

**Paper presented at the Western Australian Bar Association CPD Conference
15 October 2011**

Two fundamental questions for the law of trusts

**by
The Hon Justice James Edelman
Supreme Court of Western Australia**

The questions

My focus in this paper is on two fundamental issues in the law of trusts. The first issue is raised by a decision of the Court of Appeal of England and Wales in 2010. The second is raised by a decision of the same court in 2011. Each has reversed conventional thinking in relation to fundamental issues in the law of trusts. Both developments are, I venture to suggest, very radical. However, to many academics, practitioners, and judges, the first development may be thought to be based on entirely orthodox ideas of trust law. Such a view should be carefully examined.

I was instructed by Shell to respond to an appeal from the first decision I will discuss. That case is *Shell UK Ltd & Ors v Total UK Ltd*.¹ Leave to appeal from that decision was given in 2010. The appeal to the Supreme Court was settled barely 2 weeks before the hearing, in April 2011. Essentially, the issue which underlies that decision is "what is a trust"?

The second decision is the decision of the English Court of Appeal in March this year in a case called *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd*.² Essentially, the issue which underlies that decision is "when do trusts arise?"

The answers

The point I wish to make in relation to the first issue, "what is a trust" concerns the common language used of "equitable ownership" or "equitable proprietary right". The former expression might be better avoided altogether, but the essential point is that the nature of the beneficiary's "ownership" or "property right" is of a fundamentally different character in equity from the nature of a "property right" at common law.

From the perspective of pure theory, it has been suggested by leading trust law academics that the fundamental difference between the character of the beneficiary's interest under a trust and the nature of a common law property right can be seen in relation to tangible things. The common law property right is in relation to the land or the chattels themselves. The equitable 'property' interest is one step removed. It is an interest which relates to the trustee's *rights* to that thing. This point was first made by Maitland. It has been recently reiterated by

¹ [2010] EWCA Civ 180; [2011] 1 QB 86.

² [2011] EWCA Civ 347; [2011] WTLR 1043.

Professors Burrows, Chambers, McFarlane, Smith, and Stevens.³ This view is not 'conventional wisdom'.⁴ Conventional wisdom suggests that the beneficiary under a trust has an interest in the trust asset itself. But the conventional view may cause some serious difficulties. It needs to be examined carefully.

In relation to the second issue, my primary focus in this paper is on constructive trusts, ie trusts which arise other than by the manifested intention of the parties. There are many examples of situations in which constructive trusts arise and the underlying basis, or reason, why the trust arises in these cases is often very difficult to discern. The main point I wish to make is that there is a counter-revolution in relation to these trusts in English law and that there is a possibility that Australian law may follow suit. When the question arises it is essential that, as recent Australian authority has insisted, the reason for the existence of the constructive trust is examined.

Issue 1: What is a trust?

On 11th December 2005, the largest peacetime explosion in the history of the UK occurred at the Buncefield oil terminal in Hertfordshire. Astonishingly, no-one was killed. The explosion was caused by negligence for which Total UK Ltd was vicariously responsible. There was widespread damage to the terminal itself and the pipelines at the terminal.

Shell used the Buncefield terminal in two important ways. One way was to store aviation fuel and to export it to airports, including Heathrow and Gatwick. Another way was to load ground fuels into road tankers for supply to its customers.

There was an important difference between Shell's use of aviation fuels and its use of ground fuels which was not mentioned by the Court of Appeal. The aviation fuels were obtained through a pipeline system which was held on bare trust by trustees for four oil companies, which included Shell. The ground fuels were obtained from a different site at the terminal, the HOSL West site. That site was also held on trust but Shell was not a beneficiary of that trust.

There was no doubt that Total were liable to compensate the trustees, as owners of the two sites, for the physical damage caused by the explosion. But the problem was the massive economic losses suffered by Shell caused by its inability to supply fuels to its customers, save in reduced volumes or at increased cost. These losses were suffered directly by Shell, rather than by the trustees. The trustees (WLPS and UKOP) were vehicle companies run on a not-for-profit basis and controlled by the oil company beneficiaries who had all the voting rights in the companies. Arrangements for the sale of fuel were entered into directly between

³ A Burrows *The Law of Restitution* (3rd edn) 191-193; R Chambers "Constructive Trusts in Canada" (1999) *Alberta L Rev* 173; L Smith, "Unravelling Proprietary Restitution" (2004) 40 *CBLJ* 317; B McFarlane and R Stevens "The Nature of Equitable Property" (2010) 4 *Journal of Equity* 1.

⁴ That phrase was actually used by John Kenneth Galbraith in *The Affluent Society* as a term of derision.

Shell and its customers, so that the revenue accrued directly to Shell and was not routed through WLPS or UKOP.

So, here was the problem. Since Shell was not the owner of the pipelines or the assets at the HOSL West site, it could not bring the very ordinary claim that any owner of an asset could bring for the consequential losses suffered as a result of damage to that asset. A claim for what is colloquially called ‘pure economic loss’ might have succeeded in Australia. The case bears a strong resemblance to the facts of the pioneering pure economic loss case in Australia: *Caltex Oil (Australia) Pty Ltd v Dredge "Willemstad"*.⁵ However, one significant obstacle in the path of a tortious claim by Shell in Australian law may have been whether Shell could be said to have been 'vulnerable' to the actions of Total.

In any event, the Australian approach to pure economic loss has not yet been adopted in England. The leading decision is *Leigh and Silavan Ltd v Aliakmon Shipping Co Ltd (The Aliakmon)*.⁶

In *The Aliakmon* the claimants were purchasers of steel coils under a contract of sale. The contract provided that during shipping of the goods, the title to the goods remained with the seller although risk passed to the buyer. The coils were damaged by negligence for which the defendant shipowners were responsible. The claimant purchasers sued the defendants. The claimants argued that they had an equitable interest in the cargo and that this equitable interest meant that they were owed a duty of care. At 809E-F, Lord Brandon said

“My Lords, there is a long line of authority for a principle of law that, in order to enable a person to claim in negligence for loss caused to him by reason of loss of or damage to property, he must have had either the legal ownership of or a possessory title to the property concerned at the time when the loss or damage occurred, and it is not enough for him to have only had contractual rights in relation to such property which have been adversely affected by the loss of or damage to it.”

The decision in the *Aliakmon* has been approved on a number of occasions in England. It represented the culmination of a line of authority right up to the previous year when the proposition quoted was endorsed by the Privy Council in *The Mineral Transporter*,⁷ over powerful objections by counsel for the unsuccessful party, Mr A M Gleeson QC. If *Shell UK Ltd & Ors v Total UK Ltd* had not settled before the Supreme Court hearing, then the *Aliakmon* would have been directly challenged.

Shell failed before the trial judge and it appealed to the Court of Appeal. Since the Court of Appeal was bound by the *Aliakmon*, Shell could only succeed by finding an alternative route to sideline the decision in the *Aliakmon*. Shell raised four arguments:

⁵ [1976] HCA 65; (1976) 136 CLR 529.

⁶ [1986] AC 785.

⁷ [1986] AC 1.

- a. First, it argued that it was a beneficiary in possession and therefore that it had a proprietary right which entitled it to recover its consequential losses under wholly conventional principles in the law of torts.
- b. Secondly, it argued that it fell within a 'joint venture' exception to the prohibition against recovery of pure economic loss, deriving from the decision in *Morrison Steamship Co Ltd v Greystoke Castle (Cargo Owners)*.⁸
- c. Thirdly, it argued that in relation to the aviation fuels it was the beneficiary under a trust and that this fact could create a new exception, at common law, to the prohibition of the recovery against pure economic loss.
- d. Finally, it submitted that the *Aliakmon* was wrongly decided. However, Shell accepted that this point could only be raised in the Supreme Court and reserved its right to do so on appeal.

In a single joint judgment, the Court of Appeal allowed Shell's appeal. But it did not adopt any of the routes to recovery which Shell had urged. The essence of the reasoning of the Court of Appeal was that provided that the trustee is joined to the action then the beneficiary of the trust can recover all of those consequential losses which only the beneficiary suffered.

The reason why the Court of Appeal reached this conclusion was essentially that the court did not consider that equitable title should be treated any differently from legal title. For instance, the court said (at 102 [142]) that '[we] *would be prepared to hold that a duty of care is owed to a beneficial owner of property (just as much as to a legal owner of property)...*'

The Court of Appeal said '*it would be a triumph of form over substance to deny a remedy to the beneficial owner of that property when the legal owner is a bare trustee for that beneficial owner*' (103 [143]).

And the most revealing passage of all: '*On the face of things, it is legalistic to deny Shell a right to recovery...It is, after all, Shell who is (along with [the other beneficiaries]) the "real" owner, the "legal" owner being little more than a bare trustee of the pipeline.*'

'Legalistic' is an unfortunate term to use as a vituperative epithet. It ought to be a term of pride. It is what lawyers do. The antonym of 'legalistic' is 'anarchistic'. More fundamentally, there are difficulties with the conception that the beneficiary under a trust is the "real" owner; the legal owner being a weaker counterfeit.

One difficulty with the reasoning of the Court of Appeal is that there is an apparent inconsistency with an earlier decision of the Court of Appeal in *MCC Proceeds Inc v Lehman Brothers International (Europe)*.⁹

⁸ [1947] AC 265.

⁹ [1998] 4 All ER 675.

In that case, the Court of Appeal held that a beneficiary under a trust could not sue a third party for conversion of bearer shares. The claim for the tort of conversion lay only with the trustee. Hobhouse LJ explained¹⁰ that the prohibition on such a claim by a person with an equitable interest "*is not a quirk of history... Equitable rights are of a different character*" from legal rights.

Apart from precedent, the most fundamental issue raised by *Shell v Total* was the Court of Appeal's conception of a trust. It is a conception which is not uncommon. But it does not stand up to close scrutiny.

The reasoning of the Court of Appeal was essentially that at the heart of the common law lies a monstrous contradiction. The common law and equity are both looking at the same bundle of rights but reach fundamentally different, and opposing, conclusions. The common law sees one person as the owner. Equity sees another.

Perhaps the most brilliant proponent of this flawed view was the late Brian Simpson. After an immaculate description of the history of the trust, A W B Simpson in *An Introduction to the History of Land Law* (1961) 194 says that '*the Chancellors modelled the incidents of equitable ownership upon the common law*'. Simpson then continues, suggesting that:

'the Chancellors refused to copy the more unjust and indefensible doctrines of the common law; for example no conveyance of an equitable interest could have a tortious operation. Here there was nothing to recommend the common law rule, which offended against the principle nemo dat quod non habet; it was in fact an archaic survival of the pre-eminence attached to seisin in the medieval law. The Chancellors refused to perpetuate this archaism in the new field of trust estates.'

There are conceptual difficulties with the notion of a beneficiary as 'owning' the trust asset, in apparent competition with the legal 'owner'. Some of these are well canvassed in a recent article by Professors McFarlane and Stevens.¹¹ To give just a few examples:

- a. If the beneficiary were the equitable 'owner' and the trustee were the legal 'owner' then both ought to be able to sue a third party for torts committed in relation to the trust assets. The same should also be true of a sub-trust, and a sub-sub-trust. The liability of a tortfeasor could be multiplied simply by the unilateral creation of a trust and sub-trust and so on. A similar point was made by Viscount Cave in *Performing Right Society Ltd v London Theatre of Varieties Ltd*.¹²

¹⁰ [1998] 4 All ER 675, 701.

¹¹ B McFarlane and R Stevens 'The Nature of Equitable Property' (2010) 4 JOE 1. There remain difficulties with the formulation of McFarlane and Stevens, particularly in relation to the formulation of the beneficiary's interest as a 'right to the trustee's right' but those are not material to this paper.

¹² [1924] AC 1, 14.

- b. If the beneficiary were the equitable owner and the trustee were the legal owner then rules of private international law would make no sense. Those rules provide that courts cannot adjudicate questions of title to foreign land, but that the courts can adjudicate on questions of equitable rights under a trust: see *Penn v Lord Baltimore*,¹³ *Webb v Webb*.¹⁴
- c. Perhaps the most fundamental difficulty of speaking of a beneficiary under a trust as an equitable 'owner' of the trust assets is that personal rights can be held on trust as well as property rights. Indeed, most modern commercial trusts are comprised of personal rights. Consider a trust which comprises of 'money'. The trust asset held by the trustee is a personal right, a debt, (usually) against a bank. It is a nonsense to speak of the trustee 'owning' the debt. It is even more of a nonsense to speak of the beneficiary, unknown to the trustee, owning the debt which is owed to the bank. As Cotton and Lindley LJJ said in *Lister & Co v Stubbs*¹⁵ in a context considered later in this paper, this confuses ownership with obligation.
- d. Flowing from (c), we can see errors in reasoning which can be caused by the notion that equitable rights are of the same nature as legal ownership. One obvious error is that the common law ought to be able to adapt its rules to protect legal rights in the same way as equitable rights. One manifestation of this confusion is the decision in *Trustee of the Property of FC Jones & Sons v Jones*.¹⁶ In that case, the English Court of Appeal was concerned with a debt which a bank had owed to its customer, Mrs Jones. The rights of Mrs Jones were disputed, as a result of issues relating to what was said to be common law tracing. The bank interpleaded and the Court of Appeal concluded that the money was not owed by the bank to Mrs Jones but was, in fact, owed by the bank to the trustee in bankruptcy of Mr Jones' partnership. One may wonder how a bank can promise to pay money to Mrs Jones, yet turn out to owe the money to someone entirely different?¹⁷
- e. Conversely, errors in reasoning are also invited by the notion that equitable rights ought to be treated in the same way as legal rights. In *International Factors Ltd v Rodriguez*¹⁸ the English Court of Appeal held that a person with 'equitable title to goods' could sue for conversion because '*since the fusion of law and equity that is sound law*' (359). That conclusion was later soundly rejected by the Court of

¹³ (1750) 1 Ves Sen 444; 27 ER 1132.

¹⁴ [1994] QB 696.

¹⁵ (1890) 45 Ch D 1, 12, 15.

¹⁶ [1997] Ch 159.

¹⁷ Even in relation to equitable assignment of debts, the need for joinder of the legal right-holder is a substantive requirement which reflects the fact that the legal relationship is between the creditor and the legal right-holder.

¹⁸ [1979] QB 351.

Appeal in *MCC Proceeds Inc v Lehman Brothers International (Europe)*.¹⁹

The fundamental point is that the interest of the beneficiary under a trust is not a right to the trust asset itself. It is an interest which relates to the *rights* which the trustee holds. For this reason:

- a. The first and second United States Restatements of the Law of Trusts, s2, focus on the nature of the trust as concerned with the duties of the trustee in relation to his or her rights: '*subjecting the person by whom the property is held to equitable duties to deal with the property for the benefit of another person*'.
- b. The definition of a trust in the *Indian Trusts Act* 1882, s3, perhaps the only comprehensive statutory definition of a trust, describes the trustee's duties and the beneficiary's interest as 'annexed' to the trustee's ownership of the trust property: '*A "trust" is an obligation annexed to the ownership of property, and arising out of a confidence reposed in and accepted by the owner, or declared and accepted by him, for the benefit of another, or of another and the owner*'.
- c. In *The Law of Trusts in New South Wales* (1961) p 7, Jacobs also focuses upon the trustee's duties in relation to the trust rights he or she holds, describing the trust as existing when the 'holder of a legal or equitable interest in certain property is bound by an equitable obligation to hold his interest in that property not for his own exclusive benefit but for the benefit...of another person or persons...'. Unfortunately, years later, as a Justice of the High Court of Australia, Jacobs J saw 'no difficulty' in describing a trust as involving a beneficiary as '*the beneficial owner of the estate of which the vendor is the legal owner*': *Chang v Registrar of Titles*.²⁰
- d. Finally, by far the best, and clearest, description of the trust was that given by F W Maitland, in his lectures at Cambridge²¹

"Equity did not say that the cestui que trust was the owner of the land, it said that the trustee was the owner of the land, but added that he was bound to hold the land for the benefit of the cestui que trust. There was no conflict here. Had there been a conflict here the Judicature Act would have abolished the whole law of trusts.[²²] Common law says that A is the owner, equity says that B is the owner, but equity is to prevail, therefore B is the owner and A has no right or duty of any sort or kind in or about the land. Of course the Judicature Act has not acted in this way; it has left the law of trusts just where it stood,

¹⁹ [1998] 4 All ER 675.

²⁰ [1976] HCA 1; (1976) 137 CLR 177, 190.

²¹ FW Maitland, *Equity - A Course of Lectures* (2nd ed, 1936) 17.

²² Section 25 of the Judicature Act 1873 provides as follows: 'Generally in all matters not hereinbefore particularly mentioned, in which there is any conflict or variance between the rules of equity and the rules of the common law with reference to the same matter, the rules of equity shall prevail'.

because it found no conflict, no variance even, between the rules of the common law and the rules of equity."

This approach to understanding a beneficiary's interest as involving an interest which relates to the rights that the trustee holds, rather than being an interest in the trust assets themselves has also gained significant academic support in recent years.²³

Not only is the conception of a beneficiary having an interest in the trust asset itself potentially inconsistent with a significant body of opinion in this area of law, there are also real conceptual difficulties with this approach. For instance, suppose a trustee (T) holds a debt (a personal right) on trust for a beneficiary. What does it mean to say that the beneficiary has a property right in the *debt itself*? The debtor may not even know of the existence of the trust. He may know only that he owes money to T. Further, at common law the notion of a property right in an asset itself is usually taken to mean a right to prevent others from interfering with the asset. So, a person who trespasses on my land, or damages my goods, will be strictly liable for interference with my property right to the thing itself. But a third party who 'interferes' with a debt which is held on trust will not be liable unless the third party's involvement amounts to knowing assistance in a breach of trust. It is, at the very best, awkward to speak of the beneficiary having property rights in a debt itself.

McFarlane has described the rights of the beneficiary as "persistent rights"²⁴ in order to differentiate them very clearly from common law property rights, but also to explain that the rights of the beneficiary are not merely personal rights. As McFarlane has explained, the special nature of a beneficiary's rights are that they are not merely personal rights, but nor are they rights to the asset itself. The nature of those rights, as he explains them, is that they are rights in relation to the trustee's rights (whatever the trustee's rights might be). This is why the beneficiaries rights under a trust are the same nature whether the trust asset is a right to an intangible (a debt, shares) or a right to a tangible thing (land, chattels). It is also why many of the descriptions of a beneficiary's rights have focused on those rights being 'annexed' to the trust property rather than rights in the trust property itself.

I do not consider that there is necessarily any danger in using the label "proprietary" to describe a beneficiary's rights under a trust. Most lawyers recognise that the word "property" is like the word "love". It is used in a number of different senses. But it is essential not to forget that when we speak of "equitable proprietary right" or "equitable ownership" we are using those terms in a different sense from the sense in which they are used at common law. That is the point which was neglected in *Shell v Total*.

So, to come back to *Shell v Total*, a difficulty with the reasons given for the decision is that the Court of Appeal treat the beneficiary of a trust as having a

²³ A Burrows *The Law of Restitution* (3rd edn); R Chambers "Constructive Trusts in Canada" (1999) Alberta L Rev 173; L Smith, "Unravelling Proprietary Restitution" (2004) 40 CBLJ 317; B McFarlane and R Stevens "The Nature of Equitable Property" (2010) 4 Journal of Equity 1.

²⁴ B McFarlane *The Structure of Property Law* (2008) 364.

right in relation to the trust asset itself, as if the right were the same as a legal property right. That is an assumption which I suggest must be considered very cautiously.

Issue 2: When do trusts arise?

In the vast majority of cases the answer to this question is quite simple. Most trusts arise by declaration. They arise because the settlor manifested an intention to create a trust. The intention is an intention which is objectively manifested. It is not a subjective intention. Very recently, Heydon and Crennan JJ summarised the English and Australian authority in relation to declarations of trust in *Byrnes v Kendle*²⁵ and explained at [114] that:

'the "intention" referred to is an intention to be extracted from the words used, not a subjective intention which may have existed but which cannot be extracted from those words. This is as true of unilateral declarations of alleged trust as it is of bilateral covenants to create an alleged trust. It is as true of alleged trusts which are not wholly in writing as it is of alleged trusts which are wholly in writing. In relation to alleged trusts which are not wholly in writing, the need to draw inferences from circumstances in construing the terms of conversations may in practice widen the extent of the inquiry, but it does not alter its nature.'

Of course, difficulties may arise in relation to declared trusts. One common example of difficulties in this area concerns declared trusts which do not comply with formalities either *inter vivos* or *post mortem*. But my focus is not on the detail of trusts which are declared. I want to consider the question raised by a recent case involving trusts which arise in the absence of declaration.

As is well known, and as Holdsworth explains, since 1676²⁶ the express, or declared, trust has not exhausted the category of trusts. Trusts have historically been divided into express trusts, resulting (implied) trusts, and constructive trusts.²⁷

Trusts which arise in the absence of a declaration of trust are usually described as 'constructive trusts'. On one view, a resulting (or, sometimes unfortunately named an 'implied') trust is another type of trust which arises in the absence of a declaration of trust, but my focus here is on constructive trusts.

The immediate difficulty with the language of 'constructive trust' is that it is the language of fiction. Professor Lon Fuller said of the use of the term 'constructive' that ' "*Constructive fraud*", "*constructive trust*", "*constructive possession*", "*constructive intent*" ...these expressions stand out like ugly scars in the language of the law, the linguistic wounds of discarded make-believes.'²⁸

²⁵ [2011] HCA 26.

²⁶ Holdsworth does not refer to the event in 1676 but it is the decision in *Cook v Fountain* (1676) 3 Swans 585.

²⁷ See W Holdsworth *A History of English Law* (1924) vol V, p 304.

²⁸ *Legal Fictions* (1967).

Many older cases referred to a 'constructive trust' in a fictitious sense. The most prominent example was in the context of claims for knowing assistance in a breach of trust. A knowing assister was described as a 'constructive trustee' even if the knowing assister did not have any assets which were to be held on trust: see for example *Re Montagu's Settlement Trusts*.²⁹ The cases were not recognising a trust at all. The phrase 'constructive trust' was shorthand for 'liability to account in equity as if the defendant were a trustee.'

It is now well recognised that these so-called 'constructive trusts' are not trusts at all. Clarity first came from Mr Justice Ungood-Thomas.³⁰ The lesson was reinforced in England but for the repetition of the point by Lord Millett in a series of cases.³¹ And in *Giumelli v Giumelli*,³² the same point was emphasised by Gleeson CJ, McHugh, Gummow and Callinan JJ:

'some constructive trusts create or recognise no proprietary interest. Rather there is the imposition of a personal liability to account in the same manner as that of an express trustee. An example of a constructive trust in this sense is the imposition of personal liability upon one "who dishonestly procures or assists in a breach of trust or fiduciary obligation" by a trustee or other fiduciary.' (footnote omitted).³

However, there remains a large collection of unrelated situations where a constructive trust is awarded and the order is for a genuine trust over particular rights. It is not merely for a defendant to account personally as if the defendant were a trustee. Some of these situations involve difficulties of understanding the basis for the trust.

One example is *Re Rose*.³³ In that case, on 30 March 1943, Mr Rose executed two transfers of shares as gifts. The shares were registered as transferred on 30 June 1943. Mr Rose died several years later. The law concerning death duty had the effect that if the transfers had occurred on 30 March 1943 then they would not be taxed. If the transfers had occurred on 30 June 1943 then they would be taxed. The question under the *Customs and Inland Revenue Act 1889* was whether:

"property taken under gift, whenever made, of which property bona fide possession and enjoyment shall not have been assumed by the donee immediately upon the gift and thenceforward retained, to the entire exclusion of the donor, or of any benefit to him by contract or otherwise."

²⁹ [1987] Ch 264, 276.

³⁰ *Selangor United Rubber Estates Ltd v Cradock (No 3)*[1968] 1 WLR 1555 (Ch D) at 1582; [1968] 2 All ER 1073 at 1097 (Ungood-Thomas J): "*formula for equitable relief*".

³¹ *Paragon Finance Plc v DB Thakerar* [1999] 1 All ER 400 at 409 (Millett LJ) and *Dubai Aluminium Co Ltd v Salaam*, [2002] UKHL 48; [2003] 2 AC 366 at 404 [142]: '[T]he expressions "constructive trust" and "constructive trustee" create a trap... I think that we should now discard the words "accountable as constructive trustee" in this context and substitute the words "accountable in equity"'

³² [1999] HCA 10; 196 CLR 101 at [4].

³³ [1952] Ch 499.

Unsurprisingly, the Crown argued that the transfers did not operate as a gift until 30 June 1943. Alternatively, the Crown submitted that possession and enjoyment of the shares had not been obtained by the donees until 30 June 1943. This argument, at first glance, might have seemed compelling. Until 30 June 1943, any dividends would be paid to Mr Rose. Any voting rights until that date would be exercised by Mr Rose.

The Court of Appeal rejected this argument. The Master of the Rolls, Sir Raymond Evershed, described as "startling" the proposition that Mr Rose could have kept the dividends which had been paid to him prior to the transfer of the shares. I do not understand why such a conclusion is startling. Rather, the contrary conclusion reached by the Court of Appeal seems to raise a considerable number of difficult problems.

- a. No enquiry was made as to whether Mr Rose was aware that shares are not transferred until they are entered in the company register. But one might have thought that this point was obvious since Mr Rose signed a share transfer and sent it back to the company. What if Mr Rose had made the transfer after a dividend had been declared with the intention of receiving the dividend prior to the registration of transfer?
- b. What would happen if Mr Rose had made the transfer several days before intending to vote at a general meeting, aware that the transfer would not be registered until after the general meeting?
- c. Further, even if all the 'enjoyment' and 'benefit' of the shares was that of the donee then how would Mr Rose exercise his right to vote? Could the donee instruct him how to vote? And even if there were a trust, how would this be consistent with the rule against dictation to a trustee?
- d. If the shares were held on trust by Mr Rose for the donees then what happens if the private company refused to register the donees, as it was empowered to do in certain circumstances? Could it be enjoined to do so? Even counsel for Mr Rose's estate, Mr Pennycuick QC (as his Lordship then was) stepped back from this proposition.
- e. Perhaps the most important power of a sole beneficiary under an express trust is the power which the beneficiary usually has to call for the immediate transfer of the legal title: *Saunders v Vautier*.³⁴ But that power is plainly empty in the case of Mr Rose's donees. If the donees sought to exercise their *Saunders v Vautier* power, there is nothing more that Mr Rose could have done to attempt to transfer the shares to them.

The Court of Appeal did not deal with any of these points. The Master of the Rolls concluded that Mr Rose "was, by the necessary effect of his own deed, a trustee of

³⁴ (1841) Cr & Ph 240; 41 ER 482.

that legal estate". Alternatively, both his Lordship and Jenkins LJ (Morris LJ agreeing with both) held that there was a complete gift vis-à-vis the donee, although not vis-à-vis the company.

The Court of Appeal decision in *Re Rose* has been followed on a number of occasions in England and Australia. It has become an established proposition that when a settlor has done everything which the settlor, and only the settlor, can do to make a gift then a trust arises. In this respect, the Master of the Rolls in *Re Rose* had exploited an ambiguity in the reasoning in *Milroy v Lord*.³⁵ It was unclear whether in that case, Turner LJ had insisted that there was "no equity to perfect an imperfect gift" because the donor had not done everything in his or her power to complete the gift or because the transfer was not complete. The Master of the Rolls adopted the former view, and courts in Australia have taken the same approach: *Anning v Anning*,³⁶ *Corin v Patton*,³⁷ *Gardiner v Chief Commissioner of State Revenue*.³⁸

There is an unresolved difficulty with this reasoning. In *Milroy v Lord*,³⁹ Turner LJ had also focused upon the intentions of the settlor: if the gift was intended to take effect as a transfer then a trust would not be created. It may be, therefore, that *Re Rose* could be understood as just turning upon a particularly robust finding of fact, namely that the "necessary effect" of Mr Rose's conduct was to manifest an intention to create a trust. But the question does not seem to be one of construction of intention. Rather it has become a rule of law that when everything is done to effect a gift then a trust arises, even if the gift has not yet taken effect and even if a trust was not intended.

In England, the reasoning has been taken even further. In *Pennington v Waine*,⁴⁰ Arden LJ (Schiemann LJ agreeing) held that in some circumstances, even if the settlor had *not* done everything necessary to perfect a gift then a trust will arise if it is unconscionable not to recognise one.

The challenge in these cases, therefore, is to articulate why the trust is arising. It appears that it is not arising because the settlor manifested any intention to create it. In fact, it is possible that the trust may arise even if the settlor positively manifested an intention that it should *not* arise. Most recently in *Curtis & Ors v Pulbrook & Ors*,⁴¹ Briggs J remarked that he had no "*great comfort that the existing rules about the circumstances when equity will and will not perfect an apparently imperfect gift of shares serve any clearly identifiable or rational policy objective.*"

I should add that I am not necessarily advocating a wholesale abolition of this area of law. This doctrine has considerable roots. It is also very closely related to other well recognised areas where a trust arises independently of the manifested intention of the parties, such as upon a specifically enforceable agreement for sale: *Lysaght v*

³⁵ (1862) 4 De G F & J 264 at 274; 45 ER 1185 at 1189.

³⁶ (1907) 4 CLR 1049.

³⁷ (1990) 169 CLR 540.

³⁸ (2004) 59 NSWLR 549, [32].

³⁹ (1862) 4 De G F & J 264 at 274-275; 45 ER 1185 at 1189-1190.

⁴⁰ [2002] 1 WLR 2075.

⁴¹ [2011] EWHC 167 (Ch).

Edwards.⁴² In those cases it has long been thought that the vendor holds the asset on trust for the purchaser, pending completion. This is so even though the vendor has manifested an intention to make a sale, not to create a trust. The vendor usually intends to complete the sale at a later point in time. She does not intend to create an immediate trust.

Nevertheless, it should be noted that although this line of constructive trust cases has deep roots, they are not roots which have always been subject to unquestioned acceptance. In 1872, Lord Westbury rejected the trust as based on an 'improper use of the term' in *Knox v Gye*.⁴³ And in *Rayner v Preston*,⁴⁴ Brett LJ (as Lord Esher MR then was) said that he 'doubt[ed] whether it is a true description of the relation between the parties to say that from the time of the making of the contract, or at any time, one is ever trustee for the other'.

In Australia, the High Court of Australia has rejected the existence of such a trust in the specific performance context. In *Tanwar Enterprises Pty Ltd v Cauchi*,⁴⁵ Gleeson CJ, McHugh, Gummow, Hayne and Heydon JJ said (quoting in part from *Chang v Registrar of Titles*⁴⁶) that

"the analogies drawn over a century ago in Lysaght with the trust and the mortgage are no longer accepted...[w]here there are rights outstanding on both sides, the description of the vendor as a trustee tends to conceal the essentially contractual relationship which, rather than the relationship of trustee and beneficiary, governs the rights and duties of the respective parties."

This excursus into the *Re Rose* constructive trust is by way of background to the difficulties that can confront understanding the jurisprudential foundations of constructive trusts. I mentioned that in *Pennington v Waine*⁴⁷ the Court of Appeal had explained that the foundation of the constructive trust in that case was the concern of equity to prevent unconscionable conduct. In England, this explanation is now said to be the basis for the imposition of all constructive trusts: *De Bruyne v De Bruyne*.⁴⁸

The constructive trust in England has become a fount for judicial discretion. Uncertainty is embraced and lauded. As Edmund Davies LJ said in *Carl-Zeiss Stiftung v Herbert Smith (No 2)*,⁴⁹ 'English law provides no clear and all embracing definition of a constructive trust. Its boundaries have been left perhaps deliberately vague, so as not to restrict the court by technicalities in decide what the justice of a particular case may require.'⁵⁰

⁴² (1876) 2 Ch D 499.

⁴³ (1872) LR 5 HL 656, 675-6.

⁴⁴ (1881) 18 Ch D 1, 11.

⁴⁵ [2003] HCA 57; 217 CLR 315, [53].

⁴⁶ [1976] HCA 1; (1976) 137 CLR 177, 190.

⁴⁷ [2002] 1 WLR 2075.

⁴⁸ [2010] EWCA Civ 519, [2010] 2 FCR 251, [49] (Patten LJ, Sir Paul Kennedy and Thorpe LJ agreeing).

⁴⁹ [1969] 2 Ch 276, 300.

⁵⁰ This sentence is quoted with approval in the opening paragraph of Professor Oakley's *Constructive Trusts* (1997) 1.

In England, the warnings of Lord Nicholls in *Royal Brunei Airlines v Tan*⁵¹ have passed into history. Lord Nicholls had warned as follows:

'Unconscionable is a word of immediate appeal to an equity lawyer. Equity is rooted historically in the concept of the Lord Chancellor, as the keeper of the Royal Conscience, concerning himself with conduct which was contrary to good conscience. It must be recognised, however, that unconscionable is not a word in everyday use by non-lawyers...If unconscionable means no more than dishonesty, then dishonesty is the preferable label. If unconscionable means something different, it must be said that it is not clear what that something different is. Either way, therefore, the term is better avoided in this context.'

In Australia, the views of Lord Nicholls have much more resonance. There is strong resistance to the notion that an abstract concept such as unconscionability should govern the process of reasoning to a conclusion about when a constructive trust should arise. For instance in *Garcia v National Australia Bank*,⁵² Gaudron, McHugh, Gummow and Hayne JJ, said that 'the statement that enforcement of the transaction would be 'unconscionable' is to characterise the result rather than to identify the reasoning that leads to the application of that description.' In *ACCC v C G Berbatis Holdings Pty Ltd*.⁵³ Gummow and Hayne JJ approved remarks of John McGhee QC that the broad use of terms like unconscionable and unconscientious 'may have masked rather than illuminated the underlying principles at stake.' See also K Hayne 'Letting Justice be Done without the Heavens Falling' (2002) 27 Mon ULR 12 at 16

The most fundamental problem with the use of 'unconscionability' as a substantive justification for a conclusion is that this methodology is contrary to the rule of law. It conceals reasoning rather than revealing it. It inclines the judge to instance-specific decision making. It abhors comparison or analogy.

In *Perre v Apand*,⁵⁴ McHugh J powerfully made the following remarks (repeated in his dissent in *Mann v Carnell*⁵⁵), quoting from Lord Devlin's extrajudicial writing:

'But attractive as concepts of fairness and justice may be in appellate courts, in law reform commissions, in the academy and among legislators, in many cases they are of little use, if they are of any use at all, to the practitioners and trial judges who must apply the law to concrete facts arising from real life activities. While the training and background of judges may lead them to agree as to what is fair or just in many cases, there are just as many cases where using such concepts as the criteria for duty would mean that "each judge would have a distinct tribunal in his own breast, the decisions of which would be as irregular and uncertain and various as the minds and tempers of mankind."

⁵¹ [1995] 2 AC 378, 392.

⁵² (1998) 194 CLR 395, 409.

⁵³ (2003) 214 CLR 51, 73.

⁵⁴ (1999) 198 CLR 180, 211-212.

⁵⁵ [1999] HCA 66; (1999) 201 CLR 1, 41 [130].

Furthermore, when legislatures and courts formulate legal criteria by reference to indeterminate terms such as "fair", "just", "just and equitable" and "unconscionable", they inevitably extend the range of admissible evidentiary materials. Cases then take longer, are more expensive to try, and, because of the indeterminacy of such terms, settlement of cases is more difficult, practitioners often having widely differing views as to the result of cases if they are litigated. Bright line rules may be less than perfect because they are under-inclusive, but my impression is that most people who have been or are engaged in day-to-day practice of the law at the trial or advising stage prefer rules to indeterminate standards.⁷

Against that lengthy background I come to the important recent English decision concerning a different category of constructive trust, namely *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd*.⁵⁶ The decision in *Sinclair Investments* focused very heavily upon the advice given by the Board of the Privy Council in *Attorney General v Reid*.⁵⁷

In *Attorney General v Reid*, a corrupt prosecutor in Hong Kong received bribes to obstruct prosecutions and invested some of those bribes in properties in New Zealand. The properties appreciated in value. The Crown asserted that the properties were held for it on constructive trust so that a caveat could be lodged on the basis of the breach of fiduciary duty by its employee, Reid. Lord Templeman, delivering the advice of the Privy Council on appeal from New Zealand, upheld the caveat and allowed the constructive trust, essentially because 'he is not allowed by any means to make a profit out of a breach of duty' (331).

At the time it was decided in 1994, the decision was heterodox. A well known decision of a very strong Court of Appeal had held that in similar circumstances no trust could arise. In *Lister & Co v Stubbs*,⁵⁸ Stubbs took secret commissions when he placed orders for his employer, Lister & Co. He bought a house with the secret commissions. Lister & Co sought an injunction to restrain Stubbs from dealing with the real estate. The Court of Appeal considered that Lister & Co needed a proprietary right in relation to the real estate in order to obtain an injunction. The Court rejected the claim by Lister & Co that the property was held on trust for them. As Lindley LJ said, the relationship between the corrupt fiduciary Stubbs and his principal, Lister & Co, was a relationship of debtor and creditor. It was not a relationship of trustee and beneficiary.⁵⁹

Lister v Stubbs did not stand alone. In *Metropolitan Bank v Heiron*,⁶⁰ in which Cotton LJ had sat a decade earlier, a director of a company had received a bribe and was being sued by the company. He succeeded in a limitation defence because the

⁵⁶ [2011] EWCA Civ 347.

⁵⁷ [1994] 1 AC 324.

⁵⁸ (1890) 45 Ch D 1.

⁵⁹ (1890) 45 Ch D 1, 15. There is one aspect of *Lister v Stubbs* which is decidedly odd and that is the remark by Cotton LJ (at 12-13) that a trust might still be decreed at the moment of judgment by the court, in its discretion (see also Stirling J at first instance, 10-11).

⁶⁰ (1880) 5 Ex D 319.

company could not treat the bribe "as the money of the company".⁶¹ James LJ emphasised that the obligation to disgorge the bribe was 'a debt only differing from ordinary debts in the fact that it is merely equitable'.⁶²

Another reason why the decision of the Privy Council was heterodox was because it was contrary to House of Lords authority. As Professor Watts has observed, the ratio decidendi of *Tyrell v Bank of London*⁶³ was that a trust does not arise as a remedy for breach of fiduciary duty. See P Watts 'Constructive Trusts and Insolvency' (2010) 3 Journal of Equity 250.

There was also an answer to the conundrum posed by Lord Templeman, which did not require a trust to be imposed. There was no reason why Mr Reid should not have been ordered to account for the profits from his wrongdoing. An account and disgorgement of profits is a wholly orthodox remedy for breach of fiduciary duty. Although an account and disgorgement of profits is usually concerned with the profits immediately received by a wrongdoer, there is no reason why it could not extend to subsequent, and further profits made provided that those profits are causally related and not too remote.

The only other strand to the reasoning in *Reid* derived from an article written by Sir Peter Millett ([1993] RLR 7) which had been an extrajudicial address rushed into print by the editor of the Restitution Law Review. Sir Peter had argued that the reason why a trust must be imposed in cases involving breach of fiduciary duty was because equity insists on treating the fiduciary as if he had acted properly: 'treating [the bribe] as a legitimate payment intended for the benefit of the principal'. As Lord Millett, he repeated, and elaborated upon, these arguments extrajudicially.⁶⁴

One difficulty with Lord Millett's reasoning is that it may involve a fiction. If the fiduciary had been acting properly he would not have taken the bribe in the first place. It seems that the argument requires the fiduciary to be treated 'as if' he had behaved legitimately betrays the fiction. The words 'as if', are the hallmarks of fictitious reasoning: *Haskins v Commonwealth of Australia*;⁶⁵ *Re Macks*; *Ex parte Saint*.⁶⁶

In short, neither authority nor principle necessarily compelled the Privy Council to award a constructive trust in *Reid*.

Then came the decision last year of the Court of Appeal of England and Wales in *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd*.⁶⁷ *Sinclair* involved one of a number of Ponzi schemes which are currently dominating the English commercial courts. In *Sinclair* a company called TPL had received money from "high net worth" investors for trading. TPL was controlled by its director, Mr Cushnie. In breach of his fiduciary duties to TPL, Mr Cushnie transferred that money

⁶¹ *Metropolitan Bank v Heiron* (1880) 5 Ex D 319, 319, 324, 325.

⁶² *Metropolitan Bank v Heiron* (1880) 5 Ex D 319, 323.

⁶³ (1862) 10 HL Cas 26.

⁶⁴ P Millett 'Proprietary Restitution' in S Degeling and J Edelman *Equity in Commercial Law* (2005) chapter 12.

⁶⁵ [2011] HCA 28, [95] (Heydon J).

⁶⁶ [2000] HCA 62; (2000) 204 CLR 158, 203 [115] (McHugh J).

⁶⁷ [2011] EWCA Civ 347.

to another company, VGP, and used it to inflate VGP's share price fraudulently. Mr Cushnie then sold his shares in VGP for approximately £29 million. Mr Cushnie was hopelessly insolvent. And this was the least of his problems. One question was whether £29 million, acquired in breach of fiduciary duty, was held on constructive trust for TPL.

The Court of Appeal declined to follow *Reid*. Lord Neuberger MR delivered a lengthy judgment with which Richards LJ and Hughes LJ agreed. He made the point that *Reid* was not supported by authority, rather the opposite.⁶⁸ He made the point that the reasoning of Lord Templeman was question-begging.⁶⁹ He made the point that an account and disgorgement of profits could have been ordered in *Reid* but that there had been no argument to that effect in the case.⁷⁰ He made the point of principle that '*a bribe paid to a fiduciary could not possibly be said to be an asset which the fiduciary was under a duty to take for the beneficiary*'.⁷¹ He referred to academic criticism of *Reid*, including by Professors Birks, Goode, Virgo, Burrows, Tettenborn, Watts and McCormack⁷² albeit recognising that others support the decision.⁷³ And he explained that Lord Templeman may have given insufficient weight to the potentially unfair consequences to the interests of creditors.⁷⁴

The decision in *Sinclair* was immediately applied by Newey J in *Cadogan Petroleum plc v Tolley*,⁷⁵ over ingenious attempts by Mr Richard Morgan QC to distinguish it. Unless the asset over which the trust is sought was originally held on trust, or unless it is a substitute for an asset originally held on trust, then a claim for a constructive trust arising from a breach of fiduciary duty has no prospect of success in England.

The purpose of this exposition on constructive trusts has not been to support *Reid* or to oppose it. My purpose is simply to warn of the dangers of too readily recognising a constructive trust, an imposition of a trust as a matter of law, without a clear principled foundation.

In Australian law, the path is not yet clear. In *Chan v Zacharia*,⁷⁶ Deane J said that a fiduciary holds any benefit obtained from breach of fiduciary duty as constructive trustee. But did his Honour mean a constructive trustee in the fictional sense described above (at [...]) as 'a liability to account as if the recipient *were* a trustee?'

There have been a number of first instance decisions in Australia which have followed *Reid* or approved it in *obiter dicta*. For instance *Zobory v Commissioner of*

⁶⁸ *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd* [2011] EWCA Civ 347, [77].

⁶⁹ *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd* [2011] EWCA Civ 347, [78].

⁷⁰ *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd* [2011] EWCA Civ 347, [79].

⁷¹ *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd* [2011] EWCA Civ 347, [80].

⁷² *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd* [2011] EWCA Civ 347, [81].

⁷³ *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd* [2011] EWCA Civ 347, [82].

⁷⁴ *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd* [2011] EWCA Civ 347, [83].

In the last point, it might be said that the interests of creditors is a *consequence* of a finding that a trust exists (which could predate insolvency). The existence of an insolvency regime is based upon pre-existing entitlements, it should not be a factor in determining those entitlements.

⁷⁵ [2011] EWHC 2286 (Ch).

⁷⁶ (1984) 154 CLR 178, 198.

Taxation;⁷⁷ *Mainland Holdings Ltd v Szady*;⁷⁸ *Western Areas Exploration Pty Ltd v Streeter [No 3]*;⁷⁹ *Jones (as trustee of the property of Macneil-Brown, a bankrupt) v Southalland Bourke Pty Ltd*.⁸⁰

On the other hand, the learned editors of *Jacobs Law of Trusts in Australia* (7th edn) refer to a number of Australian decisions which refer, approvingly,⁸¹ to *Lister v Stubbs*, but they rightly point out that the matter is not settled in Australia. They support the ‘robust’ decision in *Reid*.

Although the status of *Reid* in Australia might not be firmly secure, an appellate court considering whether to apply the case in Australia will need to examine whether the imposition of a trust for breach of fiduciary duty can be justified. The reason for this is the decision in *Bathurst City Council v PWC Properties Pty Ltd*,⁸² where Gaudron, McHugh, Gummow, Hayne and Callinan JJ said:

‘before the court imposes a constructive trust as a remedy, it should first decide whether, having regard to the issues in the litigation, there are other means available to quell the controversy. An equitable remedy which falls short of the imposition of a trust may assist in avoiding a result whereby the plaintiff gains a beneficial proprietary interest which gives an unfair priority over other equally deserving creditors of the defendant.’

Conclusion

This paper is not a plea for major reform or change to the law of trusts, although the two decisions I have discussed will have very significant effects on the law of trusts and Australian courts will need to consider the issues raised by these cases very carefully before they are followed.

In relation to the first issue, this paper is a plea that we should not neglect a focus on the nature of the interest of a beneficiary under a trust. That difficulty is not resolved simply by verbal formulae such as “equitable owner” or “equitable proprietary right” which sometimes invite a direct comparison with common law notions of property without consideration of how the equitable interest might differ.

In relation to the second issue, namely trusts imposed as a matter of law, the modest argument of this paper is really just to ask that we do not forget the words of Lord Nottingham, in the *fons et origo* of the constructive and resulting trusts, *Cook v Fountain*:⁸³

⁷⁷ (1995) 64 FCR 86 (Burchett J).

⁷⁸ [2002] NSWSC 699 (Gzell J).

⁷⁹ (2009) 234 FLR 265; [2009] WASC 213 (E M Heenan J).

⁸⁰ [2004] FCA 539 (Crennan J).

⁸¹ At 274.

⁸² [1998] HCA 59; 195 CLR 56, [42].

⁸³ (1696) 3 Swans 585, 591.

'The law never implies, the Court never presumes a trust, but in case of absolute necessity. The reason of this rule is sacred; for if the Chancery do once take liberty to construe a trust by implication of law, or to presume a trust unnecessarily, a way is open to the Lord Chancellor to construe or presume any man in England out of his estate.'

Lord Nottingham drafted the *Statute of Frauds* 1677. He was responsible, for better or worse, for our classification today of trusts as express, constructive and resulting. This statement of Lord Nottingham (who sat in *Cook* with the two Chief Justices) would have been lost forever, were it not for the ingenuity of Swanston in 1827, who took it from Lord Nottingham's manuscript and published it as an appendix to his reports. It is now one of the most commonly cited paragraphs in trusts texts, and one of the most commonly forgotten principles.