

TRUST LAW COMMITTEE
WORKING PARTY ON CONFLICTS OF INTEREST IN TRUSTS

Introduction

1. This paper contains a proposal made by a working party of the Trust Law Committee. The working party's terms of reference were to consider the current law in relation to conflicts of interests in connection with trusts, the problems that arise in practice, and to suggest possible solutions.

Summary

2. The working party began by considering the distinctions between two current rules, or two aspects of a single rule, as follows : —
 - (a) The self-dealing rule, by which a trustee is disabled from purchasing the trust property;
 - (b) The fair-dealing rule, under which in other circumstances a trustee suffering a conflict between his personal interest and his duty as trustee, or a conflict between different fiduciary duties, may find that the burden of demonstrating the fairness of a transaction falls upon himself.
3. We refer here, and generally in this paper, to a 'trustee', but in principle the two rules, and this paper, apply without significant modification to executors and other personal representatives : *Kane v Radley-Kane* [1999] Ch 274. A fuller summary of the current law is set out in Appendix One to this paper.
4. We considered, but soon rejected, a proposal to abandon the self-dealing rule as a separate rule. Adoption of that proposal would have meant that all cases of conflicts currently falling under either rule would be dealt with exclusively in accordance with

the principles of the fair-dealing rule. We concluded that the self-dealing rule performs an essential function in protecting the interests of beneficiaries. So does the fair-dealing rule.

5. One area of doubt in the law as it stands concerns implied authority (please see paragraphs 10–12 of Appendix One) : in what circumstances should a trust instrument be taken as impliedly authorising a trustee to act despite a relevant conflict? But in this paper we do not propose a clarification of the law on this point, on the ground that on this point it is preferable to leave the uncertainty to be resolved in litigation where the relevant facts can be fully analysed.
6. While not proposing any change to the substantive law, our experience leads us to the view that the current law and practice sometimes combine to act as an inhibition to trustees proposing transactions which are not only proper and harmless but positively beneficial. In principle therefore we are inclined to look for an improved way of helping trustees to manage conflicts of interest in appropriately clear cases, provided that sufficient safeguards are in place to prevent any improper attempts to exploit that assistance.
7. We do not regard these views as unique or heterodox. Indeed some professionally drawn settlements and, to a lesser extent, wills have for decades included express provisions authorising trustees to participate in transactions despite conflicts of interest, subject normally to built-in safeguards of some kind.
8. It may be thought that the existence of express provisions of that kind means that no general liberation of the current law or practice is desirable or necessary. But we are conscious that not all trust instruments are professionally drawn, and that not all professionally-drawn trust instruments adopt up-to-date practices. More importantly, we are conscious that some trusts arise by virtue of statute (including in particular all trusts arising under intestacy) or by operation of law. We have concluded that a resource of general application would be desirable.

9. In short what we propose for clear cases is a means of enabling and encouraging trustees to seek the directions of the court more easily and therefore more readily. The crucial factor here is that, despite recent changes to the procedure of the courts, litigation is expensive. Much of the expense is not incurred in the hearing itself, but in the preparation of forms, witness statements, and written submissions, and in the exchange of this documentation amongst the parties and their legal representatives. This expense can mount up when numerous parties or groups of parties are involved, which often happens in trust litigation. In short, preparation for an oral hearing involving a number of speaking parties is far more expensive than preparation for an application by one effective party (the trustee or trustees) and dealt with solely on paper.
10. Times have changed since 1892 when Lindley LJ was able to say this in the well-known case *In re Beddoe* [1893] 1 Ch 547 (CA), allowing an appeal from an order of Kekewich J, at page 558 : —

‘But, considering the ease and comparatively small expense with which trustees can obtain the opinion of a Judge of the Chancery Division on the question whether an action should be brought or defended at the expense of the trust estate, I am of opinion that if a trustee brings or defends an action unsuccessfully and without leave, it is for him to shew that the costs so incurred were properly incurred. The fact that the trustee acted on counsel’s opinion is in all cases a circumstance which ought to weigh with the Court in favour of the trustee; but counsel’s opinion is no indemnity to him even on a question of costs.’

This suggests that the strictness of the current legal position of the trustees may even owe something to the comparatively low cost of a chambers summons as compared with counsel’s opinion more than a century ago. The comparison would be completely different today.

11. For these reasons the working party has considered a means of making applications to court for approval of transactions easier in clear cases. We repeat that this is not a weakness of the substantive law. The courts have repeatedly confirmed, in a variety of factual contexts, that there is jurisdiction to consider and, if thought fit, to approve a transaction notwithstanding the existence of a conflict. Instead the nature of the problem is a more practical one, namely that procedural, financial and logistical difficulties can often conspire to prevent or deter trustees from making or proceeding with the necessary application. In our experience this can lead to one or other of two results : —

(a) The first possible result is that the court is not asked to approve the transaction, and the proposal is dropped. In circumstances where the transaction would have been for the benefit of the beneficiaries or the trust property generally, this is a disadvantage. This situation can arise in the both self-dealing and fair-dealing contexts.

(b) The second possible result is that the trustees decide to take the transaction forward without obtaining approval, and here it is the trustee who is at a disadvantage : —

(i) This occurs infrequently in a true self-dealing context because, as is no doubt generally known amongst professionally advised trustees, the result is to give the beneficiaries the right to avoid the transaction : *Kane v Radley-Kane* (above). This disadvantage can arise even if the transaction might have been approved if an application had been made in advance.

(ii) Even in a fair-dealing context, where it occurs more frequently, a heavy standard of proof is imposed on the trustees involved. They have to satisfy the court that their decision was not only one which any reasonable body of trustees might have taken but was also one that had not in fact been influenced by the conflict : *Public Trustee v Cooper* [2001] WTLR 901, 934.

12. The solution that we propose is for the court to have power to deal with clear cases of this kind by a procedure which does not involve oral argument or an oral hearing. In short we propose a paper procedure. But although the proposal is procedural in nature, we apprehend that primary legislation would be necessary. The Practice Directions associated with Part 64 of the Civil Procedure Rules 1998 do already envisage applications being dealt with on paper and without a hearing in appropriate cases. Rule 6.5 of 64PD covers prospective costs orders, and paragraph 6.1 of 64BPD covers other applications to the court for directions by trustees in relation to the administration of the trust. It is thought that this latter formulation was not intended to cover (say) cases seeking an order approving a purchase by a trustee. Such cases are mentioned specifically in paragraph 1(2)(b) of 64PD, and then immediately paragraph 2 refers the reader to 64BPD for applications for directions. This suggests that applications for approval of sales are separate and distinct from applications for directions. But it is possible that some applications for approval can take the form of applications for directions and be dealt with under 64BPD.
13. Be that as it may, and even assuming that there is theoretically scope for a paper hearing under the existing procedure, in practice we apprehend that judges would be reluctant, without statutory authority, to decide such cases without hearing argument. Indeed the Chief Chancery Master very kindly discussed our proposals with us, and it was his clear view that masters would not be well placed to deal with such applications at all. We perceive our proposal, if adopted, as leading to applications being dealt with by judges.
14. A similar jurisdiction was created by section 48 of the Administration of Justice Act 1985 : please see volume 2 of the White Book paragraph 9B–63. This section allows questions of construction to be determined without hearing argument. The evidence must include the written opinion of a High Court advocate of 10 years' standing. The procedure cannot be used if it appears to the court that a dispute exists making the short procedure inappropriate.

15. Our proposal is for a similar section to be enacted so as to allow questions involving conflicts of interest and duties to be determined without hearing argument. It is important nevertheless to recognise that cases involving conflicts are significantly different from those involving questions of construction. We do not suggest that they are parallel, merely that a similar procedure might still be appropriate. The principal differences are that (i) the relevant affidavit or statement of facts is likely to be more complex and (ii) the evidence would normally need to address questions of value, and both elements might be sensitive in individual cases.
16. Indeed many cases will not be suitable for a paper procedure of this kind at all. Those cases will still need to be dealt with under the existing procedures involving oral argument in court and all the other procedural steps which that implies. These will include all cases where the beneficiaries have already expressed disapproval of the transaction, and they will include any other cases where the valuation evidence or the basic factual evidence raises a significant doubt about the benefits of the transaction. We submit that a judge, faced with an application to deal with such a case on a paper procedure, would have little difficulty in identifying the doubtful case and declining to exercise the jurisdiction. In these cases the judge would need to give directions for the future conduct of the application.
17. We are aware that a different committee, the Pension Litigation Court Users Committee, have made proposals for amendments to the CPR, the PDs and the Chancery Guide to broaden the scope for applications for directions by trustees to be determined without an oral hearing. Our own proposal is in significant ways different from those other proposals, but we believe that it is not in any way inconsistent with them.

Details of the proposal

18. Appendix Two contains a draft clause. It echoes section 48 of the 1985 Act (above) by giving the Court express power to decide clear cases on paper, and it specifies three

categories of case in which the new jurisdiction would or could be exercised. It prohibits the use of the new procedure in inappropriate cases, such as cases where a dispute already exists.

19. In regard to pension scheme trusts there already exists a special provision in section 39 of the Pensions Act 1975 giving a general authority to trustees who are scheme members to exercise powers in favour of the members. Our own proposal would not interfere with that section. It would indeed expand on it by applying to cases in which a trustee has conflicting fiduciary duties, cases not covered by section 39.
20. The draft clause does not mention charitable trusts. It is submitted that there is no need expressly to exclude such trusts from the operation of the provision, but charity trustees are unlikely to find it helpful. In clear cases the Charity Commission will have power to provide the necessary authorisation itself, and in unclear cases it would not be appropriate to exercise the jurisdiction at all. It is intended that the new provision would apply in principle to a non-charitable trust with human beneficiaries having one or more charities as additional beneficiaries or discretionary objects.
21. In the following paragraphs we describe the kind of case falling within each category which might benefit from the proposed jurisdiction.

Transactions

22. The category in sub-clause (1)(a) includes classic self-dealing transactions. It would include the facts of *Kane v Radley-Kane* (above) in which an intestate person's widow and sole administratrix informally appropriated shares in a private company (believed by her to be of little value at the time) towards satisfaction of the statutory legacy to which she was beneficially entitled. Her step-son later succeeded in setting aside the appropriation. By the time of the order the shares were extremely valuable.

23. The case itself might or might not have been a good candidate for the new procedure. Looked at with the benefit of hindsight, one view is that the shares were in truth more valuable at the date of the appropriation than the widow supposed, in which case the outcome of the case was justified. The other view is that the shares were really worth no more than she supposed at the time, so that her step-son took an unjustified windfall from a later rise in value. On an application to the court in advance of the appropriation, whatever procedure might be employed, the issue would turn on the reliability of the contemporary valuation.

Dispositive discretions

24. The second category consists of the exercise of dispositive powers by trustees, such as classic powers of appointment, where some of the trustees are themselves objects of the power. One example might be the facts in *Edge v Pensions Ombudsman* [2000] Ch 602 (CA), where however it was held that the trustees were impliedly authorised to exercise the power despite their conflict of interest, and that the existence of the conflict did not throw on them the burden of proving the propriety of the exercise.
25. The paradigm case would be a family settlement conferring a power of appointment on the trustees, exercisable in favour of the children and remoter issue of the settlor; the current trustees including one or more of the settlor's children. Reported cases of sufficiently uncontroversial cases of this kind are rare.

Company votes

26. The third group involves trustees holding shares in a company, and voting on transactions to be effected by the company.
27. The following facts are abbreviated from an actual case : the settlor is a minority shareholder of the trading company which he established; a majority of the shares are

comprised in an accumulation and maintenance settlement for his minor children; substantial annual instalments of capital are payable to the settlor's former wife; he has proposed a programme of purchases by the company of its own shares from him to finance these payments; he and his former wife are expressly excluded from benefit under the settlement; one of the trustees is a non-executive director of the company.

28. The High Court has already approved the first two or three purchases, and more may need to follow. On the second application the judge expressed dismay at the expense (a dismay shared by the trustees) and gave directions for later applications to be dealt with on paper if possible. Some expense is inevitable, such as the expert advice or evidence of current value and the ability of the company to survive and thrive despite the cash-calls required by the purchases. But the expense is exacerbated by the need to copy and triplicate all that material and to satisfy all the other procedural requirements leading to an oral hearing, with the court expecting reasoned submissions from counsel for a representative beneficiary as defendant.

APPENDIX ONE

Summary of current law

The self-dealing rule

1. It was argued in *Tito v Waddell (No 2)* [1977] Ch 106 that the self-dealing rule and the fair-dealing rule are in truth parts of a single rule. But that was rejected in that case, and we adopt what Sir Robert Megarry V-C described as the orthodox view of two separate rules. On that footing —

‘The self-dealing rule is (to put it very shortly) that if a trustee sells the trust property to himself, the sale is voidable by any beneficiary *ex debito justitiae*, however fair the transaction : *ibid* at page 241.

2. The rule applies to all types of trust property. It is based at least partly on the wider principle that a trustee must not put himself in a position of possible conflict between his duty and his personal interest. There are therefore exceptions to the rule, as where the conflict is thrust upon the trustee by the settlor or the terms of the trust, or where the transaction in question is authorised by statute, the trust instrument, the beneficiaries or finally the court.
3. Subject to those exceptions, however, the rule is strict. A beneficiary, unless barred by concurrence or delay, has a right to have the transaction set aside. The title of the purchasing trustee, and of any successor in title of his (in the absence of a bona fide purchaser for value), is voidable. The aggrieved beneficiary does not need to show that the transaction was dishonest, unfair or even disadvantageous, or that the trustee has made a profit.
4. See generally Lewin on Trusts (17th edition) paragraphs 20–60 to 20–112, a passage which comprehends both rules.

The fair-dealing rule

5. The strict self-dealing rule does not apply to all transactions and dispositions in which a trustee may be able to exploit his position. In other such cases a different rule applies to throw onto the trustee the burden of proving that the transaction or disposition was fair. The citation from *Tito v Waddell (No 2)* above continued as follows : —

‘The fair-dealing rule is (again putting it very shortly) that if a trustee purchases the beneficial interest of any of his beneficiaries, the transaction is not voidable *ex debito justitiae*, but can be set aside by the beneficiary unless the trustee can show that he has taken no advantage of his position and has made full disclosure to the beneficiary, and that the transaction is fair and honest.’

6. The accepted boundaries of the fair-dealing rule have perhaps not been drawn with precision. We take the rule as applying not solely to the purchase of a beneficial interest in the trust property (as in the previous citation) but also to other transactions and dispositions where the trustee may exploit the situation. The following examples are not intended to be exhaustive, but may help to indicate the general application of the rule : —
- (a) A transaction between two sets of trustees having one or more individuals common to the two trusteeships;
 - (b) A transaction between trustees and a company, where one or more of the trustees is a director or shareholder of the company;¹
 - (c) The exercise of a dispositive or administrative power by trustees where one or more of them have an interest in the mode of exercise;
 - (d) A transaction between trustees and the wife or husband of one of their number.²
7. If a transaction or disposition in these categories is challenged, the burden of showing that the trustees have made full disclosure to the beneficiaries, and that the transaction was fair and honest, lies on the trustees.

Exceptions to the rules

8. Exceptions to the strict self-dealing rule have already been briefly mentioned. In more detail : —

¹ The *self-dealing* rule applies if the trustee is both director and a significant shareholder; also to a transaction between trustees and a partnership of which one or more of the trustees is a partner : *In re Thompson's Settlement* [1986] Ch 99, 114–115

² In some jurisdictions this has been held to fall within the self-dealing rule

- (a) Transactions may be authorised by statute. An example is section 68 of the Settled Land Act 1925 under which, instead of the tenant for life selling settled land to himself, the trustees of the settlement have a statutory power to exercise the power of sale.
- (b) The beneficiaries, if of full age and sui juris, are at liberty to authorise a trustee to purchase the trust property. Unless the trustee takes care to make full disclosure of the relevant facts and circumstances to the beneficiaries, the transaction is still liable to be set aside.
- (c) The trust instrument may expressly authorise the transaction, either specifically (which is rare in our experience) or in general terms. A general authority for trustees to sell trust property to one of their number, with appropriate safeguards, is not uncommon in modern professionally-drawn settlements and wills.³

9. Similarly there are exceptions to the fair-dealing rule : —

- (a) The beneficiaries, fully informed, may sanction the disposition.
- (b) The trust instrument may impliedly authorise the trustees to act notwithstanding a conflict of interest. For example, if the trust instrument positively requires some of the trustees to be beneficiaries of the trust, in whose favour dispositions are to be made, they are free to effect dispositions as trustees despite the conflict. Not only are they free to effect dispositions in favour of themselves, but the burden of disproving the fairness of the exercise lies with the beneficiaries : *Edge v Pensions Ombudsman* [2000] Ch 602 (CA).

10. The position is less clear where the trust instrument, while giving no explicit authority to the trustees to take part in transactions or dispositions despite a conflict, and not

³ But please see paragraph 12 below

positively requiring the body of trustees to include beneficiaries, nevertheless appoints one or more beneficiaries to be original trustees. Also unclear is the case where the settlor, in exercise of a power reserved to him by the settlement, appoints one or more beneficiaries to the trusteeship. In both cases a widely-held view is that this amounts to an implied authority for the trustees to exercise powers in favour of themselves.

11. *Sergeant v National Westminster Bank* (1990) 61 P&CR 518 (CA) is often cited as authority for that view, but on analysis the case dealt with the rather different case of a tenant of farmland being made executor by his landlord father. The will contained an express authorisation for the executors to sell land to one of their number, and the tenant-executor proposed to buy at a price which reflected the existence of his tenancy. Other beneficiaries claimed that he must first surrender his tenancy so as to allow the land to be sold with vacant possession. The Court of Appeal held, in effect, that the tenant was not bound to give up the benefit of his pre-existing asset.

12. But the decision is not authority for the general proposition that an original trustee-beneficiary is impliedly authorised to exercise dispositive powers in his own favour. The question whether he is so authorised is therefore still open. In Scotland, *Johnston v Macfarlane's Trustees* 1986 SC 298 held that an express power for trustees to sell to beneficiaries did not authorise a sale to a beneficiary who was an original trustee. Even the more fundamental question whether a beneficiary-trustee can validly be authorised *expressly* by the trust instrument to exercise a power in his own favour was described as 'difficult' in *In re William Makin & Sons Limited* [1992] PLR 177 [1993] OPLR 171, though on a closely related point in *Bray v Ford* [1896] AC 44, 51 Lord Herschell had included the words 'unless otherwise expressly provided', and there seems little room for doubt today in the light of *Edge v Pensions Ombudsman* (above).

Managing the conflict

13. Once a conflict of interest or duties has been identified there is a variety of methods in which the conflict may be managed. A useful summary appears in *Public Trustee v Cooper* [2001] WTLR 901, 933–934. The judge identified three means in particular : —
- (a) The retirement or resignation of the trustee. This may not always, or even often, be satisfactory.
 - (b) The conflict may be so pervasive that the trustees as a body have no alternative but to surrender their discretion to the court.
 - (c) Finally the trustees may exercise the discretion themselves but apply to the court for approval of that decision.

In the third type of case the burden of proof lies on the trustee applying for approval, but the standard of proof is lower than the case where a trustee goes ahead without approval and is subsequently challenged.

APPENDIX TWO

Draft clause

- (1) Subject to the following provisions of this section, where any question arises as to the validity or propriety of —
- (a) Any transaction proposed to be effected by personal representatives or the trustees of a will or trust in circumstances that any one or more of their number or anyone associated or connected with any of them (whether as a personal representative or trustee of another will or trust or in any other capacity) will have, or may be perceived to have, an interest in the transaction; or

- (b) Any disposition of property proposed to be made in the exercise of a discretion conferred by a will or trust (including a discretion conferred on personal representatives or trustees by a statutory power) in circumstances that the person or any of the persons exercising the discretion, or anyone associated or connected with any of them, will have, or may be perceived to have, an interest in the manner of the exercise; or
- (c) The proposed casting of any vote or the proposed failure to cast any vote by personal representatives or the trustees of a will or trust in relation to any shares or other securities in a company on any resolution proposed to be made by the company any of the securities of which they are trustees in circumstances where any of the personal representatives or trustees or any one or more of them will have, or may be perceived to have, a personal interest in the resolution (whether as a personal representative or trustee of another will or trust or in any other capacity)

the court may, on the application of any of the personal representatives or trustees or any other person intending to participate in the transaction or, as the case may be, effect the disposition or vote on the resolution, and without hearing argument, make an order authorising those persons to take such steps as may be specified in the order

- (2) Paragraphs (a), (b) and (c) of subsection (1) shall apply to a trustee which is a company as if its directors and shareholders also were trustees or (as the case may be) exercising the discretion or casting the vote
- (3) The court shall not make an order under subsection (1) if it appears to the court that a dispute or other circumstance exists such as to make it inappropriate for the court to make such an order without hearing argument