit of William H-B for life, with remainders over, which they had not appreciated were void for perpetuity. The trustees' purpose was to avoid 80% death duties payable on the death of William's father, life tenant under the head trusts, because the sub-settled property would be safe if his father survived for seven years. This purpose was achieved even though the remainders were void, and, overall, the advancement was "for the benefit of" William and so intra vires. Thus the Revenue's claim that the

[1] [1975] Ch 25
[2] [2005] 1 WLR 3811
[3] [2011] EWCA Civ 197

advancement was void failed. No issue arose[4] as to "whether the exercise of the trustees' power might have been vitiated by some fault which rendered it voidable at the instance of a person affected, i.e. a beneficiary, rather than entirely void."

The Court of Appeal set out the position as follows:

1) If the trustees' purported exercise of a discretionary distributive power is outside the scope of the power it will be void[5] e.g. advancement not "for benefit of" beneficiary (Re Abrahams[6]); or appointment to non-object or by way of a fraud on the power so a non-object actually benefits rather than the nominal object; or failure to obtain a necessary consent.

2) If the exercise of a discretionary distributive power is within the scope of the power

(a) but in breach of the trustees' duties in respect of that exercise, it will not be void, but it may be voidable at the instance of a beneficiary who is adversely affected, though subject to equitable defences and discretionary factors[7]. [Only rarely will it be appropriate for the trustees to take the initiative in the proceedings[8] e.g. if as in *Abacus* v *Barr*[9] they need to seek directions if a beneficiary alleges a breach of trust but does not bring his own proceedings.]

(b) but if there is no breach of the trustees' duties in respect of that exercise (e.g. because advice, in general or specific terms, is sought

[4] Ibid at [67]
[5] Ibid at [96], [222(i)], [229], [231], [233], [237]
[6] [1969] 1 Ch 463
[7] *Pitt* at [99], [127], [222(ii)], [229], [231], [234], [236]
[8] Ibid at [130], [231(e)]
[9] [2003] Ch 409

from apparently competent advisors as to the implications of the proposed exercise and such advice is followed) the exercise is valid, even though not achieving what was intended due to overlooking a relevant matter[10]. A remedy lies not in the realms of equity but by way of a claim for any professional negligence of the relevant advisers[11]. "The cases set a high test for the ability of the court to intervene where trustees have exercised a discretion that is within the terms of the relevant power."[12]

3) The trustees' duty in respect of the exercise of a distributive power is to take relevant but not irrelevant, matters into account so as to give "a fair consideration" to the issues[13]. Relevant matters include[14] the settlor's wishes, the circumstances and needs of beneficiaries as known to the trustees, fiscal consequences. Often the duty of care and skill will require taking professional advice[15]. No breach of duty occurs if because of inadequate advice the trustees do not take account of a relevant matter e.g. concerning tax consequences[16]. Note that voidability is extended beyond breach of the fiduciary 'no profit, no conflict ' rules regarded by Millett LJ in *Bristol & West BS v Mothew*[17] as the only truly fiduciary duties.

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[10] *Pitt* at [127]
[11] Ibid at [220]
[12] Ibid at [113], [222(ii)], [229], [231], [238]
[13] Ibid at [109], [110], [229]
[14] Ibid at [114], [115], [234], [238]
[15] Ibid at [119]
[16] Ibid at [120], [127], [139], [238]
[17] [1998] Ch 1 at 16

The impact of these principles is that it will be exceptionally rare for the exercise of a distributive power to be void, and, if the exercise is voidable, normally only a beneficiary, not the trustee, will be able to take advantage of this. Trustees will become particularly careful to obtain advice from an apparently competent professional so that they cannot be found to have acted in breach of trust, so increasing the costs of running the trust. This taking of advice is likely to lead to an increase in negligence claims by trustees against those advisers for loss suffered by the trust fund and so by the beneficiaries on whose behalf the trustees took the advice: the trustees on approaching the adviser should make it clear that they are not acting solely on their own behalf. This will lead to an increase in advisers' insurance premiums to be passed on to the trustee and to be borne by the trust fund. Thus the costs of running trusts will increase.

The above principles were applied as follows to reverse the judgments that had applied the H-B rule, but the Supreme Court on 1 August 2011 granted leave to appeal to it, so the saga is ongoing.

Futter v Futter

Trustees had enlarged a life interest into an absolute interest in one trust and had made advancements to beneficiaries under another family trust, having taken and followed advice from solicitors that the capital gains tax thereon could be offset using the beneficiaries personal losses and annual exemptions. The advice was incorrect.

Held: the enlargement and advancement were not void because they were intra vires, and no breach of trust by trustees had occurred, so the trust was not voidable.

Pitt v Holt

Mrs. Pitt, widow and personal representative of Mr. Pitt, was his receiver appointed by the Court of Protection to look after his damages after he had been badly injured. She created for him a discretionary trust having taken and followed advice from financial advisers, who told her there were no adverse tax implications in what they proposed (though they had not considered inheritance tax implications e.g. £100,000 initial charge that could have been avoided if a disabled person trust had been set up under s. 89 1HTA 1984).

Held: the creation of the discretionary trust was not void because it was intra vires, and no breach of fiduciary duty had occurred, advice having been taken, so the trust was not voidable.

2. SETTING GIFTS TO TRUSTEES ASIDE FOR MISTAKE

English law laid down in Pitt v Holt

In *Pitt v Holt* the Court of Appeal clarified in restrictive fashion the requirements if a settlor-donor is to set aside his voluntary disposition. Millett J in *Gibbon v Mitchell*[18] had held that for a settlor-donor to do this, his mistake had to be as to the legal *effect* of his act: if the legal effect of his deed was not that which he intended he was entitled to have it set aside. A mistake merely as to its *consequences* or the *advantages* to be gained by it was insufficient. Millett J did not have cited to him a

[18] [1990] 1 WLR 1304

broad test put forward by Lindley L.J. in *Ogilvie v Littleboy*[19] requiring the donor to show "that he was under some mistake of so serious a character as to render it unjust on the part of the donee to retain the property given to him." It does appear that *Lady Hood of Avalon v Mackinnon*[20] was incidentally cited to him though he did not mention it in his judgment. Here, Lady Hood, having forgotten an appointment made to her elder daughter 16 years earlier, made another appointment to her intending to bring about equality with a younger daughter to whom an appointment had just been made, and Eve J. set aside the appointment to her elder daughter as made under a mistake as to existing facts.

Lloyd LJ held[21] "there must be a mistake on the part of the donor either as to the legal effect of the disposition or as to an existing fact which is basic to the transaction. Moreover, the mistake must be of sufficient gravity as to satisfy the *Ogilvie v Littleboy* test ... The fact that the transaction gives rise to unforeseen fiscal liabilities is a consequence, not an effect, for this purpose, and is not sufficient to bring the jurisdiction into play."

Three things need to be shown for a settlor-donor to succeed[22] "first, that there was a mistake, secondly that it was a relevant type of mistake, and thirdly that it was sufficiently serious to satisfy the *Ogilvie v Littleboy* test".

In *Pitt v Holt*

[19] (1897) 13 TLR 399 endorsed by HL on appeal in *Ogilvie v Allen* (1899) 15 TLR 294
[20] [1909] 1 Ch 476
[21] *Pitt* at [210]
[22] Ibid at [211]

(1) Mrs. Pitt was under a mistaken belief at the time of creating the trust that there were no adverse tax implications.

(2) This was, however, not a mistake as to the legal effect of the transaction but merely a mistake as to its consequences, so the claim failed even though

(3) The mistake was of sufficient gravity to satisfy the *Ogilvie v Littleboy* test, which[23] "requires the court to consider the effect of the mistake upon the conscience of the recipient ... it points to a need to protect the recipient in his possession and enjoyment of the property given. In that respect it sets a very high test as to the gravity of the mistake."

Lloyd LJ pointed out, however, that in *Re Griffiths*[24], the *Ogilvie v Littleboy* test should not have been held to have been satisfied. Mr. Griffiths had made a transfer into a trust which was potentially exempt if he survived for seven years, believing there was high chance of this. If he had known at the time that he was suffering from terminal lung cancer so that any PET would be a "no-hoper", he would not have made the transfer – he had made a mistake of fact as to his good health. He had, however, been advised to take out term insurance in case he should die within seven years, but he rejected the advice and so accepted the risk. Thus[25] "it was not against conscience for the recipients of the gift to retain it."

The Court of Appeal refused leave to appeal to the Supreme Court but on 1 August 2011 leave was granted by the Supreme Court. This seems justified when one considers whether one should extend the basic mistake of fact jurisdiction to a basic mistake of law, as did the Jersey Royal Court when refusing to follow *Pitt v Holt.*

[23] Ibid at [203]
[24] [2009] Ch 162
[25] *Pitt* at [198]

Jersey law under *Re R and the S Trust*

In *Re R and the S Trust* [2011] JRC 117 R, who was deemed domiciled in England for Inheritance Tax purposes, owned shares in a French company that owned shares in a trading company. In 1997 R transferred her French shares to a Jersey Trustee which then declared that it held these shares on Jersey discretionary trusts in favour of R's issue, who happened to be USA citizens and residents. R did this because her English solicitors had advised her that 100% business property relief would apply to the transfer. The advice was wrong so almost £2 million IHT had to be paid. R sued her solicitors for negligent advice. The action was compromised on undisclosed terms.

Also overlooked was that distributions of accumulated income to American beneficiaries of a foreign non-grantor trust would be subject to onerous USA tax rules imposing a tax charge of up to 100%.

R deposed that if she had known of the very burdensome UK and USA tax treatment of her trust she would not have transferred her shares to the Jersey Trustee and have it declare the trust. She would have done nothing or would have moved to Switzerland – as, indeed, she subsequently did.

In 2007 R as grantor created three New Trusts for her issue governed by the law of the State of Delaware so that in 2008 the Jersey Trustee transferred the French shares to the trustees of the New Trusts.

R now sought declarations that her transfer of the French shares to the Jersey Trustee was voidable by her as were its transfer of the shares to the New Trustees bound as volunteers by her equitable rights.

At the hearing before the Jersey Royal Court, R and the Jersey Trustee were separately represented, the position of the Trustee being one of neutrality. The beneficiaries and the New Trustees, who had been notified of the proceedings, had no objection to the relief sought by R.

The English Revenue had not been notified, though a partner in the English law firm acting for R deposed that, if R were granted the relief sought, the partner had been instructed that no claim would be made to recover any IHT paid on the creation of the trust or on its tenth year anniversary.

On this basis, and believing it possible that if the Revenue had been notified it would only have asked the Court to apply *Pitt v Holt,* the Court decided it was not appropriate to adjourn to convene the Revenue.

In the absence of the Revenue, the Court considered that it was concerned with whether there had been an unjust enrichment of the trust beneficiaries by R's transfer of the French shares and, to determine this, it had to apply either the English law of R's residence and deemed domicile for IHT tax purposes or the Jersey law of the trust and the Jersey Trustee and of the place where the enrichment occurred. It found Jersey law applicable as Jersey factors were more significant than R's residence and deemed domicile in England. It was not argued that R's *actual* domicile was more relevant for capacity to make gifts than her current residence or a *deemed* domicile arising by virtue of her English residence for 17 out of the last 20 years, though surely both residence and domicile ought to be irrelevant. After all, the shares were in a company incorporated in France with its share register in France, so that according to Rule 126 of the 14th edition of the authoritative Dicey, Morris & Collins on *Conflict of Laws,* French law is the relevant law as the law governing the rights that are being assigned. Enrichment of the beneficiaries under the Jersey trust enforceable against the Jersey Trustee could not be at all unjust if pursuant to a gift valid by French law.

The Court in applying Jersey law regarded itself as bound by its earlier decision in *Re the A Trust* [2009] JLR 447 unless the reasoning in *Pitt v Holt* had undermined that decision which had rejected the *Gibbon v Mitchell* distinction between a mistake as to the "effect" of a transaction as an operative mistake and a mistake as to the "consequences" of a transaction as an inoperative mistake. The Court favoured the more liberal approach of *Ogilvie v Littleboy* (not cited in *Gibbon v Mitchell*) so as only to ask "Was the mistake of so serious a character as to render it unjust on the part of the donee to retain the property?"

The Court of Appeal in *Pitt v Holt* had expressly rejected this simplistic approach of *Re the A Trust* and had re-affirmed the need for a mistake as to the *effect* of a transaction as opposed to the *consequences* of a transaction, but in the light of *Lady Hood v Mackinnon* [1909] 1 Ch 476 (not cited in *Gibbon*) it accepted that a mistake as to an existing fact basic to the transaction in issue would suffice to enable the transaction to be set aside.

Lady Hood in 1904 had exercised her power of appointment under a family trust to appoint £8,600 to her elder daughter with intent to maintain equality with her younger daughter to whom she had just appointed £8,600. In fact, the £8,600 appointment made the elder daughter much better off than the younger daughter because in 1888 the elder daughter on her marriage had already been appointed half the family trust fund by Lord & Lady Hood to be thenceforth held for her under the terms of her marriage settlement. Lady Hood after her husband's death had totally forgotten this fundamental fact and so had mistakenly achieved the opposite of what she had intended. She had made no mistake as to effect of the appointment of £8,600 as an appointment of that sum, but she had made a big mistake as to the factual consequences of that appointment, so Eve J had set aside the appointment.

In *Pitt v Holt* Mrs Pitt similarly had made no mistake as to the effect of her discretionary trust of her disabled husband's £800,000 personal injury damages as an intended discretionary trust. She had, however acted under the mistaken belief that this had no adverse tax consequences as erroneously informed by her advisers when £100,000 IHT became payable forthwith and IHT would become payable on subsequent distributions or ten year anniversaries. Despite this, the Court of Appeal held at [210] and [217-218] that the tax treatment of a transaction is merely a consequence and not an effect of the transaction so that Mrs Pitt's mistake was not an operative mistake.

The Jersey Royal Court, nevertheless, disagreed with the Court of Appeal. It could not see why a mistake, like that of Lady Hood, as to a *fact* basic to a transaction so as to lead to an unforeseen consequence should be sufficient to make the transaction voidable but a mistake, like that of Mrs Pitt, as to *law* basic to a transaction so as to lead to an unforeseen consequence is not sufficient. After all, Millett J in *Gibbon* in 1990 had held that a mistake of fact or of law as to the *effect* of a transaction enabled it to be set aside when the life tenant had mistakenly believed that he had effectively surrendered his protected life interest in favour of his children as remaindermen, though in law this forfeited his life interest and created a discretionary trust for the life tenant and his children. Subsequently, the House of Lords in *Kleinwort Benson Ltd v Lincoln CC* [1999] 2 AC 349 had comprehensively swept away the distinction between mistakes of fact or law.

Thus the Jersey Court held, following *Re the A Trust,* that a mistake of fact or of law basic to a transaction sufficed to make the transaction voidable so long as of so serious a character as to make it “unjust” on the part of the donee-trustee to retain property received under the transaction. R’s catastrophic fiscal mistakes as to English IHT and USA income tax were of such a character: thus she was entitled to the declarations she sought.

There is some reason to doubt this when one considers that in seeking and taking specialist advice as to tax R had to be aware that tax matters involving trusts and foreigners could be complex and that tax advisers are not perfect but can sometimes provide inadequate advice. Did she not take the risk of this and should this not be of particular significance?

While it makes sense not to distinguish between a mistake of fact or of law, it also makes sense to investigate whether the donor consciously took a risk of making such a mistake. If she lost the gamble it is not “unjust” to let the loss lie where it falls: she should not get her stake back so she can try again for a better result.

Thus, as Lloyd LJ pointed out in *Pitt v Holt,* in *Re Griffiths,* a serious mistake of fact case, the settlor, when transferring property to trustees, mistakenly believed himself to be in good health (when terminal lung cancer had just taken root in him), and so declined to take out the recommended term insurance. Thus, he took the risk that his health might turn out to be so bad that his PET was a “no-hoper” and not a “good chancer.” The risk materialised as he died just over a year later so IHT was payable. Lloyd LJ considered that an application of the *Ogilvie v Littleboy* test to this serious basic mistake of fact would result in it not being “unjust” to leave the gift as a valid gift: Lewison J’s decision to set aside the transfer in .*Re Griffiths* had fallen into error in not appreciating this, though he had been handicapped by the absence of adversarial argument on the law or the facts, the Revenue having declined to take part in the proceedings before him.

Where a case concerns a mistake of law as to tax consequences of a transaction that the transferor hoped would avoid or mitigate tax, he has to have been conscious that there was always the possibility that he was acting under a mistake, whether his own or that of his adviser. Surely, if he failed to achieve the hoped-for tax advantages, he cannot be allowed to undo what he has done and have a better try at achieving those advantages. It is not unjust to leave his gift as a valid gift so that he cannot recover the trust property. As Lord Hoffmann stated in *Deutsche Morgan Grenfell v HM Commissioners of Inland Revenue* [2006] UKHL 49 at [26] when considering a cause of action for “relief from the consequences of a mistake” within

Limitation Act 1980 s 32(1) (c), “The real point is whether the person who made the payment took the risk that he might be wrong. If he did then he cannot recover the money.”

Where he was his own adviser and so had a fool for his client, is it not just that he cannot complain that he is remediless? Where he wisely took advice but this was erroneous and negligent, then does he not have a just and adequate remedy against his negligent adviser? Of course, if the adviser had warned that there was a risk that the transaction might not avoid or mitigate tax as hoped and the client had chosen to take the risk, which subsequently materialised, then it is just that nothing can be done.

There thus seems to be an arguable case for Equity allowing a donor-settlor to set aside as voidable a transfer of property to trustees (or others) which he would not have made but for making a mistake of either law or fact as to the effect or consequences of the transfer or appointment, so long as he did not consciously take the risk of the consequences turning out to be significantly different from what he intended.

Indeed, why not hold there to be, in Sir George Jessel MR’s immortal phrase, a “distinction without a difference” between effects and consequences, and just apply the *Ogilvie* v *Littleboy* test where there is a mistake of sufficiently serious gravity to justify taking away the donee’s possession and enjoyment of apparently unimpeachably gifted property because it would be unjust for the donee to retain it.

In *Re R and the S Trust* and in *Re Griffiths* all parties were happy for tax to be avoided by the transfers to trustees being set aside for a grave mistake but this alone cannot make this just or conscionable where all parties benefit at the expense of the Revenue. The security of transfers of title to property requires there to be clear strict rules so that, while a donee can give property back to his donor he cannot simply let the gift be regarded as if it had not taken place except if he disclaims the gift promptly on becoming aware of it. In Revenue cases it seems that the donor ought not to have the opportunity to set aside his gift where the risk was taken of a mistake causing serious unforeseen tax consequences.

Clarification of the law is needed when the Supreme Court hears the appeal in *Pitt v Holt.* There will never be appeals in cases like *Re R and the S Trust* and *Re Griffiths* where the outcome suited all parties before the court.

3. VULNERABILITY OF POWERS OF REVOCATION OR GENERAL POWERS OF APPOINTMENT

Where a settlor has a power to revoke his trust or a power to appoint trust property to himself he is, of course, entitled to have the trustees transfer the trust property to himself or his nominee at any time for any reason or for no reason just as he can demand his bank pay him money out of his account. For most practical purposes this is tantamount to ownership, though unless and until the power is exercised the donee of the power is not the owner of the property subject to the power, while a client of a bank owns a chose in action.

In *Fonu v Merrill Lynch Bank and Trust Company (Cayman) Ltd* [2011] UKPC 17 Lord Collins for the Privy Council held that at the behest of a judgment creditor the court can, by way of equitable execution, appoint a receiver in respect of a judgment debtor's power of revocation of his trust, which is equivalent to a power to appoint to oneself. Following *Re Triffitt's Settlement* [1958] Ch 852 where a settlor, who had a personal power to appoint trust property to herself or anyone else except her father and any wife of his, was held by Upjohn J to be able to delegate this power to trustees of newly appointed discretionary trusts, the PC held that a debtor can be ordered to delegate his power of revocation to the receiver and, in default, the court can empower a court officer or the receiver to execute the delegation on the debtor's behalf. Once the receiver exercises the power of revocation the debtor becomes beneficially entitled to the trust property so that it is available to satisfy his debts, and the trustee, having being notified of the receivership, must deal with the trust property as directed by the receiver.

It would be more straightforward to obtain an order that the debtor directly revoke his trust with the usual default order, but *Field v Field* [2003] 1 FLR 376, a decision of Wilson J in the English High Court Family Division, seemed to preclude this approach. Lord Collins in the PC doubted the correctness of *Field* but avoided ruling on the issue by using the delegation approach.

By parity of reasoning the court should be able to make similar orders in respect of a personal power of appointment exercisable by the donee of the power in favour of himself, whether or not he happens to be the settlor. Any consent, however, required for the exercise of a power of revocation or other power to appoint to oneself will prevent the position of the donee of the power being tantamount to ownership unless and until the consent has been given as Upjohn J accepted in *Triffitt*.

It may therefore be considered advisable for such a power to be exercisable only with some requisite consent. It would seem that problems cannot be avoided by having the donee of the personal power not within the class of objects of the power if he also has a personal power to add himself to that class. The court could order delegation of both powers to a receiver so as to ensure that the trust property is made available for the judgment creditor.

Note that by virtue of most trust law countries' bankruptcy legislation powers of revocation and general powers of appointment vested in a bankrupt will vest in the trustee in bankruptcy but under the Turkish insolvency law applicable to the debtor in *Fonu* this was not the case. Fonu, however, undertook to use the trust property once acquired for the benefit of all the creditors of the debtor. Note also that *Fonu* opens the way for it to be argued that a release of a power of revocation or of a power to appoint to oneself or the exercise of the latter power to appoint the trust property to another object of the power can amount to a transaction defrauding creditors or a transaction at an undervalue within a prescribed period before being made bankrupt.

4. VULNERABILITY OF BAHAMIAN TRUSTS WITHIN S 3(2)(i)

"Any beneficial interests of the settlor (including absolute beneficial interests) in the capital or income of the trust property or in both such capital and income" “shall not invalidate a trust or the trust instrument or cause a trust created inter vivos to be a testamentary trust or disposition or the trust instrument creating it to be a testamentary document.’

Under English law an inter vivos trust to hold income and capital on trust for the settlor, S, while he is alive, but after his death for his children equally per stirpes, is a bare trust for S absolutely because it leaves S as absolute beneficial owner of such property held to his order during his lifetime. Thus his disposition of whatever property is left in the trust at his death is a testamentary disposition and so ineffective unless complying with the requisite formalities for a will. Of course, even if such formalities were satisfied, the trust property would be part of S’s beneficially owned property at death and so be available to satisfy claims of the Revenue or other creditors and of any forced heirs.

Under Bahamian law such a trust created inter vivos is not to be a testamentary trust and the trust instrument creating it is not to be a testamentary document, so that testamentary formalities need not be satisfied. S’s rights under the inter vivos trust, however, are tantamount to ownership as held by the Privy Council in *Fonu* in respect of a settlor’s rights under a power of revocation. Thus, the Bahamian courts could find that the trust property is available to satisfy the settlor’s creditors, the remaindermen only being entitled to whatever happens to be left in the trust fund at the time of the settlor’s death, though the Trusts (Choice of Governing Law) Act 1989 as amended in 1996 will protect the inter vivos trust from forced heirship claims.

It is noteworthy that where trust property is located outside The Bahamas, the courts of the forum will apply their own law to characterise the trust as inter vivos or testamentary. An English court will most likely characterise a s 3(2)(i) trust as a bare inter vivos trust for the settlor, with the purported trust after his death being a testamentary trust in respect of whatever happens to be comprised in the trust fund at his death, subject to his creditors' claims and forced heirship claims; see *BQ v DQ* [2011] WTLR 373, [2010] SC (Bermuda) 40 Civ.

5. PROPRIETARY LIABILITY FOR SECRET PROFITS

After the Privy Council decision in *Att-Gen for Hong Kong v Reid* [1994] 1 AC 324 one thought it was settled law that profits made by a fiduciary from his fiduciary *position* or from fiduciary *property* affected by his fiduciary "no profit' obligation are held on trust for his beneficiaries. Surprisingly, the English Court of Appeal in *Sinclair Investments Ltd v Versailles Trade Finance Ltd* [2011] EWCA Civ 347 recently rejected this. It held that profits (eg bribes/secret commissions) made out of exploiting a fiduciary *position*, as opposed to fiduciary property, are not held on trust for his beneficiaries who, therefore, merely have a personal and not a proprietary claim to the profits.

On the face of it, it would seem from the Bahamian Court of Appeal decision in *Att-Gen of The Bahamas v Royal Trust Co (No 2)* that the Bahamian courts have to follow a Privy Council decision until there is an English House of Lords or, now, Supreme Court decision to the contrary. It can however be argued that under s 2 of the Declaratory Act (No 2 of 1799) the Bahamian courts have to apply English common law and equity as at the reception date of 2 December 1799 and as subsequently declared and developed by English courts (subject to any inconsistent Bahamian legislation), in particular in the *Sinclair Investments* case which now represents English law. While there may be justification for accepting this where the reasoning of the subsequent Court of Appeal decision is impeccable in dealing fully with both sides of the issue, it is submitted that this is not such a decision as will be shown below. Thus the Bahamian courts should follow the Privy Council decision and it should be left to the party alleging the Privy Council to have erred to raise this in an appeal to the Privy Council, which, in my provisional view could well affirm its position in *Reid*.

In *Sinclair Investments Ltd v Versailles Trade Finance Ltd* [2011] EWCA Civ 347 Lord Neuberger MR in his judgment, with which Richards and Hughes LJJ simply agreed, surprised many Equity lawyers. Equity is based upon a person being a good person with the result that even if the person behaves badly the claimant can insist that he be forced to behave as a good person or, if he is a fiduciary, that he cannot deny that he behaved like a good fiduciary in accordance with his core fiduciary obligation to act in the best interests of his beneficiaries to the exclusion of his own.

Thus, if a trustee makes an unauthorised distribution or investment the beneficiaries are entitled to falsify his accounts so that the unauthorised acts are ignored, and the trustee, by way of substitutive performance of his obligations, cannot deny that, in accordance with his duty, he still retains the fund assets that were wrongly disposed of: thus he needs to augment the fund so that his accounts are in order. Similarly, if a trustee mixes the trust fund with his own money the beneficiaries can pick and choose what dispositions cannot be denied to be dispositions benefiting them.

Following this philosophy Lord Templeman, delivering the unanimous advice of the Privy Council in *Att-Gen for Hon Kong v Reid* [1994] 1 AC 324, held that if a fiduciary accepted a bribe he could not deny his principal's assertion that the bribe had been immediately received by the fiduciary as a legitimate payment to be held for his principal. Thus the State had an equitable proprietary interest in land in New Zealand that had been purchased with bribe moneys.

Lord Templeman (at p 337) was much influenced by a paper which he cited, 'Bribes and Secret Commissions' [1993] Restitution LR at 20, in which Millett J (as he then was) emphasised that "Equity insists on treating him [the fiduciary] as having acted in accordance with his duty ... equity insists on treating it [the bribe] as a legitimate payment intended for the principal." Equity thus disables a fiduciary from asserting that he acted wrongfully where the claimant insists that, in receiving a payment, the fiduciary acted rightfully in accordance with his overriding obligation as a good person to further the claimant's best interests to the exclusion of the fiduciary's own interest in making a profit for himself. For liability resting not on breach of duty but from an inabilty or impossibility of making a profit also see Lord Porter in *Regal Hastings (Ltd) v Gulliver* (1942) [1967] 2 AC 134 at 159, Browne-Wilkinson in *Guinness Plc v Saunders* (1987) 3 BCC 271 at 337 and Rich, Dixon and Evatt JJ in *Furs Ltd v Tomkies* (1936) 54 CLR 583 at 592.

Since the payment is the claimant's property, the defendant fiduciary's primary obligation is to deliver it and any traceable product to the claimant *in specie*. If he cannot do this because he has dissipated it, he must personally account and so make a compensatory payment. An option, however, is open to the claimant if the defendant is wealthy enough: the amount of the defendant's profit can be claimed instead of the particular asset, for example where the claimant does not want to have to reimburse the defendant his cost of acquiring an asset for the claimant as in *Boardman v Phipps* [1967] 2 AC 46.

In *Sinclair Investments* the good person philosophy described above was ignored, the defendant being treated (seemingly as pleaded) as a wrongdoer who had committed a breach of trust rather than a person who had acted rightfully to make a profit held for the claimant, being unable to make a profit for himself. It was held that secret profits made by a fiduciary out of his *position*, as opposed to *property* subject to the fiduciary obligation, are not held on any trust for the fiduciary's beneficiary. The fiduciary's liability can only be a personal liability unless it derives from property or an opportunity that belonged beneficially to the beneficiary.

In *Sinclair* Cushnie owned an alter ego company, VGP. In breach of his fiduciary duties as director of TPL he misused money given by traders to TPL on trust for proper trading purposes. The money was used, instead, to finance a Ponzi scheme fronted by VGP. Before the fraud was discovered Cushnie sold some of his VGP shares for £28 million and used £9.9 million to acquire a house. The assignee of TPL's rights sued on the basis that there was a proprietary constructive trust of Cushnie's secret profits sufficient to justify a proprietary claim against the house.

Lord Neuberger M.R. ("the M.R."), in endorsing the judgment below of Lewison J [2010] EWHC 1614 (Ch), pointed out (at [32]) that the "proprietary claim is based on the proposition that, in his capacity as a director of TPL, Mr. Cushnie misused the funds provided by traders, that this amounted to a breach of trust and that the proprietary interest which TPL had in the funds can be traced through the proceeds of sale of the Shares" in VGP. He commented (at [40]) that where a trustee or fiduciary commits a breach of trust the beneficiary's remedy is normally a personal one. As a sceptical property lawyer, he queried at [52] how a fiduciary's wrongfully making a profit from his breach of duties could give the beneficiary a proprietary interest in that profit.

The MR then examined the case law up to *Reid* and decided not to follow *Reid*, but rather to follow the Court of Appeal in *Lister v Stubbs* (1890) 45 Ch D 1, which held that only a personal liability arises where a fiduciary receives a bribe or secret profit from misusing his position. He was also much influenced by *Tyrell v Bank of London* (1862) 10 HL Cas 26, which he interpreted differently from Lord Templeman, while he also interpreted *Boardman v Phipps* [1967] 2 AC 46 differently from Lord Templeman, who had considered it authority for the fiduciary solicitor having become a trustee of the shareholding obtained for himself by exploiting his office. The Supreme Court will need to consider which interpretation is correct, though it is also free to refuse to follow such interpretation.

The MR also found (at [85]) of "direct relevance" two subsequent Court of Appeal cases dealing with constructive trusts under the Limitation Act 1980, *Gwembe Valley Development Co. Ltd. v Koshy* (No 3) [2003] EWCA Civ 1048; [2004] 1 BCLC 131 and *Halton International Inc v Guernroy Ltd* [2006] EWCA Civ 801; [2006] WTLR 1241 "where the reasoning in *Lister* was followed"

There is reason to doubt this. *Lister* and *Reid* were not mentioned at all in those cases. Indeed, in *Gwembe* the Court of Appeal in a judgment delivered by Mummery LJ approvingly cited (at [44]) a passage from *Furs Ltd v Tomkies* (1936) 54 CLR 583 at 592 in which Rich, Dixon and Evatt JJ regarded undisclosed profits obtained by a director negotiating the sale of his company's assets as "belonging in equity to the company ... resting upon the impossibility of allowing the conflict of duty and interest which is involved in the pursuit of private advantage in the course of dealing in a fiduciary capacity with the affairs of a company."

In *Gwembe* Gwembe brought a personal action against the wealthy Koshy for secret profits made by Koshy. As managing director of Gwembe, Koshy had procured that it borrow 56.4million Zambia kwacha from his controlled company, Lasco, which had acquired the kwacha for US$1 million, but Gwembe acknowledged the debt as one of US5.8 million at the official exchange rate. Lasco thus made a massive profit for Koshy by way of the enhanced value of his shareholding and actual payments from Lasco to him as acknowledged by Mummery LJ (at [137]-[138]) when, in giving the court's judgment, he stated "that fact does not affect the application of the doctrine that he profits made by him, as a result of his dishonest breach of fiduciary duty, belong in equity to Gwembe."

Despite Gwembe's apparent equitable interest, Mummery LJ found Gwembe's claim fell outside 21(1)(b) of the Limitation Act 1980 that ousts any limitation period where there is an action "to recover from the [constructive] trustee trust property or the proceeds of trust property in the possession of the trustee or previously received by him and converted to his use." He held that Gwembe's claim for Koshy personally to account for his profits as a constructive trustee was based on a class 2 constructive trust and not a class 1 constructive trust within the terminology provided by Millett LJ in *Paragon Finance plc v Thakerar & Co* [1999] 1 All ER 400 at 409 terminology which, when taken out of context, has created confusion rather than clarity.

The liability of a class 1 constructive trustee is unlimited under s 21(1) of the Limitation Act 1980 whereas a six-year period under s 21(3) applies to a class 2 constructive trustee. A class 1 trustee is one who "does not receive the trust property in his own right but by a transaction which both parties intend to create a trust from the outset and which is not impugned by the plaintiff. His possession of the property is coloured from the first by the trust and confidence by means of which he obtained it, and his subsequent appropriation of the property to his own use is a breach of that trust."

A class 2 constructive trustee "never assumes the position of trustee, and if he receives trust property at all it is adversely to the plaintiff by an unlawful transaction which is impugned by the plaintiff."

Applying this distinction at face value, Mummery LJ held (at [119]) "that any trust imposed on Mr. Koshy is a class 2 trust. Mr. Koshy's liability to account for undisclosed profits, and any constructive trust imposed on them, do not depend on any pre-existing responsibility for any property of the company. They arose directly out of the transaction which gave rise to the profits and the circumstances in which it was made."

Reid was not cited to the court for the proposition that Koshy's position as director fiduciary required him to act in the best interests of Gwembe to the exclusion of his own interests, with the result that Koshy could not deny that it was impossible to hold his secret profit for himself and he was compelled to hold it for Gwembe as if it had been duly acquired in the course of his duties. Did not Koshy's liability arise by virtue of his fiduciary obligations that preceded the acts complained of rather than his liability in equity first arising by virtue of the acts of which complaint was made?

The reason why limitation periods do not under s 21(1) of the 1980 Act apply to express or constructive trustees is that the possession of property by the trustee is treated from the outset as held on behalf of the beneficiaries and so treated as the possession of the beneficiaries. Having held this not to be the case, with the result that s. 21(1)(b) was inapplicable, Mummery LJ went on (at [128]) to hold that s. 21(1)(a) covering actions "in respect of any fraudulent breach of trust to which the trustee was a party or privy" was applicable to oust any limitation period because Koshy had been fraudulent. Yet, in *Paragon Finance* Millett LJ had pointed out that for s. 21(1)(a) to apply there had to be a class 1 constructive trust based upon the trustee's possession being from the outset regarded as as being on behalf of the beneficiaries. How could there be a class 1 trust for s 21(1)(a) but a class 2 trust for s 21(1)(b)?

The unsatisfactory view of s 21(1)(b) taken in *Gwembe* was applied in *Halton* above where shareholders had given one of themselves a power of attorney to exercise their voting rights to facilitate matters in various ways including the issue of new shares. The attorney exercised the power so as to increase his shareholding and dilute the claimants' shareholdings. The claimants alleged that he held a portion of his increased shareholding on constructive trust for them and that he should be ordered to transfer the requisite number of shares to the claimants in return for being reimbursed their cost price. No fraud within s. 21(1)(a) of the 1980 Act was alleged so it was common ground (see at [9]-[10]) that this proprietary claim was barred unless it fell within s. 21(1)(b).

On the assumption that there was a preceding fiduciary relationship, s. 21(1)(b) was nevertheless held to be inapplicable in a brief judgment which followed *Gwembe* on the distinction between class 1 and class 2 constructive trustees and on the proposition that class 1 only applies where there is (at [23]) "a trust (or trustee-like responsibility) for specific existing property, not merely for the means to obtain it in the future."

Thus both *Gwembe* and *Halton* focused on applying the phraseology of the distinction between class 1 and class 2 constructive trusts rather than on comparing *Lister v Stubbs* with *Reid*.

Lord Neuberger concluded (at [88]) that "a beneficiary of a fiduciary's duties cannot claim a proprietary interest, but is entitled to an equitable account, in respect of any money or asset acquired by a fiduciary in breach of his duties to the beneficiary, unless the asset or money has been beneficially the property of the beneficiary or the trustee acquired the asset or money by taking advantage of an opportunity or right that was properly that of the beneficiary."

What, however, if the beneficiary submits that the fiduciary cannot favour himself (and his creditors) by claiming to be a wrongdoer, who has acted in breach of his fiduciary duty, when the beneficiary is asserting that the fiduciary cannot deny the beneficiary's claim that he acted as a good fiduciary in accordance with his core duty to act in the best interests of the beneficiary to the exclusion of his own. As Megarry V-C stated in *Cowan v Scargill* [1985] Ch 270 at 286-287, "the starting point is the duty of trustees to exercise their powers in the best interests of the beneficiaries...This duty is paramount." This is the fundamental fiduciary obligation that precedes the acts complained of. If the fiduciary purports to take advantage of his opportunity and powers as a fiduciary to make a profit for himself, is not the beneficiary entitled to claim that this opportunity was properly that of the beneficiary for whom the profit must be held as soon as received?

Is it not the case that Equity, if requested by a beneficiary, looks on as done that which ought to be done because of the core duty inherent in a fiduciary relationship (and expressed for directors in s. 172 of the Companies Act 2006) based on an express or necessarily implied undertaking of the fiduciary that makes it impossible for him to become beneficial owner of any secret profit if his beneficiary claims it as an authorised transaction?

A worry seems to be that proprietary liability cannot arise in respect of property that is not originally or in traceable form subject to a fiduciary obligation but is acquired in the future by means of a fiduciary's office. There is no doubt, however, that after-acquired property in marriage settlements becomes subject to trusts as soon as received by a spouse (*Pullan v Koe* [1913] 1 Ch 9) and a contractual obligation may be enforced in equity so as to confer an equitable proprietary interest on property received in the future by one party to the contract. For example, if X pays Y £5 million to acquire whatever Y receives in respect of rents or royalties to be received in the next two years and Y becomes insolvent after six months, X has priority over Y's general creditors because Y's receipts as soon as received belong in equity to X: *Reid Newfoundland v Anglo-American Telegraph Co Ltd* [1912] 1 AC 555 at 559-560, *Re Lind* [1915] 2 Ch 354 at 360, *Palette Shoes Pty Ltd v Krohn* (1937) 58 CLR 1 at 16. Similarly, a completely constituted equitable obligation can be enforced, though many fiduciaries will be paid so that, in consideration of their entitlement to be paid, they can undertake, expressly or by necessary implication in the eyes of the law, to act exclusively in their beneficiaries' best interests. In such a case anything purportedly acquired in their own best interests will be held immediately for their beneficiaries.

A case can thus be made out for not distinguishing between, on the one hand, exploiting a fiduciary office in respect of property originally or in traceable form subject to the fiduciary obligation or a mature opportunity subject to such obligation and, on the other hand, exploiting a fiduciary office so as to acquire some property like a bribe or secret profit sometime in the future.

Ultimately, the Supreme Court (after comprehensive forensic argument from leading counsel not available to me and taking account of academic commentary acknowledged by the MR at [81] but too extensive to be covered here) will have to decide what is essential to the integrity of trusteeship or directorship or other fiduciary relationship, including one in which the fiduciary has no role to play in respect of property e.g. the Director of Public Prosecutions or a Chief Superintendent of Police.

It is essential to the ring-fenced security of a trust fund that the trustee cannot sell trust property and with the proceeds buy assets for his own patrimony available to satisfy claims of his own creditors: such assets are part of the trust fund. If a director procures that his company sells property in order that with the proceeds he can acquire assets for himself, such assets are also held on trust for the company. If a trustee or director sells off trust or company property at an undervalue, because he has earlier been paid a bribe, or if he causes the trust or company to enter into disadvantageous transactions with his alter ego company so as to profit himself, should such bribe or profit not also be held on trust for the beneficiaries or the company? Indeed, Lawrence Collins J (as he then was) stated in *Daraydan Holdings Ltd v Solland International Ltd* [2004] EWHC 622 (Ch);2005] Ch 119 at [86]: "There is no injustice to the creditors in their not sharing in an asset for which the fiduciary has not given value and which the fiduciary should not have had."

When a person is elevated to become DPP or a Chief Superintendent it would seem that, if there was no express contractual term against taking bribes, the answer to the officious bystander who asks "Can you take bribes for yourself?" will be "Of course, not. I'll do my job properly." *Reid* regards such a fiduciary as disabled from taking any bribe to the extent that, if he does so, he can only hold it for his employer in accordance with his duty to do his job properly by acting exclusively in his employer's best interests.

If the Supreme Court does not follow this approach, one can expect to see in trust deeds and in contracts terms providing that the trustee or the fiduciary contracting party is unable to receive any bribe or other secret profit for himself beneficially, but if and as soon as he does actually receive such bribe or profit it will be held on trust for the relevant beneficiaries or the other contracting party. While Lord Neuberger insists that "a proprietary claim is based on property law", Equity permits property to be derived from an obligation affecting property, whether existing or after-acquired property.

Finally, it should be noted that Lord Neuberger was happy to follow *Lister v Stubbs* as a decision of the Court of Appeal, when the Court of Appeal in *National Westminster Bank v Spectrum Plus Ltd* [2004] EWCA Civ 670 at [58] had held that the Court of Appeal must follow its own decisions unless (1) there were two inconsistent decisions or (2) a decision was per incuriam in a narrow sense or (3) a decision could not stand with a decision of the House of Lords or, now, the Supreme Court. What however of two Court of Appeal decisions, *Doughty v Turner Manufacturing Co Ltd* [1964] 1 QB 518 and *Worcester Works Finance Ltd v Cooden Engineering Ltd* [1972] 1 QB 210, which are inconsistent with *Sinclair Investments* and *Spectrum Plus* because following decisions of the Privy Council rejecting decisions of the Court of Appeal and thereby recognise as a fourth exceptional case that a Court of Appeal decision that cannot stand with a Privy Council decision need not be followed? Where there is a very substantial overlap between the membership of the Supreme Court and the Privy Council the person on the proverbial Clapham omnibus will surely regard the system of precedent as foolish if it places the onus of taking a case up to the Supreme Court upon the litigant having in his favour a Privy Council ratio rejecting the ratio of a Court of Appeal decision.

In *Cadogan Petroleum PLC v Tolley* [2011] EWHC 2117 (Ch) however, Newey J on 9 Sept 2011 followed *Sinclair*, discretion no doubt being the better part of valour for a High Court judge. On a similar basis one expects that Caribbean judges in jurisdictions having the Privy Council as its highest court will apply *Reid.* Currently, I believe that a leap-frog appeal to the Supreme Court is being contemplated in *Cadogan.*