law cannot provide justice, or when strict application of the common law would be unjust. Otherwise equity should follow the law. Equity follows statutes and the common law unless there is a problem with these laws — there is a gap in the law or the application of a statute or the common law would cause injustice, hardship or to do so would be unconscionable. An early example was *Bassett v Nosworthy*,[24] where Lord Nottingham specified that where a purchaser could defend his purchase at law then "his adversary shall never be aided in a Court of Equity". Of course, this depended on the purchaser also satisfying the principles of equity by being equity's darling — "a Purchaser, bona fide, without Notice of any defect in his Title at the Time of the Purchase made ...".[25]

More recently, the Court of Final Appeal in Hong Kong and the Privy Council have reiterated the importance of this first principle of equity in a number of decisions involving claims for ownership of property by way of a beneficial interest in a trust.[26] In these cases interest in the disputed property may be established by evidence of an express trust or an implied trust (resulting trust or constructive trust). However, equity first follows the law and the legal owners of property are the owners in equity unless those seeking to establish otherwise can prove this. Equity follows the law and anyone asserting otherwise has to establish this to the court's satisfaction.

2.4.1.2 *Equity will not permit a statute to be used as an instrument of fraud*

Though not one of the original maxims, and sometimes considered to be more an aid to statutory interpretation than a maxim, this guiding principle is often now invoked and is the justification for very important doctrines and rules of equity, for example the doctrine of secret trusts and the rule in *Rochefoucauld v Boustead*.[27] It may apply as follows. Some legislation provides formalities in the creation of instruments such as those for the declaration of a trust of land (Conveyancing and Property Ordinance (Cap.219)),[28] and the writing of a will (Wills Ordinance (Cap.30)).[29] These provisions are intended to prevent fraud by ensuring there is full documentation of the intents of the parties. However, sometimes parties will neglect the formalities, and a party to the transaction will try to use the non-compliance with the statutory requirement to their advantage by denying the transaction took place. For example, the party who has had land transferred to them to hold on trust may argue that, if there is no evidence in writing to comply with the requirement for a declaration of a trust of land in s.5(1)(b) of the Conveyancing and Property Ordinance, then there is no trust and the land is theirs absolutely. The statute is being used to perpetrate a fraud. In these circumstances equity may look to the true intent of the parties even though the formalities were not observed. However, there have been questions about the constitutional significance of a court using an equitable principle to ignore a statute.

2.4.1.3 *Equity will not suffer a wrong to be without a remedy*

As previously stated this maxim underlies the very reason for the emergence of equity. Equity was developed to mitigate the harshness of the common law as the common law had

24 (1673) Rep Temp Finch 102. Lord Nottingham was Lord Keeper at the time.
25 *Ibid.*, 103.
26 For example, see *Leung Wing Yi Asther v Kwok Yu Wah* (2015) 18 HKCFAR 605. For PC decisions see *Marr v Collie* [2017] UKPC 17; *Whitlock v Moree* [2017] UKPC 44.
27 [1897] 1 Ch 196.
28 Section 5; similar to the UK Law of Property Act 1925, s.53(1)(b).
29 Section 5; similar to the UK Wills Act 1837, s.5.

no remedy available to correct an obvious wrong.[30] The most important example of this is the trust. The common law does not recognise the existence of the trust and is only interested in legal ownership; therefore to enforce beneficial interests under a trust the beneficiary must rely on equity. However, equity will not always provide a remedy in order to do "justice". As Lindley LJ stated in *Holmes v Millage*,[31] "It is an old mistake to suppose that, because there is no effectual remedy at law, there must be one in equity". In order for an equitable remedy to be awarded there must be a recognised equitable cause of action or infringement of a legal or equitable right, or one must be capable of being asserted by analogy. For example, Sir George Baker P, when refusing to grant a husband an injunction to prevent an operation of abortion being performed upon his wife to prevent a clinic assisting his wife in aborting their child,[32] noted that the husband had "no legal right enforceable in law or equity to stop his wife having this abortion or to stop the doctors from carrying out the abortion".

2.4.1.4 *Equity will not assist a volunteer*

A volunteer is one who has given no valuable consideration for a transfer of property. Equity generally dislikes interfering with the rights of a third party, especially if they have no notice of prior equitable interests. Thus equity's darling will defeat a tracing action because he has given consideration, value, for the transfer. However, an innocent volunteer, ie, a party without notice but who has not given value, will not receive equity's aid. The only volunteer who is regularly an exception to this is the beneficiary, who usually has not given any consideration for his beneficial interest but upon whose behalf equity will enforce the trust.

2.4.2 Equity and priorities

If there has been a series of transactions and equity has to consider which should have priority, that is which should prevail over the others, or which should be recognised and enforced and in which order, the following principles give guidance.

2.4.2.1 *Where the equities are equal the law prevails*

This maxim again evidences equity's recognition and respect for legal interests and is the foundation of the doctrine of notice and the source of the *bona fide* purchaser without notice rule. The *bona fide* purchaser for value of a legal interest without notice of an equitable interest is known as "equity's darling". An equitable claim will not prevail against equity's darling because equity's darling and the holder of an equitable interest both have equitable rights (interests in the property). However, as both have interest in equity, the equities are equal, but the *bona fide* purchaser has a legal right also, he is the owner in law, and the law prevails.[33]

2.4.2.2 *Where the equities are equal the first in time prevails*

This maxim, in Latin *qui prior est tempore, potior est jure*, also explains the doctrine of notice. A purchaser with notice of another's prior beneficial interest takes their legal title subject to the other's equitable interest. Both the purchaser and the beneficial interest owner have equitable interests. As the purchaser's equity is newer, the prior beneficial interest wins.

30 *Li Pui Chuen v Chan Kam Ming* [1961] HKCU 59.
31 [1893] 1 QB 551, 555.
32 *Paton v Trustees of British Pregnancy Advisory Service* [1979] QB 276, 281.
33 An early example was the previously mentioned *Bassett v Nosworthy* (1673) Rep Temp Finch 102.

2.4.3 Equity and formalities

The common law is obsessed with formality. Thus legal transactions must be carried out in the correct form. This is to ensure certainty. This is particularly the case when the law's most important interests are being transacted — interests in land. Equity is less interested in the correct form and more in making sure the intent of the parties to the transaction are respected. Equity wants to ensure the parties to a transaction have been treated equitably and have acted in good conscience. Thus equity has developed guiding principles to deal with the lack of formality or even completion of all stages of a transaction.

2.4.3.1 *Equity looks to the substance rather than the form (sometimes equity looks to the intent rather than the form)*

Equity is not obsessed with formality as the common law is. Thus, at common law if a receipt is given for full payment of a price but only part-payment has been made, the law presumes that the full payment has been made. The form is all. In equity the true state of affairs is more important. In other words, it does not matter how an agreement is worded or recorded, it is the effect of the agreement that matters. For example, positive covenants in a sale or lease of land may not be enforceable against subsequent purchasers of land. A covenant is a formal agreement to do something, and a positive covenant involves the person bound by the covenant having to do something, for example spending money. A covenant may be worded, "not to allow a property to fall into disrepair". This would seem to be a negative covenant, as it says "do not do something", but its substance is positive, as its effect is to make the person bound by the covenant spend money. Therefore, equity regards this as a positive covenant.

2.4.3.2 *Equity imputes an intention to fulfil an obligation*

This maxim provides the foundation for the doctrines of satisfaction and performance. It is therefore the reason for the rule in *Strong v Bird*,[34] that if an imperfect gift is made during the donor's lifetime, and the intended donee is made executor/administrator of the donor's estate, then the vesting of the property in the donee as executor/administrator perfects the gift. It fulfils the intention of the donor. Similarly, it is the basis for the doctrine of satisfaction. Thus, if a testator leaves a legacy to a creditor it will be assumed this was done to aid in satisfying the debt. If the amount satisfies the debt the creditor has no further claim against the testator's estate.

2.4.3.3 *Equity regards as done that which ought to be done*

This maxim is used mostly in contract cases and is the reason for the remedy of specific performance and the rule in *Walsh v Lonsdale*.[35] Thus, when a contract is specifically enforceable, equity regards the promisor as already having done what he promised to do. In *Walsh v Lonsdale*, a contract to grant a legal lease that did not comply with the required formalities was still seen as giving rise to an equitable lease. The maxim also applies when a party has acted unconscionably in a fiduciary position. So, in *Attorney General of Hong Kong v Reid*,[36] where a fiduciary received a bribe in breach of his fiduciary duty, it was held that the fiduciary "ought" to have paid the money instantly to their principal. As equity would regard that this had been done, the fiduciary was therefore regarded as holding the money for the benefit of his principal, he was a constructive trustee.

The use of the maxim for specifically enforceable contracts is seen most often in contracts for the sale and purchase of land. When contracts have been exchanged for the sale and purchase of land, the contract is usually subject to specific performance. If the vendor tries to wriggle out of the contact and refuses to transfer the land, the purchaser can apply to the court for the equitable remedy of specific performance. If the court awards this remedy, which they usually do, then the vendor will have to fulfil their side of the bargain and transfer the land to the purchaser, of course the purchaser will have to pay all the purchase monies. The order for specific performance is granted because equity regards as done that which ought to be done under the contract for sale and purchase of the land. As the vendor has agreed to sell in the contract, the purchaser is regarded in equity as the owner of the land. As the vendor is still the legal owner of the land, the only way the purchaser can be the owner in equity is if the property is held on trust for him by the vendor. This is a constructive trust because the vendor's conscience is affected by their contractual obligation and promise to sell. The maxim is also the basis of the equitable doctrine of conversion considered later.

2.4.3.4 *Equity will not permit a trust to fail for want of a trustee*

Recently described by Queeny Au-Yeung J in the Court of First Instance as, "[t]he fundamental maxim of equity",[37] this maxim has its basis in the simple principle that once a trust is constituted it will be enforced by equity. If a trustee resigns, retires, is removed from his position or dies, equity will not allow the absence of a trustee to prevent the valid trust being carried out. The Chancellor and thus the court has always had the jurisdiction to appoint a new trustee.

2.4.3.5 *Equity will not perfect an imperfect gift*

This principle is derived from *equity follows the law* and *equity will not aid a volunteer*. This principle evidences the certainty that equity requires in ensuring a gift has been made because of the important consequences of the recognition of a valid gift. If a donor gives a gift to a donee, the donor loses all interest on the subject matter of the gift and the donee receives the subject matter absolutely. The donor cannot require the subject matter to be returned to them, as the common law does not recognise a gift for a second. Once a gift is made, it is a gift.

This maxim is the principle that was used to justify the decision in *Milroy v Lord*.[38] A donee of a gift does not give value for it. At law, to perfect a gift there must usually be intent by the donor to allow the donee to enjoy the property the donee's own and this is "perfected" or finished by the donor delivering the gift to the donee. Some forms of property, such as land and shares, require certain formalities in their transfer. If the donor or their agent does not follow these formalities, then equity will not step in to perfect the gift. The justification behind this maxim seems to be that the law requires delivery of the property to perfect the gift to allow the donor to realise the significance of their actions and the chance to change their minds. This is especially true of important property such as land,

34 (1874) LR 18 Eq 315.
35 (1882) 21 Ch D 9.
36 [1994] 1 AC 324.
37 *Peter William Lord v Balzac Ltd* [2019] HKCFI 1694, [2019] HKEC 2164, [23] (CFI).
38 (1862) 4 De GF & J 264.

which is why formalities are required. Equity here follows the law and will not step in to perfect an imperfect gift by assisting the volunteer (the proposed done).

2.4.3.6 *Equity will not construe a valid trust out of an imperfect gift*

This principle has been quite a strict rule and again evidences the importance of recognising gifts and trusts. The principle was noted in *Milroy v Lord.*[39] When a donor has not perfected a gift, many purported donees have attempted to argue that, as the donor wanted to give them the property but did not transfer it correctly and so still held legal title to the property, they must have held that property on trust for the donee. Generally, equity will not recognise this failure to give property in the required manner as a trust.[40]

2.4.3.7 *Equity will not strive officiously to defeat a gift*

This is a relatively recent principle and may not be considered a true maxim yet. It was enunciated and used by the Privy Council in *T Choithram International SA v Pagarani.*[41] The donor in this case had not transferred ownership of his shares to all the trustees of his charitable foundation but he was himself one of the trustees. On his deathbed he made a declaration that the shares now belonged to the trust. The Privy Council advised that, as he was a trustee he did not have to complete the formalities to transfer the shares to himself, and, although he should have transferred shares to all his fellow trustees as well, this was merely an administrative exercise. The full principle was explained as, "Although equity would not aid a volunteer, it would not strive officiously to defeat a gift." The principle was relied upon in the Court of Appeal's controversial decision in *Pennington v Waine.*[42]

2.4.4 Guiding principles in awarding remedies

Equity has developed principles to decide whether a remedy may be awarded to a party and how these remedies work.

2.4.4.1 *He who comes to equity must come with clean hands*

This maxim is sometimes given as *He who comes to equity must approach the court with clean hands* and is linked to the maxim *He who seeks equity must do equity* (considered next).[43] This maxim applies to conduct before the trial, whereas "doing equity" refers to future conduct. This maxim means that equity will not assist a plaintiff who has acted unconscionably or illegally in connection with the matter before the court. A party seeking equitable relief, based on good conscience, cannot rely on their illegal actions or intent.[44] For example, in *Re Emery's Investments Trusts,*[45] the British husband wished to purchase American Savings Bonds but was unable to do so at the time because of American tax law. The husband used his money to buy the bonds but registered them in the wife's name with the husband named as the beneficiary. The Bonds were later swapped for common

39 *Ibid.*
40 But see later discussion of *Re Rose* [1946] Ch 312, and *Pennington v Waine* [2002] EWCA Civ 227, and the use of constructive trusts to perfect gifts and constitute trusts.
41 [2001] 2 All ER 492.
42 [2002] EWCA Civ 227, [2002] 1 WLR 2075.
43 *So Chun Man Paul v Incorporated Owners of Chee On Building* [2000] 1 HKC 732.
44 *Li Pui Chuen v Chan Kam Ming* [1961] HKCU 59; *Hang Cheong Mould Pty (A Firm) v Rodopi Ltd* [1992] HKCU 75.
45 [1959] Ch 410, [1959] 1 All ER 577.

stock but still registered in the wife's name. There was evidence the intent was for an equal beneficial interest in the stock, but that the husband wished to avoid paying US tax as an alien. The wife sold the stock and the husband claimed half. In giving judgment that the wife held all of the interest in the stock, because of the presumption of advancement, Wynn-Parry J refused to accept the husband's evidence as it was tainted with an illegal purpose, to evade tax:

> "The husband … satisfied me by his evidence that his intention was that the beneficial interest should be shared, and there are various indications to support that, such as the retention of control and payment of dividends into the joint account. But matters such as the retention of control and the payment into the joint account cannot be decisive when once the equitable presumption of advancement has arisen, and it is necessary for the husband, in his endeavour to rebut that presumption, to assert that the property in question was put into his wife' name in order to avoid the payment on his beneficial interest of tax which would otherwise have been payable … He comes to this court seeking the aid of equity … it is impossible for this court to help him."[46]

Similarly, in *Li Hung Chan v Wong Woon Heung,*[47] after assigning property to his concubine in order to defeat his creditors, a scheme which was successful, a husband attempted to claim a beneficial interest in the property. The husband claimed the concubine had always known of the reason behind the transfer. The concubine denied any knowledge of the improper purpose of the transfer claiming it was a gift. Williams ACJ held that the husband could not rely on his improper motives to establish an equitable claim: "if he is to succeed, he must come with clean hands". Of course, the concubine, who knew of the purpose of the transfer and so was complicit in the husband's activities, was not asking for equitable relief to support her legal title and so her actions and knowledge were irrelevant. Thus the general principle is as opined by Salmon LJ in *Tinker v Tinker*:[48]

> "It is trite law that anyone coming to equity to be relieved against his own act must come with clean hands. If, in a case such as the present, he were to put forward, as a reason for being relieved against his own act, a dishonest plot on his part, for example, to defraud his creditors, the court would refuse him relief and would say: let the estate lie where it falls."[49]

Therefore, if a plaintiff has intended to or even has performed illegal or improper actions they may still be able to obtain assistance from equity provided that they do not have to rely upon their illegality in order to establish their claim. This is known as the "reliance principle"[50] and was exemplified recently in Hong Kong in the case of *Lau Ting Tai v Chung Chun Kwong.*[51] The Court of First Instance was asked to decide

46 *Ibid.*, 420–422 (Wynn-Parry J).
47 [1950] HKCU 21.
48 [1970] P 136.
49 *Ibid.*, 143 (Salmon LJ).
50 See *Tinsley v Milligan* [1994] 1 AC 340. The concept of illegality and resulting trusts is discussed in the chapter on the presumption of resulting trust.
51 [2010] 3 HKC 352.

and used the children's funds. The resulting trust of the option in his favour had come to an end at this point. Lord Denning MR noted:

> "A resulting trust for the settlor is born and dies without any writing at all. It comes into existence whenever there is a gap in the beneficial ownership. It ceases to exist whenever that gap is filled by someone becoming beneficially entitled. As soon as the gap is filled by the creation or declaration of a valid trust, the resulting trust comes to an end."

Section 53(1)(c) of the LPA 1925 did not apply, as this was a new declaration of trust. As this new trust involved shares not land it was also not covered by s.53(1)(b) of the LPA 1925.

Further attempts to avoid formalities using implied trust, as had been attempted but narrowly rejected in *Oughtred v Inland Revenue Commissioners*,[48] were considered by the English Court of Appeal in *Neville v Wilson*.[49] However, this time the issue was specifically enforceable contracts, constructive trusts and s.53(1)(c) of the LPA 1925.

Neville v Wilson[50]

Trustees (nominees) held shares in U Ltd on trust for N Ltd (beneficiary). N Ltd was liquidated. The shareholders of N Ltd orally agreed to distribute the beneficial interests in the shares in U Ltd, which N Ltd owned beneficially, amongst each other. The court had to decide whether s.53(1)(c) invalidated the oral agreement to distribute the beneficial interest in the shares in U Ltd. If it did invalidate the agreement, the shares would have no beneficial owner, and would thus pass to the Crown on the principle of *bona vacantia*.

Judgment:

> The oral agreement gave rise to a constructive trust in favour of the shareholders of N Ltd. Therefore s.53(1)(c) did not apply because of s.53(2). Therefore, the disposition of the equitable interest did not have to be in writing and the agreement was valid. This follows the argument put forward on behalf of Mrs Oughtred, in *Oughtred v Inland Revenue Commissioners*,[51] that her oral agreement with her son to exchange interests in shares in a private company was specifically enforceable and thus gave rise to a constructive trust. This had been the dissenting judgment of Lord Radcliffe in *Oughtred*. Of course, the circumstances of *Oughtred* are very different to *Neville*, as in the former the court was asked to decide whether Mrs Oughtred and her son had avoided taxation, whereas in the latter the court had to decide between the shareholders receiving the benefit or it going *bona vacantia* to the state. Whatever the outcome of a case however, the legal principles should be consistent.

These decisions have been much criticised by academics as showing little coherent reasoning about the nature of a disposition. This may because they are tax cases and there is a tendency for the courts to interpret legislation in favour of the tax authorities on the principle that the

48 [1960] AC 206, [1959] 3 All ER 623 (HL).
49 [1997] Ch 144, [1996] 3 All ER 171 (EWCA).
50 *Ibid*.
51 [1960] AC 206, [1959] 3 All ER 623 (HL).

legislature would not intend its legislation to be used to avoid taxation. Thus, whenever a transaction occurs which involves a beneficial interest in England the parties should be wary of falling foul of s.53(1)(c) of the LPA 1925, unless, of course, it is a deliberate attempt to avoid the writing requirement in order to avoid taxation.

5.2.5 Formalities for the creation of a valid testamentary trust

All declarations of testamentary trusts must comply with s.5 of the Wills Ordinance, the most important elements of which provide that a will shall be valid only if it is in writing, signed by the testator, or by some other person in his presence and by his direction and the signature is witnessed by two or more witnesses.[52] These formality requirements apply to all forms of property — personal and real (land). If a testamentary disposition does not comply with these formalities, for example it is not in writing or is not witnessed, it will be void. However, as we shall see equity will sometimes enforce testamentary trusts known as secret trusts even though they are not in writing in the will.

5.3 CAPACITY OF SETTLORS, TRUSTEES AND BENEFICIARIES

Capacity here refers to legal capacity, being legally able to do something. Everyone is presumed to be capable unless it is established otherwise.[53] Thus it is the burden of the party seeking to establish that someone was not capable, to establish that the relevant party acting under some legal incapacity. For the latter point, some people are not recognised as having legal capacity, for example the mentally ill or minors, this is for their protection. The law will not automatically recognise some actions of these people. This is to protect them so that they do not enter into transactions that they do not understand or do not intend. These restrictions on capacity are usually provided in statute.

Minors are those under the age of 18 years (Age of Majority (Related Provisions) Ordinance (Cap.410)).[54] There are no restrictions on minors holding the legal estate in land in Hong Kong, although the minor may not have the capacity to deal with land during his minority. When a minor attempts to settle personal property, then the trust will be voidable at the instance of the minor at any time within a reasonable time of his attaining majority. A minor may not make a will;[55] therefore a minor cannot create a trust by will.

Those adjudged to be suffering from a mental illness, as defined in Mental Health Ordinance (Cap.136), or suffering from some other form of mental incapacity which means they are incapable of understanding what they are doing, are considered to have no capacity to contract, execute deeds, make dispositions or manage their affairs. The court may administer the affairs of the mentally ill and make wills for them.[56]

52 This is almost identical to the UK Wills Act 1837, s.9.
53 The default presumption about capacity with regard to property transaction is provided in s.22 of the CPO:

> "A party to any instrument shall be presumed, until the contrary is proved, to have full legal capacity to execute that instrument, to bind himself in terms of that instrument and to dispose of or hold any property or rights assigned under that instrument."

54 Age of Majority (Related Provisions) Ordinance, s.2.
55 Wills Ordinance, s 4.
56 Mental Health Ordinance, s.10.

Certainty of subject: The subject matter of the trust must be certain or capable of being ascertained by the trustee. The trustees must know what property they hold subject to the trust obligation from the very beginning of the trust. The beneficiaries must be able to find out what property they have an interest in.

Certainty of subject matter divides into two parts:

(1) certainty of the subject matter itself; and
(2) certainty of the beneficial interest.

Therefore, the trust must be over certain specified property, the property must be identifiable. Thus a trust of the residue of an estate is certain as it is the amount left after all expenses of administering the estate and all other bequests and legacies have been settled and is capable of being ascertained. Although it may not be a certain amount until the estate is administered it is certain because it is whatever is left.

The beneficial interests of a trust are the subject matters of the trust property that each beneficiary is to get. Usually this must be specified, for example, "I leave $100,000 to my brother Bert to hold on trust in equal amounts for my two sons." This is a simple fixed trust with the beneficiaries and their beneficial interests clearly identified. Here the subject matter is certain, $100,000 and the beneficial interest, the shares of the beneficiaries is also certain, it is an equal share of the fund, $50,000 each.

Sometimes the beneficial interest is not specified but is left to be decided by the trustee or another. These trusts are known as discretionary trusts and do not fall foul of the requirement for certainty of subject matter, as the trustee is told what subject matter he is to hold and that he has discretion to apportion it. There is no problem with certainty of beneficial interests because someone, usually the trustee, has been given the power to decide these interests. For example, "I leave $100,000 to Bert to hold on trust for whichever of my children he regards as deserving in such amounts as he shall decide at his absolute discretion." With this trust Bert has the discretion to decide who the beneficiaries are and how much they will get — their beneficial interest. The subject matter is $100,000 and so is certain and Bert can decide on their beneficial interests.

Certainty of objects: To be valid, an express trust must also identify the beneficiaries or provide the means to identify the beneficiaries. The beneficiaries of a trust are known as its "objects"; thus there must be certainty of objects. In a fixed trust it must be possible to literally write a list of the beneficiaries; this is known as the list certainty test.[64] As we shall see, if the trustees of a trust have been given discretion to identify the objects of the trust, a discretionary trust, the trust will not fail for want of certainty of objects if a clear class of potential beneficiaries has been identified to the trustee. The problems of identifying whether a class of objects is certain, and the tests the courts have adopted to decide on certainty of objects, will be considered in the next chapter.

In addition to the requirement of certainty of objects an express private (non-charitable) trust must generally be for human beneficiaries or legally recognised entities, eg, a limited company. This is referred to as the "beneficiary principle".

64 *Inland Revenue Commissioners v Broadway Cottages Trust* [1955] Ch 20.

5.5 THE BENEFICIARY PRINCIPLE

The beneficiary principle is linked to the certainty of objects and was effectively espoused by William Grant the Master of the Rolls in *Morice v Bishop of Durham*,[65] as "there must be somebody in whose favour the court can decree performance".[66] Once the trust is formed, there must be a beneficiary of the trust who is able to ask the court to enforce the obligations of the trust against the trustee. The beneficiary controls the trust and may acquire property rights in the subject matter of the trust. This beneficiary is any individual, a human or a legally recognised entity (a registered company). If there is no identifiable beneficiary then the trust is a purpose trust, and trusts for purposes are generally void.[67] However, as with any legal rule there are exceptions, thus charitable trusts, also referred to as public trusts do not have to comply with the beneficiary principle. These are also the trusts of imperfect obligation, very limited categories of non-charitable or private purpose trusts.[68]

The beneficiary principle also causes problems for trusts in favour of unincorporated organisations, these are groups of people who have joined together for a common purpose but have not become a separate body in law from their constituent members. Unincorporated associations should be contrasted with corporations such as the registered company which has a separate legal personality. The problem is that a trust in favour of an unincorporated organisation seems to be a trust for the purposes of the organisation and so should be void as a private purpose trust. We will see how the courts have attempted to clarify such trusts and gifts in favour of unincorporated organisations in Chapter 7 dealing with the beneficiary principle.

5.6 VITIATING FACTORS: LEGALITY AND PUBLIC POLICY

A vitiating factor is a factor which makes an agreement faulty, it invalidates an agreement. In contract law misrepresentation or duress may be vitiating factors. In equity we have already considered the doctrine of undue influence which may vitiate or invalidate a contract. In trust law factors that may invalidate trusts are trust purposes which are illegal or against public policy. Such factors can be divided into:

(1) trusts for illegal purposes: trusts which are for illegal purposes or encourage illegal purposes;
(2) trusts which are for illegal purposes or against public policy in other jurisdictions: forced heirship;
(3) trusts that are against public policy: for example, traditionally trusts which may prevent or break up marriage, or have a capricious purpose; and
(4) Trusts which offend the rules against perpetuity, inalienability and accumulation.

65 (1805) 10 Ves Jr 522, 32 ER 947.
66 Although it is possible to have a trust for the benefit of an unborn or unformed beneficiary as long as the trustees are certain who they owe the obligation to, for example, a not yet incorporated company: *Town Bright Industries Ltd v Bermuda Trust (Hong Kong) Ltd* [1998] 2 HKC 445.
67 *Re Astor's Settlement Trusts* [1952] Ch 534.
68 Charitable trusts are dealt with in Chapter 8 and trusts of imperfect obligation are dealt with in Chapter 7 on the beneficiary principle.

5.6.1 Trusts for illegal purposes and the doctrine of sham

It is not possible to have a trust for an illegal purpose. Trusts are built on conscience and so it should be impossible for equity to recognise a trust which furthered an illegal purpose or one which was against public policy.[69] Trusts for illegal purposes may be to encourage others to do something illegal or to affect an illegal purpose. Trusts that are set up to encourage illegal purposes are void. For example, a trust to pay the fines of convicted poachers was declared void as it would take away the penalty of the law and thus encourage the illegal activity, poaching.[70]

The most common illegal purpose behind creating a trust is to commit fraud. Generally a "sham" or false transaction, such as a sham conveyance, will be set aside if the intent is to avoid a liability or for fraud.[71] When equity considers fraud it is not considering the same sense of deceit as at common law. In equity fraud takes a more general meaning such as, "any breach of the sort of obligation which is enforced by a court that from the beginning regarded itself as a court of conscience".[72] Thus equitable fraud would include obtaining an advantage by any behaviour which equity would consider unconscionable, as equity must "correct men's consciences for frauds, breach of trusts, wrongs and oppressions".[73] Trusts cannot be set up to attempt to avoid statutory obligations — for example, to avoid obligations on divorce in matrimonial legislation and making provision for dependents in your will.[74]

If a court believes a trust has been set up to defeat the claims of creditors, then it may be declared void as a sham.

Midland Bank plc v Wyatt[75]

Mr and Mrs Wyatt were joint owners of the family home, subject to mortgage. They both signed a declaration of trust of the beneficial interest of the house in favour of Mrs Wyatt and their daughters. At this point, if the trust were in existence, Mr Wyatt held only bare legal title and no beneficial interest. Mr Wyatt took out loans with his bank on the understanding that he still had a beneficial interest in the property. His business went into receivership and the bank attempted to effect security against the house. Mr Wyatt claimed that he was only a trustee of the house for his wife and daughters and therefore it could not be used to satisfy his creditors.

Judgment:

The court held that the arrangement was purely a sham; Young QC noted as follows:

> "I do not believe Mr Wyatt had any intention when he executed the trust deed of endowing his children with his interest in the … House, which at the time was his only real asset. I consider the trust deed was executed by him, not to be acted upon but to be put in the safe for a rainy day — as Mr Wyatt states in his affidavit, as a safeguard to protect his family from long term commercial risk should he set up his own company. As such I consider the declaration of trust was not what it purported to be but pretence or, as it is sometime referred to, a sham."

69 However, the origin of the doctrine of secret trusts may be closely associated with fast changing political regimes in 16th- and 17th-century England where secret trusts were created for purposes illegal under the existing regime but recognised and enforced by the succeeding regime.

70 *Thrupp v Collett* (1858) 26 Beav 14.

71 Eg, *Chan Chun Chung v PBM (Hong Kong) Ltd* [2005] 1 HKLRD 565.

72 *Nocton v Lord Ashburton* [1914] AC 932, 954 (Viscount Haldane LC).

73 *Earl of Oxford's* case (1615) 1 Ch Rep 1 (Lord Ellesmere).

74 Inheritance (Provision for Family and Dependants) Ordinance; see *TWH v CSK* [2011] 4 HKLRD 544, [2011] HKFLR 449.

75 [1995] 3 FCR 11.

Therefore Mr Wyatt had never intended to create a trust. He had never intended to give his beneficial interest in the property to his wife and daughters he had merely set up the arrangement to defeat his creditors. Thus the trust did not exist and the bank could take action against the house. The Court also confirmed the definition of "sham" given by Lord Diplock in *Snook v London and West Riding Investments Ltd*,[76] applied to sham trusts:

> "... acts done or documents executed by the parties to the 'sham' which are intended by them to give third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intended to create".

However, it should be noted that the doctrine of sham is a common law doctrine and equity has its own principles to deal with such issues, foremost amongst which is, equity looks to the substance rather than the form. Therefore, there have been few cases which have followed Wyatt and more where the court has just said there was no intention to create a trust, or there was intention to create a trust but its terms differed from those in the trust instrument. This is further considered when we discuss trustees, settlors and their reservation of powers.[77]

As well as not permitting the creation of a trust for an illegal purpose, equity will not consider evidence of an illegal purpose to rebut a trust or an equitable presumption such as the presumption of advancement.

> A gratuitous transfer of property from Tim to Robert creates a presumption that Robert holds the property on resulting trust for Tim.[78] However, if Robert is Tim's son then there is also a presumption of advancement; it is presumed that Tim wished to help his son, that this is purely a gift. This presumption can be rebutted with evidence that a gift was not intended, that Tim intended the property to be held on trust for him and eventually returned. However, if the property were transferred for an illegal purpose, for example, if Tim were insolvent and had creditors demanding payment, he may have transferred the property to Robert to avoid the property becoming part of his assets on bankruptcy to be divided between his creditors. If this is the case then Tim cannot plead his own illegal motives in transferring the property to rebut the presumption of advancement. Equity will not listen to his illegal motives and will see the transfer as a gift to Robert. (That is unless it can be set aside by the creditors as an illegal transaction anyway.)

76 [1967] 2 QB 786, 802.

77 See the discussion in Chapter 18 regarding the administration, duties and powers of trustees and, in particular *JSC Mezhdunarodniy Promyshlenniy Bank v Sergei Viktorovich Pugachev* [2017] EWHC 2426 (Ch).

78 The presumed resulting trust: see *Hodgson v Marks* [1971] 1 Ch 892 (CA), and the chapter on presumed resulting trusts.

powers or its inherent jurisdiction to vary the terms of a trust and so exclude or ignore a capricious element if it did not wish to void the whole trust.[90]

5.7 THE RULES AGAINST INALIENABILITY, PERPETUITIES AND EXCESSIVE ACCUMULATION

Many centuries ago the state and the common law recognised that arrangements of land which removed or alienated land from the open market could lead to economic stagnation. This recognition came because of the prevalence of gifts of land to the Church. In mediaeval England when men neared death they sought salvation by passing their property to the Church in return for forgiveness for their sins. However, the Church was a corporation which did not die, therefore, as it was not subject to normal feudal dues on death, and was unlikely to sell land, so also ensuring no fees would be payable to the crown on transfer of land, the king and the feudal lords were in genuine fear that all land would eventually end up in the "dead hand" of the Church.[91] Thus the Statutes of Mortmain (literally "dead hand") were introduced in 1279[92] to prevent gifts or trusts in favour of corporations, which could have perpetual existence and alienate property from the market forever. However, the general principle from the Acts, that property should not be alienated from general circulation, as this adversely affects commercial progress (and the state's revenue), was developed into the rules against perpetuities. These rules developed because landowners attempted to found dynasties by creating family settlement trusts that restricted land to pass to their children and their children's children, and so on. Sometimes a settlor would even attempt to place restrictions or conditions on the beneficiaries' interests such that they would lose their interest in certain circumstances and it would switch to others. If such settlements were allowed then these descendants would not be able to deal with the land as an absolute owner, they would not be able to sell or dispose of the land, in effect they would be life tenants forced to look after the land for succeeding generations and perhaps even subject to losing their interest if they did not comply with the instructions of the dead. This restriction on the freedom to deal absolutely with property, to alienate or dispose of it was again considered to tie up land in a way that would adversely affect the economy and society. As Jekyll MR stated in *Stanley v Leigh*:[93]

> "the mischief that would arise to the public from estates remaining for ever or for a long time inalienable or untransferable from one hand to another, being a damp to industry and prejudice to trade, to which may be added the inconvenience and distress that would be brought on families whose estates are so fettered".[94]

90 See Chapter 20 on beneficiaries and variation of trusts.

91 The increasing wealth of the Church also made king's nervous of the Church as a powerful political rival.

92 Such restrictions were originally included in the Great Charter of 1217. *Halsbury*'s states that the principle that a perpetuity is forbidden was a principle of the common law and may have been introduced after *Quia Emptores* (18 Edw 1, 1289–1290): *Halsbury's Laws of Hong Kong*, 13, Perpetuities (1) [230.0855]. Some of the provisions of the Acts were not repealed until the 20th century.

93 (1732) 2 P Wms 686, 688.

94 As Emery asks, "why should the dead rather than the living prescribe indefinitely who should be entitled to the use and enjoyment of property…?" C Emery, "Do We Need a Rule against Perpetuities?" (1994) 57 *Modern Law Review* 602, 603.

These restrictions were termed "perpetuities", referring to the perpetual control of the dead, and perpetuities were not accepted at common law. It was only in the late 17th century that Lord Nottingham developed the rule against perpetuities, in *Howard v Duke of Norfolk*,[95] and equity permitted restrictions on future disposition and switching of interests for a certain period.

Perpetuities represent one of the most confused areas of the common law and have been described as having "superfluous technicalities and complexities".[96] Professor Gray noted:[97]

> "There is something in the subject which seems to facilitate error, perhaps it is because the mode of reasoning is unlike that with which lawyers are most familiar.... A long list might be formed of the demonstrable blunders with regard to its questions made by eminent men, blunders which they themselves have been sometimes the first to acknowledge; and there are few lawyers of any practice in drawing wills and settlements who have not at some time either fallen into the net which the Rule spreads for the unwary, or at least shuddered to think how narrowly they have escaped it."

Leach described the rule as a "technicality-ridden legal nightmare" and a "dangerous instrumentality in the hands of most members of the bar".[98] Judicial recognition of the complexity of the rule is exemplified by the decision of the Supreme Court of California in *Lucas v Hamm*.[99] A Californian attorney had drafted a legacy in terms which made it void for perpetuity. The provision was structured such that the trust would terminate within 5 years of the order from the probate court distributing the subject matter to the trustee, the very remote possibility that it would take the probate court a life in being and 16 years, the 21-year period less the 5 years for distribution by the trustee, was enough to invalidate the trust. The Supreme Court of California held that the attorney was not liable as California lawyers are not expected to understand the rule against perpetuities.[100] Gibson, CJ gave the judgment of the Court and noted as follows:[101]

> "The complaint, as we have seen, alleges that defendant drafted the will in such a manner that the trust was invalid because it violated the rules relating to perpetuities and restraints on alienation. These closely akin subjects have long perplexed the courts and the bar… Of the California law on perpetuities and restraints it has been said that few, if any, areas of the law have been fraught with more confusion or concealed more traps for the unwary draftsman; that members of the bar, probate courts, and title insurance companies make errors in these matters; that the code provisions adopted in 1872 created a situation worse than if the matter had been left to the common law, and

95 (1681–1685) 3 Ch Cas 1, 22 ER 931, 2 Swans 454, 36 ER 690, 1 Vern 163, 23 ER 388.

96 W Barton Leach, "Perpetuities in Perspective: Ending the Rule's Reign of Terror" (1952) 65(5) *Harvard Law Review* 721, 723.

97 JC Gray, The Rule against Perpetuities (New York: Little, Brown and Co, 4th ed., 1942) p.xi.

98 W Barton Leach, "Perpetuities Legislation" (1954) 67 *Harvard Law Review* 1349.

99 *Lucas v Hamm*, 56 Cal 2d 583 (1961); Gibson CJ gave the judgment of the Court with Traynor, J, Schauer, J, McComb, J, Peters, J, White, J, and Dooling, J, concurring. See also RE Megarry's comment on the case in (1965) 81 *LQR* 478.

100 For modern consideration of lawyer's potential liability to disappointed legatees see *White v Jones* [1995] 2 AC 207 (HL). See also AHR Brierley and Roger Kerridge, "Will Making and the Avoidance of Negligence Claims" (1999) (Sep–Oct) *Conveyancer and Property Lawyer* 399–413.

101 *Lucas v Hamm* 56 Cal 2d 583 (1961), [11].

alters its register of members to reflect the transfer, issues a new certification of transfer to the new owner.[13] If appropriate the new owner also has to pay stamp duty.

Therefore, to give a gift of shares, the donor has to comply with the transfer requirements for the shares as required in the statute and in the company's constitution. Similarly, to create a trust by transfer to a trustee, a settlor has to comply with these formalities for transfer. However, to declare yourself as trustee of your own shares, there are no formalities, just compliance with the requirements of equity for a self-declaration of trust.

There are also formalities required in the transfer of a cheque. A cheque is a bill of exchange drawn on a banker payable on demand.[14] As a cheque is merely an instruction to pay, a volunteer cannot cash a cheque if the donor changes his mind or dies before the cheque has been paid.[15] A cheque is a special form of bill of exchange and so may usually be negotiated — it may be sold or given away — subject to the provisions in the Bills of Exchange Ordinance (Cap.19). If a cheque has been made out in your favour, ie, your name is on it as a payee, if you wish to pass it to someone else you need to endorse it. This is usually done by signing the back of the cheque, which allows the bearer to pay the cheque into their account. Banks have tried to restrict the negotiability of cheques to protect themselves from liability for any fraud or mistake, which is why they are usually crossed "a/c payee only". This should make them non-negotiable. However, cheques are still negotiated.

Therefore, the method of transfer of the property to be the subject matter of a trust or gift depends on the nature of the property and the legal requirements for transfer of that type of property. The formalities and consequent effort and delay involved in transferring property are important, as they give the settlor/donor the chance to think about the consequences of his actions and to be sure he intends to part with his interest in such property by way of trust or gift. The formalities also allow those outside the transaction to know that property has been transferred to another legal owner. This is why there are statutory formality requirements for conveying land and transferring shares. However, in enforcing formalities equity has to consider balancing the need for formality against the wishes of the donor/settlor.

Equity has one simple principle for the recognition of the perfection of a gift or constitution of a trust and that is what we will consider next.

9.4 THE SIMPLE PRINCIPLE OF EQUITY FOR PERFECTION OF GIFTS AND CONSTITUTION OF TRUSTS

In *Milroy v Lord*,[16] Turner LJ noted the one simple principle that equity will apply to decide if a gift has been perfected or a trust constituted, whether by way of transfer or declaration of yourself as trustee:

> "I take the law of this Court to be well settled, that, in order to render a voluntary settlement valid and effectual, the settler must have done everything which, according to the nature of the property comprised in the settlement, was necessary to be done in order to transfer the property and render the settlement binding upon him."[17]

13 Companies Ordinance, s.154.
14 Bills of Exchange Ordinance, s.73(1).
15 *Ibid.*, s.75(b). See *Curnock v Inland Revenue Commissioners* [2003] WTLR 955.
16 (1862) 4 De GF & J 264.
17 *Ibid.*, 274.

Therefore, the principle is that the person giving a gift or creating a trust must have done everything "necessary" according to the nature of the subject matter to either transfer it to the donee or trustee, or declare themselves trustee of the property.

Let us now look at how this principle is applied to identify a valid declaration of the settlor as trustee, before we go on to consider the rules of equity regarding the transfer of property for the constitution of a trust or the perfection of a gift.

9.5 DECLARATION OF SETTLOR AS TRUSTEE

A settlor may create a trust by declaring himself a trustee. Obviously, the settlor already has legal title to the property and so does not have to transfer it to another. Thus there are no problems with constitution of the trust to do with the transfer of the property. The most important factor is therefore a valid declaration of trust. There must be a clear declaration of trust and the cases regarding the certainty of intention to create a trust are important for evidencing this clear intention to place oneself under a trust obligation. The word "trust" does not have to be used, but there must be words and/or actions which evidence this intention to place the settlor under a trust obligation. Thus, in *Paul v Constance*[18] the Court held that Mr Constance's words "this money is as much yours as mine" and the couple's actions in depositing their joint winnings in the bank account were evidence of Mr Constance's intention to make himself trustee of the account for them both. The Court of Appeal noted that Mr Constance probably would not have understood the legal concept of a trust but held that his words and actions evidenced his intention to place himself under the equivalent of a trust obligation.

A self-declaration of trust may arise impliedly from the actions of the settlor: for example, in *Re Kayford Ltd*,[19] the segregation of funds into a special account from general trading funds by a company was considered evidence that the company had declared a trust of the funds on behalf of its customers. Similarly, the segregation of loaned funds by a company for use for a specific purpose may be considered a declaration of trust by the company over the funds on behalf of the lender.[20] There are no formality requirements for a self-declaration of a trust of personal property; however, to be enforceable, as noted above, a self-declaration of a trust of land will need to comply with s.5(1)(b) of the Conveyancing and Property Ordinance — it will need to be manifested and proved in writing.

One of the important principles of equity which was confirmed in *Milroy v Lord*[21] is that *equity will not construe a valid trust from a failed gift*. Often when the donor of an attempted gift has failed to transfer the property as required to the donee, perhaps because the donor has died before they can perfect the gift, then the donee, or someone acting on their behalf, will attempt to argue that the donor's intention to give the property has placed them under an obligation to give the property and so they must have been holding it on trust for the purported donee. Of course, this cannot be the case as there must be a certainty of intention to create a trust to establish a valid trust and here there is a clear certainty to give a gift, not

18 [1977] 1 WLR 527.
19 [1975] 1 WLR 279.
20 *Barclays Bank Ltd v Quistclose Investments Ltd* [1970] AC 567 (HL).
21 (1862) 4 De GF & J 264.

to place oneself under a trust obligation.[22] However, this has not prevented disappointed donees from arguing that the failure to transfer property to perfect a gift means the donor was holding the property on trust for the donee and even one English Court of Appeal decision accepting such argument.[23] There are numerous examples of equity refusing to construe a valid trust from a failed gift.

Jones v Lock[24]

Mr Jones returned from a business trip. His baby's nurse complained that he had not brought anything back for his baby son. Mr Jones then produced a cheque for £900 and said, in the presence of his wife and the baby's nurse: "Look you here, I give this to baby." He then placed the cheque into the baby's hand, before placing it in a safe. He died a few days later. The gift was not perfected as he had not endorsed the back of the cheque in his son's favour. It was argued on behalf of the son that Mr Jones had declared himself a trustee of the cheque in his son's favour.

Judgment:

> The Court was clear that the failure of the gift was not enough to evidence a self-declaration of trust. Mr Jones' words were merely "loose conversation" and not enough to evidence the certainty of intention to place him under a trust obligation.

Richards v Delbridge[25]

Mr Delbridge wanted to give the lease he had over business premises, which he used for his successful bone manure business, to his grandson, Edward Benetto Richards. He endorsed on the lease "this deed and all thereto belonging I give to Edward Benetto Richards from this time forth with all stock-in-trade". He then gave the lease to Richards' mother to hold for Richards, but died before it was delivered to Richards himself. There was no transfer of the lease as, at this time, statute required leases to be assigned by deed. Thus, the intended gift did not comply with the formalities required. It was argued on behalf of the grandson that Delbridge had declared himself trustee to hold the lease on trust for his grandson.

Judgment:

> The Court held that there was no self-declaration of trust. To declare a valid trust it was not necessary to use words such as "I declare myself trustee", but it was necessary to do or to say something equivalent to it. As the grandfather had not there was no trust. The grandfather had never intended a trust but simply a gift. This was imperfect and the court would not then construe his intention as to create a trust.

22 Eg, Romer J, in *Re Fry* [1946] Ch 312, noted that the intention of the donor to give the property, which he failed to do, could not constitute an intention to hold the property on trust.
23 *Pennington v Waine* [2002] EWCA Civ 227, [2002] 1 WLR 2075, discussed below.
24 (1865) LR 1 Ch App 25.
25 (1874) LR 18 Eq 11.

When there is a self-declaration of trust there may still be some confusion over whether constitution has occurred, especially if the settlor is not the sole trustee. This was the case in *T Choithram International SA v Pagarani*,[26] the settlor had repeatedly declared that he would give his property, mostly shares, to a charitable company which he had set up and of which he was one of the trustees. He died declaring that all his property now belonged to the trust. However, the necessary formalities for share transfer had not been complied with and his next of kin argued that there was no valid constitution of the trust and so it fell into residue and should be divided amongst them. The Privy Council, overturning a decision of the High Court of the British Virgin Islands, held that the trust was constituted at the moment the settlor declared his property belonged to the trust as he was one of the trustees. This case is considered further below.

9.6 THE RULES FOR TRANSFERRING PROPERTY TO CONSTITUTE A TRUST AND PERFECT A GIFT

The principles applicable to the transfer of property to constitute a trust when the trustee is not the settlor and to perfect a gift are the same. Both require the transfer of legal title to property to another — the trustee or the donee. When equity has to consider whether there has been a transfer of property sufficient to constitute a trust or perfect a gift it has taken a quite strict approach because of the consequences of constitution of a trust and perfection of a gift. This was exemplified in the seminal case of *Milroy v Lord*.[27]

Milroy v Lord[28]

The settlor, Thomas Medley, attempted to create a trust by transferring shares in the Bank of Louisiana to Lord to be held for his niece. However, the Bank required any share transfer to be recorded in its register of members. Medley transferred the share scripts to Lord but did not affect the change in the Bank's records. Lord had powers of attorney and could have registered the transfer but did not. Medley died without instructing Lord to do so. Medley left a substantial pecuniary legacy to his niece in his will. Milroy, the niece's husband, asked the Court to enforce the trust as there was clear evidence that the settlor had intended to create a trust. The trial judge recognised the trust. Medley's executor appealed.

Judgment:

> The Court held that there had been no transfer of property thus there was no trust because it remained unconstituted. Turner LJ noted:
>
> > "Under the circumstances of this case it would be difficult not to feel a strong disposition to give effect to this settlement to the fullest extent, and certainly I have spared no pains to find the means of doing so, consistently with what I apprehend to be the law of the Court; but, after full and anxious consideration, I find myself unable to do so."

26 [2001] 1 WLR 1, [2001] 2 All ER 492.
27 (1862) 4 De GF & J 264.
28 *Ibid.*

For the constitution of a trust or the perfection of a gift, equity required that:

> "the settlor must have done everything which, according to the nature of the property comprised in the settlement, was necessary to be done in order to transfer the property and render the settlement binding upon him".

The settlor should have transferred the shares in the required manner to the trustee, Lord, for the trust to be constituted. The niece was a volunteer, although there was mention of a dollar being paid as consideration in the declaration of trust, and equity would not assist a volunteer.

The decision in *Milroy v Lord* may seem harsh and ignore other equitable maxims, such as *equity looks to the intent not the form*, but reflects the important consequences of the constitution of a trust and the perfection of a gift.

Thus, the principle of equity which is applied by courts when considering whether there has been the constitution of a trust or the perfection of a gift is whether the settlor or donor has done "everything necessary" to transfer the property to the trustee or donee according to the nature of the property.[29] This principle was applied in *Re Fry*.[30]

Re Fry[31]

Mr Fry was a resident of Florida in the United States of America. Fry wished to transfer shares in a private company to his son. Fry signed the share transfer form and gave the share certificates to his son, who then sent the transfer to the company to be registered. As this was during the World War II, the consent of the British Treasury was required for transfers of shares involving those not resident in the United Kingdom. Fry did not apply for Treasury consent and died before it could be obtained.

Judgment:

It was held that the donor had not done all that he was required to do for the transfer of the shares to the donee; therefore the gift was not perfected. Romer J reasoned thus:

> "Now I should have thought it was difficult to say that the testator had done everything that was required to be done by him at the time of his death, for it was necessary for him to obtain permission from the Treasury for the assignment and he had not obtained it. Moreover, the Treasury might in any case have required further information of the kind referred to in the questionnaire which was submitted to him, or answers supplemental to those which he had given in reply to it; and, if so approached, he might have refused to concern himself with the matter further, in which case I do not know how anyone could have compelled him to do so… [Treasury] sanction was never in fact obtained; it might indeed (although the probabilities are certainly otherwise) never have been forthcoming at all."[32]

Romer J also held that the intended transfer as a gift did not create a trust:

> "As the testator intended the gifts now in question 'to take effect by transfer', it follows from these observations of Turner L.J. [in *Milroy v Lord*] that no question as to the creation of a trust in favour of the donees can arise, and indeed, no argument so based was advanced on their behalf."[33]

There was some criticism that the decision in *Re Fry* was too harsh and that there should be some flexibility in the principle regarding what a settlor or donor had to do to constitute a trust or perfect a gift, especially in the light of the settlors/donors clear intentions and reliance on third parties to complete the transfer. The English Court of Appeal considered this in *Re Rose*.[34]

Re Rose[35]

Rose wanted to transfer shares in a private company to trustees. In March 1943, Rose executed a deed transferring the shares to the trustees; all other formalities that Rose could attend to were completed. However, the directors of the company had the power to refuse to register transfers of shares; thus they had to approve registration of the new shareholders. The directors did not approve registration of the trustees as the owners of the shares until June 1943. The trustees were duly entered in the register of members. Rose died within five years of the transfer being registered by the directors, but more than five years after he had completed all that was within his power to transfer the shares. The time of transfer was very important, as if the trust had been constituted within five years of his death, the shares would have formed part of his estate for taxation purposes, if he had divested himself of title to the shares more than five years before his death then the shares would not form part of his estate and were not liable to taxation. Thus, the court had to consider whether the trust was constituted when Rose had done everything within his power to transfer the shares, or was it constituted two months later, when the directors approved the transfer to the trustees. The latter would follow the principle in *Milroy v Lord* and *Re Fry*, as Rose had not done everything necessary to transfer the shares as he had not obtained the consent of the directors.

Judgment:

The Court held that March 1943 was the effective date for the transfer of the equitable ownership of the shares. Rose was a trustee of the shares from that date with beneficial interest vested in the trust he was setting up. The Court was not upholding an express trust but recognising that Rose had done everything within his power to transfer the shares to his trustees when the deed was executed. He had divested himself of the beneficial

29 Approved in *Cheung Pui Yuen v Worldcup Investments Inc* [2008] HKEC 1808, (2009) 12 HKCFAR 31, [31] (CFA) (Lord Scott of Foscote NPJ).
30 [1946] Ch 312.
31 *Ibid.*

32 *Ibid.*, 317.
33 *Ibid.*, 316.
34 [1952] Ch 499.
35 *Ibid.*

ownership in favour of the beneficiaries of the express trust and held legal title purely on constructive trust to be passed to the trustees for the benefit of the beneficiaries.

The principle from *Re Rose* is that a trust will be constituted and a gift perfected when the settlor or donor has done all that is in his power to transfer title to the property to the trustees or the donees and now MUST rely on a third party to finish the transfer. This principle was applied by the English Court of Appeal in *Mascall v Mascall*.[36]

Mascall v Mascall[37]

A father wanted to give registered land to his son. The Father sent the necessary form to the Inland Revenue for the payment of Stamp Duty and gave the Land Certificate to his son. Legal title to registered land only passes when the Land Registry registers the transfer. It is usually the responsibility of the transferee to register the transfer at the Land Registry. Before the son could register the transfer he quarrelled with his father. The father attempted to prevent the gift by seeking a declaration that the transfer had not taken place and so the gift was not perfected.

Judgment:

The Court of Appeal applied *Re Rose* and held that as the father had done all within his power to effect the transfer the gift was perfected. The final transfer relied on someone other than the donor. The father held the land on trust for his son until his son registered the transfer in legal title.

The principle in *Re Rose* does conflict with *Milroy v Lord* in that equity does constitute an unconstituted trust; however, it does this by way of a constructive trust and it is done to fulfil the wishes of the settlor. The constructive trust is a convenient institution whereby equity considers a legal owner of property has fulfilled an obligation to transfer property to another even though he has not actually done so on the basis that equity looks on as done that which ought to be done. Therefore, if the legal owner of property has done everything they possibly can do to transfer the property, but has not done everything necessary to effect the transfer, equity may consider their conscience affected by their efforts and so consider the transfer effected by a constructive trust. Thus the legal owner merely holds legal title to the property and the beneficial interest is held for the intended transferee.

The relaxation of the rule for effective transfer of property in *Milroy v Lord*, that a transferor must have done everything necessary according to the nature of the property to transfer it to the transferee, to the rule in *Re Rose*, that a transferor must have done everything within his power to transfer the property to the transferee if he then has to rely on another to finish the transfer, was subjected to a strange development by the English Court of Appeal in *Pennington v Waine*.[38]

36 (1984) 50 P & CR 119.
37 *Ibid.*
38 [2002] EWCA Civ 227, [2002] 1 WLR 2075.

Pennington v Waine[39]

Ada Crampton wanted to make her nephew, Harold Crampton, a director of a private company in which she held 1,500 shares. Directors were required to have a share ownership, thus Ada wanted to give Harold 400 of her shares to enable him to become a director. She also intended to leave Harold more shares in her will so that he could take control of the company. Ada signed the share transfer form and sent it to Pennington, her accountant. Pennington arranged for Harold to be appointed director of the company, but Ada died before Pennington completed the share transfer to Harold. Ada's will left Harold more shares which would, together with the 400 she had tried to give to him, have given Harold a 51 per cent controlling interest in the company. Ada's residuary beneficiaries claimed that the transfer was invalid and that the shares should fall into residue for them. Ada had not done all that was necessary to perfect the gift and so failed the rule in *Milroy v Lord*. She had also not done all within her power, as Pennington was her agent and seen as an extension of her, thus as he had not done all within his power to transfer the shares this failed the rule in *Re Rose*.

Judgment:

The Court of Appeal held that there had been a valid transfer of the shares.

The reasoning behind the decision seems a little unclear. Clarke LJ seemed to view this as an extension of the *Re Rose* principle, although unlike *Re Rose* and *Mascall v Mascall* there had not been delivery of the subject matter or means of registering title to the subject matter to the transferee. Arden LJ seemed to approve the perfecting to the gift on the basis of unconscionability, because, if Ada had been alive, it would have been "unconscionable" for her to go back on her promise. This seems to be a variety of estoppel with the signing of the share transfer form and delivery of this to her agent, together with Harold's knowledge that he was to receive the shares as consideration for him taking over the running of the company,[40] being viewed as putting Ada in a position where she could not have instructed Pennington to stop the transfer to Harold. This seems to ignore previous authorities such as *Re Fry*, where Fry had delivered signed share transfer forms and share certificates to the transferee but not obtained Treasury consent for the transfer. Romer J noted that Fry could have changed his mind and could not have been compelled to transfer the property. Arden LJ opined that Ada could not have changed her mind. There was also some consideration that either Ada or Pennington had become trustees of the shares when the gift was not perfected.

There has been much criticism of the decision in *Pennington*,[41] as there is always a concern over the use of "unconscionability" as the basis for judicial decisions, especially in an area which has traditionally emphasised the need for certainty.[42] The decision seems to have been based on a misunderstanding of the decision by the Privy Council in *T Choithram International SA v Pagarani*,[43] where a settlor was a trustee of a charitable trust and on his death bed made a declaration that all his property now belonged to the trust. The majority

39 *Ibid.*
40 Sarah Worthington, *Equity* (Oxford: Clarendon Law Series, 2nd ed., 2006).
41 As noted in *Chan Gordon v Lee Wai Hing* [2011] HKEC 300, [65].
42 J Garton, "The Role of the Trust Mechanism in the Rule in Re Rose" (2003) 67 *Conveyancer and Property Lawyer* 364.
43 [2001] 1 WLR 1.

in *A-G for Hong Kong v Reid*,[62] Reid was the Director of the Commercial Crime Unit in Hong Kong and accepted bribes not to prosecute certain criminals. He had invested the money and it had increased in amount. The Privy Council held that he was in a fiduciary position as a Crown employee and held the bribes on constructive trust for the Crown from the moment he accepted them. The fund therefore included any increase in value. The reasoning was that he ought to have handed the money to the Crown immediately it was given to him and, as *equity regards as done that which ought to be done*, he was presumed to hold the fund on constructive trust for the Crown. Any increase in value was therefore also the Crowns. *Reid* was followed in *Secretary for Justice v Hon Kam Wing*,[63] when the Hong Kong Government took action to recover what it alleged to be bribes and property paid for with those alleged bribes. Although the action itself was concerned with time limitation, the court was clear that if the action were to succeed then the defendant would hold the property on constructive trust for the Hong Kong Government, as the recipient of the alleged bribes held them on trust for the employer as soon as they were received.[64] Although the use of a constructive trust to recover bribes from fiduciaries was doubted by the English Court of Appeal,[65] the Supreme Court has reaffirmed the principle of *A-G for Hong Kong v Reid* in *FHR European Ventures LLP v Cedar Capital Partners LLC*.[66]

A fiduciary must not make an unauthorised profit out of property acquired by reason of their relationship with the principal.[67] If the fiduciary uses their principal's assets to purchase property and makes a profit from this property, then the principal is entitled to elect between recovering the misappropriated funds or affirming the use of the funds as an investment.

Tang Ying Loi v Tang Ying Ip[68]

The dispute involved next of kin of the deceased Tang Pui King who died intestate in 1978. The defendants were administrators of the deceased's estate. The first defendant was administrator and one of the beneficiaries of his father's estate which controlled large plots of land in the New Territories. The Estate at times received large cash sums from the government for resumption of land. These were usually distributed amongst the beneficiaries. In 2003 the first defendant made a loan as administrator to himself from the Estate's bank account of some $11.48 million. The first defendant used this sum as final payment for a property, representing 40.4 per cent of the total purchase price. The first defendant then transferred the property the third defendant, a registered company he owned beneficially. Seven months after the purchase he repaid the money to the estate with interest at approximately 3 per cent per annum. When asked to account for the Estate's assets he prevaricated for some time but eventually disclosed the loan but then refused to disclose its purpose. On further order from the court the first Defendant disclosed the property purchase. One of the beneficiaries took action against him for account of the profits he had made from the transaction. By the time the case came to trial the value of the property had

62 [1994] 1 AC 324.
63 [2003] 1 HKLRD 524.
64 *Ibid.*, [62].
65 *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd* [2011] EWCA Civ 347.
66 [2014] UKSC 45. See the comments of Recorder Teresa Cheng SC in *JS Microelectronics Ltd v Achhada Dilip G* [2016] HKEC 694.
67 *Chinese United Establishments Ltd v Cheung Siu Ki* [1997] 2 HKC 212.
68 [2017] HKEC 204 (CFA) (Ma CJ, Ribeiro and Fok PJJ, Chan and Lord Millett NPJJ).

increased substantially, and the plaintiff claimed to be entitled to his share of the increased value of the property.

Judgment:

The trial judge held that the transaction should be regarded as a loan and that this precluded the plaintiff from tracing the money. However, he also held that the loan was a misuse of the estate's funds and that the plaintiff was entitled to recover his share of the profit. Thus the defendant was liable to account to the estate for the profits which he derived from the acquisition and holding of the property, including the increase in the property's value.

The Court of Appeal disagreed with the judge's conclusion that the transaction was a loan, but confirmed his finding that it was a misapplication of money belonging to the estate. The Court of Appeal confirmed the accounts and enquiries directed by the judge, ordered D1 to pay the plaintiff one fifth of the amount found due on taking the account, and dismissed the appeal.

The Court of Final Appeal, with Lord Millett NPJJ giving the full judgment, held that this was not a case of secret profits as the fiduciary had not diverted a business opportunity from his principal to obtain a benefit for himself from a third party. The present case was simply a fiduciary helping himself to money belonging to the estate and applying it for his own benefit — a breach of trust. The transaction was a voidable transaction because the plaintiff would have been able to reject or affirm it on discovering it by account. If the plaintiff had rejected the transaction the defendant would have been obliged to make this deficit in the account good. However, the plaintiff sought to affirm the transaction as an authorised investment to claim an interest in the increased value of the property.

The defendant's repayment of the money is not therefore a repayment of a loan but then becomes an attempt to purchase the estate's interest in the property — effectively self-dealing.

Lord Millett noted that the courts treatment of cases of secret profits and breach of trust might be similar in their effect and remedies but that this being simply a case of breach of trust:

> "The policy behind a claim by a beneficiary for a breach of trust of the present kind is to deter the trustee from using the trust fund as his personal bank account, borrowing from it for his own private purposes and merely repaying the amount he has borrowed. Such conduct puts the trust fund at risk without hope of gain. Equity's response is to insist that any profit is for the beneficiaries and any loss for the trustee."[69]

Thus the plaintiff was entitled to a proportionate share of the profits from the investment.

As a matter of principle, it is legally possible for a personal representative of the estate of a deceased person to make a contract with themselves in their individual capacity or another representative capacity.[70] Whether the making of such contract would constitute a breach of fiduciary duties on the part of the personal representative is another matter.[71]

If the fiduciary does make profits from their position they will hold them on constructive trust for the principal. This is because they ought to have made them for the principal and

69 *Ibid.*, [27].
70 See *Rowley Holmes & Co v Barber* [1977] 1 WLR 371.
71 *Tang Ying Loi v Tang Ying Ip* [2015] 1 HKLRD 714.

The rule applies to all fiduciaries, including mortgagees, and is very strictly applied. No series of transactions or use of corporate or trust vehicles will protect the transaction from avoidance if established. As Le Pichon J noted in *Tsang Ying Ki v Maxtime Transportation Ltd*:[91]

> "The law is clear: a mortgagee cannot sell to himself or to a trustee or an agent for himself or pursue any scheme for getting the property into his own hands under the guise of sale....The only exception to this bar is if the sale is made by court and the mortgagee obtains leave to bid.[92]...On the authorities, it would seem that the bar is absolute save in the limited circumstances of a sale being authorised by the court and the mortgagee being authorised to bid at it. Where the rule applies, the sale may be set aside...It seems that the rationale for the rule is the fear of a sale at an undervalue."[93]

Le Pichon J noted that the rule was similar to that of a trustee purchasing trust property without authorisation of the court:

> "Even in the context of the self-dealing rule, it is recognised that only in the most extraordinary circumstances will the court refuse to set aside a purchase of trust property by a trustee at the instance of the beneficiary, other than in a case where the trustee had successfully raised against the beneficiary a defence of delay or laches."[94]

When the principal discovers the transaction they may elect to affirm it; this would obviously be most likely the case where the transaction is to the manifest advantage of the principal. The transaction will then no longer be voidable if the principal has had full knowledge of the circumstances of the transaction. The rule is only relaxed in exceptional circumstances.

Holder v Holder[95]

The defendant was an executor of his father's will. He had tried to disclaim the office but, although he took no active part in the administration of his father's estate, he was too late. He was also tenant of one of his father's farms and announced to the other executors and beneficiaries of his father's will that he intended to buy this farm and another belonging to the estate at public auction. He did so. The plaintiff beneficiary claimed the son had breached the rule against self-dealing.

Judgment:

> The court held that the rule was not breached. Although the son was an executor and so in a fiduciary position, he had not taken an active part in the administration and had informed all concerned, including the plaintiff beneficiary, of his intentions. The plaintiff beneficiary had also accepted his share of the proceeds knowing what had happened.

91 [1996] 1 HKLR 150.
92 *Ibid.*, 152H.
93 *Ibid.*, 153E.
94 *Ibid.*, 154J.
95 [1968] Ch 353.

The property had been sold in a public auction and so there was no chance of the son influencing the other executors or beneficiaries and so gaining an unfair advantage from his fiduciary position.

Thus, the rule against self-dealing is quite simply that — the fiduciary must not buy their principal's property.

17.8.2 The fair-dealing rule

In *Tito v Waddell (No 2)*,[96] Megarry VC explained that the fair-dealing rule "enables a beneficiary to set aside (for cause) a transaction where the trustee purchases the beneficial interest of any of their beneficiaries." The fair-dealing rule is not a prohibitive rule but a restriction on buying the beneficial interest of the beneficiaries. The rule is not as strict as self-dealing as the trustee must here deal with the beneficiary, thus the beneficiary has knowledge of the transaction. The rule is that if a trustee's purchase of the beneficial interest of a trust from a beneficiary is challenged the trustee bears the burden of establishing that the transaction was at arm's length, to the beneficiary's benefit and fair and honest. Thus there must be no undue influence, duress and/or misrepresentation. If the trustee cannot show this, then the transaction may be set aside.

The rules may only be relied on if the actions are brought in a reasonable time and other equitable principles would apply. Thus both self-dealing and fair-dealing transactions can only be set aside if *restitutio in integrum* is possible.[97] Otherwise the fiduciary would hold any profits on constructive trust for the principal or would have to compensate the principal for any loss.

17.9 RESTRICTIONS ON THE USE OF CONFIDENTIAL INFORMATION

The fiduciary obligations often affect those in professional positions — the trustee, the solicitor, etc. Equity has long enforced restrictions on the use a fiduciary may make of any information gained from their principal which may affect the principal if it is shared without their permission. A fiduciary cannot make a profit from confidential information obtained by reason of their position because, as Lord Denning noted in *Seager v Copydex Ltd*,[98] "he who has received information in confidence shall not take unfair advantage of it." In *Seager v Copydex Ltd*, Copydex patented and manufactured an invention that Seager had informed them of whilst he was a client. Copydex had to pay compensation. This follows from the no-profit rule as, if a fiduciary is in possession of confidential information and makes a profit from its revelation, then there is a duty to account for those profits.[99] The court may also grant an injunction to forbid the fiduciary from revealing the confidential information or undertaking work for someone who might gain from their knowledge of confidential information.[100]

96 [1977] 3 All ER 129, 240–241.
97 *Tate v Williamson* (1866) LR 2 Ch App 55.
98 [1967] 2 All ER 415 (EWCA).
99 *A-G v Guardian Newspapers Ltd* [1990] 1 AC 109 (HL) — the "spy catcher" case.
100 *Lai Mei Chun Swana v Lai Chung Kong* [2011] HKEC 545.

The Hong Kong trust benefits further from the jurisdiction's lack of capital taxation.[19] Capital taxation has been mooted in China in the form of estate duty since 1994.[20] Although this has still not been implemented, many are keen to avoid any future liability if it is introduced. Thus uncertainty about future tax plans and concerns over restrictions on capital movement, because of large-scale capital flight and anti-money laundering measures in China, make Hong Kong an attractive destination for the wealth of Chinese, or at least an efficient and safe transit point for that wealth.

It is this latter point that underlies most of Hong Kong's trust business. Settlors considering creating trusts in Hong Kong have often been encouraged to consider "offshoring" their funds and to select trust products from other common law jurisdictions such as the Cayman Islands and the British Virgin Islands. These jurisdictions have developed statutory trusts that offer benefits unavailable to the standard common law private trust. For example, they permit the creation of trusts which are purely for non-charitable purposes and do not identify human beneficiaries. They may also avoid restrictive common law rules on the duration of a trust and so continue indefinitely. However, they may still take advantage of the common law's supervision of the trustee and protection of the trust property. In fact, these jurisdictions have been marketing the benefits of their trust and corporate products in Hong Kong highlighting their flexibility. Hong Kong's domestic trust industry needed modernisation of the jurisdiction's trust law to offer another choice to the domestic and overseas investor and the changes to its statutory trust law provided this.

The Trust Law (Amendment) Ordinance 2013 introduced a number of amendments to Hong Kong's trust law intended to encourage confidence in Hong Kong's law of trusts by clarifying trustees' powers, the duty of care they owe to the trust, and removing the restrictive and complicated common law rules on perpetuities.

The changes to the trust law apply to all trusts in Hong Kong whenever created unless noted otherwise. Thus the provisions are default for trusts even if they were created before the commencement date of 1 December 2013 unless stated otherwise in the statutory provisions or excluded by interpretation of the trust instrument or later exclusion by settlors or beneficiaries if the statutory provision permits.[21]

There are also changes which are directly intended to benefit the Hong Kong trust industry and professional trustees as some of the default powers will only apply to a trustee if the trustee is a trust corporation or a professional and ordinarily resident in Hong Kong.

18.4 APPOINTMENT, REMOVAL AND REPLACEMENT OF TRUSTEES

Generally, when considering any issue to do with a trust the first place to check for information on the management of the trust is the trust instrument. Then we may check relevant statutory provisions, notably the TO, and then fall back on common law.

19 Estate duty was abolished on 11 February 2006. See Revenue (Abolition of Estate Duty) Ordinance 2005.

20 Presently estate duty is not charged in China. Yongjun Peter Ni and Mingjun Jia, "Private Client Law in China: Overview" Thomson Reuters Practical Law (1 July 2020), available at https://uk.practicallaw.thomsonreuters.com/1-521-0337?__lrTS=20200501191109590&transitionType=Default&contextData=(sc.Default)&firstPage=true.

21 TO s.3. See Kwan V-P in the Court of Appeal in *Lee Pui Ling Angelina v Chen Wai* [2020] 1 HKLRD 194 (CA) (Kwan V-P, Chu and Thomas Au JJA).

18.4.1 Becoming a trustee

Any person who has the capacity to hold property has the capacity to be a trustee. This just means that a person appointed as a trustee must be capable of carrying out the role. Therefore, they must be capable of holding the legal title to the trust property and exercising the powers necessary to perform the role as a trustee with regard to the trust property. For example, entering a valid contract with regard to buying or selling property for the trust. In Hong Kong there are no statutory restrictions on minors holding land. However, at common law, a minor may not be a trustee, although there have been occasions when a court has declared that a minor is trustee of property held on resulting trust.[22] There may be a statutory restriction on minors acting as trustees in Hong Kong. Section 37 of the TO provides that trustees under the age of 21 years may be replaced. This may be construed as effectively ensuring that a trustee should be at least 21 years old.[23]

Trustees may be appointed by the settlor, those designated in the trust instrument, statute or the court. The first trustees are normally identified and appointed by the settlor in the trust instrument. If the trust is *inter vivos* they must be identified and capable of acting. The settlor will usually speak to their proposed trustee and explain what they want them to do and receive their agreement to carry out the role. The obligation must be accepted, this may be by express acceptance or implied from their beginning the duties of the trustee. Those selected may disclaim or refuse the trust obligation before acceptance. The trust obligation does not exist until the trustees accept the obligation and the trust property is transferred to them.

If the trust is testamentary then the testator will usually have communicated the intended obligation to their trustees during the testator's lifetime. Indeed, this must be done if the trust is a secret trust. The trustees are then identified as recipient of the trust property in the will and their obligations explained in the will or some other documents passed to them under this obligation. The only exception to the explanation of the trust obligations in the will would be for the creation of a secret trust.

At common law a trust may be constituted with only one trustee, but, in the interests of good practice, it is submitted that at least two trustees should be appointed because, as legal title to trust property must vest in all trustees, this will ensure that no single trustee may deal with the trust property and this helps prevent abuse of the trust. A registered company may be a trustee, whether sole or in association with other trust corporations or human trustees.

There may be any number of trustees of personal property but there should be no more than four trustees of a settlement of land or trust for sale of land.[24] This ensures that anyone dealing with purchasing land from trustees does not have to concern themselves with an unknown number of trustees. This restriction does not apply to trusts of land which are for charitable, ecclesiastical or public purposes.[25]

Once the trust is begun, it does not matter that the trustee later disclaims the trust, they will continue in their role until they have been released from the obligation, by the methods considered below. Even when the trustee has been removed from their trust obligation the trust will continue until the trust comes to an end either because it has been fulfilled, brought to an end by some power in the trust instrument, brought to an end by the beneficiaries using

22 *Re Vinogradoff* [1935] WN 68.

23 TO s.38(2), similarly restricts trustees to 21 years and over.

24 *Ibid.*, s.36.

25 *Ibid.*, s.36(3).

18.7.2 What should a trustee consider when making investment decisions?

Trustees may consider many factors when making a decision to use their powers of investment. Their own views on what would constitute the best investments for the trust are obviously important in deciding if they have satisfactorily discharged their duty to invest. Of course, trustees will bring their own experience, knowledge, expertise and prejudices to the role. Sometimes the trustee will find themselves in a difficult position, as their personal beliefs, moral and ethical standards are in conflict with their obligations to the trust. At such times, they may feel it is legitimate for them to take account of their own views. Of late, this has been particularly the case with what are termed ethical investments — or more accurately unethical investments and a wish to avoid them. Some trustees have been concerned that their duty to invest in the best interest of the trust should not preclude their considering ethical matters when choosing investments. The House of Lords considered this matter with regard to proposed trust investments nearly 30 years ago.

Cowan v Scargill[64]

The pension fund of the National Coal Board (NCB) was administered by trustees appointed equally by the NCB and the National Union of Mineworkers (NUM). The trustees appointed by the NCB proposed a portfolio of investment which involved foreign investments and companies which were in competition with the coal industry in the United Kingdom. The trustees appointed by the NUM, including Arthur Scargill, refused to approve the proposals, as they feared the investments would damage the domestic coal industry and affect the jobs of their members and the prospective beneficiaries of the pension fund. The NUM trustees put forward an alternative investment portfolio which they claimed offered similar prospects for return but would not involve investing in competing industries. The NCB trustees claimed the NUM's proposals would not provide similar returns and sought a declaration that the NUM trustees were in breach of their fiduciary duties to the pension fund.

Judgment:

Sir Robert Megarry V-C stated that:

> "...the starting point is the duty of the trustees to exercise their powers in the best interests of the present and future beneficiaries of the trust. This duty of the trustees towards the beneficiaries is paramount. They must, of course, obey the law; but subject to that, they must put the interests of the beneficiaries first. When the purpose of the trust is to provide financial benefits for the beneficiaries, as is usually the case, the best interests of the beneficiaries are normally their best financial interests".

Therefore, the NUM trustees could not consider any matter except the best financial interest of the beneficiaries of the pension fund. Their proposal would be in breach of

64 [1985] Ch 270.

trust. The Court rejected the NUM trustees' argument that the proposed investments would damage the beneficiaries because they might damage the domestic coal industry. This was because the pension scheme was fully funded and in no way dependent upon the fate of the NCB and the UK coal industry. The effect of the investment on the beneficiaries was only important *qua* beneficiary, as a beneficiary, not in other aspects of their lives.

Such was the obligation on the trustees to only act in the best interests of the beneficiaries and only consider their best financial interest in investment matters that the Vice-Chancellor noted, "Trustees may even have to act dishonourably (though not illegally) if the interests of their beneficiaries require it."[65] As an example the Vice-Chancellor approved *Buttle v Saunders*,[66] where the trustees were directed to "gazump", that is accept a higher price for a property they had already agreed to sell, in order to obtain a better price for the beneficiaries. Therefore, trustees must not allow their personal views to interfere with their judgment:

> "In the conduct of their own affairs ...they are free to abstain from making any such investments. Yet under a trust, if investments of this type would be more beneficial to the beneficiaries than other investments, the trustees must not refrain from making the investments by reasons of the views that they hold. Accordingly, although a trustee who takes advice on investments is not bound to accept and act on that advice, he is not entitled to reject it merely because he sincerely disagrees with it, unless in addition to being sincere he is acting as a prudent man would act."

The Vice-Chancellor noted that there might be circumstances where the trustees were entitled to take note of other matters including ethical considerations. For example, the settlor may have provided in the trust instrument that the trustees could take note of certain matters in exercising their powers with regard to the trust including their powers of investment. Further, the Vice-Chancellor accepted that "the beneficiaries might well consider that it was far better to receive less than to receive more money from what they consider to be evil and tainted sources". Although for such a consideration to be valid all of the beneficiaries must be adult and agree. The Vice-Chancellor also noted that the proposed investment may be contrary to the very objective of the trust; for example, the trustees of a cancer charity might refuse to invest in the tobacco industry.

The matter of ethical investment was considered again in *Harries v Church Commissioners for England*.[67] Here the plaintiff was the Bishop of Oxford who claimed that the Church Commissioners should not invest in anything which was contrary to Church of England doctrine, and he sought to limit their investment policy. The Church Commissioners already pursued an ethical investment policy by refusing to invest in armaments, gambling, tobacco, newspapers and the Republic of South Africa, while apartheid was imposed. The court approved *Cowan v Scargill*, but Nicholls V-C upheld the Church Commissioners policy because trustees were free to exclude certain investments if they could do so without jeopardising the profitability of the portfolio. As the prohibited activities excluded only about 30 per cent of the stock market there was scope for investment without a significant loss to the beneficiaries.

65 *Ibid.*, 288 (Megarry V-C).
66 [1950] 2 All ER 193.
67 [1992] 1 WLR 1241.

and the remainder man own the whole beneficial interest between them. Therefore if they are *sui juris*, of full age and in agreement they may terminate the trust and divide the property amongst them.[24] The rule has even been applied to discretionary trusts. Discretionary trusts were introduced as protective trusts to prevent objects from gaining the trust property before they were mature enough to deal with the property and as a means of settlors ensuring control of their beneficiaries. An object under a discretionary trust does not have an identifiable interest in the trust property until (and only if) they are selected by the trustees and the trustees select what they are to receive. Until they are selected the objects have a hope or *spes* of an interest only. The rule may be applied even if its application defeats the protective nature of the discretionary trust. The rule in *Saunders v Vautier* has been applied to discretionary trusts. The rule may be used even if the beneficiaries under the discretionary trust have not been selected yet. This is because, even though none yet have an individual identifiable interest, they are the group from which the beneficiaries have to be selected. Therefore, one of more of them must be selected at some point. Thus, as a group, the potential beneficiaries will own all of the beneficial interest in the trust property between them. Therefore, if they are all *sui juris*, of full age and in agreement, the potential objects of a discretionary trust may call on the trustee to deliver the property to them and divide it as they wish.[25]

> Gerald sets up a trust of a $1 million with Omar as trustee in favour of those of his 10 grandchildren who Omar at his absolute discretion will select. Even though he has not selected who is to receive the money his 10 grandchildren may, if they are all *sui juris* and of full age get together and call for their grandfather to transfer the money to them.

Developing this principle, the Rule may also be applied to those with contingent interests. Although a beneficiary with a contingent or conditional interest does not have an interest until and unless they meet the condition, they may get together with the other contingent beneficiaries to take advantage of the rule. For example, if the beneficiary has a contingent interest which if not met provides for another beneficiary to receive the property then the two beneficiaries may be able to agree to the ending of the trust between them if they are the only beneficiaries of the trust and of full age and *sui generis*. Again this exemplifies the importance and strength of the beneficiary's interest in the trust.

Settlors try to prevent the operation of the Rule in many ways. A settlor may introduce elements to prevent the rule's use. For example, they may introduce a contingency,[26] ie, only those of their grandchildren who become doctors may be eligible to be selected. However,

> Gerald sets up the following trust in his will:
>
> "I leave $1 million to Omar to hold on trust. Each of my ten grandchildren who becomes a solicitor before or at the age of 25 years old is to receive a proportionate share in this fund. If none of my grandchildren become a solicitor by the time they are 25 years old, then the fund is to be given to the Hong Kong Society for Distressed Cats."

24 *Brown v Pringle* (1845) 4 Hare 124, 67 ER 587.
25 *Re Smith* [1928] Ch 915.
26 *Hiranand v Harilela* [2004] 4 HKC 231.

> The interests of the grandchildren are not vested unless they become a lawyer before or at the age of 25 years. If any do become a lawyer by this age their interest will vest but they will not be entitled to possession until all have reached the age of 25 years and it is known how many, if any, are lawyers and what amount each is to get. Thus until all have reached the age of 25 and it is known who has a vested interest they cannot get together to use the rule in *Saunders v Vautier* when they reach the age of majority.

the wording of a contingency must be very carefully considered because, as noted above, in *Saunders v Vautier* the representation that the age specification was a contingency was rejected and it was interpreted as just a delay for accumulation.

A settlor may also prevent the use of the rule by including infants or those unborn as potential beneficiaries as they cannot consent to the use of the rule. A settlor could also include themselves as one of the beneficiaries or someone else they could trust not to agree to the rule, as the call has to be unanimous. A settlor could also add a charitable purpose as a possible use of the trust at the trustees' discretion — this would be a good way of ensuring that there could be no agreement between all of the beneficiaries, as the Secretary for Justice might have to consent to the trust being brought to an end. Of course, the Secretary for Justice might consider agreeing to the exercise of the rule and division of the property with some to the charitable trust was a good thing, so this might also be defeated.

One of the commonest ways that settlors attempt to prevent the operation of the rule in Hong Kong today is to introduce a power for the trustee of a discretionary trust to appoint new beneficiaries. Thus the trustee may appoint anyone as a beneficiary, rather than just the usual selected class. Therefore, it is impossible to identify who might be a beneficiary and so gain their consent. Although it may be possible to ask the court to consent on the unknown or unascertained beneficiaries' part using the court's powers under the Variation of Trusts Ordinance (Cap.253) discussed below.

Potential appointees under a power cannot take advantage of the rule as they are not entitled to all the beneficial interest in the property. For example, Gerald creates a trust with Omar as his trustee and gives Omar the power to appoint any of his 10 grandchildren to any of the trust property within a period of 10 years with a gift over in default of appointment in favour of the Sai Kung Buffalo Sanctuary. The grandchildren may not take advantage of the rule because they have no interest in the property. This is not a discretionary trust as Omar does not have to select them, it is purely discretionary and so it is a power for a trustee, thus a fiduciary power. Omar must from time to time consider appointing the grandchildren but does not have to. After 10 years the gift over will take effect if Omar has not appointed the grandchildren and the property must go to the Sanctuary. If there were no gift over, then the property would revert to the settlor's estate.

Some other common law jurisdictions have not embraced the rule. For example, the rule does not apply in many of the United States unless the settlor agrees. If the trust is testamentary then termination will not be permitted if it is inconsistent with a material purpose of the trust. *Claflin v Claflin*[27] established the "material purpose" rule, which may be stated as follows: a trust cannot be terminated prior to the time fixed for termination, even

27 *Claflin v Claflin* 20 NE 454 (Mass 1889). For a more detailed account of the US historical background, see Ronald Chester, "Modification and Termination of Trusts in the 21st century: The Uniform Trust Code Leads a Quiet Revolution" (Winter 2001) 35(4) *Real Property, Probate and Trust Journal* 697–729.