



Explaining the English Trust to a Civil Lawyer

The Honourable Mr Justice David Hayton,
Judge of the Caribbean Court of Justice

A San Marino Symposium of the Court of Trusts and Fiduciary

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The Court for Trusts and Fiduciary relationships was established in San Marino by the Constitutional Law no. 1 of 26 January 2012 and it is governed by the Qualified Law no. 1 of 26 January 2012 "Provisions concerning the operation and functioning of the Court for trusts and fiduciary relationships" and by Delegated Decree no. 85 of 19 July 2013, as modified by Delegated Decree no. 128 of 30 September 2013 "Proceedings before the Court for trusts and fiduciary relationships". The Court is composed by a President, the Honourable Mr Justice Linos-Alexandre Sicilianos and by six members, elected, by two thirds majority, by the Great and General Council, which is the Sammarinese Parliament.

Reviews

By

The Honourable Mr Justice David Hayton, Judge of the Caribbean Court of Justice,

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The characteristics of a trust

A trust arises where as a result of a settlor's intention to create a segregated trust fund, he ensures that his property becomes owned by a trustee as a ring-fenced fund to be independently managed by the trustee for the benefit of persons or for charitable purposes. The trust fund is separate from the trustee's private patrimony, so that the fund is immune from any claims made by the trustee's private creditors, spouse or heirs. The settlor may even be the sole trustee if there is clear evidence of this.

The trust fund comprises the original property and property subsequently from time to time *rightfully* or *wrongfully* representing that property. The trust fund has to extend to such traceable property, using principles akin to proprietary or real subrogation. If this were not the position the ring-fenced fund would be completely undermined by the trustee wrongfully using trust money to buy property for his private patrimony that could then be exhausted by claims of his private creditors, spouse and heirs.

The trustee's obligations are owed not to the settlor but to the beneficiaries and are standard ones imposed by law, except to the extent modified by the terms of the trust instrument. A trustee is

under a duty to manage the trust fund with due care and skill, and breach of this duty requires him to augment the trust fund up to the value it would have had but for the breach. He is, however, under an absolute duty to apply the trust fund only as authorised by its terms, so that if he misapplies trust property by selling shares in Glorious plc for one million Euros in order to buy an unauthorised investment or to give the money to a person who is not a beneficiary, he cannot deny that he still has the Glorious shares and so must put the trust fund in the same position as if the shares had not been sold. Furthermore, he cannot deny that any profit obtained from an honest or dishonest breach of trust has become part of the trust fund.

Breach of other fiduciary obligations will lead to a trustee's actions being set aside. This will happen where (without clear authorisation in the trust instrument) the trustee entered into transaction where there was a serious possibility of a conflict between his personal interest and his duty as trustee or a conflict between duties owed to other persons (as where he is trustee of two or more trusts). His actions involving distributions of trust property to beneficiaries will also be set aside if, in a breach of trust in failing to take steps to be adequately informed, he made a decision that he would not have made but for ignoring a relevant consideration or taking account of an irrelevant consideration.

Because the trustee's obligations are not enforceable by the settlor, only by the beneficiaries or, in the case of charitable trusts, the Charity Commission or the Attorney General, the core of the non-charitable trust is a bi-partite relationship between the trustee and the beneficiaries. The beneficiaries alone have the right to invoke the court's overriding jurisdiction to supervise, and if necessary intervene in, the proper administration of trusts by trustees. The court not only has the usual punitive role but also a paternalistic role to advise and approve trustees acting at the outer

limits of their powers and to confer extra powers on trustees where expedient in the management of the trust fund in the best interests of the beneficiaries.

The settlor, having divested himself of his own interest in the trust property, drops out of the picture (unless he is a beneficiary or trustee or has expressly reserved specific rights to himself e.g. to replace the trustee or to appoint money to beneficiaries). The trustee's right to pay himself remuneration out of the trust fund arises not from a contract but from the Trustee Act 2000 or a clause in the trust instrument that provides the reciprocal benefits and burdens inherent in the trusteeship that affect whoever from time to time holds the office of trustee.

Normally, a trustee's agreement must be obtained before he becomes a trustee, but a testator may die having named T to be trustee in his will without T's knowledge or a settlor in his lifetime may have transferred property (like shares in a company) into T's name to hold as trustee without T's knowledge. On acquiring knowledge T will be deemed to accept the trusteeship unless he disclaims it within a reasonable time.

In the case of a disclaimer the trust continues, with a court-appointed administrator (with the will annexed) as trustee in the first case and with the settlor being trustee in the latter case. The death or mental incapacity of the trustee does not affect the continuance of the trust, nor does his committal of a fundamental breach of trust, though, if necessary, the court will then replace him with a new trustee who will bring an action against him and hold the proceeds of this claim as part of the trust fund. Where more than one person holds office as trustee, the death of one trustee leaves the surviving trustee(s) to continue in office. On the death of a sole surviving trustee before his appointment of new trustees, his personal representative will take over as trustee with power to appoint new trustees.

Trusts are basically family dynastic trusts or charitable trusts or commercial trusts. The first two arise from a gift made by a settlor who wishes the trustee on his behalf to make gifts over the duration of a lengthy trust period, say, of 125 years or indefinitely for charitable trusts. Commercial trusts arise from contractual arrangements providing a dedicated programme for the segregated fund to be used to achieve particular commercial purposes, and are normally for a short period unless involving pension trusts or employee share ownership trusts or collective investment schemes.

The interests of beneficiaries or charity in the trust fund will bind third parties who, in breach of trust, receive and still have property traceably representing property that was part of the trust fund, unless the third party proves to be a bona fide purchaser of the property without notice of the trust. Traced property, having continued to be part of the trust fund, must be returned to be held with other property within the trust fund. If the property is no longer traceable but the third party gave away the property when aware it was trust property or seriously suspecting it was trust property but choosing not to make any inquiry to check on this, the third party will be liable to replace the value of the property, as will anyone who dishonestly assisted in the breach of trust.

Beneficiaries' interests in the trust fund are called equitable interests and it is clear that in civil law countries such interests cannot be property interests binding third parties, though they may create preferred obligations binding a trustee's creditors, heirs and spouse. The whole point, however, of beneficiaries having such equitable interests is the obtaining of full legal ownership of trust property from the trustee, as where income is paid to a beneficiary with a life interest, or capital is paid to B who became absolutely entitled to the capital on the death of the life tenant, or income or capital is paid out to the object of a discretionary power to appoint income or capital.

In some simple cases the beneficiaries can demand that the trustee transfers ownership of the trust property to themselves in shares agreed between them. Where property is held on trust for A for life, remainder to B and C, the three of them, if of full capacity, can require the trust property to be divided between them as they unanimously agree. Similarly, if a testator left his residuary estate on trust for R subject to an annuity being payable thereout to his spendthrift daughter, D, she and R can require the trustee to divide the capital between them as they have agreed. It is their property, so it is irrelevant that their decision frustrates the testator's intention.

A trust, unlike a corporation, is not a legal person that can sue or be sued. Thus a trustee in making a contract cannot act as agent of the trust. Nor can the trustee act as agent of the settlor who dropped out of the picture on transferring ownership of his property to the trustee. Nor can the trustee act as agent of the beneficiaries when it was the settlor, not the beneficiaries, who was responsible for the trustee becoming owner of the trust property with all the independent powers of such an owner and, in any event, there may be no current ascertained beneficiaries. Thus the trustee can only act as a principal in his own right, so that he alone can sue or be sued.

However, if he did not commit a breach of trust in making the contract or becoming liable to a claim in delict and is not otherwise indebted to the trust fund, he can reimburse himself out of the trust fund for debts and claims incurred by him in his capacity as trustee. As a matter of contract law he may persuade the other party to agree that his liability shall not exceed a specified amount in the trust fund, though the other party will normally require that he guarantees that any distributions of trust property to beneficiaries will not leave the trust fund worth less than that amount. A trustee remains liable on his contracts after ceasing to be trustee but has a right to be reimbursed out of the trust fund held by a new trustee and has a non-possessory security over that fund to help to ensure payment.

Conclusions

In the light of the above characteristics of the English trust, one can say that it approximates to a unique type of contract concerning a settlor arranging for the ownership-management of a ring-fenced fund by a trustee as an office-holder for the private purpose of benefiting beneficiaries or for public charitable purposes, though the settlor cannot enforce the arrangement unless a trustee or a beneficiary. The core trust characteristics in a civil law country should be the priority of the beneficiaries' interests in the trust fund on the insolvency, liquidation, death or divorce of the trustee and a recognition that the trustee as independent owner of the trust property has full authority to sell or otherwise deal for value with trust property (with the fruits becoming part of the trust fund). A trustee, however, has no authority to give trust property away except to persons within the class of beneficiaries and after the exercise of an independent disinterested discretion in the case of discretionary powers to benefit beneficiaries.

There is then scope for developing laws that may enable a gift to a non-beneficiary to be nullified if he actually knew that the gift was wrongful as beyond the powers of the trustee. It may also be that a monetary claim for unjust enrichment might be made against a non-beneficiary if he seriously suspected that the gift might involve some wrongdoing and yet he chose not to make any inquiry to check this.

Time will tell!