

## PART V — EXPRESS TRUSTS

### I Introduction

#### A The Nature of the Express Private Trust

A trust is an equitable obligation — that is, an obligation enforceable in a court of equity — which attaches to a person called a 'trustee'. The nature of that obligation is that the trustee must manage property on behalf of one or more other parties — collectively, the 'beneficiaries'.

The trust is a mechanism for separating legal and beneficial ownership. Property held on trust is owned in law by the trustee, but in equity by the beneficiary. Thus, the trustee has legal title. The beneficiary has equitable title. The trustee manages and maintains the property. The beneficiary uses or enjoys the property.

The settlor is the person who initially establishes the trust. Trust obligations are created when a trustee accepts legal title in the subject property by a trust deed created by the settlor.

Although a trust is described as an object of equity, it is not a legal person and does not 'itself' hold property. Instead, title to the property is vested in the trustee, subject to the equitable obligation that it be held *for the use and enjoyment of the beneficiary or beneficiaries*. Either trustee or beneficiary may be physical (real) or legal (corporate) personalities, and there can be multiple trustees, beneficiaries or both. In short:

*A trust is an **obligation** enforceable in a court of equity resting on a person, **the trustee**, who holds legal title to **property** and who must **manage** the property for the benefit of another person, **the beneficiary**, or for **legally-approved purposes**.*

Management of property involves more than merely preserving it for the beneficiary's use; it entails positive duties, such as investment and care. The final part of this definition refers to the fact that a trust may exist either for the benefit of a person, the beneficiary, or for certain legally-approved purposes (charitable purposes).

#### B Contextualisation

##### 1 The trustee–beneficiary relationship

The relationship between trustee and beneficiary is the archetypal fiduciary relation. A trustee owes a duty to account for the trust property. A trustee must not profit without authorisation from their position, and must not bring about a situation of conflict, or a sensible possibility of conflict.

Several additional duties also attach to trustees; these go beyond the traditional fiduciary duties. Such duties mainly relate to the trustee's obligation to hold the property on trust for the beneficiary. For a complete description of trustees' duties, see below Part VII.

Patrick Parkinson argues that trusts are better conceptualised as a species of obligation rather than as a form of property ownership.<sup>1</sup> Consequently, it is incorrect to think of trusts 'always in

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<sup>1</sup> Patrick Parkinson, 'Reconceptualising the Express Trust' (2002) *Cambridge Law Journal* 657, 659.

terms of legal and equitable ownership.<sup>2</sup> Thinking of trusts as obligations rather than proprietary rights also affords the advantage of clarifying the status of the *Quistclose* trust (below). Where traditional analyses face great difficulty in articulating the precise location of the beneficial and legal interests, it is more naturally understood as an equitable limitation imposed upon the use of money by a borrower upon terms.

According to this 'obligation' view of trusts, equity enlists the aid of concepts of an equitable interest when it is necessary in order to preserve its doctrines. Equitable interests under a trust are 'the result of a doctrinally-driven movement which impresses new rights ... under the mandate of the controlled conscience of equity.'<sup>3</sup> Equitable rights are the embodiment of obligations of conscience.

Parkinson goes on to argue that equitable proprietary rights are commensurate with the relief available for the enforcement of equitable obligations. Although perhaps doctrinally accurate, such a statement is unhelpful for its circularity — in short, an unhelpful truism of equity. Nonetheless, the remainder of this Part deals with interests under trusts in terms of equitable obligations, viz, to account, undertake duties, and the like.

## 2 Creation of the relationship

Express trusts arise when a person, the settlor, actually intends to create a relationship that amounts to a trust, and expresses such an intention in a manner and for persons or purposes recognised by equity, and with sufficient certainty to be enforceable.

These requirements may be contrasted with those for resulting and constructive trusts, which can arise otherwise than by intention.

## 3 Legal and beneficial interests

A trustee is said to hold the legal interest in the trust's subject matter. Each beneficiary holds an equitable interest in that portion of the property to which he or she is or will be entitled.

The legal interest is enforceable against all the world — that is, any third party who attempts to interfere with the trust property. By contrast, an equitable interest is enforceable against all but a *bona fide* purchaser of the trust property for value without notice of the beneficiaries' interests. Such a purchaser would acquire good legal title to the trust property, and any former beneficiaries' title would be extinguished. (However, in such a case, the beneficiary would likely have a remedy against the trustee for breach of its duties of trusteeship.)

## 4 Trusts and powers

If trust is an obligation, power is a discretion. A distinction must be drawn between the obligations imposed upon a trustee by a trust and the discretions conferred by a power. If a trust document creates trust obligations, the trustee *will be bound* to carry them out in accordance with its terms. If, however, what is created is a discretionary power, the trustee can *at his or her option* carry it out in accordance with the document's terms.

Many trusts contain both trust obligations and discretionary powers (more accurately, 'mere powers'). Equity regulates the exercise of both trusts and powers. That is, once a trustee has

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<sup>2</sup> Ibid 663.

<sup>3</sup> Kevin Gray, 'Equitable Property' (1994) 47 *Current Legal Problems* 157, 165.

decided to exercise their discretion under a power, a court of equity will enforce the due administration of that discretion just as it would enforce a trustee's obligations.

For example, legislation requires that all superannuation policies in Australia be held on trust for their beneficiaries. The trustee of such policies is under a duty to apply the funds to the beneficiary at the relevant time — a trust duty. There is also a 'power' to pay money to an injured employee, or to their family if they die — a discretionary power. A trustee is not *obliged* to exercise a discretionary power, but must not do so (or fail to do so) in breach of its equitable duties.

## 5 Trusts and inheritance: terminology

The vocabulary of inheritance law is apt to mislead. Although often confusing and arcane, it does follow a certain quaint logic. Some basic terms are set out below:

- **Will:** a testamentary disposition bequeathing or devising certain property to other parties, to become theirs upon the death of the testator or testatrix;
- **Testator:** a male author of a will;
- **Testatrix:** a female author of a will;
- **Deceased estate:** the sum of the property left behind by a deceased party, whether subject to a will or not;
- **Intestate:** a deceased person who died without a will;
- **Executor:** where a deceased dies with a will, an executor is appointed, who must apply the estate's property according to the will's terms;
- **Administrator:** the party appointed to apply the estate's property according to primogeniture rules where the deceased died intestate;
- **Primogeniture:** certain statutory formula specifying a default distribution of property to the next of kin (spouses, children, parents, *et cetera*);
- **Partial intestacy:** where certain provisions in a will are invalid, leaving the invalid part to be distributed under a residuary clause, or, absent that, according to primogeniture;
- **Residuary clause:** a disposition in a will specifying the residuary legatee;
- **Residuary legatee or taker in default:** synonyms for 'residuary beneficiary'; and
- **Residuary beneficiary:** the person or purpose to or for which leftover property in the estate is to be applied after all the distributions validly provided for under a will have been made by the executor.

## C Types of Express Trust

In most cases, a person (the settlor) will transfer property to the trustee, who holds that property on trust for the beneficiaries (or for particular purposes).

The settlor is the person who initially establishes the trust. The equitable obligation is imposed upon the trustee once the transfer is complete. It requires the trustee to hold for the beneficiaries (or specified objects). In general, the beneficiaries or purposes for whom or for which the trustee holds the property on trust, respectively, are termed the 'objects' of the trust.

There are many permutations on this theme — the identity and number of the trustees, dual roles (beneficiaries who are also trustees, settlors also trustees), companies as trustees, shareholders of such a company, *et cetera*. In general, however, there are three types of express disposition.

### 1 *Fixed trusts*

Under a fixed trust, the trustee is obliged to distribute the trust property without discretion as to how, as regards the beneficiaries. That is, the trustee *must* distribute the property, and the beneficiaries *must* receive their specified proportions.

The point at which property is distributed to beneficiaries is commonly termed 'vesting day', since that is the point at which title in the property finally vests in the beneficiaries under a trust.

### 2 *Discretionary trusts*

The trustee must distribute the trust property, but has discretion as to how it is distributed amongst a group of beneficiaries (ie, to whom it shall be delivered and in what proportions). Thus, for example, the trustee might decide to give a greater share to those beneficiaries whom in its view are more deserving.

### 3 *Mere powers*

A mere power simply *permits* the trustee to make a distribution. A narrower subset of duties attaches to the trustee, but they are not obliged to distribute to the beneficiaries at all. Instead, the trustee can choose whether and how to distribute the assets. For example, the trustee might wait until a certain point, then disburse some portion of the trust property, or may decide not to distribute it at all.

A trustee cannot simply rule out distribution under a mere power and keep the property for himself. Rather, the trustee must turn his or her mind to its exercise. Even if the trustee eventually decides not to distribute, property would not be retained by the trustee. Instead, it returns to the taker in default or, in the case of an *inter vivos* trust, to the settlor.

## D *Attributes of Express Trusts*

In addition to being fixed trusts, discretionary trusts or mere powers, an express trust can be classified in any of the following ways.

### 1 *Testamentary or inter vivos?*

A testamentary trust arises on the death of the settlor, whereas an *inter vivos* trust is made between living persons at the time property vests in the trustee.

### 2 *Written or oral?*

Subject to certain formality requirements, a trust may be created by written (for example, a trust deed) or oral agreement.

### 3 *Unascertained or ascertained beneficiaries?*

Where a trust is expressed to be for a class or group of beneficiaries, individuals are not specifically delimited and the trust is for an unascertained object. To be valid, trusts must be sufficiently certain; typically, this will entail being for ascertained or ascertainable beneficiaries.

#### 4 *Conditional or inevitable?*

A beneficiary may be expressed as receiving his or her share only upon eventuation of a certain event. For example, a child may be entitled to his share upon attaining the age of 21. In this case, the child's share is said to be *conditional* upon his attaining the age of 21, since he will not receive anything unless and until he attains that age.

If a precondition to disbursement never occurs — for example, if the child dies before reaching the age of 21 — the trust property results to the taker in default (some person expressed to be entitled to the remainder of the property after all possible distributions are made).

### E *Interests of Beneficiaries*

#### 1 *Fixed trusts*

If the trust proportions are fixed, beneficiaries have equitable proprietary interests in trust assets even before they are distributed. This is because the trustee *must* distribute the property in proportion to the beneficiary's share, without discretion to vary that share or to withhold distribution.

Such a beneficiary also holds an equitable chose in action. This is a personal claim to the due administration of the trust estate. For example, if the trustee is investing imprudently or otherwise dealing with trust property improperly, the beneficiary can complain to a court.

The beneficiary can deal with their interest as they would any other equitable property right. For example, they may assign or otherwise alienate it. In essence, the fixed interest entitles the beneficiary to sell or transfer their share even before receiving it.

#### 2 *Discretionary trusts*

The beneficiary of a discretionary trust does not have an equitable proprietary interest in the trust property until it is distributed. This is because the amount, if any, that such a beneficiary receives under the trust depends on the discretion of the trustee. The beneficiary may not even receive any interest at all — as where the trustee simply decides to favour the other beneficiaries.

#### 3 *Mere powers*

For similar reasons, the beneficiary of a mere power cannot have an equitable proprietary interest in the trust property.

However, a mere trustee cannot decide to simply not distribute the property at all and keep it all for themselves. If this happened, the property would be appointed to a taker in default. Such a person would receive all the property, or any amount of it that remains after a partial distribution.

If no taker in default has been specified, the property returns to the settlor. If the settlor is dead, the property defaults back to their estate.

It is sometimes difficult to determine whether a clause should be construed as giving rise to a mere power or a discretionary trust. This may be problematic where the beneficiaries are seeking to compel distribution, but the taker in default is the trustee.

## F      *Obligations of Beneficiaries*

The beneficiaries cannot dictate to the trustees how they should operate the trust. However, in some circumstances beneficiaries can elect to put an end to the trust and thereby compel vesting. This will be possible where all the beneficiaries are ascertained, of full age and capacity, and in agreement to end the trust (*Saunders v Vautier*). Distribution in accordance with the trust's terms is the result, even if this undermines the intention of the settlor.

### ***Saunders v Vautier* (1841) UK Ch:**

#### Facts

- A trust is created in a will
- The trustee is to hold some shares on trust for one beneficiary
- When he reaches 25, the beneficiary is to be entitled to the shares and any proceeds
- The beneficiary wants access to this money earlier
- When he reaches 21, he brings an action seeking to dissolve the trust

#### Issue

- Can the beneficiary prematurely dissolve the trust of his own accord?

#### Reasoning

- If the beneficiaries are ascertained, and all (who are legally capable: adults, of sound mind, *et cetera*) agree to put an end to the trust, then, regardless of what is said in the trust deed about termination, this will be the result
- A distribution will then occur, pursuant to a court order about proportions (if there is a dispute)
- However, if a potential beneficiary is not yet in existence (eg, where property is gifted 'to X and Y and any of their children'), this will not be possible and the trust must stay on foot until such time as all beneficiaries exist and are capable of making the decision to dissolve the trust
- Thus, in the above example, X and Y could not compel vesting until either:
  - X and Y had a child, Z, who had reached adult age, and could not have any more children; or
  - The main vesting condition is satisfied

#### Decision

- Early distribution is possible since there is only one beneficiary, who is of sound mind, full legal capacity and seeking dissolution

Settlors employ a variety of mechanisms to prevent the kind of distribution seen in *Saunders v Vautier*. One such method is to add a secondary charitable purpose: the purpose cannot 'agree' to dissolve the trust, so distribution cannot occur until the eventuation of the primary condition.

A second method is to create unascertained beneficiaries, or beneficiaries not likely to be of full age before the primary condition is met. For example, 'to A upon reaching the age of 30, A's children and A's grandchildren, if any' — A's children may be unascertained and, even if they were, could not possibly have reached full age before the primary condition is fulfilled.

### G *Obligations of Settlers*

The settlor cannot modify the terms of the trust after formation unless they have reserved the power to do so. In general, the allocation of power between the settlor, trustees and beneficiaries will remain fixed. Thus, the settlor cannot compel the trustees to modify the distribution if he or she does not agree with their decision.

In practice, settlors rarely grant themselves powers of reservation or reallocation. This is because tax penalties apply to such an arrangement. (Otherwise, a settlor could create a tax deferral mechanism and dissolve it whenever they wished.)

### H *Circumstances of Dispute*

The archetypal express trust challenge revolves around the next of kin attempting to invalidate portions of a testator's will so that the primogeniture formula is applied. Doing so returns property held under the invalid dispositions to the next of kin.

Alternatively, the testator may fail to provide for someone for whom the testator should have provided under the 'Family Provisions' of the *Estates and Probate Act 1958* (Vic), leading to a further challenge by that person or their guardian.

## II History

### A Mediaeval England

In 13<sup>th</sup> century England, a practice developed whereby land was held for the use of another (the feoffor *que use*). Owners of land frequently invoked these arrangements to avoid the payment of feudal dues (such as death duties), which became payable upon death. By holding beneficially under a use, they were not deemed the owner at law and no dues were payable.

Another reason for the development of the mediaeval use was to permit greater control over the distribution of assets by inheritance. Very strict rules of succession were normally applied in the absence of a use; so strict were these rules that they often subverted the true intentions of testators. By means of the use, however, a testator could transfer land to a third party for his own use and enjoyment until death, and then for the use and enjoyment of another party, for whose use the third party, heirs and assigns continue to hold.

The Lord Chancellor eventually came to enforce the use as a matter of conscience. This saw the emergence of an obligation enforceable in a court of equity (ie, the Court of Chancery or Star Chamber) to recognise the entitlements of the feoffor *que use* notwithstanding that legal title was held by another. In effect, the third party holder of legal title was bound to uphold the rights of the feoffor *que use*, creating a rudimentary form of trustee–beneficiary relationship.

### B The Statute of Uses

By the 16<sup>th</sup> century, the use had developed to the point where feudal dues payable to the reigning monarch were being significantly eroded. To prevent this affront to his Majesty's rule, the King passed the *Statute of Uses 1535 (Imp)*, which effectively abolished the use. However, renaissance lawyers quickly circumvented this by creating uses upon uses. Because the legislation only applied to first-level uses, the second holding was effective to avoid feudal dues. For historical reasons, this mechanism became known as a trust.

Trusts continued to be used to circumvent strict common law rules. Sometimes this benefited minorities or historically disadvantaged groups (for example, children, women), as by retaining property after marriage or permitting more specific direction of property after death, bypassing the typically patriarchal primogeniture rules.

However, one study suggests that trusts were not actually used to correct social inequalities. More women were able to inherit property according to the default primogeniture rules (eg, because there was no son), rather than by effecting a wilful disposition under a trust. This suggests that settlors more frequently disposed of property to sons or more distant male relatives when given the choice, than to daughters. Whatever the reasons, it does not appear that the development of the trust substantially influenced the content of this choice.

### C Modern Trusts

Surprisingly, trusts today are used for much the same purposes. Intergenerational wealth transfer is still a common feature among modern trusts, as is the supervision of dependents by way of stipends and allowances. Similarly, asset protection and preservation feature prominently as purposes of modern trusts. To these uses have been added investment, governance and superannuation — all common applications of trust law.



By far the most common usage of trusts, however, continues to be the avoidance or minimisation of the modern incarnation of feudal dues — taxation. Having regard to the perennial manifestations of human greed, this is far from surprising.

It seems trite to describe trusts as the single greatest invention of equity. More interesting are the many varied uses to which the equitable mechanism has since been put. These are dealt with as follows.

### 1 *Granting access to property*

If Bob wants to share property with his partner, Jane, Bob can establish a trust in which they are both beneficiaries. Trusts also enable parties to share bank accounts and other divisible assets (*Paul v Constance*). The advantage of trusts (as distinct from a purely contractual mechanism) is that they afford the flexibility of specifying to whom access should be granted and in what proportions, and the further protections provided by trustees' duties and proprietary remedies against breaching trustees.

### 2 *Guarding against bankruptcy*

If Bob is carrying on a risky enterprise, he can create a trust in favour of himself and appoint Jane as trustee. Jane holds legal title to Bob's assets, but Bob is still entitled to use and enjoyment of the property he accrues. This may be by way of a short-term (eg, monthly) allowance, or some form of licence to remain on the property. By holding assets in the third party, Bob can insulate his assets from creditors in the event that he becomes insolvent — upon failure of the enterprise, for example.

More generally, trusts can be used to protect beneficiaries from their creditors. For example, if A wants to give money to B, who is likely to go bankrupt, but does not want B's creditors to get the money in the event of bankruptcy, A can use a discretionary trust to effect the transfer: because the trust is discretionary, B will not have an equitable interest (cf a fixed trust) until distribution, and A will retain legal title in the property. Consequently, until distribution, B's creditors will not be entitled to the assets. If B does become bankrupt, A can simply choose not to distribute the money, or to distribute it to another beneficiary, such as B's partner or sibling, who will commonly be beneficiaries of the trust alongside B.

Alternatively, A could pay a fixed income to a principal beneficiary, B, until the beneficiary dies or a prescribed event occurs (such as bankruptcy, or a danger thereof). If that event happens, then a second set of dispositions comes into effect: usually, to apply the income for the maintenance or benefit of the principal beneficiary and his family (see s 39 of the *Trustee Act 1958* (Vic)). This statutory instrument legitimates the tactic of giving full control of the money to the principal beneficiary until it looks like they will become bankrupt, at which point, the interest determines, and it turns into a discretionary trust; the trustee may then provide money for their maintenance in small increments (so as to minimise loss to B's creditors) for them or their family.

Naturally, these defensive uses of trusts exist in tension with statutory provisions designed to protect creditors (bankruptcy laws). Note, for example, the 'clawback provisions' included in many jurisdictions' bankruptcy laws. These enable a transaction creating a trust to be undone if bankruptcy occurs within six months of that event. Thus, if an individual finds themselves facing imminent bankruptcy, they cannot simply hide away their assets by way of sale to a trusted friend for nominal consideration, to be held on discretionary trust for them. (The cynic might say that at least some forward planning is required.)

If there is a dishonest intention (eg, to defraud the creditors), such transactions might even be undone within two years of bankruptcy. The longer the period, the more difficult it is to undo a transaction. To reverse a trust created five years before bankruptcy would require a threshold of dishonesty verging on criminal fraud.

### 3 Subscribed investments

Bob can subscribe to a unit trust offered by Managed Investments Pty Ltd, thereby accruing returns on a wide portfolio of investments.

Historically, unit trusts were used to invest in a way that minimises the taxation liability of the individual investors. Fractions of the beneficial interest in property, called units, were offered for subscription to the public. The holders of the units were then issued with unit certificates — evidence that they held a fractional interest in the property. These units could be traded, sold and bought, and would entitle the holder to a share of the profits from their investment in proportion to the quantum of their subscription.

Today, unit trusts are used less for tax minimisation than for general investment and asset management. Unit trusts can hold land, shares and other interests. Unit trusts that hold shares are known as equity trusts. Unit trusts that hold land are called property trusts. Unit trusts that hold cash are known as cash management trusts. If the subject matter is the carrying on of a business (including its assets), the unit trust is called a trading trust.

All of these unit trusts are flexible investment transfer mechanisms. They are flexible because they allow individuals to hold a fraction of a large number of property interests, and to deal with their unit independently of the investments themselves. For example, the unit trust may hold many billions of dollars of assets in multiple properties throughout multiple countries; yet each unit entitles the subscriber to a fractional interest in every one of those properties. This allows investors to diversify their investment interests. Units can also be traded, bought and sold.

The basic structure of a unit trust is property held by trustees. In most jurisdictions, disclosure requirements similar to those that apply to the issue of shares apply to trustees of unit trusts. The aim of these requirements is to protect investors against negligent or improper use of the funds.

### 4 Furtherance of charitable causes

In each of the above cases, the trusts are made for people — be they joint beneficiaries, individuals, subscribers or shareholders. However, a trust can also be for purposes rather than people. This enables trust property to be applied in favour of any number of individuals, providing the disbursements are consistent with some founding purpose or objective.

Because of the scope for abuse created by purpose trusts, equity places restrictions on the kinds of purposes that will be recognised. Specifically, a valid purpose trust must normally be for 'charitable' purposes. There are four heads of charity:

- Advancement of religion;
- Advancement of education;
- Relief of poverty; and
- Other purposes beneficial to the community (an unusual, *ad hoc* category construed largely by analogy to the *Charitable Uses Act 1603* (Imp)).

Trusts for charitable purposes, to be valid, must also pass the 'public benefit' test, meaning that they must benefit the public (as distinct from some private group, such as a family). Trusts for the relief of poverty are always assumed to be for the public benefit.

If a purposive trust is declared for a non-charitable purpose (among others), it will be wholly invalid, subject to exceptions. Any purpose having a political component is automatically disqualified from being charitable. The validity of trusts for charitable purposes is just another advantage — alongside tax relief and other concessions — that attach to charities.

### 5 *Conducting trust accounts*

Solicitors who hold money on behalf of clients — for example, property settlements, compensation and other payments into and out of court — must hold it in a trust account. A great deal of money is held in trust accounts.

Historically, solicitors also acted as bankers. In this capacity, they would often take client money and lend it to others on interest. Sometimes it was lost — as where the mortgagor defaulted on loan repayments and sale of the charged assets was insufficient to satisfy the debt. For this reason, from the 19<sup>th</sup> century onwards, solicitors were obliged to hold client money on trust for the client and not to use it as they please or for security.

Since then, trust account regulations have only become more onerous. Today, strict operational requirements are imposed by statutory instruments in each Australian jurisdiction. They deal with defalcation and audits, among other things, and aim to minimise fraudulent and negligent misappropriation of client funds.

### 6 *Intergenerational wealth transfer*

The trust is the primary mechanism by which family wealth is preserved and passed on from one generation to another. Family trusts will often be established for the maintenance and disbursement of family assets, or formed in wills to bequeath property to others. The latter category of trusts is known as the testamentary trust.

Testamentary trusts are formed under wills, and are frequently used to leave assets to minors, gamblers, untrustworthy, disabled or mentally ill heirs. The testator will appoint his or her executor to be trustee of those trusts and either deliver up the money at the relevant time (eg, 'upon attaining the age of 21'), or provide a regular flow of income to the beneficiary. Such an executor performs their trust role under the guise of trustee, rather than executor.

### 7 *Taxation minimisation*

Because income received by a discretionary trust will only be taxed upon distribution and receipt by its beneficiaries, using a trust allows income to be spread across multiple individuals. This maximises the exploitation of the tax free threshold, and reduces the amount subject to higher or marginal brackets of taxation. This strategy is commonly referred to as 'income splitting'.

Alternatively, trusts can be used to defer payment of taxes. Income may be stored in a trust until one or more of the beneficiaries' incomes fall into a lower bracket of taxation. Income may be partially distributed to optimise each beneficiary's taxable income. In this manner, a company or individual may defer income until a financial year in which it either earns less or can demonstrate greater deductions. This strategy is known as 'income deferral'. In practice, a combination of these two strategies is deployed to minimise taxation.

There are significant ethical issues associated with taxation minimisation: if the tax law requires income over a certain amount to be taxed at a given rate, many argue that it should be paid at that rate, and not minimised using artificial separation or deferral techniques. Trusts also

disproportionately assist the wealthy to minimise their liability, without assisting those in lower brackets. Traditionally it is the wealthy who know about and have the means to exploit trust law for their benefit. The reality of tax avoidance by the rich has led some commentators to argue that tax relief ought to take place at lower brackets so as to benefit the poor more directly.

Penalty tax rates apply to distributions to minors. Thus, for example, a family trust cannot spread income over its children. (It is arguable that allowing children to be used as tax buffers would encourage further population growth in Australia. However, this is a somewhat distasteful proposition.)

## 8 Commercial trust deeds

Commercial trusts invent the notion of an ‘appointer’. This allows a party to dismiss and appoint new trustees.

The settled sum concerned by the deed is often small. This is to avoid stamp duty, which is payable only on assets held by the trust at its creation. For this reason, trusts are often created with respect to a nominal settled sum (eg, \$10). Although surprising, this makes sense when considered in its taxation context. Assets are transferred to the trust later by way of alienation, which does not attract a transaction tax.

Limitation of liability clauses are common, with the effect of excusing the trustee from civil liability unless dishonest or aware that they are committing a breach of trust. Some case law suggests that not all liability may be excluded: fraudulent breaches, it would seem, will always attract liability.

The settlor in a trust deed is usually someone unrelated to the trustee or beneficiary. This is a nominal settlor only (the real settlor may be the family head, or the company). This is because taxation may be payable on any benefit the settlor receives under the trust.

Distributions are often on paper only. Thus, the *real* settlor may obtain possession of all the trust assets that are distributed, but the paper ‘beneficiaries’ declare it on their taxation returns. The main recipient would claim that the money was still applied *for the benefit* of the other beneficiaries. The other beneficiaries must still declare the ‘on paper’ payment as income.

The trustee is ordinarily given a very large discretion so as to allow the trust to respond to changes in commercial or other circumstances. For example, if one beneficiary earns a lot of income in one year, they would not want to receive a large distribution that year. There is also discretion for the trustee to invest the money in the meantime.

The trustee is usually a company of which the main recipient or recipients are directors.

These practices illustrate that commercial trusts make significant changes to the traditional notions of trust law. Usually this is done to minimise tax. This emphasises that trusts are today mechanisms for achieving a particular result: taxation minimisation (among other things). It highlights the dichotomy between trust law as theorised by courts and trust law as practised by individuals.

### III Requirements for Validity

#### A Introduction

A trust must be validly constituted to be enforceable. Although courts are generally lenient about what will suffice to constitute a trust, several rules govern the creation of express trusts ('the formalities and certainty rules').

Specifically, express trusts will only arise where there is manifested:

- 1 **Compliance with formalities**  
Some dealings with trusts must be evidenced in writing; others may proceed by parol;
- 2 **Certainty of intention**  
The settlor must actually intend to create something that amounts to a trust, and must express such an intention in a manner recognised by equity;
- 3 **Certainty of subject matter**  
The property to be held on trust must be capable of adequate identification, and the settlor must hold title at the time of settlement; and
- 4 **Certainty of objects**  
The trust must be for a sufficiently distinct class of persons, or for certain, recognised purposes, primarily charitable.

To create a trust, property is vested in a party (the trustee) by another (the settlor), accompanied — normally contemporaneously — by a declaration of sufficient certainty and formality that the trustee is to hold the property on behalf of for another (the beneficiary). Such a declaration may need to be in writing, depending on applicable formality requirements.

#### B Formality Requirements

##### 1 Creation of a new express trust

Section 53(1)(b) of the *Property Law Act 1958* (Vic) ('*Property Law Act*') imposes a formality requirement necessary to constitute trusts involving land. This requirement operates in addition to the certainty rules. Namely, such trusts must be manifested and proved in writing:

#### **Property Law Act 1958 (Vic) s 53(1):**

...  
 (b) a declaration of trust respecting any land or any interest therein must be manifested and proved by some writing signed by some person who is able to declare such trust or by his will;  
 ...

Importantly, the drafters used the words 'manifested' and 'proved' in relation to the written declaration. This suggests that a trust can be created in some other medium (eg, orally) and

recorded on paper only later — for example, a diary note. Such a note would, after all, be sufficient to manifest or prove the declaration of the trust.

The manifesting and proving writing must be penned by the settlor, since only they have power to create the trust.

Section 53(1)(b) only regulates the creation of new trusts. It only applies to land. That is, trusts involving only personalty can be created orally. In practical terms, a claimant under such a trust may face difficulty in adducing evidence of its terms with sufficient precision for there to be certainty, but there is no legal bar to doing so.

## 2 Dealings with existing express trusts

Section 53(1)(c) deals with existing trusts. Specifically, it regulates the manner in which beneficiaries under existing trusts may deal with their interests, by requiring them to create the disposition in writing.

### **Property Law Act 1958 (Vic) s 53(1):**

...

- (c) a disposition of an equitable interest or trust subsisting at the time of the disposition must be in writing signed by the person disposing of the same, or by his agent ....

Section 53(1)(c) is not restricted to land: it will apply to any realty or personalty that is currently held on trust. It also differs from paragraph (b) in that the dealing must itself be created in writing — not ratified after the fact by a note in writing. (However, depending on the terms of the note, and if it was signed, it might be argued that the subsequent note was itself sufficient to create the interest arising as a result of the transfer.) The writing requirements are, however, more stringent than in relation to paragraph (b).

For example, suppose that a birthday card is sent from a father, which purports to vest equitable ownership of a car in his son. It is signed, 'love Dad'. Such a card may be argued to create an express trust in the son's favour. The subject matter of that trust do not include realty, so only s 53(1)(c) might apply. If the car is unencumbered and the father's interest is legal, the formalities enquiry ends: no writing is required. However, if the car is already the subject of an existing trust in favour of the father, then the card will be a disposition under s 53(1)(c) and be required to be evidenced in writing. Whether the card is sufficient writing depends on how the Court construes the father's signature. If the signature issue is decided in the son's favour, trust requirements are likely satisfied and the trust will be validly created.

A declaration can be electronic; as, by email.

## 3 Other kinds of trusts

Clearly, the writing requirements do not apply to the creation of resulting, implied or constructive trusts: s 53(2).

#### 4 Rationales for formality requirements

There are two rationales for these requirements. First, they prevent fraud: see, eg, the *Statute of Frauds 1677* (Imp):

##### **Statute of Frauds 1677 (Imp):**

FOR prevention of many Fraudulent Practices which are ... upheld by Perjury ... Bee it enacted by the Kings most excellent Majestie ... and with the advice ... of the Lords ... and the Commons in this present Parlyament ... That from and after the fower and twentyeth day of June which shall be in the year of our Lord one thousand six hundred seventy and seven All

- Leases
- Estates
- Interests of Freehold or
- Termes of yeares or

my uncertaine Interest ... in ... any

- Messuage
- Mannours
- Lands
- Tenements or
- Hereditaments

made or created ... onely or by Parole and not putt in Writeing and signed by the parties ... or their Agents ..., shall have the force and effect of Leases or Estates at Will onely and shall not either in Law or Equity be deemed ... to have any ... greater force or effect, Any consideration for makeing my such Parole Leases or Estates or any former Law or Usage to the contrary notwithstanding. (edited for clarity)

By requiring evidence of a trust, spurious claims from hopeful beneficiaries are prevented. This is especially important for a resource as valuable as land — hence the more stringent requirements applying to the creation of a trust involving realty, as distinct from other kinds of property.

Second, the *Statute of Frauds* (and related formal writing requirements) allow the government to track transactions that give rise to stamp duty. Because stamp duty is payable not on the basis of a transaction, but on the basis of a document creating or evidencing a transaction, the written documents are crucial to ensure full collection of taxation from relevant transactions.

#### 5 Sub trusts

Which provision deals with sub-trusts? For example, if the head trustee, A, holds property on trust for B, the beneficiary, and B decides to dispose of their subsisting equitable interest by creating a sub-trust in favour of C, B will hold their equitable interest on trust for C. Whether this may be described the creation of a new trust or the disposition of an existing one will depend upon the precise terms of the sub-trust. The issue is whether that disposition deals with subsisting interests or new interests. Assuming that the disposition concerns land, potentially either provision may apply.



## C Certainty of Intention

### 1 General principles

Intention refers to the intention of the settlor to create a trust, as distinct from another kind of equitable obligation.

Such an intention may be inferred from words or conduct, but the settlor need neither know about nor specifically use the language of trusts (*Paul v Constance*). The settlor must simply form an intention to create a state of affairs that, in the Court's view, *amounts* in substance (if not in form) to a trust relationship.

#### ***Paul v Constance* (1977) HL:**

##### Facts

- Mr Constance and Ms Paul are involved in a *de facto* relationship
- During the relationship, a bank account is opened in Mr Constance's name
- He wanted to open it in their joint names, but was told this is not allowed because they were not married
- Mr Constance says to his *de facto* partner that it is 'as much [hers] as it was [his]'
- They make joint deposits and joint withdrawals from the account
- Mr Constance dies intestate
- However, he never formally divorced his ex-wife (Mrs Constance), so she inherits the account by operation of primogeniture rules
- Ms Paul argues that, although Mr Constance was the legal owner of the account, she is in part its equitable owner and should therefore have priority over Mrs Paul
  - She argues that Mr Constance created a trust in her favour and held her share for her on trust in equity
- Consequently, that portion of the account is not his in equity to give away under inheritance laws
  - Ms Paul would have a prior equitable interest that would receive priority over Mrs Constance's subsequent equitable interest as heir in default

##### Issue

- Did Mr Constance create a trust in Ms Paul's favour such as to entitle her to equitable ownership of a share of the account?

##### Reasoning

- A formal declaration of trust is not required
  - Thus, Mr Constance did not need to say 'I declare myself trustee'
  - Indeed, he did not even need to know what a trust is
  - All that is required is 'a clear declaration of trust, and that means there must be clear evidence from what is said or done of an intention to create a trust'
- Court: 'these are simple people', but they did have a particular intention vis-à-vis ownership of the account
  - 'Of course, the words which I have just used are stilted lawyers' language, and counsel for the plaintiff was right to remind the court that we are dealing with simple people, unaware of the subtleties of equity, but understanding very well indeed their own domestic situation. It is right that one should consider the various things that were said and done by the plaintiff and Mr Constance during their time together against their own background and in their own circumstances.'



- The basic issue is therefore a question of fact
- The language of Mr Constance is important to indicate this intention
  - Mr Constance ‘was saying, on occasions, that the money was as much the plaintiff’s as his.’
  - Other features in the history of the parties’ relationship supports an interpretation of these statements as a declaration of trust
- The joint deposits and withdrawals are also relevant
  - Putting the shared ‘bingo’ winnings into the account and withdrawing money for the benefit of both of them suggests that a trust was intended
- In light of these circumstances — the use of words and joint transfers ‘on numerous occasions’ — there was an express declaration of trust
  - This declaration arose at “some” stage before Mr Constance’s death, but possibly after the opening of the account
  - On the facts it is unnecessary to achieve greater precision
- Because they held jointly, the Court says that *they hold equally* (half/half)
  - However, the Court also states the Ms Paul is now entitled to half
  - In theory, she should be entitled to the whole by right of survivorship
  - (In equity, joint owners have equal and undivided ownership; when one dies, the other subsumes the whole of the ownership)
  - [The result here is therefore questionable]

#### Decision

- Mr Constance held the account on trust for himself and Ms Paul jointly
- He did so by declaring himself trustee of that account
- He is thus both settlor and trustee, and also one beneficiary
- The Court holds that Ms Paul is entitled to 50 per cent of the account
- However, if the terms of the trust were such as to create joint ownership, Ms Paul ought to have been entitled to 100 per cent and the ex-wife would have no interest at all

In most cases, intention will be obvious — as where, for example, a formal trust deed is created or there are express words to that effect.

In the middle of the spectrum, cases like *Paul v Constance* require the Court to draw an inference from conduct that a trust relationship was intended. Such an inference may be drawn from evidence that suggests joint ownership. In *Paul v Constance* this was the joint deposits and withdrawals, and Mr Constance’s magnanimous words.

However, at the far end of the spectrum lie those borderline cases in which intention is difficult to ascertain because of some special feature of the relationship.

## 2 Contractual promisees and third parties

In *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd* (*‘Trident’*), this special feature was the absence of a direct contractual relationship between the alleged settlor and beneficiary. The issue of intention was resolved by looking at the terms of the contracts indirectly linking the beneficiary–claimant, through the alleged trustee–promisee, to the alleged settlor–promisor. The result of primary importance is that contractual promises may be held on trust for a third party. The consequence of *Trident* is to provide a means of circumventing the operation of the doctrine of privity.

**Trident General Insurance Co Ltd v McNiece Bros Pty Ltd (1988) HCA:**Facts

- Trident, an insurer, promises to provide insurance to an assured for the purpose of carrying on a development project
- The contract purports to apply to the assured and its sub-contractors
- McNiece is a sub-contractor of the assured, and seeks to invoke the policy after a workplace injury
- There is no contract between Trident and McNiece

Issue

- Can McNiece enforce the policy, even though there is no privity of contract?
- Does a trust arise by way of Trident's manifest intention to confer benefits upon McNiece as a third party?

Reasoning

- Deane J:
  - Trust law can be used to circumvent the doctrine of privity
  - The promisee (the assured) can be treated as trustee of the promise made for the benefit of the third party (McNiece)
  - The subject matter of the trust is a contractual promise to benefit the third party
  - The beneficiary of the trust is McNiece
  - The trustee is the assured
  - Obligations therefore arise in equity to enforce the undertaking of the promisor (Trident) to provide insurance to the beneficiary
  - This allows the third party to enforce the promise, making the promisee, if necessary, a second defendant in an action against the promisor
    - [Wouldn't this simply mean that the promisee would be in breach of duty if it failed to bring an action on the contract?]
    - [Would this mean that the promisor is an accessory to a breach of fiduciary duty?]
  - Novel idea: a contractual promise may be held on trust for a third party
    - There is an innate flexibility to the law of trusts to operate in this way
    - [I agree that a trust relationship exists, but disagree as to its effect; it should simply entitle McNiece to sue the assured if the assured fails to commence proceedings enforcing the third party's entitlement]
  - However, (traditional principle) there must be an intention to create a trust
  - This will be so if:
    - There appears an intention that the third party is entitled to insist on the enforcement of the promise; and
    - The trust is the appropriate legal mechanism for giving effect to the intention
  - This requirement will be satisfied if the contract between promisor and promisee expressly *or impliedly* shows an intention that the third party should benefit
    - The contract itself must be examined
    - This is relatively easy in the case of an insurance contract
  - Consequences of trust relationship
    - Promisee can bring an action to obtain damages or specific performance
    - If they refuse to sue, the third party can sue the promisor and *join the promisee* as a second defendant
  - Whose intention is relevant?
    - It is unclear whether it should be the promisor and promisee or the promisee alone

- How can they be distinguished? The contract is the mutual agreement of the parties — an expression of their joint will (it is therefore artificial to separate their intention any further than the document as expressed)
- However, in traditional equitable principles, the settlor creates the trust; the promisee's (trustee's) intention isn't relevant
- Or, maybe the contractual promise (as a chose in action) belongs to the promisee (so that they are the settlor)

#### Decision

- Majority: If the insurance policy evidences an intention that it will apply to subcontractors for the purpose of the policy, then the third parties may sue the insurer in their own right, notwithstanding that there is no privity of contract
- Gaudron J: an insurer who has accepted an obligation to benefit a third party must provide that benefit; otherwise, it would be unjustly enriched

The approach in *Trident* was also referred to with approval by Mason CJ and Dawson J in *Bahr v Nicolay [No 2]*:

*If the inference to be drawn is that the parties intended to create or protect an interest in a third party and the trust relationship is the appropriate means of creating or protecting that interest or of giving effect to that intention, then there is no reason why in a given case an intention to create a trust should not be inferred.*

The more recent decision of Mandie J in *Marks v CCH Australia Ltd* provides further support for the approach of Deane J in *Trident*. Although unavailable on the facts, Mandie J reasoned that a trust relationship could arise between a party who stands to benefit under a contract, though not a party to it, and the promisor who created it.

### ***Marks v CCH Australia Ltd (1999) Vic SC:***

#### Facts

- Mr Bernard Marks is a legal academic in the Faculty of Law at the University of Adelaide
- The University of Melbourne ('the University') contracts with CCH Australia Ltd ('CCH'), a legal publisher, pursuant to which CCH agrees to endow a professorial chair for Marks
- The contract is determinable by the University CCH fails to provide funding
- One of the terms of the contract provides that its existence is itself 'a fundamental term' of Marks' separate contract of employment with the University
- The contract of employment between Marks and the University provides that Marks will hold the chair during the term of the contract between the University and CCH
- Marks leaves his post at the University of Adelaide and travels to Melbourne to occupy the chair at the University of Melbourne
- 10 years elapse
- CCH now notifies the university that it intends to cease funding
- The University accept CCH's repudiation and terminates the contract
- The University also terminates Marks' contract of employment
- Marks seeks an order requiring CCH to continue funding the chair, as well as damages from the University

#### Issue

- Did the University hold CCH's promise to fund the Chair on trust for Marks, such that Marks could sue CCH on its own footing?

Reasoning (Mandie J)

- There will be a trust over the promise if it appears from the language of the parties, construed in the context of the case and including the ‘matrix of circumstances’ that ‘the parties’ did intend a trust to exist
- ‘The relevant intention is the intention of the promisee’ (here, the University)
- Relevant factors:
  - The nature of the transaction
  - Surrounding circumstances
  - Commercial necessity (can lead to an imputed intention)
- Did the University intend the contractual promise by CCH to fund the Chair be held for the benefit of Marks, the third party?
  - No, the University did not so intend
  - The University was only protecting itself, not third parties
    - Eg, the provision entitling the University to terminate the agreement if CCH stops providing funding
  - **[532]** It seems to me that the plaintiff faces considerable difficulty in establishing that the university intended to hold the benefit of CCH’s promises, in particular CCH’s promise to fund the chair, on trust for the plaintiff. The CCH agreement is a formal agreement in writing executed under the common seal of each of the two parties, CCH and the university. The apparent purposes of the agreement, from the point of view of the university, were to secure full funding from CCH for the chair ... (cl 4), to protect the academic independence of the chair (cl 9) and ... to limit the tenure of the chair to the term of the agreement. Importantly, the term of the agreement was circumscribed ... by the express option of the university to terminate the agreement if CCH failed ... to pay the promised funding: cl 7(i). It hardly needs to be stated, therefore, that ... the university’s option to terminate the agreement, if that promise was broken, was for the protection of the university. The express inclusion of that **[533]** option, it seems to me, militates against any inference that the university intended the plaintiff to have the benefit of CCH’s promise.’
  - However, it might be argued that since Marks gave up a tenured position at his former university on the basis of the contract, he expected to benefit from the agreement
- Were the facts different, then arguably a *Trident* (Deane J) analysis could be applied to compel CCH to continue funding the Chair
  - If successful, Marks could have sued CCH directly, or joined the University as a defendant for breach of trust
  - However, on the facts, the relevant intention to hold the benefit of the promise on trust for the third party was absent
  - Consequently no trust exists

Decision

- On the facts, no trust exists because it was not the promisee’s intention to hold CCH’s contractual promises on trust for Marks

Another judgment considering the approach of Deane J in *Trident* is that of Gummow J in *Cambros*. In that case, his Honour also found against the third party on the basis that there was no relevant intention manifested by the primary contract to hold the promise on trust. The author is unaware of any successful applications of *Trident* outside of the insurance context, though from the comments of Mason CJ and Dawson J in *Bahr v Nicolay [No 2]*, such a possibility is certainly open in property law. Nevertheless, it must be conceded that the intrusion of express trusts into

the area of private contract law appears artificial and contrived. It is also apt to fuse law and equity, for better or worse.

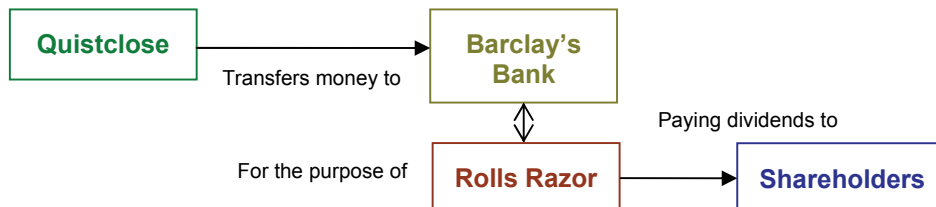
### 3 Loans for specific purposes

In the United Kingdom, there has also been considerable activity in the field of trusts arising from loan agreements. In this context, trusts function as a kind of security for lenders, ensuring that if the borrower defaults the lender has a secured interest against other creditors. A trust is said to arise where a loan agreement specifies certain purposes to which the money loaned must be put. The first case to recognise this approach was *Barclays Bank v Quistclose Investments* ('*Quistclose*'), a case since acknowledged to have created the '*Quistclose* trust'.

#### ***Barclays Bank v Quistclose Investments* (1970) HL:**

##### Facts

- Rolls Razor is a company that seeks to pay a dividend to its shareholders
- However, it needs money to do so, and is suffering financial troubles
- A related company, Quistclose Investments, loans RR the exact amount it needs to pay the dividend; however, the money is loaned for the sole purpose of paying the dividend
  - In a letter accompanying the payment, Quistclose stipulates that the money is to be used exclusively for this purpose
  - The money is transferred by Quistclose into a bank account, specially opened, with Barclay's Bank
  - The Bank has notice of the purpose to which the money is to be applied
- Essentially the situation is as follows:



- Alas, before the dividend can be paid, RR goes bankrupt
- The Bank uses the account money to offset debts in other of RR's accounts
- Quistclose disputes the Bank's right to do this, and seeks the return of its money, the purpose of the loan not having been carried out

##### Issue

- Although it is clear that Quistclose has a personal right to recovery of the loan, this would not place it in a secured position relative to RR's many other creditors
  - Quistclose therefore seeks a secured, proprietary right to return of the money
- Does a trust relationship exist between Quistclose and RR, such as to entitle Quistclose to a proprietary right to compel return of the money from the Bank?

##### Reasoning

- A trust can coexist with a contract
  - The loan from Quistclose to RR creates both contractual and trusteeship obligations
    - In contract, it compels repayment on its terms

- In equity, it specifies RR as holding on trust for the shareholders, or alternatively for Quistclose in default
  - Not every loan contract will create a trust — most of them will leave the money at the free disposal of the mortgagee; however, if a loan agreement specifies the *only* purposes to which the money must be put, then the money will not be at the mortgagee's free disposal, but will instead be held on trust
    - Does this contravene the 'beneficiary principle'?
    - Arguably not: although the operation of the trust relationship is triggered by a purposive restriction on the exercise of a right to dispose of the funds, it remains a trust for the people that are the immediate subject of that right
  - The keyword here is 'only'; it is only if a specific and exhaustive class of certain and particular purposes are specified that an intention to prevent other uses can be inferred
  - Lord Wilberforce: this is an example of the flexible interplay of law and equity (fusion by any other name?)
- RR held the money as trustee for the shareholders ('primary trust')
  - It was not intended that the money ever form part of RR's own assets
  - RR was to hold as trustee only
  - RR cannot use the money for any purpose of its own choosing but must apply it in accordance with the terms of the trust
  - The money is held on trust for persons (shareholders); it can only use the trust for purposes consistent with the trust (ie, payment of dividends thereto)
  - Consequently, the money does not belong to RR and cannot be distributed to its creditors, including the Bank, to satisfy accrued debts
  - This is the primary trust
- The primary trust failed because the shareholders could not be paid after RR became insolvent
  - It is unclear why the trust failed
    - Some commentators have suggested that the relevant stock exchange rules denied the ability of a company in liquidation to pay dividends to its shareholders
    - Others have pointed to clawback provisions in bankruptcy legislation that undid the transactions of an insolvent company — here, the creation of a trust was a voidable preference — ie, a company, about to go into liquidation, expunges its assets to shareholders; this meant that the trust was dissolved and payments to beneficiaries will be prevented
  - Consequently, a secondary trust in favour of Quistclose came into effect ('secondary trust')
  - There was an agreed secondary purpose (return of the money to Quistclose); that, if the first trust fails, the property would result back to Quistclose
  - Is there a possibility of double recovery (ie, recovery of the loan at common law)?
    - Arguably, the interest would still need to be repaid, but the principal figure would be deemed restored
    - However, this is not addressed by the Court
    - It highlights the difficulties created by superimposing equitable trust concepts onto common law loans
- There was an intention to create both the primary and secondary trusts
  - Clearly, not every loan creates a trust
  - Further, the purpose here is not charitable

- Is this the invention of a new purpose trust that is valid?
- It seems more likely that the confusion is linguistic: it is not a trust for purposes, but really a trust for individuals — for the benefit of the shareholders
- The judgments speak in terms of applying the loan money to only certain ‘purposes’; in reality, what is probably meant is that these purposes do little more than give effect to the terms of a trust for persons
- The creation of a special account and the loan of the precise amount suggests an intention to create a trust
- When an express trust fails, the property results back to the settlor (basic principle of equity; see below Part VI)
- However, there are two theories as to how this occurs:
  - (i) The resulting trust back is automatic and inevitable
  - (ii) The second trust is actually another express trust going back to the settlor, and there needs to be an intention to create it
- The difference between these two approaches is probably immaterial, since there will normally be an intention to create a second express trust in circumstances where money is lent for a specified purposes
- However, there might conceivably arise cases where the settlor does not turn their mind to the contingency of failure of the primary purpose; in this situation, only approach (i) would entitle the settlor to return of the money
- [For this reason, approach (i) is arguably preferable as a matter of equity]

#### Decision

- The Bank had actual notice of the trust because there were dealings between Quistclose and the Bank
- Because the Bank had notice of these trusts, it held the money as constructive trustee for Quistclose
- The trust is used as a security device for Quistclose, the lender, without formal documentation beyond the letter (ie, no mortgage)
- The case illustrates that trust and debt can coexist, and provides an example of how flexibly courts deal with trusts

The effect of the *Quistclose* trust is to provide a kind of security device in lieu of property. Lenders are able to lend money to a mortgagee because the trust money itself becomes the security for its own repayment. This is because the lender becomes a beneficiary of the trust and will have a secured interest, allowing it to succeed against unsecured creditors and serving the same function in bankruptcy proceedings as securitised property.

Several issues remain to be discussed as a result of *Quistclose*:

(a) *How do trust and contract law coexist in Quistclose?*

If the purpose for which money is lent is carried out (ie, the dividend is paid), the trust is complete and the lender’s rights become purely contractual. However, if that purpose is not carried out (eg, if the shareholders are not paid for whatever reason), or if — worse — the money is misapplied, then the lender has an equitable interest in the money loaned and can trace that money into the hands of third parties. Thus, contract law comes into its own once the trust is exhausted. Until that time, the lender retains an equitable interest in repayment.



(b) *What is the nature of the Quistclose trust?*

The trust may be classified as either an express or a resulting trust. Under a resulting trust, money *results* (returns) back to the original owner or lender automatically. The prevailing opinion in Australia is that the *Quistclose* trust is a kind of express trust. Such was said by Gummow J in *Re Australian Elizabethan Theatre Trust* (1991), a case decided in the Federal Court of Australia.

This case forms one of two decisions interpreting *Quistclose* in Australia.

***Re Australian Elizabethan Theatre Trust* (1991) FCA:**Facts

- Australian Elizabethan Theatre Trust ('AETT') is an arts umbrella organisation
- It collects donations from the public and distributes the funds to arts organisations
- Donors would gift money to AETT, and would indicate a preference about how their money was to be disbursed (ie, a particular arts purpose)
- Some donors gift money and express a preference that money should go to Opera Australia, Ballet Australia, or the Victorian Tapestry Workshop
- AETT subsequently goes into liquidation with a lot of money in its accounts at the time
- It is argued that the money in the AETT accounts is held on trust for the various arts organisations, such as the Opera, Ballet and Tapestry organisations
- If a trust exists, the specified arts organisations will be entitled to the money as against unsecured creditors of AETT
- (The case does not specifically concern a *Quistclose* trust)

Issue

- Does a trust arise over the money held for disbursement by AETT?

Reasoning

- The donors' 'preference' about disbursement does not satisfy the certainty of intention requirement to create an express trust because there is no requirement for the money to be distributed to those organisations
  - A duty or obligation must be imposed to create an express trust, not a 'preference'
- Several comments are made in *obiter* about the nature of a *Quistclose* trust
- According to Gummow J, the *Quistclose* trust is an express trust with two limbs
  - First limb: pay the dividend to the shareholders
  - Second limb: if first limb fails, repay the money to the lender
- In *Quistclose* itself, the RR's insolvency prevented the first limb from being carried out, meaning that the second limb came into operation and Quistclose became entitled to repayment of the money
  - 'the intention was clear to create the secondary trust for the benefit of the lender, to arise if the primary trust, to pay the dividend, could not be carried out. This characterisation of what occurred is indicative of an express trust with two limbs rather than an express trust in favour of the shareholders and a resulting trust in favour of Quistclose which arose by reason of an incomplete disposition by Quistclose of the whole of its interest in the money lent to Rolls Razor.'
- The *Quistclose* trust, if it exists, must therefore satisfy all the ordinary requirements of the express trust, viz:



- Intention to create the express trust
- However, this is here the mutual intention of the parties, rather than the settlor
- Relevant factors to determining intention:
  - Nature of the parties
  - Nature of the transaction
  - Circumstances of the relationship
- The existence of a *Quistclose* trust does not imply that it is a trust for non-charitable purposes; rather, it is a trust for persons (ie, the shareholders)
  - ‘However, in my view, it would be an error to treat the references by Lord Wilberforce in *Quistclose* ... to “purpose” as characterising an express trust which did not have to satisfy the ordinary requirements for any private (as distinct from public) trust.’
  - ‘The expression “purpose” was apt to describe the end sought to be achieved by the settlor, *Quistclose*, and accepted by the trustee, Rolls Razor. This was formulated in the terms stipulating the conditions upon which the shareholders might take a beneficial interest in the fund. The use of the expression “purpose” should not be read as heralding a new era for the non-charitable purpose trust.’
- Thus, there is nothing new about the *Quistclose* trust — it is just an example of an application of existing principles to a novel environment
  - ‘To speak of a *Quistclose* trust as if it were a new legal institution, rather than an example of the particular operation of principle upon the facts as found, is to set the listener or reader off on a false path. So it is that one sees what in truth are pointless debates in some of the commentaries as to whether a *Quistclose* trust may arise where the money is lent not to pay the borrower’s debts, but to buy equipment ..., or not lend but paid to subscribe for shares...’

#### Decision

- No trust arises
- *Quistclose* trusts are a variety of express trust

However, respectfully, there are several difficulties with Gummow J’s analysis. Primarily, it is not specified precisely what prevents the first limb from being carried out. In *Quistclose*, for example, the bankruptcy did not *per se* prevent distribution of the funds. (There may have been an implied term in the loan agreement that repayment was only necessary in the event that the company was still operating, since the interests of creditors at and after liquidation would have priority over shareholders. However, this is a relatively weak implication: under a trust arrangement, the shareholders clearly have priority.)

There have been other analyses of *Quistclose* trusts in Australia. For example, in many commercial loan agreements, money will be lent for the sole purpose of funding the purchase of property (be it real, as in land, or personal, as in the case of computer or agricultural equipment). The reason for this is that lenders bear a lower risk when funds are applied to property having resale value and likely to improve the value of the mortgagee’s capital. A great deal of this equipment is bought on *Quistclose* terms.

However, purposes such as ‘purchasing equipment’ and the like are not charitable, and not for persons. Consequently, they are in breach of the beneficiary principle, at least as traditionally applied, and notwithstanding that in *Quistclose* the trust was clearly for the benefit of the shareholders as people. For this reason, Lord Millett, writing extracurricularly, has stated that a *Quistclose* trust is not an express trust at all, but rather a resulting trust. (An alternative view may

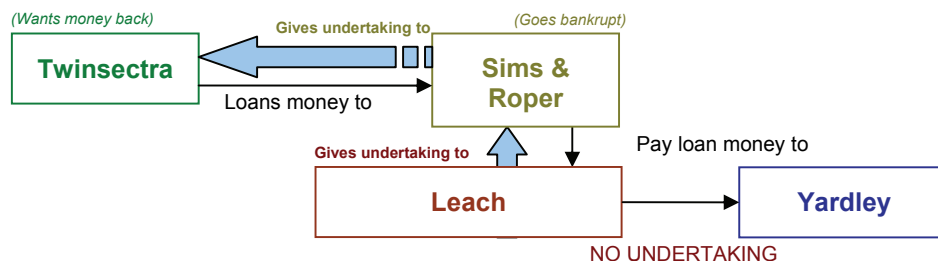
be that the trust is not one for purposes but rather for persons, being indirect beneficiaries. This view has yet to be considered by the courts.)

Lord Millett's view was first aired in *Twinsectra Ltd v Yardley*. The House of Lords there held that a trust arose in favour of a lender from whom money had been borrowed through an intermediary for a specific purpose, and misapplied by that intermediary. Predictably, Lord Millett described this trust as a *Quistclose* trust, the nature of which was a resulting trust owed in favour of the lender, by the intermediary, subject to a power to apply the trust money for the agreed purpose (transfer to the borrower for purchase of the agreed property). The borrower has legal but not equitable title, and the intermediary has equitable but not legal title. Wrongful transfer by the intermediary will render them liable for breach of trust, and possibly also breach of fiduciary duty.

### ***Twinsectra Ltd v Yardley* (2002) HL:**

#### Facts

- A solicitor, Leach, acts for a borrower, Yardley, in financing a loan of £1m from the lender, Twinsectra
- Leach does not deal directly with Twinsectra, but deals with another firm of solicitors, Sims & Roper, which procures the funds from Twinsectra
- In return, Leach gives the following undertaking: 'the loan moneys will be retained by Sims & Roper until such time as they are applied in the acquisition of property on behalf of our client, Yardley. The loan moneys will be utilised solely for the acquisition of property, and for no other purpose. We will repay the amount of the loan with interest.'
- Sims & Roper releases the money to Leach subject to this undertaking
- Contrary to this agreement, Leach releases the money directly to Yardley without receiving any such undertaking from Yardley
  - The chain of receipt is: Twinsectra → Sims & Roper → Leach → Yardley
  - Leach gives the undertaking, but not Yardley



- In fact, property is not purchased with the money, Yardley defaults against Twinsectra, and the loan is unable to be repaid
- Sims & Roper is in breach of trust, having failed to repay the money to Twinsectra as required by the undertaking; however, the firm is insolvent
- Twinsectra argues that the transfer of its money by Leach without receiving an undertaking amounts to dishonest assistance in a breach of trust by the firm

#### Issue

- Is there an express trust such as to strengthen the terms of the loan as against other unsecured creditors?

#### Reasoning (Lord Millett)

- Lord Millett is the only judge to analyse the nature of the trust in this case
  - Lord Millett describes the trust as a *Quistclose* trust

- The money is not at the free disposal of Yardley, and Leach was not supposed to part with the money except for the stated purpose
  - '[184] a loan to a borrower for a specific purpose where the borrower is not free to apply the money for any other purpose gives rise to fiduciary obligations on the part of the borrower which a court of equity will enforce.'
  - '[184] When the money is advanced, the lender acquires a right, enforceable in equity, to ... prevent its application for any other purpose [than the stated purpose]'
  - '[185] A *Quistclose* trust does not necessarily arise merely because money is paid for a particular purpose. ... Commercial life would be impossible if this were not the case. ... The question in every case is whether the parties intended the money to be at the free disposal of the recipient .... His freedom to dispose of the money is necessarily excluded by an arrangement that the money shall be used *exclusively* for the stated purpose' (emphasis in original)
  - '[184] Once the purpose has been carried out, the lender has his normal remedy in debt. If for any reason the purpose cannot be carried out, ... whether the money falls within the general fund of the borrower's assets ... depends on the intention of the parties collected from the terms of the arrangement and the circumstances of the case'
  
- However, the nature of a *Quistclose* trust is not express; it is simply a resulting trust subject to a power
  - The property the subject of a transfer to the intermediary is held on trust, ie on resulting trust for the transferor
  - This process is automatic — there does not need to be any intention to create a resulting trust on the part of the transferor
  - The borrower has a bare legal title to the property, but no equitable interest in it
  - The borrower has a mandate (power or authority) to apply the trust money for the specified purposes (buying the agreed property)
  - This means that the borrower does not obtain full title but holds on resulting trust, subject to a power to use the money for the specified purposes
  - '[190] Insofar as the transfer does not exhaust the entire beneficial interest, the resulting trust is a default trust which fills the gap and leaves no room for any part to be in suspense. An analysis of the *Quistclose* trust as a resulting trust for the transferor with a mandate to the transferee to apply the money for the stated purpose sits comfortably with [this] thesis.'
  - Citing *Barclays Bank plc v Weeks Legg and Dean*, '[192] The function of the undertaking is to prescribe the terms upon which the solicitor receives the money remitted by the bank. Such money is trust money which belongs in equity to the bank but which the solicitor is authorised to disburse in accordance with the terms of the undertaking but not otherwise. Parting with the money otherwise than in accordance with the undertaking constitutes at one and the same time a breach of a contractual undertaking and a breach of the trust on which the money is held.'
  
- It is not a primary trust to the shareholder, such that a resulting trust arises in favour of the transferor after failure of payment to the shareholder
  - Rather, it is a resulting trust directly in favour of the transferor subject to a power to exercise for a purpose (distribution to shareholders)
  - '[192] if the borrower is treated as holding the money on a resulting trust for the lender but with power (or in some cases a duty) to carry out the lender's revocable mandate, and the lender's object in giving the mandate is frustrated, he is entitled to revoke the mandate and demand the return of money which never ceased to be his beneficially.'

- '[193] Like all resulting trusts, the trust in favour of the lender arises when the lender parts with the money on terms which do not exhaust the beneficial interest. It is not a contingent reversionary or future interest. ... It is a default trust which fills the gap when some part of the beneficial interest is undisposed of and prevents it from being "in suspense".'
- On the present facts, Sims & Roper held the money on resulting trust for Twinsectra subject to a power to apply it by way of loan to Yardley in accordance with the undertaking
  - '[184] In the present case the money was paid into Mr Sims' client account ... the money was held in trust [185] for ... Mr Yardley.'
  - '[185] A settlor must, of course, possess the necessary intention to create a trust, but his subjective intentions are irrelevant. If he enters into arrangements which have the effect of creating a trust, it is not necessary that he should appreciate that they do so; it is sufficient that he intends to enter into them.'
  - '[185] Arrangements of this kind are not intended to provide security for repayment of the loan, but to prevent the money from being applied otherwise than in accordance with the lender's wishes.'
  - Here, Mr Sims undertook to use the money '[186] *solely* for the acquisition of property *and for no other purpose*' (emphasis in original)
  - '[186] Any payment by Mr Sims of the money, whether to Mr Yardley or to anyone else, otherwise than for the acquisition of property would constitute a breach of trust.'
  - '[186] It is unconscionable for a man to obtain money on terms as to its application and then disregard the terms on which he received it. Such conduct goes beyond a mere breach of contract.'
- The trust property never becomes part of the assets of the intermediary, who just holds as trustee
  - Thus, a claim against the intermediary cannot be satisfied by the trust money
  - Creditors of the intermediary cannot seize the trust property
  - Similarly, the intermediary becomes liable in equity for breaches of trustees' duties
  - Instead, the equitable interest remains throughout in the lender
- Certainty is not an objection to this analysis of the *Quistclose* trust
  - 'A trust must have certainty of objects. But the only trust is the resulting trust for the lender. The borrower is authorised (or directed) to apply the money for a stated purpose, but this is a mere power and does not constitute a purpose trust. Provided the power is stated with sufficient clarity for the court to be able to determine whether it is still capable of being carried out or whether the money has been misapplied, it is sufficiently certain to be enforced.'
  - 'Uncertainty works in favour of the lender, not the borrower'
- Conclusion as regards the nature of the *Quistclose* trust
  - '[192] As Sherlock Holmes reminded Dr Watson, when you have eliminated the impossible, whatever remains, however improbable, must be the truth. I would reject all the alternative analyses, which I find unconvincing for the reasons I have endeavoured to explain, and hold the *Quistclose* trust to be an entirely orthodox example of the kind of default trust known as a resulting trust.'
  - '[192] The lender pays the money to the borrower [193] by way of loan, but he does not part with the entire beneficial interest in the money, and in so far as he does not it is held on a resulting trust for the lender from the outset. Contrary to the opinion of the Court of Appeal, it is the borrower who has a very limited use

of the money, being obliged to apply it for the stated purpose or return it. He has no beneficial interest in the money, which remains throughout in the lender subject only to the borrower's power or duty to apply the money in accordance with the lender's instructions.'

- '[193] When the purpose fails, the money is returnable to the lender, not under some new trust in his favour which only comes into being on the failure of the purpose, but *because the resulting trust in his favour is no longer subject to any power on the part of the borrower to make use of the money.*' (emphasis added)

#### Decision

- Sims & Roper holds the money on trust for Twinsectra, subject to a power to apply in favour of Yardley
- Note also a possible *Barnes v Addy* knowing assistance claim against Leach, though here he had insufficient knowledge and dishonesty: [28]
  - (Lord Millett dissenting on this point) This is because, at all relevant times, Leach had honestly believed that the undertaking given to Twinsectra through Sims & Roper was none of his concern and that, once in his hands, he could treat the loan money as at the free disposal of the client
- This suggests that a workable strategy may be simply to find a solvent fiduciary through whom the money passed (and who acted dishonestly)
- Note that an apportionment regime may operate to spread responsibility among intermediaries, or between an intermediary and the borrower, where there are multiple breaching parties

It may immediately be observed that the *Quistclose* trust is a commercial arrangement similar to a retention of title clause. It enables a lender to restrict the application of borrowed funds to certain purposes. The money remains the property of the lender 'unless and until' it is so applied. If it cannot be so applied, it must be returned to the lender. According to Lord Millett, failure to apply the funds successfully causes the money to *result* back to the lender. Throughout, the lender retains a beneficial interest in the money, though legal title may pass through an intermediary. The intermediary has a mere power to apply the money for the stated purpose.

Respectfully, there are also several problems with Lord Millett's description of the *Quistclose* trust, though — as his Lordship wryly notes — not nearly as severe as those faced by the other approaches. Perhaps the most serious objection that might be made is that his Lordship effectively rewrites the contract between the parties. In the *Twinsectra* contract, for example, the borrower is expressed as being under a *duty* to purchase the property. However, under the Lord Millett analysis, this becomes a 'power' (mandate) to use the money for that purpose. This is much weaker than a duty. However, his Lordship also states that the borrower may well be under a duty to apply the money, so perhaps this is more a factual disagreement than one in principle.

Treating the *Quistclose* trust as a form of resulting trust enables it to be used for transactions other than charitable in nature. Such purposes do not violate the beneficiary principle, because the trust is not an express trust (the beneficiary principle does not apply to restrict the purposes of resulting trusts).

*Twinsectra* has yet to be considered by an Australian court.

(c) *Countervailing policy issues*

Although the position of *Quistclose* trusts is relatively cemented in Australian equity jurisprudence, there are some reasons against their recognition and enforcement. Some scholars have argued that court should not recognise *Quistclose* trusts in their present form.

Primarily, this is because they lack transparency. Money lent on *Quistclose* terms is not usually identified separately on company accounts. It can give many borrowers an illusion of solvency, when in fact the borrower is or is close to insolvency. There is ambiguity in their assets in that it is unclear whether they are free to apply money as they please. An auditor or potential creditor thinking of lending money to someone in Rolls Razor's position, for example, is unable to correctly ascertain their present financial situation, and risks suffering an injustice caused by mismanagement or (worse) conscious distortion of the borrower's financial position by means of purposive loans that it would not have been able to obtain on a more general basis.

This concern is overstated. Principally, that is because a company could just as well inflate its financial position artificially by means of ordinary unsecured loans, or loans with respect to the same security. Potential creditors would be none the wiser if a company's accounts were bolstered by unregistered loan instruments rather than *Quistclose*-type arrangements. However, at least in the case of a *Quistclose* arrangement, such creditors stand a chance of recovering the amount loaned when insolvency does ensue.

Alternatively, a register of trusts could be created, as has occurred in other jurisdictions. In the United States of America, for example, UCC § 9 requires *Quistclose* trusts to be registered in an externally appraisable register in order to be enforceable against third parties. The relevant statutory requirements are contained in personal property security legislation.

D *Certainty of Subject Matter*

For there to be certainty of subject matter, the trust property must be clearly identified.

Typically, this will mean that the nature and quantum of the property must be ascertained. Property that forms the subject matter of a trust can be real, personal, tangible, intangible, legal or equitable. For example, patents, houses, debts, copyright, choses in action and shares are all valid subjects of a trust. The subject matter must be proprietary rights. For example, a mere licence to occupy land will not be capable of being held on trust.

Although the nature and quantum of the subject matter may change throughout time, at any given point its type and value must be ascertainable. For example, shares held on trust might (strictly in accordance with the terms of settlement) be sold and converted to land, which may in turn be leased (with the remainder retained). At all stages, the property that forms the subject matter of the trust is capable of precise description.

The property must generally be ascertained or in existence at the moment a trust is created. Future property is problematic. However, courts can construe this in a certain way to allow it to form the subject matter of a trust. (Specifically, if consideration has passed to create a contract, the Court will infer it is an agreement to declare a trust of future profit; the agreement will then be specifically enforceable. That is, a specifically enforceable agreement to create future property can lead it to be held on trust.) This confers an equitable interest in the property.

Another cause of failure is if the specific beneficiaries or proportions cannot be ascertained.

## 1 Family trusts

Where the trust is a family trust, it is relatively easy to identify the subject property. However, care must be taken that the terms of the trust specify a precise portion of the property, or at least a portion that is capable of being given sensible meaning by a court (cf *Palmer v Simmonds*).

***Palmer v Simmonds* (1854) UK Ch:**Facts

- The deceased settles his estate on trustees
- The relevant clause in the wills states: ‘the bulk of my residuary estate will be held on trust for one Henrietta Roscoe’

Issue

- Is there sufficient certainty of subject matter?

Reasoning

- The word ‘bulk’ is too uncertain — does it mean 50%, 50.1%, 75%, 90%, or some other amount?
- To use the words ‘bulk of my estate’ renders the trust invalid because it does not have sufficient certainty of subject matter

Decision

- The will fails

The test for certainty of subject matter is objective. However, sometimes courts will be willing to be flexible when dealing with vague language. *Golay* suggests that there is either a trend towards a more liberal interpretation of subject matter or that the clauses being used in wills have become more certain over time.

***Re Golay’s Will Trusts* (1965) HL:**Facts

- Testator directed executors to ‘let Tosci enjoy *one of my apartments* during her lifetime and to receive a *reasonable income* from my other properties’ (emphasis added)

Issue

- Is this subject matter uncertain?

Reasoning

- Once the beneficiary is ascertained (for it was not initially apparent just who ‘Tosci’ was, being unknown, as she was, to the family — this is an issue of certainty of objects, though here unproblematic), the issue becomes one of certainty of subject matter
- The executors can simply select a flat from the estate that they consider to be suitable
- The use of the word ‘reasonable’ in the context of the phrase ‘reasonable income’ is not too vague, since courts often have to determine what is meant by ‘reasonable’
  - For example, in the law of negligence and contracts, courts will frequently need to determine what is ‘reasonable’ in a given context
- Whether the testator’s intention about the word ‘reasonable’ is known is irrelevant



Decision

- No, the will is of sufficiently certain subject matter to be valid

2 *Commercial trusts*

If the trust is created as part of a commercial transaction, determining the subject property can be much more difficult. The intersection between contract law and trusts is increasingly important, especially in the context of retention of title clauses.

Retention of title clauses are most commonly used in situations where a supplier sells a product, say, 'widgets', to a manufacturer, which produces goods which it sells on to a customer. In sale agreements from supplier to manufacturer, a clause is often inserted allowing the supplier to retain title in the raw materials until it has received payment in full. For example:

*X will sell to Y 15 000 widgets but will retain title until payment in full is received by X.*

The retention of title clause is most commonly used when a supplier passes goods onto a buyer, who then on-sells or produces other goods with them. The seller retains title until the agreed point (typically, payment). For example, suppose a supplier, S, sells steel to a buyer, B, who has 30 days in which to pay for them. If B goes into liquidation in the interim period, S will be an unsecured creditor and may not receive full recovery of their unpaid debt. However, if S can create a source of continuing proprietary ownership in the goods, then S will still be the owner of those goods and therefore be a secured creditor. This is the function of such a clause.

This is known as a *Rompala* clause, after the 1976 decision of the English Court of Appeal.

***Rompala (1976) UK CA:***Facts

- Rompala manufactures aluminium foil suitable for use in electronics and other equipment
- A contract is made for the supply of aluminium foil to a manufacturer of products containing such foil
- This contract provides that the foil will remain the property of the supplier, Rompala, until it has been paid in full (what is now a standard reservation of title clause)
- The contract also provides that, if the foil is incorporated into any product by the purchaser, and that product is sold, the purchaser will find itself under a fiduciary duty to account for the proceeds of the sale of the products incorporating the supplier's foil until the supplier has been paid in full
  - This is an example of introducing equitable principles into a commercial contract
- After foil is sold to the manufacturer, Rompala is not paid
- The manufacturer subsequently goes into liquidation, and the liquidator finds on the manufacturer's premises two kinds of property:
  - Unused foil; and
  - Money representing the proceeds of products that had been sold incorporating Rompala's foil
- Rompala seeks to trace into the foil and proceeds and thereby obtain a proprietary remedy that would entitle it to priority over the manufacturer's other creditors

Issue

- Does the supplier have a continuing beneficial interest in the foil and proceeds such as to



entitle it to their recovery?

Decision

- Yes, the supplier has a fiduciary right to be paid the proceeds of sale for the products, and to recover the remaining foil

*Rompala* was controversial because it suggested parties could create their own fiduciary relationships. This stands in marked contrast to the traditional approach, which holds that courts of equity create and impose fiduciary obligations to bind the conscience of the parties.

Since *Rompala*, many courts have exhibited reluctance to uphold retention of title clauses. This has manifested itself as an apparent search for reasons to strike them down or deny that a fiduciary relationship arises. In response, suppliers have been expressing the obligations more directly in the form of trusts. The issue is one of certainty of subject matter.

A trust can consist of future property, such as money that is to be received in the future (*Associated Alloys*).

***Associated Alloys Pty Ltd v ACN 001 452 106 Pty Ltd (2000) FCA:***

Facts

- Associated Alloys ('AA') supplies steel to Metropolitan ('M'), a manufacturer, between 1991 and 1996
- After incorporating the steel into products, Metropolitan sells goods to Lucky Goldstar ('LG') in Hong Kong
- The contract between AA and M contains a *Rompala* clause
  - The clause allows AA, as the seller of property, to retain equitable title in goods until they are paid for in full by M
  - In the proceeds clause, it is provided that any proceeds of sale of any product incorporating the plaintiff's steel shall be held on trust for the plaintiffs ('AA') until they have been paid in full
- Sometimes, however, the buyer will pass on the goods to a third party or assimilate them into some other product, before paying
  - A more complex retention of title clause must be employed
- B uses the goods to create products which it sells for money, losing possession of the goods
- S is attempting to assert property in the goods even once they have been passed on for value to a third party
- There are a number of clauses vesting ownership in S; eg, clause 5:
  - 'In the event that the buyer uses the goods or product in some manufacturing or construction process of its own or some third party, then the buyer shall hold such part of the proceeds of process as relates to the goods or product on trust for the seller; such part shall be equal in dollar terms to the amount owing to the seller at the time of the sale or process'
- M becomes insolvent, but AA has not been paid for its latest steel supplies
- AA demands payment for goods provided but yet to be paid for
- In 1995, the defendant is not able to pay up all the amounts owing to S, and goes into liquidation
- The liquidator discovers bank accounts containing money, including money arising from the sale of goods incorporating AA's steel supplies
- However, it is unclear how much of that money was derived from sale of the steel, and

how much was obtained through other means

- AA brings an action seeking a declaration that it holds an equitable interest in the money held in M's bank accounts pursuant to a trust created in its favour by cl 5

#### Issue

- Is there sufficient certainty of subject matter?

#### Reasoning

- The plaintiffs argue that a trust had been created
  - Clause 5 purports to establish an agreement to constitute a trust of future acquired property (ie, the money from selling steel from B to others)
  - It is acceptable to do this *for value*: as it is, here
  - The subject matter of the trust is *money received from time to time owing but unpaid by the buyer to the seller*
- In principle, such an arrangement is fine
  - The proceeds clause creates a valid trust over (Kirby J dissenting)
  - Kirby J: as a matter of substance and not of form, the agreement created a mortgage and not a trust
    - The proceeds would have been mortgaged rather than held on trust the arrangement, although termed a trust, is more akin to a mortgage
    - Being a mortgage, it should have been registered
    - AA's failure to do so renders it null and void
- It is possible to create a trust over future, as well as present, property
  - This is important because when the trust was established, M had not at that stage sold any products incorporating AA steel
  - Nonetheless, it is possible to have a trust whose subject matter concerns future property
  - The money that a trustee will receive in the future can form the valid subject matter of a trust
  - This is highly commercially significant because it allows assets held under a futures contract to be held on trust
- On the facts, however, the trust is not enforceable in equity
  - This is because the plaintiffs cannot establish as a matter of evidence that the payments received by the buyer were actually related to the purchase of steel supplied by the seller
  - Proceeds of sale of products incorporating the plaintiff's steel from the proceeds of selling other products
  - They needed to establish that:
    - B sold the steel to a third party
    - B had received money
    - That money had been received by B as proceeds of the sale of steel supplied to it by S, such as to activate the clause
  - Moral: be careful to record evidence of the link between money received and the purpose for which it was paid

#### Decision

- No trust existed on the facts

*Associated Alloys* is the latest move in a game of chess between courts and commercial drafters. Retention clauses are of extreme commercial importance to commercial parties. However, the

courts dislike reservation clauses and will find every excuse to strike them down. As a result, drafters invent increasingly complex ways of expressing the equitable entitlements so as to circumvent what has been said by the courts. *Associated Alloys* is unlikely to deter commercial parties from relying on the latest incarnation of the *Rompala* clause — the only difficulty is an evidentiary one.

## D Certainty of Objects

The objects or purposes of a trust must be stated with 'sufficient certainty'. If a trust is established for a purpose, it must be 'charitable'. It is harder to create a valid trust for purposes than for persons. In most cases, the purpose must be charitable, though there are several recognised non-charitable exceptions.

There are thus two bodies of rules regulating certainty of objects:

- **Trusts for charitable purposes**  
These rules specify the scope and permissible aims of charitable purposes ('charitable purpose trusts'); and
- **Trusts for persons**  
These rules prescribe the extent to which trusts for persons must identify the class of entitled beneficiaries ('the certainty rules').

These rules are now taken in turn.

### 1 *The charitable purpose trust*

A charitable purpose trust is a trust whose aim or objective falls within a class of 'charitable purposes' recognised by courts of equity. These purposes are invariably public, rather than private. Charitable purpose trusts are therefore a major vehicle by which wealth is distributed for public purposes. So popular is the charitable trust that they have often been used in substitute to public welfare programmes, with donations encouraged by means of taxation incentives (such as tax deductions).

Most charitable dispositions are testamentary. (Whether the ailing settlor is eager to curry favour in the afterlife or simply develops a charitable bent upon their death bed is unclear.) It is therefore an unhappy though unsurprising reality that the context of most charity litigation is a contest between delighted trustees and devastated next of kin. The testator's next of kin or residuary beneficiaries will usually attempt to claim that the trust is void so that they can receive their inheritance (or, more typically, a larger inheritance).

In other cases, the Commissioner of Taxation will allege that a charity is improperly claiming taxation privileges, and bring action against the charity challenging the trust and seeking payment of taxes owing. Still other cases involve the Attorney-General of the state in which the trust is operated bringing an action against the trustees alleging that they have failed to comply with the trust's purposes.

Because such trusts are for public purposes, only the Attorney-General has standing to challenge their administration. This ensures that the conduct of the charitable purpose trustees is subject to public supervision. The Attorney-General is responsible for enforcing a charitable purpose trust, for assisting in litigation to determine their validity, and for bringing actions against the trustees for breach of duty.

Other benefits accorded to charities in England and Australia are numerous, and include: exemption from income taxation; exemption from gift and death duties (where they exist; less so in Australia); tax deductible donations to charities; relief from council rates; the availability of trusts for charitable purposes; and a lenient approach to construing charitable trusts by courts.

A further concession to the public aims of charitable trusts is the *cy-près doctrine*, which states that if for any reason the stated charitable purpose has failed, the Court may apply the property under a *cy-près* scheme. This is a purpose as near as possible to what the settlor intended.

Two issues chiefly arise in the context of charitable purpose trusts:

- What is the meaning of 'charitable objects'?
- What privileges does being a charity confer?

## 2 What are 'charitable objects'?

In a popular sense, charity is associated with a benevolent public purpose. However, 'benevolent' purposes are not necessarily 'charitable', as was illustrated most disastrously in *Re Diplock*. The legal meaning of 'charitable' is not confined to helping the poor. The proper scope of the term is somewhere in between its strict and social meanings, encompassing various religious, educational and miscellaneous public purposes.

The development of the meaning of 'charitable' was *ad hoc* and largely unprincipled. One source of the definition is the *Statute of Uses 1601* (Imp) ('the *Statute of Elizabeth*'). The legislation did not intend to define 'charitable', merely extending earlier regulations of charitable purpose trusts. In the preamble, it set out a taxonomy of the types of bequests that it was designed to regulate:

### **Statute of Charitable Uses 1601 (Imp):**

#### **Preamble**

An Acte to redresse the Misemployment of Landes Goodes and Stockes of Money heretofore given to Charitable Uses.

Whereas Landes Tenementes Rentes Annuities Profittes Hereditamentes, Goodes Chattels Money and Stockes of Money, have bene heretofore given ... and assigned, as well by the Queenes most excellent Majestie and her moste noble Progenitors, as by sondrie other well disposed persons,

- some for Reliefe of aged impotent and poore people,
- some for Maintenance of sicke and maymed Souldiers and Marriners, Schooles of Learninge, Free Schooles and Schollers in Universities,
- some for Repaire of Bridges Portes Havens Causwaies Churches Seabankes and Highwaies,
- some for Educacion and prefermente of Orphans,
- some for or towards Reliefe Stocke or Maintenance of Howses of Correccion,
- some for Mariages of poore Maides,
- some for Supportacion Ayde and Helpe of younge tradesmen Handicraftesmen and persons decayed, and
- others for reliefe or redemption of Prisoners or Captives, and for aide or ease of any poore Inhabitanes concerninge paymente of Fifteenes,
- setting out of Souldiers and other Taxes ...

This list of purposes has formed the foundation for the modern definition of ‘charitable purposes’. The role of the *Statute of Elizabeth* has essentially been to influence the development of an analogous set of modern categories. Note, however, that there is no statutory definition of ‘charity’ — even though charities enjoy substantial taxation advantages. The lack of such a definition is therefore problematic and surprising.

### ***Commissioners for Special Purposes of Income Tax v Pemsel (1891) HL:***

#### Facts

- Income is bequeathed to the Advanced Missionary Church for its work in ‘the heathen nations [sic]’
- The Taxation Commissioner argues that the trust is invalid because it is not for the relief of poverty

#### Issue

- Is the trust valid notwithstanding that it does not aid ‘the poore’?

#### Reasoning (Lord Macnaghten)

- The definition of charity is not its colloquial meaning, meaning ‘aiding the impoverished’; it is much broader
- The *Statute of Elizabeth* cites instances of charity, but it is non-exhaustive
- Items in the list from the *Statute of Elizabeth* may be grouped into precisely four categories:
  - Relief of poverty
  - Advancement of education
  - Advancement of religion
  - Trusts for other purposes beneficial to the community
- In all categories except poverty, the public benefit test must also be satisfied: it must benefit a certain number of members of the public (as distinct from a family)
  - Here the people of those nations benefit
  - And the benefit must be of a kind that is useful

#### Decision

- On the facts, this is a trust for the advancement of religion; namely, spreading Christianity beyond the borders of England through the Missionary
- The trust is therefore valid

Since *Hemsley*, Lord Macnaghten’s view has prevailed. This is a very broad view of ‘charity’. However, occasionally courts will narrow its definition.

### ***Royal National Agricultural and Industrial Association v Chester (1974) HCA:***

#### Facts

- Property is left for the purposes of ‘improving the breeding and racing of homing pigeons’
- Evidence is led that homing pigeons had been used in wartime and peacetime
- Their ability to return home is unknown and is therefore of continuing scientific interest

Issue

- Is this a charitable purpose?

Reasoning (McTiernan, Menzies and Mason JJ)

- 'It may be that in a general way the breeding of pigeons for racing is a purpose beneficial to the community. It provides recreation for quite a number of pigeon fanciers; it produces birds which are interesting, beautiful, and may at times be useful as a means of communication; it affords an opportunity for the scientific study of the birds' remarkable homing instinct.'
- However, what must be asked is whether it is within 'the spirit and intendment' of the *Statute of Elizabeth*; specifically, either
  - The purpose must by its character be an activity that can be said to be of benefit to the community in a sense within the preamble; or
  - The purpose must by analogy be within the spirit and intendment of the preamble
  - 'It is when the inquiry turns to the question whether the breeding of racing pigeons is within the spirit and intendment of the [*Statute of Elizabeth*] that the case of the appellant plainly fails.'
- The 'breeding of pigeons for racing' is not of a kind included in the preamble
  - No analogy may be drawn with any of the items there listed
  - It cannot be said to be of benefit to the community in a sense within the spirit of the preamble
  - It may indeed be for the benefit of the community, but to be charitable it must also be within an established category — somehow linked, even if by analogy, to the *Statute of Elizabeth*

Decision

- The trust is not charitable and fails for want of certainty of objects

Note, however, the distinction between trusts for a charitable *purposes* and a donative gift to a charity by a settlor: the former is a trust for the purposes of an organisation, which must be charitable; the latter is a trust in favour of the person (perhaps even a corporate entity) who is the recipient. Thus, parties may make gifts to any incorporated body, which may in turn use the gift for any purpose it sees fit. However, trusts must either be expressed to be in favour of such a body or for recognised charitable purposes that encompass its activities.

### 3 Charity and politics

Political purposes are not charitable. A political purpose is one which supports or opposes a change to the law or government policy. It also includes the support or opposition of political parties.

An early example of a trust void for pursuing political purposes may be seen in *National Anti-Vivisection Society v Internal Revenue Commissioner* (1948), an English case in which a gift to a charitable society was held to be invalid because one of that society's main objectives was to repeal animal cruelty legislation and introduce animal protection legislation.

Any trusts attempting to advocate for a change in the law are for political and not charitable purposes. Thus, a 'law reform trust' is an oxymoron. Even 'attempts to sway public opinion on

controversial social issues' can sometimes be considered to be political, providing the information is biased and designed to shock the reader.

The policy justifications behind refusing to recognise political purpose trusts as charitable are as follows. First, it would be contradictory for the Attorney-General enforce a trust that is contrary to government policies, since it would, in effect, require advocating purposes inconsistent with his or her mandate to uphold the laws and policies of the government. Second, assessing whether the proposed change is for the public benefit would result in a court overstepping its judicial function to intrude upon the proper purview of the legislature.

These reasons were summarised by Slade J in *McGovern v Attorney-General* (1981), another English decision:

*First, the court will ordinarily have no sufficient means of judging as a matter of evidence whether the proposed change will or will not be for the public benefit. [Second], even if the evidence suffices to enable it to form a prima facie opinion that a change in the law is desirable, it must still decide the case on the principle that the law is right as it stands, since to do otherwise would usurp the functions of the legislature.*<sup>4</sup>

In *Royal North Shore Hospital (Sydney) v Attorney-General*, Dixon J observed that a coherent system of law 'can scarcely admit that objects which are inconsistent with its own provisions are in the public welfare.'

Nevertheless, these policy objectives are at odds with the practical definition of charities — that adopted by the Australian Taxation Office ('ATO'). The ATO permits political organisations to be charitable.

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<sup>4</sup> [1981] 3 All ER 493, 506.

**Public Trustee v Attorney-General (New South Wales) (1997) NSW SC:**Facts

- A testator leaves her estate to the Federal Council for the Advancement of Aborigines and Torres Strait Islanders
- The will creates a trust for various purposes — some charitable, some political, including:
  - Abolition of legislation discriminating against Torres Strait Islanders and Aborigines;
  - The introduction of legislation providing recognition in various ways; and
  - Assistance towards equality and ownership of land traditionally occupied
- The will was written at a time when the *Racial Discrimination Act 1975* (Cth) had been passed, but not its state counterparts
- The Public Trustee (executor of the will) seeks a declaration that the will is invalid because it creates a trust for political rather than charitable purposes, so that the estate goes to the next of kin on intestacy
- The Attorney-General (defendant) argues that the gift is valid gift for charitable purposes and that an order for a cy-près scheme should be made over any invalid purposes

Issue

- Does the presence of political purposes in the will automatically invalidate the entirety of the trust?
- Must the pursuit of charitable objects by means of political agitation invalidate those objects?

Reasoning (Santow J)

- “The case law dealing with the distinction between charitable purposes and political objects is in an unsatisfactory condition ...” wrote Sir Owen Dixon in 1938: *Royal North Shore Hospital of Sydney v Attorney-General* ... at 426.’
- **[612]** Traditionally, the rule has been strict that where even one object in a trust is non-charitable, unless subsidiary to the main charitable purpose, the trust fails as a charitable trust: *Morice v Bishop of Durham*; *National Anti-Vivisection Society*
  - ‘Dicta from *Royal North Shore Hospital* suggests that the pursuit of charitable objects by means of political agitation cannot be a valid charitable trust: see Starke J (at 420), Latham CJ (at 412) and Dixon J (at 426)’
  - In order to discern a distinctly charitable intention one must look at the trust objects as a whole
- A trust is not automatically rendered a trust for political purposes because it advances a charitable object by means which seek to influence public opinion (as by public meetings)
  - ‘Pressure for political change can range from direct lobbying of the government for legislative change, to attempts to educate and persuade the public and change public opinion on a particular issue.’
  - ‘The danger with that kind of a priori judgment is the courts thereby enter into the political arena by arbitrarily classifying something as a political problem merely because society may be divided about it. On most issues of the day, there is a wide spectrum of views. So that mere controversiality can be no reliable guide to the courts in the present context.’
- Even if it were otherwise, a trust may still survive as charitable, despite adopting political means, providing that the object is to introduce new law consistent with the way the law is tending
  - If the purpose advocates a change in the law in a direction that the law is going in anyway, then it should not fall foul of the political purpose exemption



- Eg, furtherance of race relations
- Application
  - The charitable organisation is here ‘dedicated to improving the position of Aborigines and Torres Strait Islanders in an active and effective way, in a difficult social and political climate’
  - ‘To the extent the Federal Council for the Advancement of Aborigines and Torres Strait Islanders’ objectives were to be achieved by public meetings and other means of influencing public opinion, doing so for the advancement of Aborigines (and Torres Strait Islanders) as a disadvantaged group, that does not in my judgment render it a trust for political purposes.’

#### Decision

- The trust has objectives which include charitable purposes, as well as:
  - Objectives that are charitable but carried out by pseudo-political means; and
  - Objectives that are political
- Pseudo-political means such as public meetings are not political, so those objectives are valid as charitable objects
- However, the political objectives are invalid; this would normally invalidate the entire trust
- Nevertheless, the charitable objectives are capable of severance from the political ones
- A *cy-près* scheme should be implemented, consistent with the testator's general charitable intention

#### 4 Critique of the equitable conception of ‘charitable objects’

In the author’s opinion, this entire controversy can be done away with quite simply by asking, in the case of a gift to an allegedly charitable organisation, whether that organisation is eligible for charity taxation status. In the case of an abstract purpose, one need only identify organisations in whom the money could be vested that are themselves charitable.

This effectively defers the decision to the ATO, but permits the organisation to contest its status pre-emptively by seeking merits or judicial review of the initial decision. In this way, the ATO bears primarily responsibility for determining the proper scope of ‘charity’. It can continue do so both by reference to social and economic criteria, independently of any archaic statute and in response to shifting trends in the accepted nature of charity, as it has done for some time. Further, as a part of the executive, this assessment encounters none of the conceptual difficulties encountered by judicial assessments of political purposes.

Such a definition is simple, flexible and — most importantly — of such crystalline certainty that settlors’ intentions will rarely if ever be subverted by a dispute about so trivial a matter as charity. Fundamental to this approach is that an organisation will rarely if at all alter its charitable status. This being assumed, a willing testator has only to access the public register and enquire as to the nature of the organisation to which they wish to gift assets to determine whether the gift will fail in equity. This all but eliminates litigation about definitions of charity. It is the kind of conceptual pragmatism that ensures equity retains its nimbleness and is not beset by tangential definitional quandaries.

This could be taken one step further by permitting bidirectional dialogue *between* courts of equity and the ATO: thus, in an extreme case, a judicial determination that an organisation is charitable could overturn a prior contrary classification, providing the case be pleaded as such and leave given to the Commissioner of Taxation to intervene, if sought. One possible objection to a government-centric approach to charity is the libertarian argument that public policy development should not be the role of government alone; it may lead to controversial organisations being

denied charity status. Although such cases are likely to be small in number and lie at the margins of charity, this is an important objection. However, established procedures for judicial review are sufficient for defence of decision-making legitimacy — indeed, have been relied upon for just such a purpose for decades by the administrative law regimes.

Apparently, however, the matter falling for consideration is somewhat more complex. See also *Report for the Inquiry into the Definition of Charities and Related Organisations* (2001) ch 16 ('the Sheppard Report').

The Sheppard Report suggests several options for reform, none of which has been implemented (except for one minor change to public benefit and religious purpose trusts). There is no indication that the existing, arguably outmoded categories will be updated.

The Committee considered several proposals, which include:

- Leave the definition to the courts, to proceed in accordance with Lord Macnaghten's four heads of charity
- Adopt the popular meaning of 'charity'
  - This would narrow the allowable purposes to 'assisting the poor'
  - This would prevent many important public interest purposes from being carried out, such as environmental and religious purposes
  - It would narrow the equitable meaning of charity significantly
  - Such a course is therefore 'impractical and unrealistic'
- Define it as 'any purpose beneficial to the community' without limiting it by reference to the *Statute of Elizabeth*
- Enact a comprehensive list of charitable purposes in legislation
  - This is a kind of updated *Statute of Elizabeth*
  - In time, however, it is liable to suffer from the same problems
  - Static and inflexible when compared to courts of equity
  - Essentially similar to the *Statute of Elizabeth*, with a few additions
    - 'fostering of culture'
    - 'protection of the Australian heritage'
    - 'sport and recreation'
    - 'relief of suffering of animals'
- Enact a series of broad categories; namely, the advancement (or protection) of
  - Health;
  - Education;
  - Social and community welfare;
  - Religion;
  - Culture;
  - Natural environment; and
  - Other purposes beneficial to the community
- Enact a statutory definition of charity designed to encompass these categories

The Sheppard Report made the following observations:

- The principles used to determine charitable status should no longer make reference to the preamble to the *Statute of Elizabeth*
- The language adopted should be flexible and continue to correspond to changing social and economic conditions

- The language should introduce precision and certainty, thereby reducing litigation and ensuring the settlor's intentions are not defeated
- The definition should be simple, internally consistent and flexible
- The definition should be broad purposes rather than specific groups or activities
- Human services should be at the core of charity

Ultimately, the Committee proposed a statutory definition of a particular list of purposes, supplement by an 'other purposes beneficial to the community' category to ensure flexibility.

## 5 Non-charitable objects

A trust must be for persons or for charitable purposes ('the beneficiary principle'). Traditional case law supports this requirement. However, some cases do appear to uphold non-charitable purpose trusts:

- (i) **Anomalous exceptions**  
'Trusts for the care of particular animals';  
'Trusts for the maintenance of my tomb'; and
- (ii) **Indirect beneficiaries**  
The distinction between purposes and persons is not clear, because many trusts for purposes also benefit people; 'Trusts for the payment of dividends to shareholders'; such trusts are simply for persons not purposes.

A trust in favour of any legal person is not a purpose trust, direct or indirect. The issue of charitable objects only arises if the trust is *expressed* as being for purposes.

### **Re Astor's Settlement Trusts (1952) UK Ch:**

#### Facts

- In 1945, Viscount Astor and his son settle the issued shares of Observer Ltd on certain trusts thought to be charitable
- The income was to be applied to public, non-charitable purposes, including: the co-operation between nations and the preservation, independence and integrity of newspapers

#### Issue

- Are the trusts valid?

#### Reasoning (Roxborough J)

- After referring to authorities that support the beneficiary principle, his Honour examines the anomalies
- Are they aberrations or do they support a claim that the principle does not really exist?
- With a trust, the legal owner of property is constrained to deal with the property so as to give effect to the legal rights of another
- (There must be a claimant who can assert their rights against the legal owner — ie someone who is interested in enforcing their equitable right)
  - For charitable purposes, it is the Attorney-General
  - But for other purposes, who is the enforcer?
  - A 'purpose' cannot keep watch over the trust, nor can a 'purpose' sue
  - This is why non-charitable purpose trusts are not permitted
- 'Anomalies':

- There were persons who were interested in the residue (ie a residuary beneficiary) who would take after the trust for the anomalous purpose was completed
- It was this residuary who could keep watch over the trust
- Thus, trusts for horses, dogs or other animals would go to a taker in default upon death of the animal
- Alternatively, these cases are 'concessions to human weakness and sentiment'
- Thus trusts for maintenance of monuments and graves, etc
- However, such anomalies are isolated and do not justify the conclusion that the beneficiary principle does not exist

#### Decision

- The trusts here are void because they violate the beneficiary principle: they are not for charitable purposes, but they are for purposes; they are therefore invalid

The cases in which a trust for non-charitable purposes is held to be valid are either anomalous concessions to human frailty or distinguishable because they each contained an identifiable residuary legatee capable of enforcing the terms of the trust. In general, however, a trust must be for persons or charitable purposes to be valid. This is the traditional position.

*Re Denley* qualifies the beneficiary principle. It upholds a non-charitable purpose trust because the problem traditionally associated with such purposes — that there is no-one able to enforce them — does not exist, there being a number of indirect beneficiaries capable of doing so. It is unclear from Goff J's judgment whether the trust was valid because it was a trust for purposes (having indirect beneficiaries) or because it was simply a trust for such persons having sufficient certainty. If the trust was valid because it was for identifiable persons notwithstanding that it was for purposes, the result is effectively to broaden the concept of a trust for persons beyond a trust expressly described as being for a person.

### ***Re Denley's Trust Deed (1969) UK Ch:***

#### Facts

- A testamentary trust deed provides for a sporting ground to be conveyed to the trustees on the following terms:
  - 'Land is to be maintained and used as a recreation or sports ground primarily for the benefit of the employees of the company, and secondarily for the benefit of such other person or persons (if any) as the trustees may allow to use the same'
  - This purpose is to be carried out for a fixed period, shorter than the perpetuity period
- Subject to certain powers vested in the trustee to alter and maintain the sporting ground, 'the employees of the company shall be entitled to the use and enjoyment of the said land'
- If the land ceases to be used as a sporting ground, it should be conveyed to the General Hospital Cheltenham
- The trustees seek a declaration that the trust is valid
- However, the defendant argues that the trust is either for the benefit of individuals or is a purpose trust, but invalid in either case:
  - If it is a trust for individuals, the employees are an unascertainable class and the trust is therefore void for uncertainty
  - If it is a trust for purposes, the purpose of providing recreation is void on the beneficiary principle

Issue

- Is the declaration of trust valid?

Reasoning (Goff J)

- The trust is not invalid for offending the beneficiary principle
  - It is true that a non-charitable purpose trust will be invalidated for breach of the beneficiary principle if the benefit to an individual is 'so indirect or intangible ... as not to give those persons any *locus standi* to apply to the court to enforce the trust'
  - Thus, a trust will be invalid where those benefited would not have standing to apply for its enforcement in a court
  - However, the beneficiary principle of *Re Astor* is confined to trusts carrying abstract or impersonal objects
  - The mere fact of being a trust for a purpose is not what invalidates a trust for non-charitable purposes; it is because there is no person capable of enforcing it
  - By contrast, where a trust, 'though expressed as a purpose, is directly or indirectly for the benefit of an individual or individuals, ... it is in general outside the mischief of the beneficiary principle.'
  - For example, purpose trusts that would benefit individuals when carried out will not offend the beneficiary principle
  - In general, where a trust is not abstract, not impersonal, and benefits individual people, it will not fall afoul of the beneficiary principle because it 'does not fall within its mischief'
  - This is because such trusts are capable of enforcement by those individuals, unlike an abstract trust, which is without protector
  - The present deed expressly provides that the employees as beneficiaries shall be entitled to the land's use and enjoyment
  - It therefore directly benefits individuals and, despite being construed as a trust for purposes can be treated as a trust for persons
- The trust is limited in point of time so it does not infringe the rule against perpetuities
- The trust has sufficiently certain objects because it creates a bare power in favour of employees that can be assessed according to the criterion certainty test
  - However, the trust comes close to being invalid because it is in its nature beyond the Court's possible control
  - A problem might thus arise if some employees wish to use the sporting ground for one sport while others want to use it at the same time for another inconsistent purpose, such as another sport
  - The trustees could resolve this by making regulations as provided by the deed
  - However, they would not have to, and might in any case fail to resolve the dispute
  - At an impasse, the Court could not resolve it because — this being a non-charitable trust — it could not abrogate the trustees' power to make regulations
  - However, 'it would not be right to hold the trust void on this ground'
  - Similar problems undoubtedly arise and are nonetheless resolved where a property is left for the occupation of multiple siblings

Decision

- The trust is valid

## 6 Certainty rules

Here we are concerned once again with non-charitable trusts for persons, rather than purposes. Such trusts must also have certainty of objects. If a trust has objects which are not certain, the trust will be invalid. However, the certainty requirements for non-purpose trusts differ; a separate series of rules has emerged to govern the evaluation of certainty by courts.

Recall the distinction between fixed and discretionary trusts. Under the former, entitlements are fixed and the trustee is obliged to effect distribution in accordance with the trust's terms, whereas the latter leaves the decision to distribute, and to whom and on what terms, up to the trustee. Powers, a further member of the taxonomy of equitable obligations, are discretionary mandates vested in a trustee, who is not obliged to exercise the power but must consider the decision.

Different rules for certainty of objects apply depending upon whether the obligation relates to a fixed or discretionary trust, or a mere power.

### (a) Fixed trusts

For a fixed trust, the traditional test for certainty of objects is known as 'list certainty'. List certainty means that a list of all the beneficiaries must be able to be constructed from the declaration. The trustee must be able to construct an exhaustive list of all beneficiaries at the outset or the trust will be invalid.

The reason for such a strict test is that fixed distributions cannot be made until the number and identity of the beneficiaries are known; otherwise the proportions may be wrong and some property would either remain undistributed or be wrongly distributed. Thus, a sum cannot be distributed 'in equal shares' among a fixed class of beneficiaries until the number and identity of those beneficiaries is known. Further, as the trustee may have no power to vary the terms of the distribution, it would be impossible to validly proceed without fully identifying the entitlements of all possible beneficiaries.

In *Kinsella v Caldwell* (1975), a case concerning taxation of a fixed trust, the High Court of Australia appears to have assumed that the list certainty rule applies to fixed trusts.

However, *West v Weston* (1998) departed from this view, relaxing the test for certainty to allow validity if a substantial majority of the class could be listed.

### ***West v Weston* (1998) NSW SC:**

#### Facts

- A testator leaves his residuary estate upon trust to be divided equally amongst 'such of the issue of his four grandparents as are living at [the testator's] death and [have] attained the age of 21 years'
- The trustee searches for two years to find appropriate beneficiaries
- In this time, some 1675 names are found, and probably more people exist
- However, the trustee thinks it will not be able to find them, and seeks a declaration that distribution at this point will be permissible

#### Issues

- Does this trust exhibit certainty of objects?

#### Reasoning (Young J)

- This is a fixed trust: the residuary must be divided equally amongst a group of beneficiaries
- There is no conceptual uncertainty
  - 'Issue' means offspring of the grandparents, whether born within marriage or outside it; but does not include adopted children
  - Evidential uncertainty is a possible objection but does not affect certainty: whether X is a child of Y can be resolved by appropriate evidence
- List certainty normally applies
  - If list certainty were required, the trust would surely fail
  - However, *Kinsella v Caldwell* is not directly binding
- The strictness of list certainty should be relaxed
  - Strict application of list certainty rule would render the disposition invalid since not all beneficiaries have been accounted for
- Certainty of objects will be satisfied if a substantial majority of the beneficiaries can be listed and no reasonable enquiry can assist in their further enumeration
  - '[664] The rule will be satisfied if, within a reasonable time after the gift comes into effect, the court can be satisfied on the balance of probabilities that the substantial majority of the beneficiaries have been ascertained and that no reasonable inquiries could be made which would improve the situation.'

#### Decision

- This relaxed test is satisfied
- The trust is valid and the trustee can properly distribute the property equally among those who had been identified after the reasonable inquiries
- However, such distribution is without prejudice to the rights of issue not yet ascertained
- This means that if, later, more beneficiaries were discovered, they would have no claim against the trustees (see *Trustee Act 1925* (NSW) s 63) but could recover their entitlement from fellow beneficiaries
- The 1675 people receive a 1/1675 share upon distribution
- The alternative — striking out the clause — would make the money go to the next of kin; this would be against the settlor's intention

Peter Creighton has made several criticisms of the relaxed test in *West v Weston*:<sup>5</sup>

- It is difficult to measure what constitutes a 'substantial majority' of the beneficiaries, as has been seen in relation to Megaw LJ's test in *Baden*
  - The total number of the class cannot be known so nor can a 'majority'
  - Uncertainty in a test for certainty is ironic and invites arbitrary application
- It undermines the nature of a fixed trust, the essential nature of which is to fix the size of each beneficiary's share
- It authorises what would otherwise be a breach of trust
  - The trustee is permitted to distribute not merely where it is thought that the distribution is correct but where it is known to be incorrect
  - All beneficiaries receive an incorrect entitlement
  - If new beneficiaries are subsequently identified, whether haphazardly or as a class, they will either (i) be unjustly deprived of their share; or (ii) the approach

<sup>5</sup> Peter Creighton, 'Certainty of Objects of Trusts and Powers: The Impact of *McPhail v Doulton* in Australia' (2000) 22 *Sydney Law Review* 93, 97–9.



- adopted in *West v Weston*, to anticipate complex litigation for recovery from all of the existing beneficiaries of a small fraction of their share
- This is problematic because for two reasons: first, the newly-discovered beneficiary has little if any way of ascertaining the identity of fellow defendants, except by compelling disclosure from the trustee; second, even when they are discovered, there may be a large number of them, making the case unwieldy and expensive to pursue; third, at any rate, good faith change of position may well be a defence to most claims
  - On the other hand, should the majority be denied their interests just because of what is effectively evidentiary uncertainty?
  - By contrast, list certainty is fairer and more conceptually sound
    - Evidentiary uncertainty can be resolved by a court or, where the number of eligible but absent beneficiaries is known, by reserving their portion while distributing the remainder
    - It must be possible to know that the list is complete: a fixed trust should fail if there is no practicable way to ascertain all members of the class
  - Essentially, the difference between Young J and Creighton's approaches is one of consequence
    - For Creighton, when beneficiaries of a fixed trust cannot practicably be specified, the trust should fail and property should return to the taker in default
    - However, for Young J, the property should go to those beneficiaries who are known
    - Leaving to one side any conceptual difficulties, Young J's view is more consistent with the settlor's intention
    - It is also fairer to the majority of beneficiaries, who are better off than they otherwise would have been: no-one is worse off, and trust is substantially put into effect
    - Creighton insists upon perfection, which in the case of many dispositions simply isn't possible and is unrealistic to expect of trustees in an age where large and unwieldy classes are commonplace

(b) *Mere powers*

For a mere power, the 'criterion' certainty test applies (*Re Gulbenkian's Settlement Trusts*). That is, it must be possible to identify some criterion or criteria according to which a person may be evaluated as falling within or outside the class of beneficiaries. If there is a person to whom no criterion can be applied that would enable determination of whether by presence or conduct he or she is a beneficiary, the power will be void for uncertainty.

***Re Gulbenkian's Settlement Trusts* (1970) HL:**

Facts

- Mr Calouste Gulbenkian, an oil millionaire, wants to establish a family trust to provide for his wife and children
- Mr Gulbenkian makes a settlement under which trustees 'shall' during the life of his son, Nubar, 'at their absolute discretion pay all or any part of the income of the property hereby settled ... to ... all or any one or more ... of the following persons ... [including] any person or persons in whose house or apartments or in whose company or under whose care or control of by or with whom the said Nubar ... may from time to time be employed or residing...'
- Mr Gulbenkian's intention was to benefit those who had assisted his son during his lifetime

- The clause confers a power (discretion) to pay trust money to anyone in whose house his son had stayed, or by whom his son had been employed

#### Issues

- Is the trust a fixed or discretionary trust, or is it simply a mere power?
- Is the objects clause too uncertain such as to be invalid?

#### Reasoning

- Interpretation of the clause
  - The trustee has a discretion as to whether or not it applies the fund to the class of eligible beneficiaries
  - Despite the use of the word 'shall', taken in the context of the disposition it connotes a permissive intention
  - The clause should be construed as 'shall ... pay all or any part' — thus, the trustees are obliged to pay only 'any part' (including zero) of the estate to this class of beneficiaries
  - Consequently, it is a mere power
  - The clause is an example of 'slovenly' drafting
- Lord Reid: is there any reasonably clear intention that can be discerned?
  - It is impossible to draft an exhaustive list of all potential beneficiaries — the son's employers and accommodators will change from time to time
  - 'The clause would be bad for uncertainty if it purported to impose on trustees duties which, even in the help of the Court, they could not carry out'
  - (For example, if the clause was simply so confusing that it could not give adequate directions as to the distribution of the money)
  - The test for certainty is that:
    - 'the class of beneficiaries must be defined with sufficient particularity to enable the Court to determine whether a particular person is or is not, on the facts at a particular time, within the class of beneficiaries'
    - That is to say: 'can the trustees make a determination of anyone coming before them that that person is or is not within the terms of the power?'
    - This is the 'criterion certainty test'
  - The validity of the power is decided as soon as it comes into operation
  - If the Court can envisage cases where it could not be said with certainty whether a person is or is not within the class of beneficiaries, then the power will be void
    - This will be so notwithstanding that there is someone who is clearly within the class
    - The whole power fails — even to the extent (if any) it could have been exercised with respect to those clearly entitled
  - It does not matter if all beneficiaries cannot be ascertained by means of a list, providing there is a criterion which the Court can apply to make a determination
  - Here there is no difficulty in determining whether a given person has provided housing or employment
  - Note the distinction between conceptual and evidentiary uncertainty
    - Conceptual uncertainty: where the meaning of a concept or word in a trust is uncertain (eg, power to pay money 'to the settlor's friends' — how close must the friendship be? What duration? Context? Or 'to the settlor's best friend' — even more uncertain)
      - In such cases, the Court cannot accurately determine what is required to obtain an entitlement under a trust
    - Evidentiary uncertainty:
      - Where the Court requires further evidence to identify those who are entitled to an interest

- Eg, 'to students in the equity class' (need to consult register of enrolled students)
      - A clause will not fail for want of evidentiary certainty
      - However, it will fail if there is conceptual uncertainty
- Lord Upjohn:
  - 'My Lords, I do not think the late Mr Withers' language (if indeed he was responsible for the draftsmanship) is open to very serious criticism; the clause, it is true; ran together too many possible situations and did so rather ungrammatically, but its general object was clear; it is a 'spendthrift' clause and must be read in the light of that general intention and construed with the object of giving effect to it if it is possible to do so.'
  - 'I would paraphrase the words of the clause thus: "any ... persons ... by whom the son may from time to time be employed and any ... persons ... with whom the son from time to time is residing whether in ... [their] house or apartments ... or whether in [their] company or... care'
  - It is a matter of construction whether a particular clause amounts to a mere power or a discretionary trust
    - Here it is a mere power
    - A court can modify the literal language of a disposition in order to try to ascertain the settlor's intention
    - The Court must give a reasonable meaning to the language used, if possible, without 'doing complete violence to it'
    - This is, in effect, a spendthrift clause: the legatee is to be indirectly benefited by providing money to the people that support him, but not to the legatee himself (probably because the settlor does not trust the beneficiary)
  - Certainty
    - Can the Court with certainty say whether any given individual is or is not a member of the class of beneficiaries?
    - The Court need not ascertain every member of the class, but it needs a criteria that can, given a candidate, make a determination about entitlement
    - There are several sources of uncertainty here, but none of them is fatal:
      - What does 'residing' mean?
      - Which persons are those 'with whom' the son is residing?
      - Who are those 'in whose company' the son is residing?
      - Who are those 'under whose care or control' the son is residing?
    - Perhaps 'difficult or borderline cases' arise in each of these situations
    - However, 'mere difficulty is nothing to the point'
    - 'If the trustees feel difficulty or even doubt upon the point the Court of Chancery is available to solve it for them. It solves many such problems every year. I cannot for myself see any insuperable difficulty arising in the solution of any given state of affairs which would make it necessary to hold that the relevant clause as I have construed it fails to comply with the test.'
    - 'In my opinion, this clause is not void for uncertainty, and the Court of Appeal were quite right ...'

#### Decision

- The trust is a mere power
- Its objects clause complies with the criterion certainty rule and it therefore bears sufficient certainty of objects
- The trust is valid; appeal dismissed

When analysing a settlement, the reader should commence by classifying it within the taxonomy of equitable obligations heretofore expounded (be it a fixed or discretionary trust, or mere power). One proceeds by identifying possible interpretations and articulating with precision the consequence for the trust at hand. Having ascertained its class, the trust may be considered for certainty. Identify possible sources of difficulty; pose scenarios; ask questions about what the words suggest is the proper scope of the class of entitled beneficiaries; and consider whether the problem is semantic, ie conceptual, or merely evidentiary.

Since *Re Gulbenkian*, some commentators have argued that the notions of residence and provision of food entail significant conceptual uncertainty in themselves. Does residence mean anything from an overnight stay or only something more? Such comments suggest that the classification of uncertainty as 'conceptual' or 'evidentiary' is itself fluid and a matter upon which reasonable minds may differ.

In *Re Tuck* (1978), a family trust was held to be valid where the settlor stated that income was to be paid to each of his sons, provided that each son married 'an approved Jewish wife', with the Chief Rabbi to be arbitrator of such approval. Lord Denning held that the use of the Rabbi as a kind of umpire was sufficient to resolve any conceptual uncertainty about what might constitute 'an approved Jewish wife'. Lord Denning argued that permitting an arrangement of this nature was more conducive to giving effect to the settlor's intentions.

Similarly, a settlor can create a trust under which the entitlement of beneficiaries depends on a valuation made by the settlor herself. For example, 'to all authors of an equity treatise whom [I] consider to be deserving'. The conceptual certainty would here be 'what is a deserving author of equity notes?'; however, the clause would nonetheless be valid, since the settlor's judgment would be sufficient to make such a determination and the clause suggests a reasonable basis upon which to go about doing so.

### (c) *Discretionary trusts*

In the case of a discretionary trust, the trustee has a discretion to determine the beneficiaries and their respective entitlements. The traditional equitable rule was originally list certainty. However, as trusts grew larger and used in more complex transactions, such as superannuation, investment and welfare trusts, this became impracticable: the beneficiaries were not static but part of a shifting class.

As a result of these difficulties, the certainty of objects test for discretionary trusts was reconsidered by the House of Lords in *McPhail v Doulton*. There, the Court held that a two-stage test applies: (i) criterion certainty; and (ii) the loose class test.

#### ***McPhail v Doulton* (1971) HL:**

##### Facts

- An employer, a Mr Baden, establishes a fund under which the trustees 'shall apply the net income of the fund in making, at their absolute discretion, grants to:
  - 'Officers or employees of the Matthew Hall Company;
  - Ex-officers or employees of the company; or
  - Relatives or dependants of such persons'
- The settlor's widow, also his next of kin, challenges the validity of the trust

Issue

- Is the trust sufficiently certain?

Reasoning

- Construction of the settlement
  - Court of Appeal (majority):
    - Mere power: the clause simply means that the trustee 'may' distribute the income
  - House of Lords:
    - This is a discretionary trust
- Test for certainty of objects (House of Lords): (3:2), including Wilberforce LJ
  - The test for certainty of objects is the criterion and not list certainty
    - The distinction between a mere power and a discretionary trust is artificial because it is difficult to tell the difference
    - Consequently, the test of validity for each should not depend on that distinction
    - There should not be a completely different test for certainty of objects between mere bare and trust powers
    - The trustee in either case will have duties, though perhaps of slightly different content
  - For relevant purposes, the difference between a discretionary trust and a mere power is the extent of the survey which the trustee is required to carry out in relation to the class of beneficiaries
    - There is an obligation to conduct a wider and more systematic survey if the power is one of discretionary trust (since they *must* distribute the entire fund); however, this is not the list certainty test (the trustee need not make a list of beneficiaries)
  - For mere powers, the test in *Re Gulbenkian* should be applied: the trust is valid if it can be said with certainty that an given individual is or is not a member of the class of beneficiaries (criterion certainty test)
    - However, there is a difference between linguistic (semantic) and evidentiary (factual) uncertainty
  - Criterion test of certainty concerns semantic uncertainty — whether the words used to describe the class are sufficiently certain, as a matter of language
    - Eg, 'to all persons who have been kind to Y'
    - The meaning of the words is unclear
  - By contrast, evidentiary certainty involves ascertaining the existence or whereabouts of members of the class
    - Eg, 'to all persons who saw X go to work today'
    - It is almost impossible to find everyone who might fall within the class
    - Thus, evidentiary uncertainty will not itself void a trust
  - Note that there are two questions here:
    - Is the trust valid?
    - If so, is the claimant within the class and entitled to a distribution?
    - If not, has money been wrongly distributed such that personal liability may arise under *Barnes v Addy*?
  - If discretion is given totally to the trustee (eg, to form a view as to merit) a settlement may be valid notwithstanding that the same declaration would have been void for semantic uncertainty if expressed in general (ostensibly objective) terms
    - Eg, 'to any person who in Y's view is deserving' [??? What if someone other than the trustee is named? Ie, Y != trustee [???]]

- A criterion that is potentially ambiguous should therefore be left in the discretion or opinion of the trustee
- Administrative unworkability
  - There may be trusts which meet the criterion certainty tests but which are nevertheless invalid because they are administratively unworkable
    - Even if the meaning of the words is clear, the definition of the beneficiaries may be so wide as to form nothing in the nature of a class and make the administration of the trust all but unworkable, a disposition may also be invalid ('the loose class requirement')
  - For example, administrative unworkability would arise where a discretionary trust purports to benefit 'all the residents of Greater London'
    - Such a trust would be conceptually certain and satisfy the criterion certainty test, yet would be invalid for want of administrative viability
    - Having a trust with a large number of beneficiaries has never been a basis for invalidating a trust
    - (It is more likely to be an issue with the trustee's duties to identify all potential beneficiaries and consider relevant issues and responsibilities to each)
    - Eg, 'to all in the world except X'
      - Clearly would fail the list certainty test
      - (No uncertainty, though evidentiary uncertainty, and loose class — nothing like a group of people: (almost) *all* people)
    - Eg, 'all the residents of greater London' (this is a relatively narrow disposition)
      - May be some semantic uncertainty: where does greater London begin?
      - All the population in that region; not a class
      - Don't know the number of people
    - Eg, 'all the people on the Australian electoral roll'
      - *Can* make a list
      - But probably falls afoul of the loose class requirement, since it is virtually an entire population
  - Loose class requirement is essentially a concession to the trustee of a discretionary trust: if the trust class is too large, it would administratively be unwieldy and the costs of distribution could possibly exceed the value thereof
    - The meaning of 'administratively unworkable' is not intended in a financial sense; it refers to the practical or logistical difficulty of contacting or distributing the assets to a large class
  - Discretionary trusts:
    - Two-prong test:
      - Criterion certainty test
      - Linguistic and loose class requirements
  - Mere powers:
    - Criterion certainty test

#### Decision

- The case is remitted to the trial judge to determine whether the criterion certainty test is satisfied on the facts
- Upon remission to the lower court, the trial judge held that the trust was valid; this was subsequently appealed to the Court of Appeal *again*, which also held that the trust was valid
  - The next of kin argued that, although the employees and ex-employees limbs were certain, the limb dealing with dependents and relatives was uncertain

- The concept of 'dependence' is not of itself problematic; in all cases it must simply be asked whether a given person is dependent upon an employee or ex-employee
- However, 'relative' was argued to be more uncertain; a semantic argument was put: specifically, they argued that it is impossible to conclusively make a negative pronouncement that a person is *not related* to another person (though it is, of course, possible to prove that two people *are so related*)
- Court of Appeal: relative of a person simply means 'those persons who will take that person's estate when he or she dies' — this is an understanding of the concept based on principles of succession
- The trust is valid

(i) *Status in Australia*

In Australia, the significance of *McPhail v Doulton* has yet to be considered by the High Court. However, lower courts — mostly single judges — have accepted the approach of the House of Lords and applied the criterion certainty test to discretionary trusts.

One early case considering the certainty of a trust power (discretionary trust: cf *Chief Commissioner of Stamp Duties v Buckle*) is the decision of the Supreme Court of Victoria in *Re Gillespie* (1965). However, the Court there applied the old 'list certainty' test, which is now reserved for fixed trusts.

***Re Gillespie* (1965) Vic SC:**

Facts

- A trust is created in favour of 'ex-members of the Australian Defence Forces who are Protestant, of British descent and in need of financial assistance'

Issue (Little J)

- Does the clause exhibit certainty of objects?

Reasoning

- This is a mere power trust
- The terms are sufficiently certain, but it is virtually impossible to ascertain all members of the class

Decision

- No; the clause is invalid
- [This is arguably an inappropriate outcome, given that the settlor would hardly have intended equal division among *all* eligible beneficiaries; clearly, what was intended is that a portion of such people be selected for distribution, providing they meet the criteria]

More recently, the Court of Appeal of the Supreme Court of New South Wales expressly applied *McPhail v Doulton*, holding that list certainty is no longer required. Instead, the Court adopted a criterion certainty test. However, the Court appears to have ignored the second requirement from *McPhail*; namely, that the class also be workable.



**Horan v James (1982) NSW CA:**Facts

- The testator leaves property on trust 'to anyone but [the testator] or [his] wife'

Issue

- Is the disposition sufficiently certain?

Reasoning

- Because the clause gave such a wide discretion to the trustee (anyone in the world except an exceedingly small class of people), the wills principle is violated
- However, the Court says in *obiter* that if it had been *inter vivos*, the disposition would have been valid
  - Glass and Mahoney JJA expressly apply the *McPhail* test
  - However, it is unclear whether the *McPhail* should actually have been satisfied
  - *McPhail* created a two-pronged test for certainty of discretionary trusts: the criterion and loose class requirements
  - Here, the criterion certainty test is easily satisfied ('is X the settlor or his wife?')
  - However, the Court appears to ignore the latter requirement, such a class obviously being unworkable

Decision

- Although the disposition has certainty of objects, it is nevertheless invalid because it delegates will-making power in breach of wills law

The *McPhail* test has also been applied to a discretionary trust by the Supreme Court of Queensland in *Re Blyth*.

**Re Blyth (1997) QLD SC:**Facts

- The testator leaves property on trust to 'such organi[s]ations as ... in the public Trustee's opinion are working for the elimination of war and ... such organi[s]ations as in the Public Trustee's opinion are formed for the purpose of raising the standard of life throughout the world.'

Issue

- Is the disposition sufficiently certain?

Reasoning

- People selected on a subjective basis by the trustee
  - Generally, courts are unwilling to allow this to save a clause otherwise invalid for lack of certainty of objects
  - Otherwise, settlors could use to circumvent certainty requirements
  - There are some exceptions, however
- Certainty of objects must be satisfied according to the criterion certainty test (*McPhail*)
  - Disposition 1: what does 'an organisation working for the elimination of war' mean?
    - This is certain
    - It can be asked whether organisation X is working for the elimination of

- war
      - What constitutes ‘the elimination of war’ is conceptually certain
  - Disposition 2: what does ‘an organisation ... for the purpose of raising the standard of life throughout the world’ mean?
    - This is conceptually uncertain
    - What does ‘raising the standard of life’ mean? There is no criterion by which the Court can agree to decide whether or not an organisation does or does not satisfy the criterion
    - This is because the phrase ‘standard of life’ is too subjective
  - The fact that disposition 2 is expressed as ‘who in the trustee’s opinion’ cannot save the clause
    - Deferring responsibility to the trustee will not save a clause from conceptual uncertainty
- The discretionary trust is a trust for persons (the eligible organisations)
  - [However, if it is invalid as a trust for persons, it might also be possible to argue that it is a trust for purposes (for the elimination of war, raising the standard of life)
  - It is not analogous to any category in the *Statue of Elizabeth*, and political purposes (war) may pose a major problem]

#### Decision

- The first sub-class of objects is valid: it is easy to say whether a given organisation is working for the elimination of war, even though all qualifying organisations cannot *a priori* be identified
- However, the second sub-class of objects is invalid: ‘raising the standard of life’ lacks conceptual certainty
- [This distinction is, respectfully, questionable]

#### (ii) *Administrative unworkability*

Administrative unworkability has been applied in Australia. In *McCracken*, for example, Phillips J in *obiter dicta* expressed the opinion that even if the trust was not void for conceptual uncertainty it might also have been void for administrative unworkability.

### ***McCracken v Attorney-General (Victoria) (1995) Vic SC:***

#### Facts

- The testatrix bequeaths her estate in the following manner:
  - ‘half of the assets to be divided between such Christian societies and organisations as my trustee shall in his absolute discretion think fit’
- The executor of the gift seeks a determination whether the clause is valid

#### Issue

- Is this disposition sufficiently certain?

#### Reasoning

- In order for the gift to take effect, it must take effect as gift to persons or for purposes
- That is, it may be a class gift (trust for persons) or a valid purpose trust
- In the case of the former, it is a discretionary trust but it lacks certainty of objects
  - Although there is no binding authority applying the *McPhail* test of criterion

- certainty, it should be applied in preference to the list certainty test
      - In any case, this disposition fails both the list certainty and criterion certainty tests
    - There is conceptual uncertainty in the adjective 'Christian'
      - The phrase 'Christian organisations and societies' does not enable determination whether a given organisation or society is a member of the class
      - That is, no criterion is specified by which it can be determined whether an organisation or society is Christian, and is within the class
    - For example, can an unincorporated association be included? What does the word 'Christian' mean, anyway? What criteria did the testatrix intend to be used to determine eligibility?
      - Members — must the organisation's members be Christian?
      - Philosophy — must the organisation adhere to Christian ideals? Is there a single set of such ideals?
      - Works — must it be religious or missionary work, or can it simply be general work in society?
    - The loose class requirement must also be satisfied; here, the class is very large, so the clause would likely fail even if it did have conceptual certainty
  - However, this might survive as a purpose trust (for charitable purposes), though this position was not argued
    - Different tests apply depending on whether a trust is for persons or purposes (criterion certainty test and charitable purposes tests, respectively)

#### Decision

- *McPhail v Doulton* should be applied in Australia
- However, as a trust for persons, such a gift would fail either test because it is conceptually uncertain
- This case illustrates that the outcome may well depend on the classification of the trust

The administrative unworkability (loose class) test will only apply to discretionary trusts, if the test applies at all in Australia.

Creighton argues that Australian courts should not adopt the administrative unworkability test as a ground of invalidity — it is an 'unnecessary complication' to the law of certainty of objects:<sup>6</sup>

- Liberalisation of certainty requirements is important: the settlor or testator's intentions should be carried into effect where possible
- The *McPhail v Doulton* test is of sufficient clarity to allow trustees and courts to carry out their respective tasks
- Evidential uncertainty is not regarded as a ground of invalidity for either discretionary trusts or mere powers (*Baden; Re Blyth; McCracken*)
  - This is similar to the High Court's acceptance in *Kinsella v Caldwell* that evidential difficulties would not defeat a fixed trust (providing list certainty is still met)
- Permitting a disposition with evidential uncertainty is likely to increase the number of disputed distributions (or non-distributions), but allows far more dispositions to be upheld
- The number of occasions on which dispositions are invalidated should be reduced, so any means by which uncertainty might be avoided, or uncertain objects salvaged, should be considered

<sup>6</sup> Ibid 102–3.

- However, there are limits; for example, a class cannot be defined by reference to the opinion of others (*Re Blyth*; *Tatham v Huxtable* per Kitto J)
- A class can be construed so as to be certain, as by ignoring words or interpreting them in a way that avoids ambiguity (*Re Griffiths*: ‘near relatives’ becomes ‘blood relatives’)
- An invalid class of objects cannot normally be severed from the other, valid, sub-classes unless it is a charitable purpose trust, which may be saved by excision of any non-charitable purposes, or a *cy-près* scheme applied
- Lord Wilberforce’s ‘Delphic dictum’ (at 109) gives rise to problems of its own
  - Lord Wilberforce in *McPhail v Doulton*: objects ‘so hopelessly wide as not to form “anything like a class” so that the trust is administratively unworkable or ... one that cannot be executed’
  - Provides the example of ‘all the resident sin Greater London’
  - However, the size of the class need not cause insurmountable difficulty for trustees
  - This is not an objection to fixed trusts (though the size of the fund will necessarily limit the feasible size of its class)
  - Further, trustees need not consider every possible beneficiary before making a distribution; they need only survey the objects ‘by class and category’ with detail appropriate to the size of the fund (*McPhail v Doulton*)
  - One reason for limiting the class size relates to the beneficiary principle
  - If the class was so unworkably large as to render any individual beneficiary lacking in the ‘immediate and peculiar interest’ necessary for standing, then no-one could enforce the trust
  - This would place the trust — though for persons — in the position of a non-charitable person trust: a trust without enforcer
  - On this view, all that is required is that the disposition distinguishes the private class from the broader public
  - Thus, factors such as familial connection, club membership and financial status could be used to delimit a large class, but not general factors such as the city in which a person lives (hence Lord Wilberforce’s example)
- This objection may not extend to mere powers, since, there being no obligation to distribute, it is not essential that there be a beneficiary capable of enforcing the trust
  - However, this argument is inconsistent with the requirement that mere powers still comply with the beneficiary principle
  - Ie, mere powers cannot be trusts for non-charitable purposes
- Liberalisation of certainty requirements is important, but has gone to far in the case of fixed trusts
- Courts should not limit the range of permissible objects because of administrative unworkability
- Further, the requirements for certainty of testamentary trusts and powers should be no stricter than those for *inter vivos* settlements

Bryan argues that Lord Wilberforce’s further limiting requirement stems from a concern about the size of the trust and the scope of the duties that this entails for trustees. However, the administrative problems presented by a large class are no longer as significant with the rise of computing technology. For example, in the superannuation industry, trustees can contact and inform many beneficiaries with relatively little effort.

Modern technology may thus have obviated the need for a further limiting requirement in order to protect the trustees.

(iii) *The obligations of trustees of discretionary trusts*

If a trustee fails to consider the exercise of their discretion under a discretionary trust, certain consequences follow. The traditional approach was to order an equal division of the trust among its beneficiaries, applying the maxim *equity is equality*. Lord Wilberforce thought this was inappropriate, and provided three new alternatives:

- (i) **Appoint new trustees**  
The Court has an inherent power to appoint and remove trustees;
- (ii) **Authorise a representative class of beneficiaries**  
A subclass of beneficiaries can prepare a scheme of distribution (way of dividing the trust assets), to be implemented by court order; or
- (iii) **Distribute directly**  
If the basis of distribution is readily discernable, the Court may itself divide the trust assets among the beneficiaries; the Court essentially assumes the position of trustee and administers the trust directly.

The third of these options is radical, and is noted by Lord Wilberforce that it is not to be taken lightly. However, since *McPhail v Doulton*, there has been greater intervention in the affairs of trustees of discretionary trust using one of these three approaches. Judicial responses to reticent trustees are becoming more proactive.

(iv) *Trust litigation*

In *McPhail v Doulton*, like most other trust cases, the trustees were themselves able and willing to carry out the terms of the trust, and did not consider the trust deed to entail any fatal level of uncertainty. In most cases, therefore, the trust is challenged for uncertainty by the settlor's next of kin, who seeks to inherit the trust assets by right of succession. Thus, in *McPhail*, it was the settlor's widow who disputed the validity of the trust at each stage.

The costs of litigation are borne by the estate, not the litigant challenging the settlement. Certainty of objects is therefore most frequently an issue raised against validity by an heir seeking entitlement to the trust assets. (Bryan: 'a peg on which disputant heirs challenge the validity of trusts in speculative litigation').

(v) *Treatment in Australia*

From the foregoing, it seems clear that there has been some support for the *McPhail v Doulton* approach in Australia. Most states' appellate courts are now willing to apply criterion certainty (and, occasionally, the loose class requirement) to discretionary trusts. It therefore seems likely that this approach would be adopted by the High Court of Australia should the issue arise for decision.

7 *Critique of the distinction between persons and purposes*

Whether a trust is characterised as for persons or purposes is far from inevitable. As cases like *Re Denley* illustrate, the classification is fluid and the categories intermingled. A trust may be for persons — directly or indirectly — notwithstanding that it is expressed as being for purposes. Perhaps this relates back to the fact that equity looks to substance and not form. In light of this, it must be questioned whether the beneficiary principle has any serious role left to play. A trust either has indirect beneficiaries or it is charitable. However, there are sound reasons for prohibiting non-charitable purpose trusts without identifiable beneficiaries. Principally these reasons relate to difficulties of enforcement and distribution.

### III Hypotheticals

#### A West

- This is a fixed trust
- The list certainty test applies (see *Kinsella v Caldwell*)
- The 'issue' has potential conceptual certainty, but can probably be resolved by the Court with sufficient clarity to make a distribution
- There is likely to be significant evidential uncertainty, but this also is not fatal: *Kinsella v Caldwell*
- It may be possible to relax the requirements if a substantial part of the class can be identified: *West v Weston*
- This would allow distribution to those beneficiaries known from reasonable inquiries
- However, to do so may distort the conceptual foundations of a fixed trust and produce enforcement difficulties if new beneficiaries are discovered later
- Should be invalid if the trustee cannot find all members of the class

#### B Blyth

- Could be a trust for persons or for purposes
- If a trust for persons
  - Discretionary trust: criterion certainty
  - Defers determination of conceptual certainty to the trustee: will not save the clause if conceptually uncertain (*Re Blyth*)
  - 'elimination of war'
    - Is an organisation working for the elimination of war if it manufactures very effective weapons; ie, weapons capable of ending a war?
  - 'raising the standard of life'
    - Clearly, no problems with an organisation working for benefit of terminally ill children
    - But is an organisation raising the standard of life if it manufactures unhealthy but delicious chocolates?
  - There is conceptual uncertainty
  - The dispositions will be invalid regardless of the test applied
- If a trust for purposes
  - Must be charitable subject to exceptions
  - No relevant exceptions
  - Political purposes: an organisation working for the elimination of war may need to support pacifist political parties, advocate anti-war legislation or changes to government policy
    - If so, may be void for political purposes
- Likely to be invalid

#### C Horan

- This is an *inter vivos* discretionary trust for persons
- The criterion certainty test applies and is satisfied: 'is X the settlor or his wife?'
- However, the loose class requirement fails
  - Does it apply in Australia? *McCracken*; cf *Horan v James*

- If it was created by will, it would definitely be invalid as an impermissible delegation of will-making power, because the class is so broad as to vest almost absolute discretion in the trustees as to how the property is distributed

## D Martha

### 1 Disposition (a)

The issue is whether there is sufficient certainty of objects.

To determine the answer, it must first be considered what type of trust it is. It is a fixed trust because the trustee must distribute the funds ('shall') and does not have discretion as to how ('equally among').

Therefore the list certainty test applies. We must be able to make a full list of every student in the equity class (cf *West v Weston*: substantial majority).

The class list is probably sufficient. However, counsel for the next of kin could raise some objections. What about students who came to class but were not enrolled? Which equity class — this year, all years; which stream, all streams? These are unlikely to be fatal.

### 2 Disposition (b)

On the face of it this is a gift. However, M can only bequeath property which she owns in equity. If J can claim equitable ownership under a trust then the account moneys are not hers to give away. To bequeath J's funds would be in breach of trust, and to receive distribution (b) would expose the recipient to personal liability under *Barnes v Addy*.

The issue is whether there was an intention to create a trust. In *Paul v Constance*, a similar statement was persuasive in conjunction with other factors: joint deposits and withdrawals, discussions with the bank manager about the intended benefit. The mere statement on its own would probably be insufficient. Here there were multiple statements ('M always said to her'). Need further information.

Formality requirements: it does not matter that there was no written agreement to create a trust; *PLA* s 53(1)(b) does not apply since this is not land. Whether a trust is created will therefore come down to whether there is enough evidence of an intention to create it.

Assuming that there is such an intention, it will be necessary to consider the terms of the trust. Were the accounts held jointly, half-half or otherwise? The portion which does, in equity, belong to J cannot be given to N.

Trustees therefore in breach for giving it away. This places them in breach of fiduciary duty. However, they are insolvent so legal action against them is unlikely to be practicable.

However, N a third party recipient so a remedy could be sought from her directly.

### (a) Personal remedies against N

Personal claim under *Re Diplock* — strict liability since under a will. Must first claim against breaching fiduciaries. ...



First limb of *Barnes v Addy*. N probably completely innocent. Mental element uncertain. ... Defences may be available. N not a purchaser but a volunteer. However, GFCOP may be fatal to a claim.

(b) *Proprietary remedies against N (tracing)*

If N has dissipated the assets, restricted to personal claims. However, if not, may be possible to trace into her hands.

3 *Disposition (c)*

What kind of trust is it? A mere power ('may apply, at their absolute discretion'). This is a matter of construction 'May' is not necessarily conclusive of mere power — depends on context; here, looks as if it is intended to mean that the trustees need not apply the funds at all.

Criterion certainty is the test for a mere powers trust.

Is it a trust for persons or a trust for purposes? It is expressed to be a trust for purposes ('promoting humour and fun in society'). No indirect beneficiary (unless the whole world, but this is far broader than *Re Denley*). Therefore it is a purpose trust. The purpose is not charitable (not within any of the three main charitable categories; not analogous to any of the *SoE* categories). It contravenes the beneficiary principle and is therefore invalid.

Any disposition under an invalid will are in breach of trust. It does not matter that the Comedy Company probably fell within the scope of the clause. The disbursement to CC was in breach of trust because it was a disposition under an invalid clause of the will (*Re Diplock*).

(a) *Personal remedies against CC*

*Diplock; Barnes v Addy*

(b) *Proprietary remedies against CC*

Tracing into the business premises: no — cannot separate improvements from existing structure (*Re Diplock*). Arguably this isn't a strong basis for deeming dissipation to have occurred.

Tracing into the repayment of debts: no — but note Smith's critique that some debts directly referable into the purchase of assets should be traceable. Here, no identifiable assets matching up against the payment of debts.

Tracing is therefore problematic.

4 *Disposition (d)*

'Bulk of my estate' too uncertain (*Palmer v Simmonds*)

*Re Golay*: more modern approach taken — flexible

Today: would 'bulk of the income' be sufficient? Perhaps, but *Palmer* would seem to suggest that it is invalid and the clause is invalid as failing certainty of subject matter.

However, in the alternative, if certainty of subject matter is satisfied, there might still be a problem with certainty of objects.

Is it a fixed trust ('shall' be divided amongst 'all those' who have assisted etc) or discretionary trust (discretion as to how)? Probably a discretionary trust, but note difficulty in classification (as in *McPhail v Doulton*). Loose class probably not satisfied (cf *Horan*).

Criterion certainty. Can a criterion be proposed that would enable distinguishing between members and non-members of the class? Test is one of linguistic and not evidentiary certainty. For example, what does 'assisted' mean? 'Befriended'? Peripheral assistance? Degree of friendship — casual acquaintance? 'Fed'? Restaurants and chefs? Currently or for all time? Whether or not they can be found or identified is irrelevant — the issue is linguistic not evidentiary. (Explain what the issues are and what factors are relevant to resolving them.) 'And' or 'or'? Must all the terms be satisfied, or any one? But, more importantly, what do the terms mean?

Probably impossible to find a criterion. If it is invalid it will be struck out.

#### 5      *Disposition (e)*

This clause deals with the residuary.

The first issue is whether it is a discretionary trust or a mere power. The word 'shall' suggests an obligation to distribute, but is not determinative. If a discretionary trust, the criterion certain test must first be satisfied. There is no problem determining whether a given person is within the class: simply ask whether they are Harry, M's ex-husband. However, the second requirement (at least traditionally) is that it is not a loose class — the class is so wide as to not be a class: it's the second-largest class possibly imaginable. However, *Horan* appears to ignore this requirement, so maybe a court would overlook or be prepared to make an exception to the requirement.

Alternatively, if it is a mere power, only the criterion certainty test need be satisfied; this it does.

Even if this is the case, however, the clause is probably a delegation of will-making power and hence invalid under probate law.

## V **Duties of Trustees**

### A *Introduction*

Trustees owe various duties to beneficiaries. These duties are incidents of a trustee's position of responsibility in relation to the trust property. Most duties relate to management of the trust assets and distribution at the relevant time. They can be broadly grouped into three categories:

- 1 **Administrative duties**  
The trustee must know and be prepared to do what is necessary to carry out the terms of the trust;
- 2 **Duties of propriety**  
The trustee must deal with the trust property appropriately and communicate with beneficiaries as required, and must not act dishonestly or improperly; and
- 3 **Management duties**  
Property must be invested and managed according to standards of prudence and reasonableness.

Failure of a trustee to perform any trust duty, or an improper or negligent performance of a duty, will result in liability attaching to the trustee. A score of equitable remedies are available to the beneficiaries of trusts whose trustees have forsaken their duty. These remedies are similar to those available for breach of fiduciary duty, and serve similar objectives: to discourage a trustee from deliberately breaching their duties; and to ameliorate the effects of any breach.

### B *Contextualisation*

Because trustees are also fiduciaries, they owe both fiduciary and trustees' duties. Consequently, breach of trust can often be pursued as an alternative to breach of fiduciary duty in circumstances where a trustee has misappropriated funds or otherwise acted improperly.

In these cases, breach of fiduciary duty and breach of trust may both be supportable simultaneously. To prevent double recovery, a plaintiff will normally need to elect to take one of the available remedies. In other cases, however, it may be that a defendant's conduct gives rise to separate remedies for breach of trust and breach of fiduciary duty. These remedies may be pursued simultaneously, if the plaintiff chooses to do so.

### C *Specific Duties*

A succinct summary of trustees' duties is provided in *Jacobs' Law of Trusts*:

- 1 *Administrative duties*
  - To become acquainted with the terms of the trust;
  - To get in the trust property;
  - To carry out the terms of the trust;
  - To pay trust money and convey trust property to any persons entitled; and
  - To provide information to the beneficiaries.

## 2 *Duties of propriety*

- Not to be placed in a position of conflict between interest and duty;
- Not to make an unauthorised profit from the trust; and
- To act impartially between the beneficiaries.

## 3 *Management duties*

- To consider the exercise of any discretion conferred by the trust instrument;
- To invest the trust property in accordance with the standards of business prudence;
- To act prudently in the administration of the trust;
- To act gratuitously unless the trust deed or equity authorises remuneration; and
- Not to delegate the performance of duties or the exercise of trust powers, unless authorised to do so by the trust deed or s 28 of the *Trustee Act 1958* (Vic);

Non-delegation is an important duty: it prevents a trustee displacing responsibility for management of the trust onto a third party unless authorised by one of two sources:

- (a) The settlor, through the trust deed;
- (b) Applicable legislation, being the *Trustee Act*.

Most trust deeds will provide for remuneration to be paid to the trustees. Historically, trustees acted for free. Today, most trustees are paid for the simple reason that their duties are onerous.

The extent of information obtainable by beneficiaries of a trust is a matter of dispute.

Considering the exercise of any discretion afforded to the trustee is also important. A trustee cannot simply refuse to exercise a mere power and retain money for themselves.

## B *The Duty to Invest*

### 1 *Introduction*

The standard is one that an ordinary prudent business person would use when investing their funds. The 'obligational' standard of professional trustees (managed investors) is higher than standard business prudence.

#### ***Re Will of Sherriff (1971) NSW SC:***

##### Facts

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##### Issue

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##### Reasoning

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Decision

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2 *The equitable duty of business prudence***Speight v Gaunt (1883) UK Ch:**Facts

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Issue

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Reasoning

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Decision

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**ASC v A S Nominees (1995) FCA:**Facts

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Issue

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Reasoning

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Decision

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3 *Wealth maximisation versus social welfare*

**Issue:** can trustees take into account external issues, such as social welfare, when choosing investments for the trust? For example, can the trustees of an superannuation fund for the coal mining industry invest in a nuclear power company?

The argument is that by investing in a competitor the trustee is actually acting against the interests of the beneficiaries. As a result of *Cowan v Scargill*, such objections are unlikely to be heeded. Financial maximisation is the only duty incumbent on trustees. Financial interest is

defined as return on the investment, not retention of current financial benefits such as employment.

**Cowan v Scargill (1985) UK Ch:**Facts

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Issue

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Reasoning

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Decision

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4 *Investment strategy and portfolio theory*

The following factors should govern the investment strategies of trustees:

**Trustee Act 1958 (Vic):****Section 5****Section 6****Section 7****Section 8****Superannuation Industry (Supervision) Act 1993 (Cth) s 52(2)(f):**