Asset Partitioning in the Trust

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DPhil Thesis

Word count: 100,000

Abstract: Asset partitioning in the trust, the question of how creditors of trustees attach their claims to trust assets, is an elaboration of the fundamental structure of trust law. The trust creates a surrogate for separate corporate personality by using elements of personal liability of the trustee towards external creditors and towards the beneficiaries of the trust. The beneficial interest and its assignability ensure fluidity in the membership of the group enterprise. Through ingenious use of equitable doctrine, the trust has become a vehicle by which parties external to the trust need only concern themselves with their legal relations to the trustee, without regard to the internal obligational contours of the trust.

This thesis explores the doctrinal operation of these rules and seeks to make both practical recommendations for streamlining certain unclear or inconsistent doctrines, and theoretical points regarding broader trust law debates. To this end it enlists comparative prespectives from American law, where changes in central asset partitioning features have led to wide-ranging changes in the structure of trust law.

It argues that the basic structure of creditor access to trust assets does not support the view that the beneficiary has equitable 'property right' in the trust assets, nor that the trust fully segregates the assets of the trust from those of its members. Instead, the trust creates an order of priorities for creditor access with access being determined by the fulfilment of the trust's purposes, and the beneficiary's position is transmissible but obligational.

The law discussed in this thesis showcases the inadequacy of traditional private law analysis of definable correlative rights as regards the trust. The emerging picture is complex, subtle and elegant, and worthy of future study.

Acknowledgements

I am grateful to Joshua Getzler for our countless discussions on law, legal history, economics, theology, music and *eudaimonia*, and of course for supervising this doctoral thesis and its previous incarnation; to Ben McFarlane for the insightful discussion on the latter; to Lionel Smith and Paul S Davies for reading and examining the finished work and their detailed analyses of the same; to Edwin Peel, my college adviser, for his understated extension of small bureaucratic kindnesses that better allowed me to concentrate on the work; to Mike Macnair for pointing me to invaluable historical materials on beneficiaries' creditors; to Richard Nolan for pointing me to more recent materials; to Dyson Heydon for early doctrinal discussions and his donations of various books; to Robert Sitkoff for his sponsoring my visiting fellowship at Harvard Law School, for our many interesting lunchtime discussions during that visit and for reviewing the US law chapters in exchange for nothing beyond directions to Hamleys toy store in London, and, together with his wife Tam, for extending us such a warm welcome in Boston; for the excellent administrative assistance I received at Harvard particularly from Molly Eskridge and Stephen Wiles; to Tamar Frankel for our discussions on life, frauds and fiduciary duties; to John Morley and Henry Hansmann at Yale Law School for their insightful points on asset partitioning and trusts; and to Kirsti and John Langbein for so kindly hosting us while we were at Yale, and Professor Langbein in particular for the lively discussions on trust law and its legislative reform.

I also wish to thank the Oxford Law Faculty for awarding me their Trusts Scholarship, Keble College for their Sloane Robinson Scholarship and the Insolvency Lawyers' Association for their Exceptional Insolvency & Restructuring Research Scholarship. Thanks must also go to the Oxford Law Faculty Travel Fund, the Keble Association and Faith Ivens-Franklin Fund for providing me with the means to travel to Boston to take up my visiting fellowship at Harvard.

Finally, and most importantly, I wish to thank my parents, Marja and Ismo Granholm, without whom this work could never have been written, and my wife Erica who travelled far and wide with me, patiently and attentively listened to detailed descriptions of obscure legal problems on Greyhound buses, and endured periods of long separation as I searched for solutions to tricky trust law puzzles.

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1. Introduction – Asset Partitioning in the Trust

i) Topic and Chapter Outline

Creditors of trustees and beneficiaries face an uphill battle in attempting to enforce their rights against their debtors. Such enforcement is difficult not only because of the complexity of the central principles involved, but also because these principles are not particularly well known or much discussed in the academic literature. At the heart of creditor claims against trustees and trust funds is the very nature of the trust as creating group enterprise with a pool of assets separate from those of its members, while simultaneously maintaining the ability of the members to further the purposes of the enterprise by limited preserving powers to use the assets. As noted by Maitland,[1] the trust does a great deal of the work of corporations through personal liability of the trustee, without creating artificial legal personality for a group enterprise:

> Now our trust provides this hard exterior shell. (…) [D]uring the age in which the trust was taking shape, all this external litigation went on before courts where nothing could be said about trusts. The judges (…) could only see the wall of trustees and could see nothing beyond it. Thus in a conflict with any external foe no question about personality could arise.[2]

A trustee who authorisedly contracts with creditors while managing a trust business becomes personally liable to those creditors; he has a strong indemnity claim against trust assets, which claim may be subrogated to the creditors. A beneficiary who deals with or commits a tort

[1] F W Maitland 'Trust and Corporation' in H D Hazeltine et al (eds) *Maitland: Selected Essays* (CUP, Cambridge 1936), 141.

[2] *Ibid.,* 188.

against a third party also becomes personally liable to that third party; his beneficial interest can be made subject to the claim of his creditors through express or implied equitable assignment.

Behind these simple propositions lie a host of difficulties: what is the nature of the indemnity; how may it be impaired, in relation to both trustee and creditors; whether trustee's obligations within the trust can affect external creditors' claims; how the beneficiary's personal interests are affected by trust creditors; what impairments can there be on a creditor's claim to attach the beneficial interest; and what rights does a successful attachment give against the trust property itself. It will be seen that the trust creates a surrogate for artificial legal personality, assigning an order of priorities and constructing asset partitioning walls between different classes of creditors, through crafty use of equitable doctrine. The topic of this thesis, how trust creditors attach their claims to trust assets, is central to understanding the operation of the trust as a trading vehicle, and demonstrates how a potent legal institution constituting group relationships can be built from personal claims in law and equity overlaying simple ownership.

This topic is both old and new—old because most of the central case law is from the 18th and 19th century (and sometimes much older), new because it is not subject to detailed discussion and analysis in any of the major English textbooks,[3] and to the knowledge of the author, no leading academic has published a major contribution on it that deals with both trustees' and beneficiaries' creditors. The topic is nevertheless of great practical importance—so much so that the Trust Law Committee in England, comprising leading academics and practitioners, issued a consultation paper on trustees' creditors in 1997,[4] a report with recommendations for reform in

[3] For this purpose the author has consulted the following leading texts: J Mowbray et al (eds) *Lewin on Trusts* (19th ed, Sweet & Maxwell, London 2016) J McGhee (ed) *Snell's Equity* (33rd ed Sweet & Maxwell, London 2016); D Hayton, P Matthews and C Mitchell (eds) Underhill & Hayton: *Law of Trusts & Trustees* (19th Ed LexisNexis, London 2016); AJ Oakley (ed) Parker & Mellows: *The Modern Law of Trusts* (9th Ed Sweet & Maxwell, London 2008); P S Davies, G Virgo and E H Burn *Maudsley & Burn's Equity and Trusts* (2nd ed OUP, Oxford 2016).

[4] Trust Law Committee Consultation Paper 'Rights of Creditors against Trustees and Trust Funds' 1997.

1998, and it was a part of the English Law Commission's ninth and tenth programmes,[6] though subsequently abandoned. To date the 1998 recommendations have not led to legislative reform. The New Zealand Law Commission has also included it in its review of the law of trusts, with recommendations for reform that have now led to legislative proposals.[7] This thesis proceeds on the basis that any practical reform programme must begin with a clear view of the basic doctrinal questions and their theoretical implications: What is the nature of creditor rights against trustees and beneficiaries, and what does that tell us about trusts?

This thesis explains the law relating to trust creditors, isolates the problems resulting from this body of law,[8] and shows how these problems can be solved. It also discusses the law of beneficiaries' creditors and its foundational principles, and goes on extensively to consider US law regarding both trustees' and beneficiaries' creditors, in order to draw comparisons of both doctrine and central principles.

In so doing, the thesis further shows how important such creditor relations are in order to understand the operation of trusts as asset partitioning devices. To offer a background for this analysis, this chapter gives a short introduction into some basic principles of trust law, from the point of view of asset partitioning.

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[6] See http://lawcommission.justice.gov.uk/areas/rights-of-creditors.htm (accessed 22 April 2014).

[7] Law Commission (NZ) 'Court Jurisdiction, Trading Trusts and Other Issues' 2011, chapter 7. http://www.lawcom.govt.nz/sites/default/files/projectAvailableFormats/NZLC%20IP28.pdf (accessed 17 Septemver 2017), with a bill introduced to the New Zealand Parliament on 1 August 2017 available at http://www.legislation.govt.nz/bill/government/2017/0290/latest/DLM7382815.html (accessed 17 September 2017), part 4(2).

[8] It should be noted at the outset that this thesis only attempts to deal with the common law trust, and not, for instance, the law regarding the estate of a deceased person (which is a matter for probate law). For an exposition of the doctrinal differences in creditor access between a common law trust and the estate of a deceased person, see L Smith 'Scottish Trusts in the Common Law' (2013) 17 Edinburg L Rev 283.

Chapter 2 offers an exposition of the main doctrinal strands associated with claims of trustee's creditors, and the trustee's powers to limit his liability. It identifies the problems that come with each strand, and offer examples of their combined effect, through factual hypotheticals and analysis drawn from foreign case law attempting to tackle these Victorian English authorities in novel contexts.

Chapter 3 gives solutions to the problems identified in chapter 2 in two ways: doctrinally and theoretically. Doctrinal solutions seek to establish internal coherency of the law. These solutions point to inconsistencies in the law identified in chapter 2, and resolve these conflicts mainly by reinterpretation of the logic of cases, and occasionally by jettisoning rulings that cannot fit the main body of doctrine. Theoretical solutions by contrast aim to align the law with the aims and purposes of trust law identified in the theoretical introduction in this chapter, and do not show the same sensitivity to positive authority.

Chapter 4 discusses some aspects of the rich history of the beneficial interest and basic structure of trusts, in an effort to discover the origins of some of the central principles and doctrine in the area of creditor access to beneficial interests. The main issues under consideration are the ability of the beneficiary to assign his interest, the nature of the rights as between the trustee and beneficiary and towards outsiders, and the origin and features of the beneficiary's power to terminate the trust. This exercise is necessary background to understand the doctrinal position of creditors of beneficiaries.

Chapter 5 explains the doctrine as regards creditor access to the beneficiary's entitlement. The general argument in that chapter is that creditor access is always based on equitable assignment, either express or implied. The picture that emerges is that the creditor is only entitled to whatever the beneficiary is entitled to and nothing more, and if the beneficiary's interest is set to terminate on assignment or bankruptcy the creditor gets nothing (unless the beneficiary continues to receive distributions). If, however, the beneficiary's *ability* to assign is encroached upon, the trust, or the purported term seeking to limit assignability, is invalidated.

Chapter 6 moves on to consider American trust law, first to give a general picture of relevant differences in central principles for necessary context to the following discussion on the doctrinal rules regarding trustees' creditors. In short, American trust law gives central stage to the settlor's intent and treats the trust as analogous to a property interest that the settlor has chosen to carve out of his property. This refocusing, coupled with academic efforts to reduce trust law to a set of directly enforceable rules, has led to much of American trust law being controlled by statute, passed in response to changing policy concerns and to attract trust money to a given state. While the basic method of reaching trust assets through the persona of the trustee remains the same as with English law, the trustee is seen more as a manager rather than a real legal owner. This position has far-ranging doctrinal consequences including the unequivocal position that the beneficial interest is a property right and the abolition of the trustee's personal liability.

Chapter 7 deals with creditor rights against beneficiaries under US law, and discusses the major conceptual and policy shifts that have attracted much academic discussion – the freedom to restrain alienation of the beneficial interest, and the ability to exclude termination powers expressly. While a convincing conceptual argument for why the settlor's property powers should reign supreme over those of the beneficiary has eluded American trust law scholarship, US academia has simply moved on to functionalist justifications, probably in response to legislative interventions having irreversibly changed the conceptual landscape.

Finally, chapter 8 offers an outline of the doctrine and its problems as expressed in this thesis and a summary of recommended solutions. It will also be suggested how an appreciation of the law of creditor access, both in England and in the US, can better inform our understanding of trust law as a whole, placing the various doctrinal strands discussed in this thesis in the context of wider debates within the law of trusts.

2. Some General Principles of Trust Law

i) Modularity

An interesting starting point in the analysis of the credit obligations attaching to trusts is to consider the function of trust law in fostering modularity of rights and duties. This is most helpfully illustrated by going from general to specific, that is, first considering property law and then drawing comparisons to trust law.

Modularity in property law is the idea of keeping the parties' obligational complexity internal while showing a simpler property-face towards outsiders.[9] This allows outsiders to adjust their behaviour with minimal costs, because those outsiders need only know that they are excluded from certain property without having to know the obligational relations attaching to that property. In the words of Henry Smith: 'Property [law] employs a thing-based exclusion governance architecture to manage complexity of the interactions between legal actors.'[10]

This rich quotation makes several important points. First, property is thing-based, where the core of protected rights comprises control of physical assets (or, presumably, developed by analogy to physical assets). In the paradigmatic case, an outsider need only know that he must not interfere with a physical thing, say a house or a bicycle, when he sees it. Second, property rights operate by exclusion. The right that a property-holder has is to exclude all others from his property. Property law need not elaborate on the *use* of property,[11] it simply needs to set the

[9] On modularity, see H Smith 'Property as the Law of Things' (2012) 125 Harv LR 1691. See also T W Merrill 'Property as Modularity' (2012) 125 Harv LR Forum 151.

[10] Smith, *ibid*, 1691.

[11] Though a *political* theory of property may find it necessary to do so; see J W Harris *Property and Justice* (OUP, Oxford 1996).

appropriate boundaries of illegal or unlawful uses.[12] In Hohfeld's classification of legal relations, the uses of property are *liberties*, that is, they do not correspond to duties of others.[13] The right to exclude on the other hand is a claim-right, which corresponds to a duty on everybody else to refrain from interfering with the property. Third, this 'architecture' of exclusion governance manages complexity of interactions. In a hypothetical system without property but with many competing obligations attaching to physical things that represent finite resources, an outsider would find it difficult and costly to work out whether he in particular is allowed to interfere with a specific thing, say to cross a bit of land. He would need to know everyone who has claims on that land and what those claims are so that he may negotiate deals with each before crossing. In a property system he simply needs to know whether the land is somebody's property.[14] All other dealings that the property holder may have are internal to the relationships between him and the other parties with whom he has dealt. The outsider need not be concerned with those – he may simply negotiate a deal with the owner. This serves an important efficiency function in keeping information costs at a minimum.[15]

Trusts, generally speaking, conform to this idea. The trustee holds legal title to trust property and is, as far as the rest of the world is concerned, the 'owner'. That his title is burdened with the beneficiary's equitable rights only concerns *him*, where no transfer of trust assets in breach of trust occurs. This principle is so strong that where the beneficiary of a trust

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[12] This point is based on the author's interpretation of basic property law in light of F A Hayek *Law, Legislation and Liberty* (Routledge Classics, London 2013), ch 8.

[13] W Hohfeld, *Some Fundamental Legal Conceptions as Applied in Judicial Reasoning* (W Cook (ed), 1923) at 76.

[14] See J E Penner *The Idea of Property in Law* (OUP, Oxford 1997), 75-76.

[15] H Smith (n 8). Douglas and McFarlane have presented a supporting argument, using a Hohfeldian rights analysis to conclude that the defining feature of property is exclusion and not the liberty to use a resource – see S Douglas and B McFarlane 'Defining Property Rights' in J Penner & H Smith (eds) *Philosophical Foundations of Property Law* (OUP Oxford 2013), Chapter 10.

disappears, the trustee may do with the property as he pleases,[16] or at least the beneficiary's title does not revert to the Crown under any rule of escheat or pass on to next of kin.[17] The outside world need only be concerned with the trustee's rights. As such, information costs associated with trusts are minimal: a bona fide purchaser of trust property receives the property free of encumbrances, an innocent volunteer transferee simply cannot use the property in priority to the beneficiary, and knowing recipients and dishonest assistants in breach of trust cases are subject to separate personal liability provided they satisfy the knowledge requirements.[18]

That the beneficiary has under certain conditions a power to collapse the trust under *Saunders v Vautier*[19] might at first glance appear to violate this principle; it suggests that in some sense the beneficiary is the true owner of the property, as he may at will take full legal ownership where the conditions of *Saunders v Vautier* are satisfied.[20] In fact a *Saunders v Vautier* power does not violate this basic principle of modularity. The beneficiary may become the legal owner, but external parties still face the same information costs as they did prior to the collapse of the trust. Their rights and duties as regards the property remain the same, they are simply now in place between the third parties and the new owner. The principle of *Saunders v Vautier* is therefore modularity-neutral. In other words, the aspects of trust law examined here, i.e. the attachment of creditors' claims to trust assets, with modularity as one of its key principles, tolerates *Saunders v Vautier* powers.[21]

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[16] *Burgess v Wheate* (1759) 1 WmBl 123, 1 Eden 177.

[17] See P Matthews '*Burgess v Wheate* (1759)' in C. Mitchell & P. Mitchell (eds) *Landmark Cases in Equity* (Hart Publishing, Oxford 2012), 115.

[18] The current judicial understanding of this last class of cases is that they are not 'true trustees' at all but only liable as though they were trustees by their ancillary liability - see *Williams v Central Bank of Nigeria* [2014] UKSC 10; [2014] AC 1189, 1198, 1208.

[19] *Saunders v Vautier* (1841) 4 Beav 115, 49 ER 282 (MR); C&P 240, 41 ER 482 (LC).

[20] See Chapter 5 for in-depth discussion of this point.

[21] See Chapter 8 for more detailed conclusions on the importance of *Saunders v Vautier*.

ii) Asset Partitioning – General Principles

Another important function of trust law is asset partitioning,[22] the doctrinal operation of which is at the heart of this thesis. Again, this is most easily analysed by moving from general to specific, in this case from functional and economic analysis of organisational law to how this applies to trusts.

Two major theses in functional analysis of the law are of use here, with a few supplements. According to the first, that of Hansmann and Kraakman, organisational law[23] performs the following essential functions of asset partitioning that are distinct from standard form contracts. First, it designates a separate pool of assets that is associated with the enterprise, distinct from the assets of the individual members of the enterprise. Second, it assigns priorities to creditors in these distinct asset pools of the enterprise and its members, depending on who the contracting parties are, and so 'partitions' the assets of the enterprise and its members.[24]

This second feature has two forms: *affirmative asset partitioning* and *defensive asset partitioning*. Affirmative asset partitioning is the assignment of a claim on the assets of the group enterprise to the creditors of that enterprise. This claim is prior to the claims of the personal creditors of individual members of the enterprise. This is also called 'entity shielding',[25] the idea being that the group enterprise (defined below) is shielded, at least to some degree, from the claims of the

[22] Hansmann and Kraakman clearly saw trust law as part of their thesis on asset partitioning: see H Hansmann & R Kraakman 'The Essential Role of Organisational Law' (2000) 110 Yale LJ 387; 390, 392.

[23] That we may define, for our purposes, as the law regarding the legal forms of joint enterprise.

[24] Hansmann & Kraakman (n 21). This description is paraphrased somewhat, in order to avoid the loose usage of terms such as 'firm', 'legal entity' and 'legal person' that can be found in the article.

[25] H Hansmann, R Kraakman and R Squire 'Law and the Rise of the Firm' (2006) 119 Harv LR 1333-1403, 1337-38.

creditors of its members. Defensive asset partitioning grants the individual members' creditors a claim on the personal assets of those members. This claim is prior to the creditors of the group enterprise.[26] This is also called 'owner shielding',[27] the idea being that the members (or 'owners', again very loosely defined[28]) are shielded to some extent from the liabilities of the enterprise. A corollary of defensive asset partitioning is that the group enterprise cannot claim from a debtor of one of its members, and individual members cannot claim from a debtor of the group enterprise (unless they are 'managers' within the meaning given below, claiming on behalf of the enterprise).

Group enterprise can be defined for this purpose as a legal structure with the following features. First, it must have the capacity to attribute decision-making power to an individual member or members. That is, there must be an individual or individuals with the capacity to direct the use of assets of the enterprise. These members may be called 'managers'. Managers in a broad sense may or may not be distinct from other members of the enterprise, on whose behalf and for whose benefit as a whole the managers act. Second, it must have a dedicated pool of assets.[29]

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[26] Hansmann & Kraakman (n 21) 393-94.

[27] Hansmann, Kraakman and Squire (n 24).

[28] What is probably meant by 'owner' in this context is something close to residual owner, that is, that class of persons who will eventually receive a share in enterprise capital once all creditors have been paid off, as is, in theory, the case with company shareholders. See further, A M Honoré 'Ownership' in A Guest (ed) *Oxford Essays in Jurisprudence* (Clarendon Press, Oxford 1961), on residuarity at 126. In this thesis the main ownership feature we are concerned with is liability to excecution (see Honoré at 123), and thus any arguments or conclusions offered here about 'ownership' of trust assets are intended to be read in that narrow light only, unless otherwise stated – see Chapter 8.

[29] This formulation closely reflects Hansmann & Kraakman's definition of 'a firm', with some important distinctions to make the definition offered here independent of the 'nexus of contracts' theory. See Hansmann & Kraakman (n 21), 392.

Asset partitioning can be 'weak-form' partitioning, merely creating priority regimes for the separate pools of assets but without creating full liquidation protection.[30] Weak-form asset partitioning is the notion that creditors of pool A have priority claims in that pool over creditors of other pools, but once pool A has been exhausted they may liquidate assets of other pools as well, where the claims of priority creditors of those pools are satisfied. An example would be a partnership, where creditors of the partnership must exhaust partnership assets before they are allowed to access the personal assets of the individual partners.[31] 'Strong-form' asset partitioning is priority rules plus liquidation protection, that is, the notion that creditors of one pool cannot liquidate assets in another.[32] This is the form of asset partitioning seen in limited liability companies, where assets of shareholders and company assets are completely distinct.

In a second major thesis that sheds light on the essential features and thus central principles of trust law, Hansmann and Mattei conducted a similar functional analysis directly in the context of trusts, resulting in the finding that 'the most important contribution of the law of trusts is that it facilitates the partitioning of assets into bundles that can be pledged separately to different classes of creditors'.[33] Hansmann and Mattei looked at the functions of trust law through a comparative analysis with civil law countries, where similar functions are performed by the law of agency and the law of contract. This provided a control situation of what would happen in common law countries without trusts.[34] They found that trust-like property

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[30] Hansmann & Kraakman (n 21), 386; Hansmann, Kraakman & Squire (n 24), 1337-38.

[31] This is known as the 'Jingle Rule'. See J Getzler and M Macnair 'The Firm as an Entity Before the Companies Acts' in P Brand, K Costello and W N Osborough (eds) *Adventures of the Law: Proceedings of the Sixteenth British Legal History Conference, Dublin 2003* (Four Courts Press, Dublin 2005), 267-288; Hansmann, Kraakman & Squire (n 24), 1281-83.

[32] Hansmann & Kraakman (n 21), 395; Hansmann, Kraakman & Squire (n 24), 1337-38.

[33] H Hansmann and U Mattei 'The Functions of Trust Law: A Comparative Legal and Economic Analysis' (1998) 73 NYULRev 434, 438.

[34] Appreciating this method is important for analysis of their conclusions.

management structures and fiduciary duties could be spelled out in contractual arrangements with a very small loss in efficiency.[35] What is unique to the trust, however, is its ability to cut down on total information and monitoring costs for the parties internal to the forming of a trust: the manager (trustee), the transferor (settlor), and the recipient (beneficiary).[36]

In a trust-like management structure the transferor would want to keep the manager's creditors away from the property, and for the property to be included in the general wealth of the recipient. Without trusts, the manager's creditors have claims against the property—the manager is the legal owner, with full liability to execution. This is in fact the general rule in continental systems.[37] The only way to achieve the same outcome would be for the manager to negotiate a clause with everyone he contracts with that the managed property is not subject to their claims. This would create immense transaction costs, and monitoring costs on the transferor and recipient—they now have to police that all of the manager's contracts contain this clause. Asset partitioning, according to Hansmann and Mattei, make trusts special.

There are aspects of Hansmann and Mattei's thesis that an English trust lawyer might consider extraordinary. The main objection for the purposes of this thesis is the idea that *all* aspects of trust law, except asset partitioning, can efficiently be created by contract-agency structures, notably including fiduciary duties.[38] Where the creation of fiduciary duties can be achieved efficiently by contract, it suggests that the law would do well to collapse fiduciary duties into contracts or some other form of voluntary undertaking, as there is no reason to keep a complex structure of two distinct categories where one would achieve the same outcome.

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[35] Hansmann & Mattei (n 32), 447-49.

[36] *Ibid,* 451- 56.

[37] *Ibid,* 456.

[38] *Ibid*, 447-48.

Whether fiduciary duties can meaningfully be described as voluntary undertakings akin to contracts is a contentious issue,[39] and one not to be assumed as axiomatic.

The debate itself has no direct relevance to the main arguments made in this thesis, but for the principles presented in this chapter there is at least one indirect way the basis of fiduciary obligations is relevant.[40] The issue is, if fiduciary duties as we know them can be achieved in all their aspects by contract and the law should therefore collapse the distinction, it would be very difficult to maintain that such duties could not be excluded or at least fundamentally reshaped by contract.[41] If voluntariness is the origin of fiduciary duties, then it must also be its essence—if a trustee agrees to take on only certain aspects of a fiduciary duty but not, say, the duty to keep the assets separate, that lack of voluntariness should release him from that basic duty.

This conclusion seems to follow from Hansmann and Mattei's methodological technique of looking into the efficiency aspects of creating a 'trust' completely by contract, which of course assumes such creation would be possible in the first place. The reasonableness of this extrapolation, from what is essentially a question of parameters of methodology, is only strengthened by the fact that fiduciary duties are not on Hansmann and Mattei's list of unique

[39] Contrast, for example, J Edelman 'When Do Fiduciary Duties Arise?' (2010) 126 LQR 302 and J Edelman 'The Importance of the Fiduciary Undertaking' (2013) 7 Journal of Equity 128 with M Conaglen 'Fiduciary Duties and Voluntary Undertakings' (2013) 7 J Eq 105; J Getzler 'As If Accountability and Counterfactual Trust' (2011) 91 Boston ULRev 973 and J Getzler 'Ascribing and Limiting Fiduciary Obligations: Understanding the Operation of Consent' in A S Gold and P B Miller (eds) *Philosophical Foundations of Fiduciary Law* (OUP, Oxford 2014); L Smith 'Fiduciary Relationships: Ensuring the Loyal Exercise of Judgment on Behalf of Another' (2014) 130 LQR 608. The Australian Federal Court has recently endorsed Edelman's view: see *ABN AMRO Bank NV v Bathurst Regional Council* [2014] FCAFC 65, Para [1066]

[40] See text accompanying n 47 *et seq*.

[41] As a matter of doctrine this goes against *Armitage v Nurse* [1998] Ch 241, although the principle in that case has, arguably, been under judicial fire as well: see *Citibank v MBIA* [2007] EWCA 11, 1 All ER (Comm) 475 and comment on that case by A Trukhtanov 'The Irreducible Core of Trust Obligations' (2007) 123 LQR 342. For the view that the *Citibank* case does not go against the irreducible core idea, see J Edelman 'Four Fiduciary Puzzles' in E Bant and M Harding (eds) *Exploring Private Law* (CUP, Cambridge 2010), 298, 303.

features of trust law. It is unclear if this is intended by Hansmann and Mattei, and going into a detailed debate on the subject would be of limited use for this thesis. It should be noted, without endorsing the opposition, that the idea of contractual fiduciary duties is not accepted for reasons separate from the main debate, briefly explained below.

iii) Asset Partitioning – Application to Trust Context

To understand the application of some of the above principles in the trust context, it is useful to look at the history of equitable forms of asset partitioning. From a legal history perspective, Getzler and Macnair have conducted inquiry into the use of corporate form,[42] which provides historical insights that are useful for the purposes of this thesis. The paper sets out to provide a 'counter-narrative' to previous historical explanations of the rise of the corporate form, which have viewed forms based on judicially-driven analysis of proprietary and contractual concepts as somehow blocked, instead concentrating on corporate forms as state-provided legislative default law.

Countering this view, Getzler and Macnair argue for an historical, Chancery-led case-by-case development of a workable organisational law, far predating the companies acts, based on equitable, fraud-based doctrines such as presumed and reversed conveyances. To showcase how courts of equity created what Hansmann and Kraakman would call 'weak-form' asset partitioning, Getzler and Macnair enlist, among others, the Chancery doctrines of fraud on creditors (based on the Roman law *Actio Pauliana*), the bona fide purchaser defence, the jingle rule in partnership law and the doctrine of reputed ownership. In essence these doctrines exemplify the comparative equities approach of Chancery, contrasting with the procedural insensitivity of the common law at the time whereby the first to reach the courtroom door could

[42] Getzler and Macnair (n 30).

drain the assets of a bankrupt leaving other creditors with nothing,[43] without forensic inquiry into the relative strength of moral claims.

In other words, using trust-structures and associated equitable doctrines the courts of equity were able to create what we now recognise as asset partitioning in the trust. The more complex procedural structure of equity allowed the courts to rank claims based not on who is first to enforce, but the comparative equities of the parties. Interestingly, the comparative equities approach armed with fraud-based doctrines is what we would expect to find in a developing system of forms of asset partitioning,[44] because of a causal link between the development of asset partitioning and the development of a bankruptcy enforcement system.

To elucidate, the fundamental reason for this is that entity shielding (or affirmative asset partitioning) brings about larger enforcement costs,[45] putting pressure on the system to find simpler rules. According to Hansmann, Kraakman and Squire, where asset partitioning exists debtor opportunism is more likely as a debtor can invest his assets in an enterprise with entity shielding, use it to leverage credit, and then invest these same assets into another enterprise. As a response, the courts would be expected to develop doctrinal rules, such as fraudulent conveyancing rules or bona fide purchaser defences to simplify case-by-case enforcement and push down enforcement costs in their efforts to avoid the *Jarndyce v Jarndyce* –type debacle satirised in Charles Dickens' *Bleak House*. In other words, the bankruptcy system becomes more efficient and sophisticated as asset partitioning develops.[46] In the trust context this simply means that we would not expect such debtor opportunism as described above to succeed, because of

[43] *Ibid.*

[44] Hansmann, Kraakman & Squire (n 24), 1352.

[45] Following Hansmann, Kraakman & Squire, 1352.

[46] *Ibid,* 1352.

the many doctrines we have in place to stop it (such as tracing rules, fraudulent conveyancing rules etc.).

There is another reason such debtor opportunism would not succeed in the trust context. That reason is, the trust involves more than one person (leaving aside charitable trusts, which have their own enforcers). The trustee owes a duty to the beneficiary not to misuse trust assets, meaning his ability to perpetrate fraud is limited, and the beneficiary only has access to his share,[47] or, in the case of discretionary trusts, to the share the trustee allocates him, limiting *his* ability to misappropriate or defraud.

Hansmann, Kraakman and Squire note that debtor opportunism is self-policed in the case of multi-person enterprises,[48] categorising this as an incidental benefit of a multi-person enterprise structure. But it is submitted as at least a possibility that in the case of trusts the connection is more than incidental. It might be that the trustee-beneficiary structure and the accompanying overlaid fiduciary duties that we find in trusts are no accident, but born out of the very feature of trusts as effecting asset partitioning. That is, the *reason* we find fiduciary duties in a trust, owed by trustees to the beneficiaries, as well as a lack of direct access of beneficiaries to the trust assets is to ensure neither can act with debtor opportunism that asset partitioning gives rise to. To so act would destroy the trust enterprise. Asset partitioning (which denies the beneficiary's opportunism) and fiduciary duties (which deny the trustee's) ensure a controlled lock-in of resources and due governance of the enterprise until the trust is terminated or the assets are dissipated in pursuit of the trust aims. This is why, it is submitted, it is a mistake to assume fiduciary duties are or can be the efficient creation of contracting, without regard to the possible or even likely development of these rules in the context of asset partitioning through equitable doctrine.

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[47] *Fraser v Murdoch* (1881) 6 AC 855.

[48] Hansmann, Kraakman & Squire (n 24), 1352.

It is therefore important to recognise that if asset partitioning is an important function of trust law, fiduciary duties are just as important in maintaining the workability of this function. Neither feature of trusts, it is submitted, can be excluded without destroying the trust concept. To imagine a trust without one or other of these features is to imagine a prairie without open spaces, or a coin with only one side. While this thesis does not deal with fiduciary duties at a level beyond what is mentioned here as the subject of this thesis is external creditors, it is submitted that their existence and special features are an important part of the whole picture, of which asset partitioning controlling trustee access forms one half.

A detailed doctrinal analysis of the rules governing access of creditors to trust assets that broadly supports the above conclusions is given in the following chapters, but we may reflect upon these theses based on the general features of trusts. As a general description, a trust seems to fit the definition of an enterprise—it has a management element, a beneficiary element and a pool of assets. This makes it a candidate for the two types of asset partitioning, affirmative and defensive, in the two forms, weak and strong, identified by Hansmann and Kraakman.

To appreciate completely the subtle structure of asset partitioning in the trust, we must consider both the trustee and the beneficiary, both defensive and affirmative asset partitioning, in both weak and strong forms. Without this exercise any classification would be misleading.

The trustee's creditors do not have direct access to trust assets.[49] Thus as far as the trustee's creditors are concerned the assets of the trust are *affirmatively* partitioned (or the entity is shielded)—the manager's personal creditors are always precluded from claiming against trust assets, and even the trustee's trust-creditors cannot enforce their claims against the trust assets directly, subject to certain limited exceptions elaborated in chapter 2 below. The trust also has *defensive* asset partitioning (or the trustees are shielded). The liabilities the trustee incurs in managing the trust are indemnified from the trust assets, and the trustee is afforded a strong

[49] See Ch 2 below for a more detailed discussion of the operation of these rules.

priority in enforcing this indemnity.[50] Thus the trustee is, to the extent of trust assets, shielded from the liabilities pertaining to the trust.

To put these basic features more accurately, there is a semi-permeable membrane between the trust pool of assets and liabilities attaching to those assets, and the trustee. In terms of defensive asset partitioning, the trustee is not shielded from liabilities in the same way as corporate shareholders or directors are shielded. The trustee incurs the liabilities pertaining to the trust activity personally, and is only indemnified from the trust.[51] If the trust assets are exhausted by an indemnity, the personal assets of the trustee are liable for execution of the creditors' claims.[52] In the language of Hansmann, Kraakman and Squire, this is, in theory,[53] weak-form defensive asset partitioning.[54]

As noted, the personal creditors of the trustee cannot force liquidation of trust assets, because the trustee has no personal right to access the trust assets—even in a case of a personal creditor discovering the trust on the bankruptcy of the trustee, reputed ownership does not apply to assets 'clothed with a trust'.[55] This is clear strong-form affirmative asset partitioning. The trustee can sell trust assets to a bona fide purchaser for value without notice, but cannot

[50] See Ch 2.

[51] *In Re Johnson* (1880) 15 Ch D 548. See Ch 2 for more details.

[52] As happened in *Muir v City of Glasgow Bank* (1879) 4 AC 337.

[53] In practice a court might in limited circumstances be reluctant to order execution of a debt that would destroy the trust where alternatives exist: see discussion on *Darke v Williamson* (1858) 25 Beav 622; 53 ER 774 below.

[54] Not strong-form, as erroneously suggested by Hansmann, Kraakman and Squire (n 24), 1384. They conclude this only considering the feature that the trustee's *personal* creditors cannot force liquidation of the *trust assets*, assuming the reverse applies to *trust* creditors.

[55] *Ex Parte Copeland* (1833) 2 Mont & Ayrt 177, 191. See also The Bankrupts (England) Act (1825) c. 16, s. 79: ('if any bankrupt shall as trustee be seised, possessed of or entitled to (…) any real or personal estate (…), it shall be lawful for the Lord Chancellor, on the petition of [beneficiaries] (…) to order the assignees (…) to transfer the said estate (…) to such persons as the Lord Chancellor shall think fit, upon the same trust'). See F Stolker 'The Rise and Fall of the Reputed Ownership Clause' (MPhil thesis, University of Oxford 2016).

attach his own credit obligations to trust assets without the obligors falling subject to equitable duties to respect the trust beneficial property.

This dichotomy of creditor rights—personal creditors cannot enforce against the trust assets but trust creditors can against personal assets, at least where trust assets are exhausted—is in essence because of two central aspects of trust law: 1) the trustee owes a duty to the beneficiary to only deal with the trust assets in due administration of the trust's terms, and therefore has no rights to enjoy the property himself, and 2) the position of the trustee is transmissible,[56] meaning the identity of the trustee can change without destroying the trust.[57] The first feature is what denies the trustee's personal creditors access to trust assets, and the second denies that access to his assignees as well.

The beneficiary's interest (where it can be ascertained) is subject to the claims of *his* creditors,[58] (though only to the extent to which the beneficiary's entitlement extends) and thus the trust assets are not entirely separate from the assets of the 'members' of the trust.[59] A beneficiary or beneficiaries can even under certain conditions collapse the trust and claim full legal title to the trust property.[60] It is therefore clear that in such circumstances there is only a remarkably weak asset partitioning membrane between the beneficiary and the trust assets. That is, from the beneficiary's side there is hardly any affirmative asset partitioning, or entity shielding,

[56] This latter point is elaborated upon in the discussion of *Burgess v Wheate*, chapter 5 onwards.

[57] The Bankrupts (England) Act (1825) c. 16, s. 79 (n 54 above) is an example of legislative recognition of the transmissibility of the trustee's position, well established in *Burgess v Wheate* 66 years earlier.

[58] *Brandon v Robinson* (1811) 18 Ves 429; 34 ER 379 is the case commonly cited for this proposition, though, as argued below in Chapter 5, the case is not so clear-cut.

[59] This aspect of the trust is fascinating and complex, and regrettably only bare highlights of its complexity can be presented within the confines of this thesis.

[60] *Saunders v Vautier* (1841) 4 Beav 115, 49 ER 282; Cr & Ph 240, 41 ER 482. For different interpretations of this decision, see P Matthews 'The Comparative Importance of the Rule in *Saunders v Vautier*' (2006) 122 LQR 266.

where *Saunders v Vautier* is available. This, it should be noted, is remarkably different under much of US law.[61]

Where *Saunders* is not available, the story changes. The beneficiary's creditors can only ever get what the beneficiary has under an express or implied assignment of the beneficial interest. Thus the trust property remains completely shielded from the beneficiary's personal creditors, except to the effect that such property is actually distributed to the beneficiary's personal estate. So long as it remains in the trust pot, it cannot be touched by a beneficiary's personal creditor other than through *Saunders v Vautier*, though if the trustee is duty-bound to make distributions the creditor will be able to demand that such distributions be made.

As regards defensive asset partitioning on the beneficiary's side, i.e., the degree of vulnerability of the beneficiaries' personal assets to the creditors of the trust, we must first appreciate the fact that the beneficiaries themselves only have personal creditors; they do not trade with the trust assets on behalf of the enterprise. As regards these creditors, is possible for the beneficiaries to alienate their beneficial interests.[62] However, the beneficiary's personal (non-trust) assets can also be subject to a *trust creditor's* claim, though indirectly. This is because the beneficiary's duty to indemnify the trustee is, without contrary stipulation, personal, and not limited to trust assets.[63] It is unclear whose personal assets are to be used up first, the trustee's or the beneficiary's, but we may say with certainty that burdens associated with ownership, such as

[61] Both the two central cases, *Saunders v Vautier* and *Brandon v Robinson*, establishing the features introduced here being overruled. See *Claflin v Claflin* 20 N.E. 454 (1889), disapplying *Saunders v Vautier*; and *Nicholls v Eaton* 91 US 716 (1875) (United States Supreme Court) disapplying *Brandon v Robinson* in the US. This might have been part of the reason Hansmann, Kraakman and Squire categorically declare the trust as having strong form entity shielding (n 53).

[62] See discussion on *Brandon v Robinson* below.

[63] *Hardoon v Belilios* [1901] AC 118, 124. In support of this general proposition Lord Lindley (in the Privy council) cites *Balsh v Hyham* (1728) 2 P Wms 453; *Phené v Gillan* (1845) 5 Hare 1; and *Ex Parte Chippendale, Re German Mining Company* (1854) 43 ER 415, calling the principle 'as old as trusts themselves'.

rent or calls on unpaid shares, will be borne by the beneficiary.[64] In other words, the beneficiaries in general only have weak-form defensive asset partitioning. In that sense the trustee-beneficiary relationship functionally resembles agency – the trustee has a power to enter into contracts that can affect the beneficiary personally, though very likely only after the trust assets have been depleted.

Therefore, the main effect that a declaration of trust has on outsiders is that it portions off property subject to the trust from the trustee's general assets, and instead earmarks it for use for the benefit of the beneficiary. In line with the argument presented above that equitable doctrines pertaining to trust assets can be seen as arising out of the asset partitioning function of the trust, the third party effects of a trust, such as a proprietary claim after tracing, can be seen as illustrations of the underlying principle of asset partitioning in the trust.[65] The pool of assets is created by the trustee's right of exclusion against the rest of the world, and the assets partitioned from the trustee's personal assets by the duty owed to the beneficiary. The beneficiary may enforce this duty by falsifying transfers, bringing assets back into the enterprise, even if he was not the certain recipient of the property.[66] This cross-dependence of asset partitioning functions of the trust and fiduciary duties, though not the main focus of this thesis, is key to understanding the full picture of what is going on in the trust.

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[64] *Hardoon v Belilios, ibid.*

[65] The relationship between tracing and subrogation of creditors to the trustee's indemnity rights, the basic tool of asset partitioning in the trust, was in fact described as one of corollaries by Sir George Jessel MR in *In Re Johnson* (1880) 15 Ch D 548, 552. This is the central case establishing the modern law regarding trustee indemnities and, thus, asset partitioning rules, discussed in detail in chapter 2.

[66] *Clough v Bond* (1838) 3 My & Cr 490, 496-97. Note also dicta in *Re Dawson* [1966] 2 NSWLR 211, 214: 'The obligation of a defaulting trustee is essentially one of effecting restitution to the estate. The obligation is of a personal character and its extent is not to be limited by common law principles governing the remoteness of damage.'

3. Concluding remarks

It can be surprising, given that trusts have been in existence for centuries, that it is difficult to find a definition or a set of principles that would be universally agreed upon by trust lawyers. This chapter by no means attempts to create a full picture of everything that comprises the institution of the trust in the common law world. What is attempted instead is to find certain basic principles that can be observed in the operation of the trust device, upon which the doctrinal analysis in the following chapters can be built.

Chapter 2: Trustees' Creditors in English Law I – Doctrine and Problems

Asset partitioning in the trust is the result of several doctrinal strands, the combined effect of which, when fully appreciated, is very problematic to some of trust law's core concepts. The courts' struggle to make law fit the facts, exemplified in the Australian decisions discussed at the end of this chapter, has led to a conceptual dead-end: either the trust creditors are treated as additional beneficiaries of the trust, or trusts are granted status very close to full legal personality. This chapter will present the law regarding asset partitioning in the trust from the point of view of the trustee. It will also discuss problems associated with this body of doctrine, and the next chapter will seek to solve these problems.

1. Trustee indemnity

The basic operation of this whole area of law derives from the fundamental structure of the trust as a property holding device vesting title and dispositive power in the trustee. A trust is, to choose one useful definition,

> [a]n equitable obligation binding a person (who is called a trustee) to deal with property over which he has control (which is called trust property) for the benefit of persons (who are called beneficiaries or *cestuis que trust*[67]), of whom he may himself be one and any one of whom may enforce the obligation.[68]

[67] The plural of *cestui que trust* corrected by the author; see C Sweet 'Cestui que Use: Cestui que Trust' (1910) 26 LQR 196.

[68] Underhill & Hayton *Law of Trusts and Trustees* (18th ed Lexis Nexis, London 2010), 2. Approved by Cohen J in *Re Marshall's Will Trusts* [1945] Ch 217, 219; Romer J in *Green v Russell* [1959] 2 QB 226, 241.

As regards everyone who is a stranger to the trust, the trustee is the owner, which for the purposes of this chapter we may identify as being the one with exclusionary powers as regards the assets,[69] leaving the beneficiary with a personal claim over how the trustee's powers of ownership are used (which can through equity be multiplied to control third party assignees of the legal estate). Despite *Shell v Total*,[70] the better opinion is that a beneficiary has in the general case no direct possessory or tort-based claims to protect the beneficial interest, though he may have some independent factual possession that can legally be defended. Internally, however, the trustee's access to the assets is limited by the terms of the trust, or the scope of the beneficiary's rights under the trust. Another way to say this is that the trustee is accountable to his beneficiary, or his conscience is affected by the beneficiary's claim;[71] still another, that the trustee's rights in the trust assets are subject to the beneficiary's rights.[72] As Maitland noted: 'Equity did not say that [the beneficiary] was the owner (…), it said that the trustee was the owner (…), but added that he was bound to hold [the property] for the benefit of the *cestui que trust*.'[73]

Whatever the way we choose to express it, it is basic to the operation of trusts that the trustee has managerial control of the property as the titleholder, but is obliged to use it for the benefit of the beneficiaries. Should the trustee incur costs in the administration of the trust, he is

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[69] This appears to be the modern net effect of *Burgess v Wheate* (1759) 1 WmBl 123, 1 Eden 177. See further, P Matthews '*Burgess v Wheate* (1759)' in C. Mitchell & P. Mitchell (eds) *Landmark Cases in Equity* (Hart Publishing, Oxford 2012), 115: *Burgess v Wheate* is about *who* can affect the conscience of the trustee (144). That is to say, there is a set of persons who 'affect the trustee's conscience', or limit his powers as regards the property, but others, such as the crown or the next of kin as in *Burgess v Wheate*, he may exclude.

[70] *Shell (UK) Ltd v Total (UK) Ltd* [2011] QB 86.

[71] E.g. in *Westdeutsche Landesbank Girozentrale v Islington LBC* [1996] AC 669, per Lord Browne-Wilkinson.

[72] This is approaching the definitions of equitable property rights in R Stevens and B McFarlane 'The Nature of Equitable Property' (2010) 4 Journal of Equity 1.

[73] F Maitland *Equity: a Course of Lectures* (2nd Ed CUP, Cambridge 1936), 17.

ultimately given access in the form of an indemnity out of the trust assets[74] unless the trust deed stipulates otherwise, or it is inconsistent with the conditions upon which beneficiaries become so.[75] A professional trustee may also be remunerated by virtue of the Trustee Act 2000, ss. 28 and 29. While this is an interesting and important issue,[76] a detailed discussion of it is beyond the scope of this thesis.

i) The Basics: In Re Johnson

Thus we get to trust creditors. One type of cost in the administration of the trust is incurring debts as part of carrying on a business that the trust deed authorises the trustee to carry on.[77] Another type of legitimate costs is a cost incurred by the trustee that is subsequently approved by the beneficiary (or the trustee is 'exonorated'). The trustee will incur these debts personally, but will be indemnified out of the trust assets where the costs are 'properly' incurred.[78] Where the trustee is personally insolvent, the creditors of the trustee may claim against the assets of the trust by stepping into the shoes of the trustee (henceforth referred to as 'subrogation') and claiming the benefit of his right of indemnity. The consolidated origin of this doctrine is *In Re Johnson.*[79]

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[74] See e.g. *Balsh v Hyham* (1728) 2 P Wms 453; *In Re Johnson* (1880) 15 Ch D 548, upholding the basic right to indemnity.

[75] *Wise v Perpetual Trustee Company Ltd* [1903] AC 139.

[76] See Law Commission "Trustees' Powers and Duties" (LC 260), part VII.

[77] Where the trustee lacks this authority will be returned to below under 'Ultra Vires'.

[78] For elaboration of 'properly' incurred costs, see MS Donald 'The "Proper" Approach to a Trustee's Right to Indemnity out of Trust Assets' (2014) 8 J Eq 283.

[79] *In Re Johnson* (1880) 15 Ch D 548.

Johnson involved a will whereby the executors were directed to call in all debts of the two businesses ('London business' and 'Cambridge business') of the testator, and convert all stock except that of the testator's London business to cash. This was to be divided among the children of his sister, subject to the willingness of one of the children, John Neill, to carry on the Cambridge business. John Neill was to pay the value of the stock to his sisters upon attaining the age of 21 should he wish to carry on the business in his name. The London business was to be wound up, and the proceeds paid to the residuary legatees.

The executor Robinson carried on the business in his own name and did not call in the debts, nor wind up the London business. An action was brought by one of the residuary legatees who obtained a judgment for the administration of the testator's estate, at which time it was found that monies were due from Robinson who was insolvent. Creditors who had supplied Robinson with goods to carry on the Cambridge business asked the court (by way of summonses) to order assignments of the trust assets to pay their claims.

Sir George Jessel MR denied their claim because creditors were not parties to suit,[80] but allowed them the liberty to present a petition. Jessel MR also responded to the point that counsel for the creditors argued, giving the following general statement of doctrine:

> I understand the doctrine to be this, that where a trustee is authorised by a testator, or by a settlor—for it makes no difference—to carry on a business with certain funds which he gives to the trustee for that purpose, the creditor who trusts the executor has a right to say "I had the personal liability of the man I trusted, and I have also a right to be put in his place against the assets; that is, I have a right to the benefit of indemnity or lien which he has against the assets devoted to the purposes of the trade." The first right is his general right by contract (…) the second right is a mere corollary of those numerous cases in Equity in which persons are allowed to follow trust assets.[81]

An important side note should be made here. As regards his Lordships's second point on the nature of the creditor's right of subrogation as corollary of tracing cases, it should be noted

[80] *Ibid,* 552.

[81] *Ibid.* See n 64 above.

that the case before Sir George Jessel MR did not fall squarely within the usual tracing claim, whereby a beneficiary (who is an internal party or a 'member' of the trust) follows trust assets following a breach of trust. It is also difficult to see how this is 'following trust assets' in any meaningful sense—the assets have never left the trust, and the only asset being followed here is the trustee's right of indemnity *from* the trust assets. Jessel MR establishes a right of a creditor, an external party to the trust, to gain access to the trust assets and in effect treats the trustee as holding his indemnity right on trust for the creditor.

The Master of the Rolls did not cite a single case in direct support of the doctrine described in the quotation above. The closest we get to an authority being cited is when Jessel MR, relying on an interpretation of that case by Lord Justice Turner in *Ex Parte Edmonds*,[82] later goes on to hold that *Ex Parte Garland*[83], cited in argument for this proposition, is not applicable as it does not determine the nature of the creditor's right. That case, as per Turner LJ, simply proceeded on the *assumption*, not at issue in that case, that 'creditors of the trade are entitled to the benefit of the right of the trustee's indemnity and thus become creditors of the fund to which the executor or trustee has a right to resort.'[84] *In Re Johnson* was therefore the first case in which the nature of the creditor's access to the trust assets was directly discussed in the language we use today, and the modern foundation of the law regarding trustee's creditors.

ii) Dependence on the Trustee's Right

As we see from the above, the right of the creditor to claim against trust asset is dependent on the right of the trustee. If there is no trustee with an indemnity right to claim

[82] *Ex Parte Edmonds* (1862) 4 DeG F & J 488, 45 ER 1273.

[83] *Ex Parte Garland* (1804) 10 Ves 111, 32 ER 786; returned to below in 'Limitation to Trust Assets'

[84] *Ex Parte Edmonds* (n 81), 498.

through, there is no creditor claim to realise.[85] A corollary is that subrogation into the rights of the trustee cannot make the creditor better off than the trustee himself. Indeed, this is mentioned as such in *Johnson*: '[The] title of the creditor, so to speak, to be put in the place of the trustee, is a title to get nothing [where] nothing is due to the trustee'.[86] We see this principle consistently applied in the case law.

In *Doering v Doering,*[87] Mr Doering had bequeathed all his real and personal estate to his widow, Mrs Doering, on trust for the benefit of the widow and his nine children. The widow then acquired two of the children's beneficial shares, one absolutely and one by way of mortgage. Mrs Doering then assigned *her* entire interest in the residuary estate of her late husband to one Colonel Fyler by way of mortgage, securing £900. It was later found that Mrs Doering was in default, a vast sum (nearly £4000) being due from her to the trust. The plaintiffs in the original administration action took summons to determine whether the default of Mrs Doering could be made good from the shares that she had become derivatively entitled to, in priority to the £900 owed to Colonel Fyler, her assignee. Stirling J held that a defaulting trustee cannot claim any portion of the estate for herself while the default exists, and her assignee cannot be in a better position even if the breach of trust was committed after the assignment.

Though not a case of indemnities or subrogation, but an assignment by the trustee of a beneficial interest she had become derivatively entitled to, *Doering v Doering* shows that anyone holding a right of the trustee takes it subject to the equities attached to that right. Indeed, *Doering v Doering* is stronger authority for this dependence on the trustee's right than a case of indemnity and subrogation: unlike in the case of an indemnity right, Mrs Doering was holding a beneficial interest that was independent of her being trustee—this right could have been held by anyone.

[85] *In Re Leslie* (1883) 23 Ch D 552.

[86] *In Re Johnson* (n 78), 552.

[87] *Doering v Doering* (1889) 42 Ch D 203.

Nevertheless, because the share had landed on a trustee before being assigned further, the next assignee is bound by the claims of the beneficiaries against their trustee to have their loss made good.

Apart from *In Re Johnson* where the discussion is *obiter dicta* because of the procedural peculiarity of the case, a case which applies the dicta in *Johnson* in the context of indemnities is *In Re British Power Traction and Lighting Co Ltd.*[88] In that case one Mr Watkins was appointed receiver and manager of the company in question. He borrowed money, guaranteed by his sureties, and incurred heavy liabilities to trade creditors. He was later replaced by another receiver and manager. After protracted litigation[89] it was held that Watkins was entitled to be indemnified out of the company's assets ('the estate') for the expenses he had justifiably incurred, which amounted to £900. When Watkins's accounts were ascertained, it was found that £400 was due from him, which he was unable to pay. The question before the court was whether the sureties of Mr Watkins should make good his default, or the trade creditors should bear the loss. Swinfen Eady J held that the trade creditors could not claim against the sureties, but only against Watkins or, as he was bankrupt, through his right against the estate. They had no direct right against the estate, as per Sir George Jessel MR in *In Re Johnson*. Therefore, the extent of their right was the extent of Watkins's right, that is, only £500 (total liability of £900 minus the amount the trustee owed to the trust, £400).

iii) The Nature of the Trustee's Right

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[88] *In Re British Power Traction and Lighting Co Ltd.* [1910] 2 Ch 470.

[89] [1906] 1 Ch 497; [1907] 1 Ch 538.

Now that it is established that the creditors' rights hinge on the trustee's indemnity rights, let us look at the *nature* of those rights more closely. This question can roughly be divided to cases concerning the *strength* and those concerning the *type* of the trustee's right of indemnity.

First, the trustee's indemnity gives him priority in an unascertained fund, that is to say, the payment of the indemnity is what ascertains the trust fund, and between trustees their costs are paid rateably.[90] In *Dodds v Tuke*[91] the beneficiaries of a trust had brought an action against the trustees. The trust funds had been paid into court to cover the costs, but it appeared they were insufficient to cover all of them. The defendant trustees asked to be paid in priority to the costs of the plaintiffs. In holding that the defendants have priority, Bacon VC stated that 'It is a good rule that trustees should have priority for their costs, because until those costs are provided for it is impossible to say what the trust fund is'.[92]

The same principle can also be said to apply in the case of *In Re Knapman.*[93] In that case the legatees had brought a claim against the executor, had failed and were ordered to pay the executor's costs. The legatees had meanwhile assigned their interests or mortgaged their shares. The argument was that the claim of indemnity could not bind the assignees. Deciding for the executor, Hall VC stated that a provision must be made for the payment of a legal representative out of the assets, and any assignee of an interest must bear the risk that the estate might be exhausted by the costs of the executor.[94] In other words, the risk is one of not knowing what the fund is before the executor's costs are paid out.

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[90] *In Re Griffith* [1904] 1 Ch 807.

[91] *Dodds v Tuke* (1884) 25 Ch D 617.

[92] *Ibid,* 619.

[93] *In Re Knapman* (1880-81) 18 Ch D 300

[94] *Ibid.* 304.

The above two cases suggest that a trustee's indemnity may exhaust the trust assets. It is, however, doubtful whether the trustee in his claim of indemnity may act inconsistently with, or destroy the trust. The origin of this doubt is *Darke v Williamson.*[95] That case concerned a trust of a chapel that had become dilapidated. The trustees borrowed money in their own name and had the premises rebuilt, using the premises as security for the loan. The plaintiff, a transferee of the loan by novation, claimed a right of foreclosure through the trustees' right to be indemnified for the costs of the rebuilding.

Sir John Romilly MR noted that if he were to grant the order that is asked, it would destroy the trust as the chapel would be foreclosed and sold.[96] The Master of the Rolls expressed strong doubt as to the ability of the trustees to sell the chapel to pay their own costs immediately after accruing them.[97] At the same time he recognised that if the chapel was to be sold, the trustees could not but pay the plaintiff. The case was one of 'great difficulty in working out the right'.[98] Conscious of this, Sir John Romilly MR went no further than to say the title deeds are to be delivered to the plaintiff, and if the trust is dissolved at some later date she is entitled to enforce her right of foreclosure. But Sir John Romilly MR did not allow her claim through the trustee's indemnity, though His Lordship did not expressly deny it either.

While the above cases describe the relative *strength* of the trustee's right, the *type* of the right is sometimes loosely described as a lien.[99] The origin of this is probably due to a solidified

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[95] *Darke v Williamson* (1858) 25 Beav 622; 53 ER 774.

[96] *Ibid.* 776

[97] *Ibid.*

[98] *Ibid.*

[99] Relatively modern examples of this are the Australian cases of *Vacuum Oil Company Proprietary Limited v Wiltshire* (1945) 72 CLR 319, 335; and *Octavo Investments Proprietary Limited v Knight* (1979) 144 CLR 360, 362

misunderstanding of *Evans v Evans*.[100] In that case the widow of a merchant of builders' materials had carried on the business of the deceased without authority of the will. In doing this she bought a consignment of cement on credit. The son of the testator filed an administration action, and the cement was sold by the receiver. On the same day the cement merchants obtained judgment against the widow for the unpaid cement. They then claimed in the administration action that they were entitled to be paid out of the proceeds of the sale, and Kay J made an order declaring that they were entitled to a lien upon the beneficial interest of the widow in the estate (the right of indemnity) for the amount owed to them.

The cement merchants were not satisfied with this, and appealed. It is possible this was because there was not enough money in the estate to pay all creditors, or that the widow was in some kind of default to the estate, although it is not clear as to why exactly the cement merchants were not satisfied with their subrogation to the widow's indemnity. Cotton LJ reiterated the position that a creditor of the trustee cannot be in a better position than the trustee herself, and cannot claim directly against the estate. His Lordship then went on to say that the goods belong to the estate, '*subject to* the right of the widow to be indemnified out of them against all claims in respect of them so far as she has not lost such right by being a debtor to the estate, and whether she has lost that right is a question depending on the *result of the general account*' (emphases added).[101] Lindley LJ pointed out that the cement merchants never had a right to seize the goods, because they never took out execution. His Lordship then noted: 'these goods must, I think, *subject to the right of the widow to indemnity*, be considered part of the estate' (emphasis added).[102]

[100] *Evans v Evans* (1887) 34 Ch D 597.

[101] *Ibid.* 601.

[102] *Ibid.* 603.

This case clearly shows that the widow does not have a lien on any part of the property including the cement, as otherwise the cement merchants would have no objection to being put in the widow's position, although it is difficult to say exactly what the effect of being given access to a supposed lien of the widow would be, as it would likely be an equitable lien. In any event, it appears the cement merchants were claiming for some kind of security that would entitle them to be paid out of the proceeds of the sale, which they would get by the order of Kay J if the widow's right of indemnity had been in the nature of a lien. However, the *dicta* of Cotton LJ and Lindley LJ can be read to mean that the inclusion of the cement in the property of the estate is subject to the indemnity being paid. If that were the case, the widow would have right to hold on to the cement before her indemnity was satisfied—she would indeed have a lien.

The obiter statements of Cotton and Lindley LJJ were seized upon in *Jennings v Mather*.[103] Mather was assigned the trade assets of a business as trustee for the benefit of the creditors of the business. He ordered goods from Jennings and did not pay for them, so Jennings obtained judgment against him and lawfully seized certain assets. Mather absconded bankrupt, and Gray was appointed *his* trustee-in-bankruptcy. Gray attempted to claim the proceeds of the seized assets to divide them among Mather's creditors. The county court judge found against Gray by virtue of the (then) s. 44 of the Bankruptcy Act 1883, that goods held by the bankrupt on trust were not divisible among his creditors. Gray appealed.

Kennedy J, citing *Evans,* reversed the county court judge's decision, and expressly treated the right of indemnity as being 'in the nature of a lien [allowing the trustee] to prevent any person from carrying away goods [belonging to the trust]'.[104] Once his accounts were made up and if nothing was due to the trustee, his lien is gone.[105] Mather therefore had a direct personal

[103] *Jennings v Mather* [1901] 1 QB 108

[104] *Ibid.* 113.

[105] *Ibid.* 114.

interest in the assets in the form of his indemnity lien, forming part of his estate, and thus it was available to his creditors. Although the trust property itself did not form part of Mather's estate, Mather's lien had passed over to Gray, Mather's trustee-in-bankruptcy.

With respect, it would seem that the trustee's indemnity and its nature has nothing to do with the trustee's ability to prevent any person from carrying away the goods belonging to the trust, except perhaps indirectly. Rather, this is a natural incident of the trustee's legal title over the trust property, which provides him with rights of exclusion. The only way in which the trustee's indemnity bears any relevance to the topic of third party attempting to carry goods away is that the exercise of the indemnity ascertains the extent of the trust property, and in some cases, the extent of the beneficiary's entitlement. In a simple donative trust, the trustee would claim his indemnity first and then present the remaining property to the beneficiary – his legal ownership of the assets only exists as long as his indemnity is not satisfied, but it is not this right of indemnity that directly prevents anyone from carrying away the goods.

It also appears that the principle laid down in *Jennings v Mather,* that the value of the trustee's right is liable for execution of the trustee's debts requires qualification. Namely, funds extracted from the trust under the trustee's indemnity are to be applied to the satisfaction of that liability which created the right of indemnity, in priority to the trustee's general creditors. That is, if the liability the trustee has incurred remains unpaid when the trustee claims for indemnity, he must use the benefit of that indemnity to meet that specific creditor's liability.

This was decided in *In Re Richardson.*[106] In that case a lessee had sold the beneficial interest of a lease to his wife, and had thus become her trustee of the leasehold. The wife was consequently liable to indemnify her husband for any rent arrears or damages for breach of covenant. The landlord obtained judgment against the husband (the lessee-trustee) for £711, which the husband was unable to pay because he was bankrupt. The landlord then brought an

[106] *In Re Richardson* [1911] 2 KB 705.

action jointly with the husband's trustee-in-bankruptcy to enforce the indemnity, followed by an application to the court to ascertain which of them was entitled to the benefit. If the landlord received the benefit of the indemnity, it would have been at the cost of the general creditors. If the trustee-in-bankruptcy received it, he would have distributed it to all creditors and the landlord would have received a fraction of what he was owed.

The Court of Appeal, reversing the first instance decision, decided for the landlord. In doing so, Cozens-Hardy MR drew attention to the absurdity of the result that if the benefit of the indemnity was applied to all creditors, the greater the trust liability incurred by the trustee, the greater the advantage to the personal estate. This, according to His Lordship, would be tantamount to profiting from his position as trustee.[107] It is unclear exactly what is meant by this, as the trustee clearly does not profit personally. However, the assumption appears to be that the trustee's bankrupt personal estate is treated as an extension of his own legal personality. Fletcher Moulton LJ reasoned among similar lines, that '[the common law] would not help a man to make a profit out of what was merely an indemnity'.[108] The trustee could not have recovered one penny from the trust because he had not paid anything to the principal creditor, the landlord, but he did have a right of indemnity that could have been converted into a right to recover money by paying the landlord. The only use of the right was to pay the principal creditor.[109]

Buckley LJ clarified these obscure statements by stating that the right of indemnity is not a right of action enforceable by the lessee for the benefit of the landlord – this would have made the lessee the trustee of the landlord. Instead, it is a right of action enforceable for the benefit of the lessee's trustee-in-bankruptcy because its use will relieve the lessee and his estate from a debt

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[107] *Ibid,* 711.

[108] *Ibid.* 712.

[109] *Ibid,* 713-14.

which ought to be borne by the wife, the lessee-trustee's beneficiary.[110] The result of division among the general creditors would have been that the lessee's estate was not in fact indemnified by the beneficiary's payment—the landlord would have been paid pennies on the pound, and as shown by the fact that the landlord would have been entitled to another dividend if more money was realised by the trustee-in-bankruptcy, the remainder of his debt was still owing. The trustee's estate would still have carried the liability.[111]

This decision reveals much about the nature of the creditor's rights. Firstly, it seems axiomatic in the reasoning that it is the liability to an individual creditor that creates (and maintains) the right of indemnity. So long as the creditor remains unpaid (and the trustee's personal liability to the creditor remains unsatisfied), the right of the trustee to indemnify himself also persists. This axiom is reflected in the line of reasoning by Buckley LJ that if trust money is allowed to leak from the trust fund through the trustee's right of indemnity being made available to all the trustee's personal creditors, trust money will continue to be paid out until either there is no more trust money left or until the specific trust creditor (together with all other personal creditors) have been paid to the extent of the trust creditor's liability.

The statements by Cozens-Hardy MR and Moulton LJ about the trustee profiting from his position appear to refer not to the trustee profiting personally, but to the notion that his bankrupt estate is enlarged. If the indemnity is divisible among the trustee's personal creditors, and it remains in place for as long as the trustee is personally liable to the creditor (i.e. until that creditor is fully paid) his personal estate has more assets to divide among all general creditors.

The reasoning assumes that the indemnity created by the trustee's personal liability to the trust creditor persists for as long as the creditor remains unpaid. The only substantial piece of reasoning for this is the idea that if the bankrupt estate was to realise more money from some

[110] *Ibid.* 715.

[111] *Ibid.* 716.

newly-discovered asset belonging to the trustee, the creditor would have been entitled to another dividend (along with all other personal creditors). This means that the trustee's liability to that creditor must still be there, and therefore the indemnity must also persist. The axiomatic trust law principle underlying this case is therefore that it is the trustee's personal liability that creates the right to indemnity.

In effect, the decision in *In Re Richardson* puts the personal creditors of a trustee in the position of a secured creditor if the trustee incurred the liability in the proper administration of the trust. The trustee's right of indemnity has priority in an unascertained fund, and in the event of the trustee's insolvency its benefit can only be applied to satisfy the claims of the creditor against whom the liability was incurred. It is submitted that the nature of the right of the subrogated creditor holds is not a lien. It is akin to a floating charge, in that it can only be applied for the benefit of that creditor and it operates to ascertain what is left for the beneficiary but it does not affect particular assets until it crystallises.[112] However, the right is not assignable under *Richardson*.

To go back to *In Re Johnson*, Sir George Jessel MR stated:

> 'It does not appear to me that (…) the creditor (…) who has only got the benefit of this equity, if I may say so, by means of the trustee, through the lucky accident of there being a trust ought to be put in a better position than any other creditor'.[113]

This was in the context of a defaulting trustee, given as justification of why the creditors of that trustee are not entitled to anything more than any other personal creditor. But he *is* put in a better position by the happy accident of there being a trust—his claim is secured, so long as the trustee is not in default.

2. Trustee in Default

[112] *Evans v Rival Granite Quarries Ltd* [1910] 2 KB 979.

[113] *In Re Johnson* (1880) 15 Ch D 548, 552-53.

A related issue which also stems from *In Re Johnson* is the issue of when the trustee is in default. As discussed above, the creditors claim in the trust assets through the trustee's indemnity, and therefore their rights are dependent on the rights of the trustee. Where the trustee is in default, or owes money to the trust, his right of indemnity is correspondingly diminished or extinguished.

Though these newly stated doctrines lacked firm precedent, Jessel MR gave policy reasons for the ability of the creditor to trace his claim to trust assets:

> The trust assets having been devoted to carrying on the trade, it would not be right that the [beneficiary] should get the benefit of the trade without paying the liabilities; therefore the Court says to him, You shall not set up a trustee who may be a man of straw, and make him a bankrupt to avoid the responsibility of the assets for carrying on the trade.[114]

Jessel MR continued to state the following principle:

> But if the trustee has wronged the trust estate, that is, taken money out of the assets more than sufficient to pay the debts, and instead of applying them to the payment of debts has put them into his own pocket, then it appears to me that there is no such equity [on the creditor to trace], because the [beneficiaries] are not taking the benefit.

However, the key cases establishing this rule are not in fact cases of indemnity but, once again, cases where the trustee was beneficially entitled to a share in the trust assets. In *Re Dacre*,[115] JG Womack appointed Henry Dacre to be his executor and trustee, and gave a £2000 legacy to Alice Dacre, Henry's wife. Alice died without having received the £2000, and bequeathed all her property to Henry. Henry then died insolvent without having received his wife's property. It was discovered that Henry had misappropriated a sum of £1500 from the estate of JG Womack. Henry's creditors brought the action for the administration of his estate, and the surviving trustee of JG Womack claimed he was entitled to retain any such part of the £2000 legacy as was

[114] *Ibid*, 552.

[115] *In Re Dacre* (1916) 1 Ch 344.

required to offset Henry Dacre's liability for misappropriation. Sargant J upheld the claim, and Lord Cozens-Hardy MR affirmed it.

The Master of the Rolls traced the authority from the judgment of Sir George Jessel in *Jacubs v Rylance,*[116]through *Doering v Doering*[117]and finally to *In Re Towndrow,*[118]where Parker J stated: 'the real principle is that where there is an aggregate fund in which the trustee is beneficially interested and to which he owes something, he must be taken to have paid himself that amount on account of his share.'[119] *Doering* we have already seen involved a beneficial share held by the trustee.

Jacubs v Rylance, the origin of this rule decided even before *In Re Johnson*, was in fact a case where the defaulting trustee was the father of the beneficiary who had died intestate. The father had therefore inherited the beneficial interest of his son as his next of kin, as well as being the (defaulting) trustee in the same trust. The case was a conflict between the surviving beneficiaries and their father's, the defaulting trustee's, insolvent estate. Sir George Jessel MR in one paragraph decided the case, stating that a defaulting trustee is taken to have paid himself all he can out of the trust assets.[120] This brief statement was also the basis in *Doering* and *Dacre*, which were factually on all fours with *Jacubs*: the trustee had also become a beneficiary.

However, the statement of Jessel MR in *Jacubs v Rylance* is broad enough to cover trustee indemnities, and His Lordship's own statements in *In Re Johnson* support this view:

> [The creditors are given] some additional benefit [i.e., the benefit to have recourse to trust assets] so as to avoid a supposed injustice; but the injustice to be avoided is the injustice of the [beneficiary] walking off with the assets which have been earned by the use of the property of the creditor: but where the [beneficiary] does not get that benefit, there is no injustice as between him and the creditors, and there is no reason for the

[116] *Jacubs v Rylance* (1873-74) LR 17 Eq 341.

[117] *Doering v Doering* (1889) 42 Ch D 203.

[118] *In Re Towndrow* [1911] 1 Ch 662.

[119] *Ibid.* 666.

[120] *Jacubs v Rylance* (n 115), 342.

> court interfering (…) to give [the creditors] a larger right than that they bargained for, namely, their personal right against the trustee.[121]

The problem with expanding the *Jacubs v Rylance* principle to indemnities in cases where trustees are not beneficiaries is that a creditor's claim can be defeated by an unconnected liability the trustee has to the trust. For example, a previous and unconnected breach of trust can mean that a creditor's has no recourse. This is perhaps the key problem in this area, as identified by the Trust Law Committee,[122] and is discussed further in Chapter 3.

3. Limitation to Trust Assets

One strand of law regarding asset partitioning in the trust revolves around the question of whether the trustee may limit the extent of his personal liabilities to the trust assets. We know that this is conceptually possible. In *Muir v City of Glasgow Bank,*[123] the trustees had entered into a partnership, the City of Glasgow Bank, 'as trustee disponees'. The partnership deed stipulated specifically that partners were personally liable. In a disastrous crash the City of Glasgow Bank fell and dragged down with it a large number of partners who had invested into the enterprise by acquiring a partnership share, and who were now ruined by the extent of their personal liability to the creditors of the bank.[124]

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[121] *In Re Johnson* (n 112), 555-56.

[122] Trust Law Committee Consultation Paper 'Rights of Creditors against Trustees and Trust Funds' 1997.

[123] *Muir v City of Glasgow Bank* (1879) 4 AC 337.

[124] See further: KG Reid 'Embalmed in Rettie: The City of Glasgow Bank and the Liability of Trustees' in Burrows et al (eds) *Judge and Jurist – Essays in Memory of Lord Rodger of Earlsferry* (OUP, Oxford 2013), 489.

The trustees argued that although there was only one class of share available that carried personal liability, there could still be two kinds of shareholders – those who held the shares personally, and those who held them as trustees. Indeed, at the time in Scotland trustees were entered into the share register as such. Nevertheless the trustees were held personally liable.

It is important to appreciate how the House of Lords approached the issue. Their Lordships did *not* say that it was impossible in all cases for a trustee to limit his liability to the trust assets. Instead, Lord Cairns LC analysed the case as depending on construction of the individual contract, including the 'capacity and duty of the parties to make the contract in one form or another'.[125] The Lord Chancellor further stated that 'I know of no reason why [a trustee] should not stipulate by apt words that he will make the payment, not personally but out of the assets of [the trusts]'.[126]

In *Muir* itself the partnership deed precluded shares with limited liability and the contract could only be read as creating limited liability.[127] The parties were simply not competent to enter into such a contract, so the contract must be read to intend personal liability of the trustees. This, in essence was also the view expressed in that case by the rest of the House. Their Lordships all seemed to consider it entirely possible that trustees could limit their liability to the trust assets, and even give examples of case law.[128] Indeed, this has been confirmed in *In Re Robinson's Settlement,*[129] and more recently by the High Court of England and Wales in *Warborough Investments Ltd v Berry*.[130]

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[125] *Muir* (n 122), 355.

[126] *ibid.*

[127] *ibid,* 359.

[128] *Gordon v Campbell* (1842) 1 Bell's App 428; mentioned in *Muir* (n 122) by Lord Cairns LC at 361-61, and Lord Penance at 369-70. See also *Watling v Lewis* [1911] 1 Ch 414.

[129] *In Re Robinson's Settlement* [1912] 1 Ch 717.

[130] *Warborough Investments Ltd v Berry and Others* [2003] EWHC 3152 (Ch).

In *Robinson's Settlement* the trustees had borrowed money by way of mortgage from an unregistered moneylender, and covenanted to pay back 'as trustees, but not otherwise'. The main point in the case is whether the mortgage is valid, but in holding that the trustees would not be personally liable for payment, Buckley LJ (after citing *Muir*) stated: 'This covenant as trustees was I think not a covenant which bound [the trustee] personally: it was a covenant which bound only the two trustees in respect of the trust fund in their hands at the date of the issue of the writ [which was nil]'.[131]

In *Warborough Investments* the trustees of a charitable trust had leased premises for their charitable organisation. They covenanted as trustees to pay rents and other liabilities to the landlord, but successfully limited their liability to trust assets 'as long as [the lease] is held on trust'. Indeed, based on this case, it seems that when this limitation of liabilities is successful, it puts an insurmountable contractual barrier to enforcing against the trustee's personal assets: at trial the lease had already been forfeited – there was no lease to be held on trust, but the clause applied nonetheless to any liabilities accrued by the trustees during the lease. If the trustees held these liabilities in their personal capacity, the shield-clause protecting the trustees personally should no longer be in operation when the lease was no longer held on trust.

This line of cases establishes that limitation by contract of trustee's liability to trust assets is a matter of construction of the contract creating the liability. Another line establishes that it is also possible for the trust deed to limit the access of the creditor to a certain portion of the trust assets, without notice of its terms.

This is the real ratio of *Ex Parte Garland*,[132] as correctly interpreted by Jessel MR in *Johnson*.[133] The case involved a trust for the benefit of the wife and children of the testator,

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[131] *In Re Robinson's Settlement* (n 128), 729.

[132] *Ex Parte Garland* (1804) 10 Ves 111.

[133] In *In Re Johnson* (n 112), see above.

whereby certain sums and annuities were to be paid to them. The testator also directed that his wife should carry on his farming business until the trustees think fit to establish his sons or either of them in the business. A sum not exceeding £600 was to be paid to the out of his personal estate to enable her to carry on the business. The full sum was advanced. At the time of her bankruptcy she was indebted to the trustees for sums exceeding £2500. The surviving trustee proved these sums in her bankruptcy.

Her trustee-in-bankruptcy disputed the debts, and asked for a declaration that all the assets in the trust were liable to all the debts contracted by the wife in carrying on the business.

Lord Eldon LC drew attention to the fact that the will had multiple purposes, the trade being carried out only being one of them. If the general assets of the trust were to have been liable to all the debts contracted in the carrying out of the business, all other beneficial purposes of the trust would have stood still. Every beneficiary would have held his interest on conditions connected with the transactions in the business, by which they could not benefit and that they could not control. That is, the extent of the beneficiaries' interests would have been determined by how well the business, unconnected to their interests, was doing and under what terms that business contracted with its creditors.[134] As regards the harshness of this result to the creditors of the trade, The Lord Chancellor stated that 'it is not so inconvenient to say, those, who deal with the executor, must take notice, that the testator's responsibility is limited by the authority given to the executor [who must equally] do many other acts [in due administration of the estate]'.[135] That is, only the amount embarked on the trade, as authorised by the trust deed, was answerable to the creditors—otherwise the rights of the beneficiaries would have been outflanked. Notice that this principle does not depend on any notice of the trust terms to third parties; it is simply a question of the beneficiaries' rights.

[134] *Ex Parte Garland* (n 131), 119.

[135] *Ibid.* 120.

4. Ultra Vires

An issue which is hinted at above is what is the extent of the creditor's right to the trust fund when the trustee incurs liabilities that are outside his powers. As the law stands, it is clear in principle that if there has been a breach of trust or the trustee is otherwise in default the value of the creditor's claim is correspondingly diminished. *In Re Johnson* referred to the trustee being *authorised* to incur debts,[136] *British Power Traction and Lighting* involved an indemnity to the extent of debts *justifiably incurred* by Watkins,[137] and dicta about the *proper authority* of the trustee in incurring debts can also be found in the line of cases starting with *Evans v Evans.*[138]

But it is perhaps here that we most starkly see the impact of the limited cross-fertilisation between different strands of trust and fiduciary law. If dicta in the previous sets of cases were to be followed where the trustee has acted outside his authority, the claim of the creditor through the trustee's indemnity would always fail in such cases. As we will see, this is not what happens.

The early foundation case is *Balsh v Hyham.*[139] That case concerned the South Sea Bubble, the 1720 crash of the South Sea Company which had been, among other things, buying its own stock with its assets and inflating the stock price. The market correction that followed was extremely violent and acts of Parliament were passed to deal with the aftermath.

The plaintiff was a trustee for the defendant for £1000 South Sea stock. The defendant had instructed the trustee to borrow £4000 from the company on a mortgage of the stock, and

[136] n 80 et seq.

[137] *In Re British Power Traction and Lighting Co Ltd.* [1910] 2 Ch 470, n 87.

[138] *Evans v Evans* (1887) 34 Ch D 597, 601.

[139] *Balsh v Hyham* (1728) 2 P Wms 453.

received the money. Following the crash, an act of Parliament[140] was passed which provided that if a borrower paid 10 percent of what was owed by a certain date, the rest of the debt will be discharged. The beneficiary, apparently armed with the unusual authority to direct the trustee's use of trust assets,[141] directed the trustee not to pay, apparently thinking borrowers were not obliged to do so.[142] The trustee did pay the 10 percent, and claimed his costs from the beneficiary. King LC held the case to be 'within the reason of that rule, where the (…) trustee has honestly and fairly, without any possibility of being a gainer, laid down money, by which the [beneficiary] is discharged from being liable for the whole money lent, or from a plain and great hazard of being so, the [trustee] ought to be repaid.'[143]

That is to say, in the context of the trustee's right of indemnity we inquire into the actual fraudulence or otherwise of the trustee to see whether his acting ultra vires will deny him his claim. If the trustee acted 'honestly and fairly, without any possibility of being a gainer' and benefited the trust, a mere exceeding of his authority will not defeat his claim.

This principle was followed by the Court of Appeal in *Re German Mining Company*.[144] The case concerned an English joint stock company,[145] which was to carry out mining in Germany.

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[140] 7 Geo 1, sess. 2, known as The National Debt Act 1721, s.7.

[141] His argument was merely that the trustee had acted against his 'express instructions', and this argument was not rejected. Not much is said about this in the case report, but this could therefore be a case where the trustee was the beneficiary's agent as well as trustee – see discussion of the 'agency exception' in chapter 4. In the normal case, as is argued in that chapter, the trustee is not an agent for the beneficiary and his authority to act is only constrained by the terms of the trust. It could also be that the shares were only held by the plaintiff as a nominee for the defendant.

[142] The report is unclear as to whether this view, or the view of the trustee which appears to be that he *is* obliged to pay, is mistaken.

[143] *Balsh v Hyham* (n 138), 810-11.

[144] *Ex Parte Chippendale, Re German Mining Company* (1854) 43 ER 415.

[145] Essentially a partnership with certain special features, see KG Reid 'Embalmed in Rettie: The City of Glasgow Bank and the Liability of Trustees' (n 123), 491.

The directors were not given powers to raise additional capital except by issuing new shares. The capital proved to be insufficient to work the mines, and the directors were given authority to sell the mines. The miners' wages being overdue the directors obtained advances from certain shareholders so that the company mines would not be seized under German law. An order was obtained from the English courts that the company was to be wound up. A call was made by the banks against the assets of the company, and the court decided that the company was not liable to the bankers. The directors paid the bankers, and asked for an indemnity. Turner LJ treated the case as essentially turning on whether the trust deed excluded the trustee-directors' right to indemnity, and, citing *Balsh v Hyham*, held for the directors. Even if the liability of the shareholders was limited to their share of the £50,000 capital, 'where parties place others in the position of trustees for them, they are in equity personally bound to indemnify them'.[146] What the directors had done was in bona fides and for the benefit of the shareholders,[147] as it facilitated a more advantageous sale.

The case of *In Re Pumfrey* expanded this principle to cover minor breaches of trust.[148] The trust deed empowered the trustees to invest in real estate. A deal was concluded, but it was worth more than the trust assets. The beneficiary was unable to bridge the gap in the funds, so he asked the trustees to borrow money from a bank in their own name and cover the difference, which they did. The trustee then died, and the beneficiary was unable to pay the loan. The creditor bank asked to be subrogated into the claim of the trustee for indemnity to force a sale of the properties without the beneficiaries' assent.

[146] *Re German Mining Company* (n 143), 428.

[147] *Ibid,* 421.

[148] *In Re Pumfrey* (1882) 22 Ch D 255.

The argument of the beneficiaries was that the trustee has committed a breach of trust, in mixing his own money (money borrowed in his own name) with the trust assets, and that the beneficiaries therefore had become entitled to the whole.

Kay J approached the case under the principle in *German Mining Company*.[149] There was no suggestion that the trustee intended to benefit himself in any way. Therefore, this was 'a case of a trustee who, without the slightest chance of benefit to himself, for the convenience of his [beneficiary] advanced a sum of money of his own to complete a purchase which otherwise was entirely within the trust, and within his power to make.'[150] The harsh rule that the beneficiary is entitled to the whole of a mixture of trust assets was interpreted here to mean that he is entitled to a *lien over* the mixture to the extent of the trust assets, not the whole mixture. The trustee was also entitled to call upon his indemnity and force the trust estate to be turned into money.[151] His Lordship did not mention *Darke v Williamson,*[152] where the court shied away from ordering a sale of property because it would destroy the trust, though it had been cited in argument to stop the trustee from realising the assets for his indemnity.

These principles were tested at the highest level in *Vyse v Foster*,[153] which deserves elaboration in some detail. The case involved a partnership and a partially overlapping trust. Most of the partners were members of the Vyse family. Richard Vyse was the senior and principal partner, who had invested over £90,000 of the £137,675 capital. In his will Richard Vyse had nominated three executors, one of whom was also a partner in the firm and another would later become a partner.

[149] *Re German Mining Company* (n 143).

[150] *In Re Pumfrey* (n 147), 260.

[151] *Ibid.* 251-62.

[152] See *Darke v Williamson,* n 94 and accompanying text.

[153] *Vyse v Foster* (1872-73) 8 Ch App 309.

The partnership deed had stipulated that upon the death of a partner, the surviving partners would buy the share of the deceased partner at a price to be ascertained from the last stocktaking, plus £5 per cent interest, to be paid in instalments over two years. At the testator's death the partners marked the price to be paid to the testator's estate as a debt of the firm with said interest, but the money was allowed to be in the hands of the firm for some years. All the residuary legatees had accepted and ratified this, except for the plaintiff who was 11 years old at the time of her father's death. When she became entitled to her share of the payment, she refused and claimed an account of profits instead, claiming that her money had been obtained by the partnership in breach of trust.

The defendant executor-partners (D) argued that since the price of the testator's share had been ascertained and put in the books, it was really only at most debt which had not been paid on time, and for which interest had been accruing at a proper rate. The fact that the class of trustees included some of the same people as the class of partners was, according to the defendant, irrelevant. The manifest intention of the will was that the testator's partnership capital was to be used as a loan to keep the business going, and this is what the trustees did.

Bacon VC ordered an account of profits, on the basis that the D had failed to obey directions in the will, and permitted the use of a large portion of the estate in business which had generated large profits. The plaintiff was therefore able to elect to take a share of the profits of the firm. Bacon VC's judgment is essentially one for strict enforcement of fiduciary duties, as established in the case law at the time.

D appealed, and their case was argued by the then Solicitor-General George Jessel. The argument was substantially the same, with the added twist that here the executors never received any money with which they then traded improperly – the money remained due from the firm to them. This of course skipped over the fact that the partners included executors – the money was due from them to themselves. It was also argued that not all partners are parties to the breach of trust, but this argument was defeated on authority[154]: the liability for persons who knowingly receive trust-money is joint and several.

The respondent (P) argued that the executors ought not have let the money remain in the hands of the firm without bargaining for additional profits. In other words, P argued that the executors acted improperly as trustees because they were on both sides of the loan agreement.

The Court of Appeal reversed Bacon VC's judgment. The first step of James LJ's judgment was to shift the focus of the case by stating that it was not a case of partnerships at all – the testator had effectively sold his interest in the partnership property, and the only relation between the executors and the surviving partners was one of debtor and creditor. According to James LJ the effect was the same as if he had sold the business to perfect strangers in his lifetime, and died before the purchase money was payable. This shift in focus effectively unravelled the plaintiff's arguments, without responding adequately to the issue of self-dealing. The issue was not discussed in the judgment.

James LJ held that there was undeniably a breach of trust in not calling the money. But he also gave recognition to the argument that the executors only followed what was intended in the will, namely that the business was kept going for the benefit of the family. His Lordship also drew attention to the fact that the plaintiff had received income from the business, which she would not have received had the will been carried out to the letter because it would have meant the break-up of the business. Further, given that there was a complex agreement by which profits were shared (evidently not based on capital invested), it would have been very difficult to ascertain what portion of the profits was attributable to the plaintiff's money.

Finally, His Lordship stated that a court of equity is not penal, but only gives full compensation of any loss or damage through failure of some equitable duty. Here the case was

[154] *Flockton v Bunning* [1864] F 89, the entire judgment being given in argument.

one of a simple equitable debt,[155] albeit one which was overdue. James LJ gave the following scenario: if the executors were to deposit money in a bank and leave it there for too long a time it would be startling if an account could be called on the profits of the bank. According to His Lordship, the case would have been different if there had been some improper motive or deception, but here there was none. The entire family knew that the money was in the hands of this firm, and if P did not know she could have asked her trustee.

The case was then appealed to the House of Lords.[156] The decision of James LJ was upheld, and all judgments (of Lord Cairns LC, Lord Hatherley and Lord Selborne) treated the case essentially as one of contractual construction. The testator was said to have contracted to sell his partnership share by his will, and the will clearly intended there to be a loan of the partnership capital (to be paid over two years) to keep the family business going. A mere delay in paying did not strike at the heart of the agreement and therefore did not rescind the contract. An account of profits was not thought to be an appropriate remedy to be considered, and the fact that all the children of the testator had been benefited by the profitable running of the business was mentioned more than once, as was the fact that there is an absence of fraud.

So it seems fraudulent intent is required to defeat the claim of a trustee to indemnity. In *Blundell v Blundell*,[157] George Blundell, the defendant (D) in the main action, was the son of the testator, also appointed as trustee. D was given the option to buy his father's business. If he did not wish to undertake it, he was to sell the business and realise all its value. D did not buy the business for himself, but he kept it going nevertheless and did not sell the goodwill. D's solicitor advised him that he had no power, outside option in the will, to purchase the business for himself. In breach of trust D nevertheless proceeded to buy part of the plant and machinery

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[155] Equitable by operation of the will.

[156] *Vyse v Foster* (1872-73) 8 Ch App 309

[157] *Blundell v Blundell* (1889) 40 Ch D 370.

belonging to the business, and had a friend buy the rest for him. The solicitors received the accounts of the sales which read 'to amount purchased by Mr Blundell's agents…'

The sale was nevertheless completed, and the solicitors deducted their costs directly from the purchase-monies, as authorised by the trustee-defendant. A creditor of the estate took out summons, asking that the solicitor pay back what they had received from the trust.

For our purposes there were two questions to be solved. First, whether the solicitors could charge their costs to the trust fund directly as they had been authorised to do by the trustee (who was engaged in unauthorised activities), and second, whether they as creditors of the trustee were entitled to the money they had received. As regards the first question, Stirling J identified the question as one of the trustee's right of indemnity, and continued: 'I apprehend that in equity, it is not a right of the trustee to be indemnified only after he has made the necessary payments to his solicitor (…) but that he is entitled to be indemnified, not merely against the payments made but against his liability.'[158] Relying on this principle, he held that the trustee was entitled to pay those he employed to assist him in the administration of the trust directly from the trust assets.[159]

On the second question, quoting Lord Selborne in *Barnes v Addy*,[160] Stirling J stated that 'strangers are not to be made constructive trustees merely because they act as the agents of trustees in transactions within their legal powers',[161] and held that the solicitors are liable only if they can be treated as standing in the shoes of the trustees, that is, if they knew that the monies were used in a way that is inconsistent with the trust. In this case there was nothing suggesting improper receipt of the trust monies by the solicitors. The solicitors had notice of the breach of

[158] *Ibid.* 376-77.

[159] *Ibid.* 377.

[160] *Barnes v Addy* (1873-74) 9 Ch 244, 251.

[161] *Ibid* 251.

trust, but not 'that the transaction was such as to preclude the trustee from resorting to the trust fund for payment of his costs'.[162]

The case shows that even where the trustee is acting in a way that is unauthorised (and therefore the actions are liable to be set aside), the money paid out of the trust assets can still be paid out to and kept by the solicitors who assisted him. This suggests that payments of indemnities to cover administrative costs, at least where they are paid to agents hired to assist in trust administration, are not vulnerable in the same way as payments to other third parties. Importantly it also states that the liability creates the indemnity, and therefore the trustee can satisfy the liability from the trust fund directly without having to pay the third party personally first.

Finally, the requirement of a finding of fraud cannot be sidestepped to deny the trustee an indemnity. This principle is drawn from the much-cited case of *Dowse v Gorton.*[163] John Gorton, a manufacturer with two distinct businesses, died in 1883. By his will he empowered the executor-trustees to carry on any of his business and to employ therein any part of his estate. At the time of his death, Gorton was indebted to his bankers, his sister and the appellants, the executors of one Turner, in substantial amounts.

Gorton had bought a business ('Anvil Street business') from Turner in instalments. In case of a default in payments the whole debt became payable immediately. Two inspectors were given power to dispossess Gorton, take control of the machinery and sell it if they were dissatisfied with how the business was run, and apply any proceeds to the balance due. At the time of Gorton's death three instalments were in arrears. Two creditors ('appellants'), one of whom seems to have also been an inspector of the Anvil Street business, visited the executor, who explained that the estate was indebted to the bankers and the sister, and that it would be in

[162] *Blundell v Blundell* (n 156), 385.

[163] *Dowse v Gorton* [1891] AC 190.

their best interest if the Anvil Street business was kept going. The creditors assented. Thereafter the executors found themselves unable to keep the business going, and called the all the creditors of the estate together.

The appellants brought an action for the administration of the estate ('the usual order') and issued an originating summons seeking it to be declared that their debts are to be paid in priority to any claim of indemnity by executors or their creditors. The Vice-Chancellor at first instance granted the order, and on the executors' appeal the order was varied to the effect that the indemnity was given priority. The creditors appealed.

The appellants argued that the trustees' right of indemnity is only against those for whose benefit and at whose risk the businesses were carried on, i.e., the beneficiaries.[164] Why this was argued is not clear as the report only gives a bare outline,[165] but the argument was probably that if an indemnity is granted and given priority to the debts of the appellants, it would in fact be at the appellants' expense. There was enough money in the estate to pay off all liabilities at the time of death, and the appellants would therefore be worse off if priority is granted to the indemnity of the trustees than they had been before the trust was set up. Because pre-trust property had been used in acquiring post-trust property, limiting the claim of the appellants to pre-trust property would effectively subsidise the trustees' indemnity from the assets of the appellants. In effect they were asking that the property acquired after the death of the testator not be earmarked to meet the claims of the trust creditors. This is essentially what the Court of Appeal (Lindley LJ) had held, based on the idea that the appellant only had a right to sue the executor and seize the assets of the deceased in the hands of the executors at the time of his death, and no proprietary right. As to after-acquired property the appellants had no claim.

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[164] *Ibid,* 194.

[165] *Ibid.*

Lord Herschell did not agree with Lindley LJ's distinction, and held that after-acquired property was as much within the assets of the testator's estate as that which was in his possession at the time of death. 'All after-acquired property, however acquired, even though it has been purchased with the proceeds of the sale of a part of the estate possessed by the testator at the time of his death, is treated as one subject-matter out of which the executors are entitled to their indemnity.'[166] If they could not claim indemnity against the whole of the testator's estate the extent of their rights would be different. Thus the distinction was not in accordance with the law.[167] The creditors had assented to the business being carried on, and it was also to their benefit—the executors were therefore entitled to be indemnified out of the whole estate.

Lord Macnaghten more directly discussed the issue of ultra vires. The appellants were asking for the usual order, not an order founded on breach of trust (a distinction which is based on the old forms of action but is not, per Lord Macnaghten, affected by the then-recent change in procedure). Nowhere did the appellants allege misconduct. But the effect of granting the usual order plus the order of priority would have been to depose the executors and deny them their claim in indemnity. A receiver would have been put in place of the executors, and priority status of their debts would have meant that the appellants passed on the accrued costs of administration of the business to the executors, without any finding of fraud or misconduct. Such an order would have been 'contrary to all principle'.[168] The appellants could not deny the executors their indemnity without alleging breach of trust.

[166] *Ibid,* 198.

[167] This is the author's rationalisation of what appears to be circular reasoning in two consecutive sentences, *ibid,* 198.

[168] *Ibid.* 203.

In Re Oxley[169] offers a contrast and provides a striking reinterpretation of *Dowse v Gorton*. In *Oxley* it was the new creditors who sought a declaration that the indemnity, and therefore their claims, were to be paid in priority to the original creditors.

The widow and her son ('the executors') of the testator had carried on the testator's boilermaking business without authority of the will. The widow was given an annuity, and the son paid a salary as manager. The testator only had three unpaid creditors, two of whom obtained a decree for administration of the estate after the executors had been running the business over four years. The creditors had been aware that the business had been taken over by the executors.

In denying the claim of the new trade creditors to priority over the old creditors, the Court of Appeal (Cozens-Hardy MR) differentiated *Dowse v Gorton* on the basis that in that case the old creditors had put themselves in the position of beneficiaries of the trust—the business was carried on to pay the instalments of the old creditors, and that was why they could not deny the trustees their indemnity by their claim of priority. To do so would have given them the benefit of the trust without assigning them the costs.[170] In *Oxley* the old creditors had not assented but only stood by with knowledge that the business was being carried on, not particularly to their benefit, and thus had not become beneficiaries.

To recap this section, there is a stringent requirement of fraudulent intent if the trustee is to be denied indemnity, and even where there is a breach of trust the same requirement of fraudulent intent is transferred to the creditor if he is to be denied the benefit of the trustee's indemnity, as in *Blundell*. The indemnity or its effect cannot be denied on grounds other than misconduct.

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[169] *In Re Oxley* [1914] 1 Ch 604.

[170] *Ibid.* 609-10.

Where the trustee exceeds his powers but acts bona fide, is not a gainer and his actions benefit the trust either actually or by saving it from a potential liability, the trustee's indemnity cannot be denied and thus neither can the creditor's claim through the trustee. It is submitted that in a true case of indemnity, the possibility of the trustee to be a gainer, at least in relation to the indemnity, does not arise. It is in the very nature of an indemnity that it simply covers a liability the trustee has incurred.

The facts of these indemnity cases resemble the 'no profit' cases such as *Regal (Hastings) v Gulliver*,[171] but with a clear difference in result. Like in *Pumfrey,* the issue in *Regal (Hastings)* was that the principal, in this case a company, could not afford to invest in an expansion scheme that the company directors then decided to invest in personally. When the directors sold their shares and made a profit, the purchasers brought a claim to recover a part of the money they had paid – the claim was wholly unmeritorious and only made to make the purchase cheaper on the buyers.[172] The court, relying on *Keech v Sandford*,[173] held that it was irrelevant that the company could not invest in the property itself, and the directors ought to have had authorisation from the board. Even this may not have been sufficient, as such authorisation was found to be ineffective in *Cook v Deeks*.[174]

Even more striking in contrast seems the result in *Phipps v Boardman*.[175] In that case, the trust solicitor Boardman was struggling with a company the trust had a major stake in and that was doing badly and losing money. After failed attempts to get one of the family beneficiaries to

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[171] *Regal (Hastings) v Gulliver* [1942] 1 All ER 378

[172] AJ Oakley (ed) Parker & Mellows: *The Modern Law of Trusts* (9th Ed Sweet & Maxwell, London 2008), 395

[173] *Keech v Sandford* (1726) Sel Cas T King 61; 25 ER 223; though it is possible that *Keech v Sandford* is in fact a case of a fraudulent trustee: see J Getzler "'As If.' Accountability and Counterfactual Trust' (2011) 91 Boston U LR 973, 984.

[174] *Cook v Deeks* [1916] AC 554.

[175] *Phipps v Boardman* [1967] 2 AC 46.

the board of that company, Boardman suggested to the managing trustee that the trust acquire a controlling share. Failing to convince the managing trustee, Boardman then acquired the shares himself, liquidated company assets and made significant profits to both the trust and himself. Boardman appears to have acted in good faith and for the benefit of the trust,[176] though he was a gainer.

It seems then that the courts analyse breaches of trust differently when it is a question of indemnities. This may be due to the historical difference between separate forms of action and the burdens of proof associated with each, but it is submitted that it is also sound in principle. The case of indemnity is fundamentally different to a fiduciary benefiting from his position, as an indemnity does not benefit anyone—it simply reimburses for costs or discharges a liability incurred by the trustee. Thus it is appropriate that actual fraud is required to deny an indemnity while it is not required for an account of profits of a fiduciary who has benefited from his position.

5. Burdens Associated with Ownership

Finally, the cases regarding creditors claims to trust assets reveals how the courts see the trustee-beneficiary relationship when inquiries are made into the internal obligational contours of the trust. Burdens associated with ownership, such as calls made on shares or rent arrears, are ultimately to be carried by the beneficiary. While this may seem trite indemnity law, and for the

[176] The first instance decision in *Phipps v Boardman* [1964] 1 WLR 993 casts some doubt on the good faith of Mr Boardman in that he failed to make full disclosure of valuations, accounts and procured financial assistance for the company whose shares Boardman later purchased. Though Boardman was 'acquit[ted] entirely of any intention to deceive or suppress' (at 1015), the plaintiff was also justified in 'thinking that he had only been told half the truth' (at 1017), per Wilberforce J.

most part is straightforward, its precise extent is an interesting addition to the main body of doctrine developed in this thesis.

In *Hardoon v Belilios,*[177] an appeal from the Supreme Court of Hong Kong, a registered holder of shares in a banking company held them beneficially for the defendant.[178] The banking company was wound up, and calls were made on the shares which were not fully paid up. Lord Lindley stated: 'the plainest principles of justice require that the [beneficiary] who gets all the benefit of the property should bear its burden unless he can show some good reason why his trustee should bear them himself'.[179] An analogy was drawn to *Fraser v Murdoch*,[180] in which a trust estate was successfully divided into smaller distinct trust estates attaching to each beneficiary individually, and where the liabilities incidental to one share could not be thrown on the beneficial owners of others. It was also stressed that the obligation to indemnify the trustee is a personal obligation on the beneficiary, not limited to the trust assets.[181] The trustee did not have to prove any request of the beneficiary to incur a liability incidental to ownership.[182]

The scope of this principle is shown in *Matthews v Ruggles-Brise.*[183] In that case two partner-trustees had taken on an onerous lease for the partnership. The partnership business was subsequently sold to a company under an agreement whereby the company undertook to take all reasonable steps in their power to bring about a novation of all liabilities of the partnership to

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[177] *Hardoon v Belilios* [1901] AC 118.

[178] The defendant disputed that there was a trust, but Lord Lindley held that nothing more was required of a trust than what was present in the case.

[179] *Hardoon v Belilios* (n 176), 123.

[180] *Fraser v Murdoch* (1881) 6 AC 855. This is a somewhat poor analogy, as the case involved liabilities of beneficiaries, not trustees.

[181] *Hardoon v Belilios* (n 176), 124.

[182] *Ibid.* 126.

[183] *Matthews v Ruggles-Brise* [1911] 1 Ch 194.

the company. One trustee died. The lease was assigned to the company, on a covenant of indemnity to the surviving trustee. He also conveyed all freehold and leasehold property to the company, without reserving any to cover his indemnity. The company defaulted, and the trustee's executors were compelled to pay rent arrears and damages for breaches of covenant of the onerous lease. They then claimed an indemnity from the partners who had been beneficiaries under the original trust, presumably because the company was now insolvent.

The defendants argued that the trustee had accepted the company as his beneficiary, and his indemnity of subsequent liabilities lies against the company only. Swinfen Eady J upheld the trustees' right to claim indemnity from the partners.

Citing *Hardoon v Belilios*, Swinfen Eady J denied that the partners' liability to indemnify the trustees had ended. A beneficiary may assign his interest to another person without consulting the trustee. But the liability of the original beneficiary to indemnify the trustee cannot be so transferred. Nothing short of novation will do, and novation requires consent of all parties to the agreement, including in this case the trustee.[184] In this case novation was not achieved by the agreement, in which the company only covenanted to undertake all reasonable efforts to bring about novation.[185]

This decision in principle makes the beneficiaries liable for costs of the trustee that are incurred after they have ceased to be beneficiaries. But it is important to appreciate the limits of *Matthews v Ruggles-Brise*. The case is decided based on the principle in *Hardoon v Belilios*,[186] namely that costs associated with ownership are to be carried by the beneficiary. In other words, if the trustee acquires new property and holds it for the new beneficiary, the old beneficiary would not

[184] *Ibid.* 203-4.

[185] *Ibid.* 204.

[186] A genuine *Hardoon*-type factual scenario being a rare thing: see A H Oosterhoff 'Indemnification of Trustees: The Rule in *Hardoon v Belilios*' (1977-79) 4 Est & T Q 180, 195.

have to pay burdens incidental to that property. It is unclear whether any other costs of the administration of the trust could be claimed from the old beneficiaries. The novation point on its own is wide enough to cover other costs too: a beneficiary has a personal liability to indemnify the trustee, and cannot transfer it without the trustee's consent. It is only the reliance on *Hardoon v Belilios* which limits *Matthews* to costs associated with ownership, though it is not made express in the judgment.

6. Combined Effect

i) Hypotheticals

The combined effect of these doctrines attracts certain criticisms. The law of trust creditors can be said to be inconsistent with other areas of trust law, and some of the combined effects of various doctrines can leave unpaid creditors with just claims with nothing, on the basis of indoor management irregularities within the trust.

One notable inconsistency is the strictness of rules on trustees in default and its effect in denying the indemnity, against the notably relaxed ultra vires regime associated with this area. Fiduciary duties do not require an element of fraud to create liability, but if a trustee contracts with a creditor outside the powers of the trust the creditor's right is preserved, so long as the trustee acts in good faith and without a possibility of being a gainer.

The ultra vires rules, taken in combination with the limitation of liabilities to trust assets or a certain portion of trust assets that is available to the trustee allow considerable protection for the trustee and trust assets in the event of damage being caused to a third party. Where the trustee has acted outside his powers but short of fraud, his indemnity is against the beneficiaries personally and not limited to trust assets. He may nevertheless contract with a third party and stipulate that his liability is limited to such assets (*Muir, Robinson's Settlement*), or even a portion of those assets if the trust deed so provides (*Ex Parte Garland*).

Say the trustee enters into a very risky speculative investment contract where a pension investment trust deed prohibits his doing so. He does this in the honest belief that it will benefit the beneficiaries, and without any possibility of his being a gainer (*Balsh v Hyham*). As a side note, he will be fully compensated for the costs of hiring the lawyer who advised him of his ability to take this undue risk personally from the beneficiary, or directly out of the trust assets (*Blundell*). But if the risk materialises, the creditor can only access that portion of the trust assets that is devoted to the scheme, at least so long as the trust has other purposes (*Ex Parte Garland*).

The creditor will also be left to bear the risk of loss if the trustee was in an unconnected default to the trust fund (*In Re Johnson*). The loss will be total if the trustee owed a sum exceeding the creditor's claim, and the creditor will end up paying for the trustee's default if his claim exceeds the liability of the trustee to the trust fund. The most rational action for a opportunistic trustee is therefore to misappropriate what they can, and incur larger trade liabilities passing the benefit of the trade to the trust. It is the unpaid creditor who will end up paying for the trustee's ticket to the Bahamas, as the value they have passed on to the trust is set off against the trustee's liability for misappropriation (*In Re Johnson*).

ii) Australian Cases

Other jurisdictions have grappled with some of these issues, leading to some conceptual muddles at the very core of trust law. As we know, the trustee's creditors cannot claim directly against the trust assets. However, the trustee 'directed to carry on the business [of the trust] having the right to resort for his indemnity to the assets directed to be employed in carrying it on, the creditors of the trade are entitled to the benefit of that right *and thus become the creditors of the fund to which [the trustee] has a right to resort*' (emphasis added).[187]

This gives rise to problematic conceptual notions when the trust assets go from one trustee to another. We see this in how *Dowse v Gorton* and *In Re Oxley* have been applied. In the Australian case of *Vacuum Oil Co Ltd v Wiltshire*,[188] a case relying on these central English decisions,[189] the assets of the business of a deceased had been transferred to an executor ('First Trustee'). The executor carried on the business, at least partly without authority. The appellant company (Vacuum Oil) had been a creditor to the original business, and was now a creditor of the executor. The executor decided to wind up the business, and called in the respondent as administrator. The respondent became the trustee in bankruptcy ('Second Trustee') of the assets of the business.

The trouble was, Vacuum Oil was only a creditor of the First Trustee personally, and the First Trustee no longer held the assets. Latham CJ pointed out that

> trading creditors whose debts are owed only by the executor personally should not [strictly speaking] be admitted as creditors in the administration of the estate. They are not creditors [of that estate]. But as the executor has a right of indemnity out of the [trust assets] (…), the trading creditors will be entitled to the benefit of his indemnity, and so will be entitled, through him, though not directly, to the application of [trust assets] to the satisfaction of their debts (…).[190]

Dixon J similarly stated that although there is no direct right on the creditors, in equity they may be subrogated to the executor's 'indemnity lien'.[191]

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[187] *Ex Parte Edmonds* (1862) 4 DeG F & J 488, 45 ER 1273, 1277.

[188] *Vacuum Oil Company Proprietary Limited v Wiltshire* (1945) 72 CLR 319.

[189] And also, to a lesser extent, *Ex Parte Garland.*

[190] *Vacuum Oil* (n 187), 328.

[191] *Ibid,* 335.

Both the majority[192] judgments proceeded on the basis that the creditors did not provide 'affirmative assent' for the continuation of the business, and therefore they had not lost their right to claim from the trust assets. According to the majority, where a creditor of a previous trustee affirmatively assents to the business being carried on, he is described as being able to lose his right of priority: its enforcement would be 'inequitable' where the creditor has acted in a way that 'exposes the trustee to risk of personal liability unless paid out of the estate' in the 'hope of obtaining an advantage'.[193] The logic is that if a creditor *does* provide affirmative assent to the continuation of the business, he does so in the hopes of having a better chance of being paid in full, and in doing so he encourages the trustee to continue trading. This exposes the trustee to personal liability, and it is thus inequitable to allow the creditor to enforce his priority claim which could potentially leave the trust with nothing, and the trustee with the newly-incurred personal liabilities contracted in the course of continued trading.

The dissenting judgments of McTiernan J and Starke J argue that the creditors *have* lost their right of priority, as they *have* affirmatively assented.[194] In other words, the case turns on a reinterpretation of *Dowse v Gorton* and *In Re Oxley*. *Vacuum Oil,* including the dissents, diminishes the importance of the awkward notion in those cases of the trust being run for the benefit of the creditor. Instead, the Australian High Court concentrated on the notion of affirmative assent, essentially turning it into an issue of construction of the parties' conduct.

This is not surprising, because the idea in how *Oxley* interprets *Dowse v Gorton,* a central decision in how trusts effect asset partitioning, is conceptually out of line with trust law. The problem with these cases is that according to how *Oxley* interprets *Dowse v Gorton*, by incurring

[192] By reason of a procedural rule, as the case was a 2-2 split, the judgment of the Chief Justice was given priority.

[193] *Vacuum Oil* (n 187), 337 (Dixon J).

[194] *Ibid,* per McTiernan and Starke JJ.

liabilities in the administration of the trust the trustee is adding beneficiaries to it. The business in *Dowse v Gorton*, as interpreted in *In Re Oxley*, was run (at least partly) for the benefit of the business creditors and thus the creditors could not deny the trustee his indemnity. This formed the basis of the somewhat thin factual distinction in *In Re Oxley*. To avoid getting into this anomalous principle, *Vacuum Oil* instead concentrates on the idea of affirmative assent and inequitable conduct as precluding a right of a creditor to assert priority.

The focus may be different (the question was whether to preclude the creditor's priority as opposed to creditor denying the trustee his indemnity as with *Dowse v Gorton*), but the net effect of this decision is in accordance with the basic features of English law. In effect, the personal creditors of the First Trustee may claim against the Second Trustee in equity *directly*, because they are subrogated to the claim of the First Trustee. Through trustee indemnities and subrogation, the (supposedly personal) creditors of a trustee may follow the asset to the hands of another trustee. Where liability is established, it in effect follows the *asset*, and not the person. The only trace of personal liability here is that the process of establishing liability is curtailed by the availability of the trustee's right, itself a problematic notion. This will be returned to below.

The combination of the creditors-as-beneficiaries idea and the ability to follow an asset is a short step from recognising legal personality of the trust.[195] The first is essentially an idea of company law, that where a company is insolvent it is run for the benefit of creditors and not shareholders, and the second establishes the pool of assets as independent of members, as it is capable of being followed on its own. Both of these features are present in the *Dowse v Gorton-Re Oxley* line, suggesting that these company law notions could apply to trusts as entities, as opposed personal liability -based doctrines applying to trustees and beneficiaries.

[195] Henceforth, to borrow a useful neologism from Lionel Smith, let us call this 'entification'. Lionel Smith explores the implications of entification, looking critically at the leakage of this idea from French comparativism in LD Smith 'Trust and Patrimony' (2008) 38 Revue Générale de Droit 379.

Further evidence of the judicial drift towards trust entification is given by the case of *Octavo Investments v Knight*.[196] In *Octavo* a trustee company ('Coastline') held assets on trust for family companies of its five directors. The five directors were also the directors of another company, Octavo. Coastline traded with trust assets, and paid out certain liabilities to Octavo shortly before Coastline became insolvent. In defending a claim for wrongful preference, Octavo advanced the following argument. All the assets of Coastline were trust assets. Upon the bankruptcy of a trustee, legal estate in trust assets does not vest in the administrator (trustee in bankruptcy). Assets held on trust are outside the insolvency regime. Unlawful preferences are void against a trustee in bankruptcy, but the trustee in bankruptcy has no legal title to trust assets – therefore the payment made to Octavo is not void, as it was paid out of trust assets.

The High Court of Australia employed an argument based on *Vacuum Oil*, in that a trading trustee has a charge over the trust assets in the form of a right to be indemnified – the trustee has his *own* beneficial interest, which takes precedence over the beneficiaries' right. The assets held by Coastline were therefore no longer property held solely in the interests of the beneficiaries, and that interest will pass on to the trustee in bankruptcy.[197] The court flagged up the question of whether legal title to trust property passes on to the trustee in bankruptcy simply because he has a charge over it (in the form of an indemnity right), but refused to answer it. The passing of the charge itself was sufficient for a finding of unlawful preference.

The case is structurally different to *Vacuum Oil*, however. In *Vacuum Oil* the creditor sought to enforce the First Trustee's indemnity lien against the Second Trustee, and was successful. In *Octavo* the court treated the First Trustee's indemnity lien as *belonging* to the Second Trustee. The key difference between the cases is that in *Octavo* it is the First Trustee who became insolvent personally, while in *Vacuum Oil* the business that was *held* by the First Trustee was

[196] *Octavo Investments Proprietary Limited v Knight* (1979) 144 CLR 360.

[197] *Ibid,* 368-9.

wound up. In *Octavo*, the only asset held by the trustee in bankruptcy was the indemnity lien, as this was the only asset held by Coastline personally and not on trust for anyone else. It therefore becomes clear that a trustee with an indemnity right has an assignable claim against the trust of which he is trustee, otherwise the right would not have vested in the trustee in bankruptcy and certainly could not have been sold to meet the claims of general creditors unless the specific creditor with whom the trustee contracted the liability has been paid.[198] The corollary of *Octavo* is that the trust must be capable of being the subject of a duty independently of the trustee.

Let us elaborate on this startling result. In essence, the trust is not a legal person in the same way as a company is. We may test this principle by looking at cases where a trustee attempts to buy trust property. As we know, it is 'clear, undisputed law that a trustee for the sale of property cannot himself be the purchaser of it.'[199] It is submitted that is meant by 'cannot' is that the court treats such transfer as non-events.[200] While the English orthodoxy, as exemplified in *Tito v Waddell (no 2),*[201] suggests that such transactions are voidable*,* the better view is that there is no transaction affecting legal relations to be set aside;[202] a purchase of property requires two parties.[203] The trustee, already being the owner of the property, cannot sell it to himself.

This is in line with fundamental structure of a trust, creating asset partitioning without separate legal personality: a sale of property by a legal owner to himself does not alter any legal relations. As the pool of property under a trust has no separate legal personality beyond that of

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[198] This latter point is established in *In Re Richardson* [1911] 2 KB 705, discussed in detail below.

[199] *Williams v Scott* [1900] AC 499, 503.

[200] *Glennon v Commissioner of Taxation of the Commonwealth of Australia* (1972) 127 CLR 503, see paragraph immediately below.

[201] *Tito v Waddell (No 2)* [1977] Ch 107, 241.

[202] On this point the author agrees with view of Edelman: see J Edelman 'The Fiduciary "Self-Dealing" rule' in J Glister and P Ridge (eds) *Fault Lines in Equity* (Hart Publishing, Oxford 2012) 107, 109. No view is expressed here as to the main thesis of that paper.

[203] *Ingram v Inland Revenue Commissioners* [1997] 4 All ER 395, 423.

the trustee, self-dealing is literally impossible as nothing changes between before and after the sale. The legal owner was the legal owner and is still the legal owner. The trustee obviously has notice of the trust when making the sale to himself, which means the trust is obviously preserved. A corollary of this well-known rule is that a trust cannot be the subject of a duty independently of the trustee, as it is the trustee's holding of legal title that equips him with decision-making powers as regards the trust property, and all obligational relations with outsiders attach to his personal estate.

In another Australian case, *Glennon v Commissioner of Taxation*,[204] a trustee attempted to 'readjust' trust distributions by transferring shares from the trust assets to himself and to his wife. The question before the court was whether this amounted to a 'disposition of property' which would attract tax liabilities. As regards the husband, the High Court of Australia held that this did not operate as a disposition, either in law or in equity: 'No proprietary right or interest vested in any person as a consequence (…) of these transfers.'[205] The trustee's attempted transaction with himself simply did not have any effect in the rights and duties of anyone. As regards the wife, however, there was a disposition. Though the transfer could very likely be set aside for breach of trust if challenged, there was no absolute rule that such a transfer was void, or forbidden by law.[206]

If a trustee's transaction with himself has no effect, it must be because he is attempting to attach a right and a duty to the same person, in this case the right to the transferable thing and the duty to transfer it. A trustee attempting to transfer trust assets to himself is taking water from one side from an island, and pouring it in the ocean on the other. If trusts are recognised as

[204] *Glennon v Commissioner of Taxation of the Commonwealth of Australia* (n 199).

[205] *Ibid,* 511.

[206] *Ibid,* 514.

having legal personality, as appears to be the corollary of *Octavo,*[207] there should be no doctrinal barrier to such transfers being non-void if unchallenged (though vulnerable as unlawful preferences or as coming under fiduciary duties, as in the case of self-dealing directors of limited companies).

What actually holds the fort against entification is one of the factual problems identified above, the central issue of unconnected liabilities. As we know, this near-proprietary claim of (apparently assignable) indemnity never arises where the trustee acts wrongfully. In that case the ensuing liability does *not* follow the asset – the trustee is not entitled to an indemnity of his wrongful acts.[208] That is, any act of the trustee can be attributed either to his trusteeship or his personal capacity, carrying with it third party consequences such as the ability of creditors to follow an asset. The trust is not a legal person separate from the trustee, as liability depends on the trustee's actions.

This brief exposition of Australian case law illustrates the conceptual problems that follow from the central case law in this area. Following the instinct to do justice to the creditor brings us into a conceptual dead-end, where the creditor either starts to look like a beneficiary, as in *Dowse v Gorton* as interpreted in *In Re Oxley*, or is given the ability to attach a claim to the pool of trust assets almost as if the trust had legal personality outside that of its members, both representing a serious threat to trust law's integrity. On the other hand, where the principles of trust law are adhered to we arrive at the thorny issue of unconnected liabilities: if the trustee is under an unconnected liability to the trust the creditor has no right whatsoever. It is submitted that these are the central problems in this area, and their solution would make the law more coherent internally, and more in tune with the principles of trust law as a whole.

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[207] Note that *Octavo* is based on arguments derived from *Vacuum Oil*, itself based on central English decisions.

[208] *In Re Johnson* (1880) 15 Ch D 548, 552-55; *ATC (Cayman) Ltd v Rothschild Trust Cayman Ltd* (2009) 14 ITELR 523 (PC).

Chapter 3: Trustees' Creditors in English Law II - Doctrinal and Theoretical Solutions

This chapter deals with the problems identified in the previous chapter. Where possible, this is done through case law analysis, fitting incoherent cases together by a process of reinterpretation or by an analysis of their reasoning. These solutions will be referred to below as *Doctrinal Solutions*. Where this is not possible, a solution will be arrived at by reconsidering some of the basic assumptions and arguments in the conflicting or problematic judgments introduced in the previous chapter, and by giving a preference to that judgment or interpretation which best reflects the principles of trust law identified in chapter 1. These will be referred to as *Theoretical Solutions*.

With these solutions the case law will be more coherent and more in line with central principles, which then allows us to make conclusions about the conceptual basis of trusts in Chapter 8 far more effectively than the untended garden of various doctrinal strands introduced in the previous chapter. This will also address the major practical issues identified by the Trust Law Committee in a way that remains loyal to the basic structure of trusts.

1. Doctrinal Solutions

i) Unconnected Liability

We may solve one of the major issues, the issue of unconnected liabilities, doctrinally. As we have seen, the basis for trustee's lack of indemnity where the trustee is in default is the principle that the trustee is taken to have paid himself all he can out of the trust assets. The origin of this is the statement of Sir George Jessel MR in *Jacubs v Rylance,*[209] a case where the trustee had become entitled to a beneficial share, suggesting that the basis of denying indemnity for a trustee in default is that the trustee has already paid himself all he can from the trust.

The statement of Jessel MR, as noted above, is broad enough to encompass trustee's indemnities, but there is a relevant factual difference between a right of indemnity and a beneficial interest that is acquired by the trustee. A beneficial interest under a trust does not, unless otherwise stipulated, carry conditions that the beneficiary must fulfil before he is entitled to the benefit of the property, or specify the use that the beneficiary might make of his interest. A right of indemnity, by contrast, is only acquired when the trustee comes under a personal liability in his capacity as a trustee. It is entirely dependent on the conditions that a liability is incurred, and that it is incurred in the proper administration of the trust – before that, the interest does not even exist. This is precisely the reasoning given in *In Re Richardson* to support the principle that the indemnity must be used to pay the principal creditor and is not divided among the trustee's general body of creditors.

That the trustee cannot be allowed to claim a beneficial interest where he is also under a liability to pay money to the trust is to be expected. While the broad statement that he has 'benefited' from the trust assets might not apply to every default, the idea is simply that the money he owes to the trust can be deducted from his beneficial entitlement. Here the principle stated by Jessel MR is entirely on point: the trustee can be taken to have paid himself his beneficial interest. But that he is not allowed to claim an indemnity against costs he has properly incurred is odd: if the creditor is unpaid he can only apply the indemnity to the payment that creditor.[210] If the creditor is paid he is using the indemnity to make good a loss he has made in

[209] *Jacubs v Rylance* (1873-74) LR 17 Eq 341, n 115 and accompanying text.

[210] *In Re Richardson* [1911] 2 KB 705, (n 105).

the administration of the trust, which could be offset against any profits he has made. The trustee in default is not allowed to profit from his office.

To base this area on the principle that the trustee has already paid himself the indemnity is problematic, and a set-off approach, concentrating on what the trustee has actually gained and lost, is to be preferred. The factual problem as regards creditors of trustees is of course that they cannot know whether the trustee is in default and do not normally have access to the internal accounts of the trust.[211] The 'taken to have paid himself' approach forces the creditors to make inquiries about whether their debtors are in fact trustees, and whether those trustees are in default. This goes against the utility of the trust as a modularity device, keeping the parties' obligational complexity internal while showing a simpler property-face towards outsiders.[212]

The strongest argument against this view is of course Jessel MR's judgment in *Johnson*, quoted above. His Lordship elaborated:

> [the creditors have] some additional benefit [i.e., the benefit to have recourse to trust assets] so as to avoid a supposed injustice; but the injustice to be avoided is the injustice of the [beneficiary] walking off with the assets which have been earned by the use of the property of the creditor: but where the [beneficiary] does not get that benefit, there is no injustice as between him and the creditors, and there is no reason for the court interfering (…) to give [the creditors] a larger right than that they bargained for, namely, their personal right against the trustee.[213]

In other words, the very basis upon which the creditor can be subrogated to the trustee's indemnity claim is to avoid an unjust benefit on the beneficiary. That the beneficiary is not liable to indemnify even the properly accrued costs of the defaulting trustee is therefore merely the result of the upstream-question of why the court allows subrogation, and cannot be solved by

[211] One of the key problems of this area as identified by the Trust Law Committee Consultation Paper 'Rights of Creditors against Trustees and Trust Funds' 1997.

[212] See Ch 1. On modularity more specifically, see H Smith 'Property as the Law of Things' (2012) 125 Harv LR 1691.

[213] *In Re Johnson* (1880) 15 Ch D 548, 555-56.

tinkering with the downstream-question of how the internal accounts of the trust ought to be determined, as suggested in the previous paragraph.

However, it seems that this argument is insensitive to the relevant difference between the unpaid creditor, who has the right to have the trustee's indemnity applied to meet his claim and nobody else's, and the paid creditor, in which case the trustee's indemnity is used to meet the liabilities of general creditors of the trustee. In the latter event the defaulting trustee gets an extra benefit and the beneficiary is worse off, in the former, if indemnity is not given, the injustice of the beneficiary walking off with the creditor's assets persists. The beneficiary's total interest may not be correspondingly enlarged (and thus the beneficiary may not be enriched) because the trustee owes money to the trust that is equal or greater to the amount the creditor has given. But the injustice is not only the benefit of the beneficiary, it is also, and chiefly, the detriment of the creditor. Appreciating all three parties in the scenario, the beneficiary is not the only one who is legally relevant or subject to potential 'injustices' which ought to be avoided, and the ability of the beneficiary to extinguish a liability with a loss is certainly such an injustice.[214]

The creditor has given value and received nothing, the beneficiary has been deprived of the amount of the trustee's default, partially or fully compensated by the creditor's given value, and the trustee has paid off his liability to the trust using the creditor's money. The beneficiary may be closer to where she was supposed to be, but the creditor is wronged and the trustee is allowed to pay off one liability with another. The beneficiary is not enriched—the *the trustee* is.[215]

[214] See HF Stone 'A Theory of Liability of Trust Estates for the Contracts and Torts of the Trustee' (1922) 22 Colum LR 527, 529 (discussed below).

[215] This is one reason why the basic US law claim of unjust enrichment of the trust estate (discussed below in Chapter 6) is not a suitable solution—aside from the double standard of having to claim the trust estate can be enriched independently of the trustee despite having no independent legal personality, the trust estate is not actually enriched in these cases. What was a liability by the trustee towards the trust has simply been paid using the creditor's money.

This insensitivity is, of course, due to the fact that *In Re Richardson,* the case recognising this relevant difference between a paid and an unpaid creditor, was decided 31 years after *In Re Johnson*—there was no relevant difference in the legal position between such creditors then. Another way to counter Jessel MR's concern is to say that it no longer applies after *In Re Richardson*, when the unpaid creditor has something closer to a floating charge.

Based on the above, it is submitted that the problem of unconnected liabilities can be solved by giving due appreciation to the changed legal landscape after *In Re Richardson*. The case earmarks the indemnity of a trustee for the benefit of an unpaid creditor. In such cases, the trustee gains nothing if he is to be given his indemnity. It comes in through the door and out through the window, straight to the creditor.

This approach does not offend the structure of trust law by imposing entification: the trust assets are still held by the trustee without creating a separate legal entity, liabilities are still accrued by him personally and the rights of the creditors are still dependent on the right of the trustee. The idea is only that the trustee's indemnity is earmarked for the payment of an unpaid creditor, for which there is judicial precedent, coupled with the appreciation of the factual difference between a beneficial interest and an indemnity. This provides a just result for the creditor, and it is doctrinally more coherent.

One legislative solution has recently been proposed by the New Zealand Parliament.[216] S. 80 of the Trusts Bill (2017) proposes to allow creditor claims against trust assets either where the trustee has a right of indemnity (s. 80(1)(a)), or where the creditor has given value, the trust has received a benefit and the creditor has acted in good faith (s. 80(1)(b)(i)-(iii)). Good faith is in turn defined as knowledge of matters that limit the trustee's indemnity (s.80(3)). The claim is limited to the extent of value given (s.80(4)(a)).

[216] NZ Parliament, Trusts Bill 290-1 (2017), s. 80. Available at http://www.legislation.govt.nz/bill/government/2017/0290/latest/DLM7382815.html (accessed 18 September 2017).

In essence this legislative provision exemplifies an approach based on the unjust enrichment of the trust estate, though relying on the indemnity right of the trustee as its basic mechanism of claim. Unjust enrichment claims of the trust estate are discussed more broadly in chapter 6 (as the main method of creditor access in US law), but in brief, such methods suffer from the basic inconsistency that the 'trust estate' has no separate personality from that of the trustee and therefore cannot be enriched independently. While legislature can carve out an exception, as they have in the US, such exceptions cannot always be consistently applied because they clash with this basic structure of trust law.[217] Further, based on the above points about appreciating all the parties involved, it is not always the case that the trust estate *is* enriched where the trustee is in default.

The concept of giving value is also not always clear cut,[218] and could give rise to difficulties where the creditor has given value but that the recipient does not regard as valuable. If someone was to paint my house bright orange, their work has value but I prefer my house the way it is. This principle, in turn, leads to quantification of liability based on the subjective preferences of the recipient. In the trust context 'giving value' is especially difficult, as the trust estate is not a legal person and cannot have preferences. In that case, is it the trustee's preference or the beneficiary's that determines what value is given?

Fortunately, there is a ready doctrinal solution to this problem, and giving it the space it deserves in our textbooks has positive ramifications all over the law of trust creditors.

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[217] See discussion of *Blair v Claflin*, 37 NE 2d 501 (Mass 1941) and *Taliaferro v Taliaferro*, 7 P 3d 1241 (Kan 2000), below in Chapter 6

[218] See, e.g., *Benedetti v Sawiris* [2013] UKSC 50; C Mitchell, P Mitchell and S Watterson *Goff & Jones The Law of Unjust Enrichment* (9th ed, Sweet & Maxwell London 2016) paras [4-04] to [4–08]; P Birks *Unjust Enrichment* (2nd ed Clarendon Press, Oxford 2005), pp 52–63; *Sempra Metals v IRC* [2008] AC 561, para 119; *Ministry of Defence v Ashman* (1993) 25 HLR 513; A Lodder, *Enrichment in the Law of Unjust Enrichment and Restitution* (Hart Publishing, Oxford 2012) , pp 51–53; ch 6; J Edelman, "The Meaning of Loss and Enrichment" in R Chambers, C Mitchell and J Penner (eds) *Philosophical Foundations for the Law of Unjust Enrichment* (Oxford University Press, Oxford 2009), pp 211, 235–239.

ii) *Other issues*

Let us now move on to more minor issues with more or less ready doctrinal solutions. First, it was noted above that there is a potential inconsistency between burdens associated with ownership (under *Hardoon v Belilios*, involving calls made on shares, as applied in *Matthews v Ruggles-Brise,* which involved rent arrears) and ordinary trade liabilities. The issue is that ownership burdens such as rent arrears or calls on unpaid shares are always borne by the beneficiary (at least where incurred with authority of the trust deed), while in the case of unpaid consignments of cement, for example, the creditor's access to indemnity is subject to there being no trustee default.

It is submitted that if the above solution to unconnected liabilities is taken seriously, this inconsistency disappears. As unconnected liabilities would no longer be an issue, there would be no inconsistency between the law regarding ownership burdens and other liabilities. In both cases the creditor's right to the trust assets would no longer depend on lack of default by the trustee, and the beneficiary would be bound to indemnify the trustee (and thus the creditor) because they have benefited from what the creditor gave to the trustee.[219] This alignment of doctrinal strands would be a welcome rationalisation of the law, not least because the principle of *Hardoon v Belilios* is actually derived by Lord Lindley from *Balsh v Hyham*, the foundation case of the ultra vires regime holding that an indemnity cannot be denied without alleging misconduct, and *Re German Mining,* which applies the former.

In *Hardoon v Belilios*, the case of *Balsh* was used to show that it is 'well settled that (…) absolute beneficial owners of property must bear the burdens incidental to its ownership' while

[219] *Hardoon v Belilios* [1901] AC 118. This aspect of *Hardoon* was followed in *Wallersteiner v Moir (no 2)* [1975] 2 WLR 389 (Ca), relevant passage cited in *Wilton v Shuttleworth* [2017] EWHC 2195 (Ch); *Independent Trustee Services v Rowe* [1998] OPLR 77 (Ch)

also acknowledging that the case had nothing to do with such burdens but was a debt taken by the trustee.[220] *German Mining* was used to show that where a liability is incurred within the scope of the trust, no additional requirements need to be satisfied for the indemnity to exist.[221] As neither of these cases had anything to do with burdens associated with ownership (both were cases of trustees incurring debts), the *Hardoon* principle should apply to all cases equally as it is drawn from a context outside its own application.

Another issue to be solved doctrinally is the conflict between *Darke v Williamson* on the one hand, and the judgment of Kay J in *In Re Pumfrey*. As we know from the previous chapter, the former case raises doubt as to whether a creditor of the trustee may destroy the trust by enforcing his right of subrogation to the trustee's indemnity to drain the trust of assets, while in the latter the whole trust property was liquidated to raise money for the indemnity.

The question is relatively straightforward. We may solve this issue doctrinally in two ways. First, we may emphasise the importance of the application of *Re German Mining* in *Pumfrey*, and confine the case entirely within an exercise of the ultra vires rules.[222] Choosing this route would make ultra vires into a load-bearing equitable doctrine that does work in solving cases and operates more or less constantly,[223] as opposed to a guiding principle operating by discretion to relax other doctrines where they become too stringent in the circumstances. A step towards this direction for ultra vires was taken by Lord Lindley in *Hardoon v Belilios*,[224] where his Lordship gave two alternative requirements for giving access to indemnity where the trustee has acted outside his powers: the beneficiary must have either 1) authorised or 2) ratified the transaction.

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[220] *Hardoon v Belilios* [1901] AC 118, 124.

[221] *Ibid*, 125.

[222] More on this in part i) of the next section.

[223] An example of such an equitable doctrine would be the bona fide purchaser defence.

[224] *Hardoon v Belilios* [1901] AC 118, 125.

This looks much more like a substantive doctrine than a guiding principle, with clearly spelled out requirements. However, the rigidity of these requirements of course depends on how the courts construe them in the trust context, leaving room for discretion to the courts.

As to this question of the status and force of ultra vires there is no hard-and-fast doctrinal or theoretical reason for either view, though a judge may prefer the additional liberty of being able to weigh the parties' equities in hard cases, when ultra vires is only a guiding principle.

However, confining *Pumfrey* to an application of *Re German Mining* does have the unwanted side effect of insulating ultra vires from doctrinal influences. This is an awkward result, given that the greatest problems this area of law has are to do with the combined unwanted effects of separate doctrines, that if allowed to cross-pollinate could be used to rationalise the law, as in the case with unconnected liabilities. Further, the fact that the highest authority for the operation of the ultra vires rules, *Vyse v Foster*, is treated in the House of Lords as an issue of construction of what the parties have intended can be considered as some evidence that ultra vires is not a rigid set of rules.

The second way to deal with this minor inconsistency is to favour *Pumfrey* over *Darke v Williamson* by confining the latter to its facts. This route offers very little difficulty. As seen in the previous chapter, *Darke v Williamson* was a case with very particular facts where Sir John Romilly MR simply did not allow the enforcement of an indemnity right in the situation, while duly recognising its existence. This right gave rise to a situation where the very purpose of the trust could have been destroyed the day after the trustee signed the credit agreement. The agreement itself was necessary to further the purpose of the trust in that case. Romilly MR clearly did not set out to create a general doctrine but simply denied a claim in doubtful circumstances. This case is therefore a prime example of the discretionary application of an equitable principle, and Kay J was right not to apply it as rigid doctrine in *Pumfrey*, cited in argument as *Darke v Williamson* may have been. It is submitted that *Darke v Williamson* may have some limited application in similar facts, but in general *Pumfrey* is to be preferred and trustee indemnity allowed to drain the trust where a liability of sufficient magnitude is incurred.

Finally, as regards the type of right that the trustee has, issue of the conflict between *Jennings v Mather*, where it was held that the value of the trustee's indemnity is available to meet the claims of his creditors, and *In Re Richardson,* the case earmarking such indemnity to the satisfaction of the specific liability that created the indemnity, deserves mention as it is a small key to the large door of solving one of the major issues in this area of law, the potential entification of trusts. The issue as seen in *Octavo Investments*, a descendant of the *Jennings v Mather* logic through *Vacuum Oil*, is that there appears to be nothing to stop a creditor from claiming against the trust assets directly where he is an assignee of the trustee's 'lien'. As such the creditor's right is no longer dependent on the trustee's right, and the trust behaves like a limited liability company rather than an enterprise based on the trustee's duty-engrafted rights as a holder of legal title. As *Richardson* is a subsequent Court of Appeal decision and *Jennings* is only first instance, it is naturally the case that any inconsistency between the two is to be resolved in favour of *Richardson*, but there are also good reasons in principle for doing so.

Jennings as we know solidifies the status of the trustee's right as a 'lien', available for *his* creditors. As such the case is very similar to the Australian case of *Octavo Investments*. It is this description of the trustee's right as a lien that causes the near-entification of the trust, by granting a creditor the ability to follow the pool of assets independently of the trustee. This is because a lien is an assignable property right—it can be held just as well by an assignee of the trustee's right as the trustee himself. Thinking of the trustee's indemnity as a lien therefore severs the creditor's dependence on the trustee's right. An assignee of this lien has a claim directly against the pool of assets in the trust, just as we would expect in the case of limited liability companies.

It was precisely this kind of reasoning that decided *Jennings v Mather* for the benefit of the creditors, and turned *Octavo* in favour of finding an unlawful preference. It is submitted the reason for describing an indemnity as a 'lien' in *Jennings v Mather*, a misunderstanding of *Evans v Evans* as we know, is that it would be odd if the trust-creditors' claims did not survive the change of trustee. By granting a lien in that case, Kennedy J created a way for the original trust creditors to gain access to the trust assets. In *Octavo* this granting of a lien was done to bring the payment within the bankruptcy regime to establish an unlawful preference.

The logic of the trustee indemnity lien is that the trustee's indemnity right is what ascertains the beneficiary's entitlement by removing certain assets from the trust corpus. Before that happens, the trustee is entitled to withhold the trust property from the beneficiaries until his claim is satisfied. So the trustee's indemnity 'lien' is clearly against the trust property, allowing the trustee to resist the beneficiary's claim to it.

But the view is more problematic than might at first seem. If the trustee has a lien over property that he holds legal title to, who or what right is that lien against? The answer might be that it is an equitable lien, against the beneficiary's right to the assets. But the beneficiary does not have a direct right to the trust property, so it cannot be against the beneficiary's property rights—in fact, it is the exercise of the trustee's indemnity that ascertains *whether* the beneficiary has any right in any property. If the lien is against the beneficial title generally, how would a lien against an equity operate?

It is submitted that there is no need to classify the trustee's right as a lien. This is ensured by the solution offered above to unconnected liabilities, by appreciating the principle in *In Re Richardson* that earmarks an indemnity to trust creditors, coupled with the principle in *Dodds v Tuke*[225] that it is the exercise of the trustee's indemnity which ascertains the pool of trust assets available. The unpaid trust-creditors of the old trustee have an earmarked priority claim to the assets by claiming subrogation to the old trustee's indemnity right, so long as the liability was incurred while the old trustee still held his office. The creditor's right of subrogation exists only

[225] *Dodds v Tuke* (1884) 25 Ch D 617.

against the trustee and his personal estate, but as the trustee's personal right to be indemnified out of the trust assets survives a change of trustee because it is the exercise of that right that ascertains the extent of trust assets in the first place, the subrogation right also retains its potency as the central creditor remedy.

This does away with fears of entification, as the trust estate is not subject to rights independently of the trustee. The real problem solved by the lien-reasoning is in essence the same as that of unconnected liabilities, namely that the trustee's right of indemnity can be destroyed by his misconduct. Once *In Re Richardson* is given its proper due, this ceases to be a problem and the dubious logic of indemnity liens can be put to rest.

2. Theoretical Solutions

i) Ultra Vires and Fiduciary Duties

A good example of a problem that is solved by appreciating the theoretical underpinnings of asset partitioning in the trust is the issue of differing standards between asset partitioning rules and fiduciary duties as regards the requirement of fraudulent conduct. As we have seen, where a liability is accrued by the trustee personally and he seeks indemnity from the trust assets, his acting ultra vires or technically in breach of trust does not invalidate his indemnity claim where the trustee has acted honestly and fairly to the benefit of the trust without a possibility of being a gainer.[226] This is remarkably different in the case of a breach of fiduciary duties, where liability arises without reference to fraudulence or benefit to the trust.

It is submitted that this seemingly odd divergence is as it should be. It was argued in Chapter 1 that the asset partitioning and fiduciary functions of the trust are interlinked: the

[226] *Balsh v Hyham* as developed by subsequent cases; see section 4 in the previous chapter.

former creates different pools of assets for the enterprise and its members, and the latter ensures the workability of this function by precluding debtor opportunism of the trustee. It was argued that without recognising this link we cannot understand the operation of trust law. However, though linked, the two must be kept separate. Asset partitioning rules, of which the doctrinal operation of the trustee's indemnity is a key example within the topic of this thesis, are about creditors' access to certain pools of assets. In the case of indemnity there is always a creditor, paid or unpaid, who is external to the members of the trust and thus, by virtue of the modularity principle,[227] should not be required to make inquiries into the internal accounts of the trust. Where no fraud has been committed, the creditor has a valid claim despite certain indoor management issues within the enterprise.

A relaxed regime is perfectly acceptable in this context. On the argument advanced in this thesis, the fiduciary asset partitioning regime seeks to ensure that the assets of the group enterprise remain separate from those of the trustee, and the central condition of preserved creditor access in cases of ultra vires actions is that the trustee does not gain personally. The two differing doctrines are theoretically in alignment, both ensuring against trustee opportunism and retaining the utility of the trust as a trading device.

Fiduciary duties are different. Although they support the asset partitioning function by policing debtor opportunism, they operate by enlisting the beneficiary. In other words, though the net effect of fiduciary duties is essential to workable asset partitioning, fiduciary duties actually protect the beneficiary's right to have the assets and administration regime of the trust preserved. In that context the strict requirement of no conflict is to be expected.

We now see that inconsistency between the two regimes is not in fact a problem at all, but already completely in line with the principles introduced in Chapter 1. From an historical perspective we may commend the system of separate forms of action for the two functions of

[227] Modularity being a key principle of trust law, as argued in Chapter 1.

trust law, hinted at by Lord Macnaghten with some nostalgia in *Dowse v Gorton,*[228]as uniquely suited for the separate development of these two functions. The two sides are rightly kept separate.

ii) The Creditor-Beneficiary Problem

Lord Macnaghten brings us back to *Dowse v Gorton*, and the key issue of creditor-beneficiaries. That is, that under *Dowse v Gorton* as applied by *In Re Oxley* the creditors of trustees claiming through indemnity subrogation start to look like beneficiaries of the trust. This is because of how the argument was framed in *Dowse v Gorton*:[229] in the case where pre-trust creditors of the enterprise decide not to liquidate the enterprise but assent to its being run by a trustee, the trustee's indemnity to the new trust creditors comes at the expense of the pre-trust creditors. The argument in *Dowse v Gorton* was that an indemnity may only come at the expense of a beneficiary. The decision of the House of Lords is only about access, but while they gave access to the new trust creditors to the whole pool of assets devoted to the enterprise,[230] the leading judgment inadvertently gave their Lordships' blessing to this argument,[231] stating in the judgment that the business *was* now run partially for the benefit of the creditors. *Oxley* interprets this to mean the creditors are now beneficiaries.

As a minor point it is worth noting that the creditor-beneficiary idea potentially imports into the area of trustee indemnities all the problems and obscurities associated with creditor

[228] *Dowse v Gorton* [1891] AC 190, 203.

[229] See n 162 and accompanying text.

[230] Which seems only a corollary of *Ex Parte Garland*: if *only* assets embarked on the trade are available to meet potential trade creditors' claims, it seems logical to say that *all* assets embarked on the trade are so available. See note 136 above and accompanying text.

[231] With the possible exception of Lord Macnaghten's judgment, in which the principle that does all the work is that an indemnity cannot be denied without alleging misconduct.

access to the beneficial interest, to be discussed in detail in Chapter 5. They may not be insurmountable, as creditors can and do claim against beneficial interests, but it would suggest that a subrogation to the trustee's right is tantamount to an assignment of a beneficial interest.

Aside from this, the creditor-beneficiary issue is a full-blown conceptual problem to trust law in the form of a dilemma: on the one hand it is integral to the operation of trusts that the trust enterprise is run for only the benefit of those persons, or for the furtherance of the interests of that class of persons, as is defined in the trust deed. If the trustee was allowed to bring in additional persons for whose benefit the trust enterprise is conducted by merely engaging in trust activities, trust law would have very different contours to what we have come to know—the creditor-beneficiary idea is out of line with basic trust law. On the other hand, denying that the insolvent business now under a trust (or a new trust) is run for the benefit of the creditors gives the old creditors a priority claim in the trust assets. This notion is just as problematic: the mere fact that an enterprise with existing creditors was once held by another trustee, or was once not using a trust structure, cannot create an additional asset partitioning wall between assets available for pre-trust creditors (or creditors of the previous trustee) and those available for trust creditors (or creditors of the present trustee). This would devote trust assets to purposes outside the trust.

It is submitted that at the root of this dilemma is the unfortunate way in which the argument in *Dowse v Gorton* was framed, and that this unhappy accident was used as the basis of a factual distinction, as part of the *ratio*, in *Oxley*. There appears to be no doctrinal solution to the question other than to downplay the importance of the creditor-beneficiary idea in *Oxley* and create a legal concept out of the idea of 'affirmative assent', as was done by the Australian High Court in *Vacuum Oil*. This solution, however, is unsatisfactory as it leaves an asset partitioning wall between old and new creditors where the old creditors do *not* affirmatively assent. This in turn allows for property to be marked for tax purposes as trust assets where that property is in fact earmarked for other uses. That is, either they are not trust assets in any real sense, or they are trust assets but only the previous creditors have access to them. This kind of asset partitioning wall is a feature of beneficial interests between beneficiaries with earmarked shares.[232] The creditors are now, once again, something close to beneficiaries.

It is worth noting also that treating the creditor as having a beneficial interest would be inconsistent with the solution above to the question of unconnected liabilities, as that solution depends on the distinction between a right of indemnity and a beneficial interest. In order to work it must deny entirely the possibility that a trustee's indemnity could be a beneficial interest, and that by subrogation a creditor could become a beneficiary. It is submitted that any attempt at a purely doctrinal solution does not in fact solve the problem.

This issue must therefore be solved by reference to the principles introduced in Chapter 1. We can say without much further analysis that the possibility of such asset partitioning walls violates the modularity principle: the new creditors must now make inquiries into the internal complexities of the trust, by having to find out whether the trust business was always a trust business and whether it has ever been held by another trustee, and if so whether the previous trustee or business manager left any creditors unpaid, and if so whether those creditors affirmatively assented to the business being run with a trust structure or with a new trustee. We also know from Chapter 1 what forms of asset partitioning attach to the office of the trustee. We need only recognise the very basic point, that these forms are different to those of the beneficiary, to appreciate that any suggestion that the trustee's indemnity is in fact a beneficial interest is going to be problematic. A beneficial interest comes with a level of access that the trustee can never have in his capacity as a trustee, limited as that access might be.

A principled solution would be to reinterpret *Dowse v Gorton* and, put *Oxley* on a different footing. The result itself in *Dowse v Gorton,* that all trust assets are subject to the claims of trust creditors is nothing controversial, indeed it could have been arrived at by considering *Ex Parte*

[232] See *Fraser v Murdoch* (1881) 6 AC 855.

Garland.[233] To uphold this principle no mention of creditor-beneficiaries need be made. If we simply interpret dicta in *Dowse v Gorton* suggesting the trust is run for the benefit of the creditors to be meant only in the sense that keeping the trust business running is beneficial to the creditors as they are more likely to get full value for their credit agreements, there is nothing offensive conceptually or in principle to trust law. The case becomes simply the counterpart of *Brandon v Robinson*, establishing that (all) trust assets devoted to the trade are subject to the trustee's trust creditors through his right of indemnity.

The remaining obstacle is *Oxley*, the problem of course being that that case uses the beneficiary-creditor idea as part of its ratio. The reinterpretation of *Dowse v Gorton* above would put *Oxley* on the footing that by their lack of affirmative assent (instead standing by with knowledge that the trade was carried on as a trust) gave the old creditors the potential right to carve out a portion of the trust assets to meet their claims as being in equity theirs, thus never belonging to the trustee.

This, however, might be giving the old creditors too strong a right, as we do not have any case law guidance as to how this potential right might be used and *Oxley* is itself far from clear. In *Oxley* it was the new creditors who were seeking priority status and were simply denied it, the case itself saying precious little about what right the old creditors actually *do* have. It is submitted that another way to deal with *Oxley* is simply to disapply it, as its ripple effect to other areas of trust law is potentially problematic to some of equity's core concepts.

iii) Limitation to Trust Assets

It is submitted that the possibility of limiting the personal liability of a trustee to trust assets is unproblematic to trust law's principles in itself. The real issue is its effect in combination

[233] See n 229 and accompanying text.

with the other problems associated with this area of law can be used to shield the trust against liabilities to a large extent.

If we go through this doctrine generally against the background principles of Chapter 1, we may conclude it does not violate them. As regards modularity, the doctrine is neutral. The basis of modularity is the efficiency of information costs associated with finding out the obligational details that concern certain property. Where the trustee in his dealings with outsiders must stipulate unambiguously that he is limiting his potential liability to trust assets,[234] such information costs do not arise. The outsider knows perfectly well what he is getting into, and can adjust the price of his credit accordingly. There is also no problem with the principles of asset partitioning. Though a successful limitation of the trustee's liability solidifies his weak-form defensive asset partitioning into a strong-form one, this is all done by separate contracting. There is no entification and the law of trusts remains intact: that any contracting party may reasonably limit his liability is an uncontroversial rule of contract law, and the availability of such limitation does not create default rules capable of changing the whole landscape of trust law.

3. Concluding remarks

These then are the proposed solutions for the main problems associated with this area of law. The next chapter delves durther into the basic concepts of trusts, primarily in order to give context to the doctrinal rules regarding creditor rights against beneficiaries but relevant to the nature of the trustee's position as the legal owner as well. The solutions offered in this chapter will be summarised briefly in chapter 8, together with lessons from the law of beneficiaries'

[234] *Muir v City of Glasgow Bank* (1879) 4 AC 337.

creditors and comparative US perspectives, and the more coherent picture of the law of asset partitioning in the trust will emerge.

Chapter 4: Beneficiaries' Creditors in English Law I – Basic Principles

The subject of this chapter, how creditors of beneficiaries can claim against trust assets and how this law was developed, is as fundamental to trust law as the ability of the trustee to contract for the trust. While the latter is a natural extension of the trustee's legal ownership of the trust assets, the law on beneficiaries' creditors is a facet of what is perhaps the most difficult debate in trust law scholarship – the nature of the beneficial interest. The picture that emerges is complex and elegant, cutting across some of the most basic conceptual issues of trust law.

This chapter is intended to clear up some basic misconceptions about the origins and doctrinal influences of the law of beneficiaries' creditors, and the nature of the beneficial interest insofar as it relates to this main topic. The doctrinal position – the ability of the beneficiary to assign their interest and collapse the trust in certain circumstances – can easily be understood in itself and almost stated in a single sentence. However, its complex corollaries and limitations[235] cannot, without appreciating its proper context and long developmental roots.

1. Beneficial Interest and Availability to Creditors

It is often assumed today that the ability of the beneficiary to assign his interest stems from *Brandon v Robinson*[236] - the case is generally taken to be authority both for the proposition

[235] Exemplified in Chapter 7 on the American position of beneficiaries' creditors.

[236] *Brandon v Robinson* (1811) 18 Ves 429; 34 ER 379.

that a beneficiary's interest under a trust is subject to the claims of his creditors,[237] and that a clause in a trust settlement purporting directly to limit the beneficiary's power of alienation of an equitable life-estate (so-called 'spendthrift clause') is invalid.[238] This reasoning is particularly pertinent in American law.[239] The actual reasoning of Lord Eldon in *Brandon v Robinson* is not easily summarised in either proposition, and the issues remained litigated for decades afterwards.[240] To appreciate the problems in the case the judgment must be analysed in some detail.

The case concerned a trust by will of Stephen Goom for the benefit of his children, one of whom was Thomas Goom. We see from the report hints that Thomas Goom was a spendthrift, and the father distrusted the son when it came to money; the trust settlement mentions that £500 pounds[241] has already been advanced to Thomas Goom in his father's lifetime, which was to be deducted from his share under the will.

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[237] See L Tucker, N Le Poidevin, J Brightwell (eds) *Lewin on Trusts* (19th ed Sweet & Maxwell, London 2016), 5-128; J McGhee (ed) *Snell's Equity* (33rd ed Sweet & Maxwell, London 2016), 22-002.

[238] See *Nicholls v Eaton* 91 US 716 (1875) (United States Supreme Court), L M McDonnell 'Trusts – Perpetuities- Restraints on Alienation of Property Held on Trust' [1952] 36 Marquette LR 97, T P Gallanis 'The New Direction of American Trust Law' [2011] 97 Iowa LR 215.

[239] The leading student textbook, J Dukeminier & R Sitkoff *Wills, Trusts, and Estates* (9th Ed, Wolters Kluwer Law & Business, New York 2013), at 696 reads: 'Under the leading case of *Brandon v Robinson* (…) such restraint [of alienation of the beneficial interest] is not enforceable in English law'; ML Ascher (ed) *Scott and Ascher on Trusts* (4th ed Aspen Publishers 2007) at 900 reads 'Thus, in England, the beneficiary can voluntarily assign the interest, and creditors can reach it, even if the terms of the trust expressly provide otherwise. The leading case is *Brandon v Robinson*, decided by Lord Eldon in 1811'.

[240] In *Godden v Crowhurst* (1842) 10 Sim 642; 59 ER 765 and *Twopeny v Peyton* (1840) 10 Sim 487; 59 ER 704, the settlor's ability to restrict alienation was still upheld, and only disapproved of two years after *Godden* in *Younghusband v Gisborne* (1844) 1 Coll 400; 63 ER 473, at 402 per Sir James Knight Bruce VC

[241] The report does not state when this money was advanced, but at the time of the will (1808), £500 was the equivalent of £41,450 adjusted to inflation, and if advanced between 1790-1800 it could be as much as £69,000. See http://inflation.stephenmorley.org, accessed 25 September 2017.

Further, the will generally directed that the share of any legatee who has attained the age of 21 at the time of Stephen Goom's death should be considered to be a vested interest in his or her share in the trust property. This direction was subject to restrictions as regards the shares of his daughters (we do not learn the nature of these restrictions), and Thomas Goom's share was specifically singled out for a special regime.

Thomas Goom's share was to be invested in government securities, and the dividends and interest, not the principal sum, were to be paid to him. Upon his death, which appears to have taken place at the time of judgment, the will directed that the principal sum, including any products thereof, was to be paid to those who would be entitled to his personal estate, as if he had died intestate. In other words, the father did not trust the prodigal son with the principal sum, but instead wanted him to have only an income from the dividends and interests, the principal sum passing on to the son's children upon his death. The will also directed that the monies were to be paid to Thomas Goom's 'own proper hands, or on his proper order and receipt (…) to the intent that [the monies] should not be grantable, transferable or otherwise assignable, by way of anticipation of any unreceived payment'.

The defendants were the trustees, and the plaintiff was a 'surviving assignee under the commission [of bankruptcy]' of Thomas Goom – a creditor. The Plaintiff (P) asked for an execution of the will so that the estates may be sold, and the Defendants (D) sought to resist the claim. In short, D argued that a testator intended the interest to be personal to his son, without any fund of credit being given to him. The son acquired nothing until a payment is made, and payment to someone else would rewrite the will.

P argued that the will took effect as a general bequest with a declaration that Thomas Goom did not have the power of assignment. This, according to P, did not mean that the interest could not be alienated in bankruptcy. An analogy was made to a lease that is unassignable before permission is given by the owner, which lease is alienable and realisable by the trustee in bankruptcy. In summary, the plaintiffs argued that although the voluntary act of alienation was restricted, it was not restricted by operation of law. It is clear that nobody was arguing for a general inability to restrain alienation or, specifically, that a beneficiary's interest is subject to creditors' claims.

Lord Eldon's brief but complex judgment can be divided into stages. First, the Lord Chancellor noted the following general principles. It is clear generally that if a life estate is given, it is subject to the incidents of a life estate.[242] A disposition to a man until he becomes bankrupt is valid, but the case is different if property is given with a condition that it shall not be alienated. If a condition is expressed that makes the interest granted short of a life estate, then neither the man nor his assignees can have the property beyond the period limited. If it is not short of a life estate, then it must be subject to creditors' claims unless it has been given away to someone else.

Lord Eldon then discussed the situation as regards trusts for the benefit of married women, who at the time were not entitled to hold property in law but could do so in equity. Presumably this is because an analogy has been drawn in the pleadings between these cases and the case at hand, but the report does not mention it. Monies under such trusts would have to be paid into the woman's proper hands (as was the case with Thomas Goom), but she could still dispose of the interest (citing *Pybus v Smith*[243]). If the interest was disposed, the court would compel the woman to give her own receipt if this was necessary for the disponee to receive the property – as if there was a contract whereby the woman validly gave title to the disponee.

His Lordship then referred to a case called *Miss Watson's Case* (without giving full citation) in which Lord Thurlow added to a settlement of which he was trustee the words 'not to

[242] The case has been revitalised somewhat by a recent citing of this principle in argument in the important case of *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2011] UKSC 38; [2012] 1 AC 383. The author's knowledge of this citing is based on an informal discussion with Richard Salter QC, who was the lead counsel for the claimants, and Gabriel Moss QC, who provided intervening written submissions in that case. The report itself mentions only that 'a reference was made' to *Brandon v Robinson*.

[243] *Pybus v Smith* (1791) 1 Ves Jun 189; 3 Bro C C 340.

be paid by anticipation'.[244] This appears to be an addition in that particular case to deal with a particularly improvident wife, who was in the habit of flippantly giving away future interests to her trust property.[245] Since equity gave her the power of alienation (because married women had no dispositive powers in law[246]), equity could limit that power if necessary to achieve what the trust deed set out to achieve. In other words, the case was confined to its own facts, and did not apply. This was particularly so considering that a man *did* have the power of alienation, if he had property, as noted by Lord Eldon.

The next stage in the judgment dealt with the instant case in two dense paragraphs. First, if it can be established that the beneficiary has no interest in the property until he 'tenders himself personally to the trustees to give a receipt, then it was not his property until then'. That is, if on construction of the will there is no interest on the beneficiary until he offers to sign a receipt personally,[247] the interest is not available for distribution on his insolvency. But if 'personal receipt is a necessary act' but the beneficiary never gives it, an arrear of interest would be accrued during his lifetime for his benefit and that would be an asset available to his creditors.

Finally, Lord Eldon established whether in this case there is enough to draw the link between the restriction of alienation to meet unreceived payments, and alienation by assignment to the trustee in bankruptcy. According to Lord Eldon, what is required to restrict the latter is that the interest be given away to someone else. In this case this had not been done.

[244] These settlements were held to be valid by Lord Alvanley in *Sockett v Wray* (1793) 4 Brown CC 483 and by Lord Eldon in *Jackson v Hobhouse* (1817) 2 Mer R 483.

[245] *Jacques v Methodist Episcopal Church* 17 Johns (NY) 549, 8 Am Dec 447 (1820).

[246] *Sockett v Wray* (1793) 4 Brown CC 483, 486: 'A married woman is in a different state from an infant, an infant has no disposing mind (…) the law says [a married woman] has a disposing mind, but not a disposing power.'

[247] This reading is based on an earlier comment by Lord Eldon: 'Can it be contended that, if the bankrupt during his whole life never signed a receipt, the interest during his life would be undisposed of, and would fall into the residue?' at 432.

The only candidate that the interest could have been given to on the facts was the next of kin of Thomas Goom, the disposition being made under the will of Stephen Goom. It was within the testator's powers to assign the interest upon the death of Thomas Goom to his next of kin to take as the testator's personal estate, not Thomas Goom's. This would have made it a gift of the testator, only to be distributed as if it was the hypothetically intestate Thomas Goom's personal estate. Instead, the principal sum plus any product thereof was to be paid by his trustees or executors as if the monies had been personal estate belonging to him, and not just distributed to whoever would inherit his estate. The interest had therefore not been given away to the next of kin of Thomas Goom upon his death, but was available for distribution to his creditors.

In summary, Lord Eldon's reasoning is the following.

1) If an estate is given, it is subject to all its standard incidents, including liability for execution of debts in bankruptcy.

2) If the beneficiary has no interest, as a matter of construction, until he approaches the trustees with an order and a receipt signed in his own hand, he has no title in the monies until he receives them.

3) If, on construction, he would get the monies as a matter of necessity but simply never signed a receipt, those monies and their accrued interest would be assets for his debts.

4) To prevent the trustee in bankruptcy receiving the interest and distributing it to creditors, the interest must have been given to someone else. This was not done.

With respect, it seems there is a step missing from Lord Eldon's judgment. It must be the case, given the actual result of the case, that receipt of the trust property by the beneficiary is, as a matter of construction, a necessary fact. The judgment itself does not give any reasons as to why this is, nor does it engage in any way particular in construing this will. Also, no reasoning is given as to why the creditors have access to the principal sum, which Thomas Goom never had direct access to, as well as the products thereof.

Therefore, whatever else we may know about *Brandon v Robinson* based on the above exposition of the report, we can see that the propositions it is usually cited for are oversimplified and potentially even misleading. The case itself appears to turn on a point of construction of the will, though the exercise of construction itself appears to be missing from the report.

It is therefore difficult to justify that the case in any way establishes the general principle that a beneficiary's entitlement is subject to the claims of his creditor – this much is already assumed in the reasoning of Lord Eldon before the case is decided one way or the other, much as we would assume this in any modern case. It is similarly difficult to justify the conclusion that the case denies legal force for so-called spendthrift trusts.[248] Nowhere in the case does this principle appear. The principle that where a life estate is given it must be subject to the incidents of life estates does not preclude a settlor from giving less than a life estate,[249] and the case turns on construction of the will as to whether a life estate or something less was actually given.

The case therefore does little to establish that a certain kind of beneficial interest cannot be carved out of the settlor's estate, only that if the settlor chose, as a matter of construction, to give a life estate and nothing less, it would be subject to the standard incidents of such estate. This is nothing unusual or particularly notable. Indeed, a distinction based on what specific interest was given is now the basis of the so-called anti-deprivation rule in English insolvency law.[250]

The fact that liability for execution of the beneficiary's interest seems to be assumed without more in *Brandon v Robinson* is not surprising. The ability of the beneficiary to assign his

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[248] Trusts restricting alienation – see chapter 7 below.

[249] This distinction still holds - see chapter 5 below under 'Permissible Restraints on Alienation'.

[250] See R Goode *Principles of Corporate Insolvency Law* (4th Ed Sweet & Maxwell, London 2011) Chapter 7, para 7-01.

interest and the ability of his creditors to execute against that interest was developed in various statutes in lockstep with the early development of the trust devise itself.[251]

The Statute of Marlborough 1267 c. 6 attempted to control feoffments made to defraud the chief lord in feudal England. The Fraudulent Conveyances Act 1376 c. 6 protects creditors against fraudulent 'gifts made by collusion', and gives the creditors execution over the subject matter of the gift. The Maintenance, etc. Act 1377 c. 9 extends similar protection over fraudulent feoffments, followed by the Fraudulent Deeds Act 1378 c. 3 easing enforcement. The Statute Concerning Grants by Cestuy que Use 1484 c. 1 allowed the holder of what we would now call beneficial interest to convey title to the property, leading to him being described using the English word 'owner',[252] though not a *dominus* which denoted feudal superiority.[253]

The proprietary view of the beneficial interest under these early statutes is notable. However, the tension between the view that the beneficial interest is proprietary and that it is the benefit of an obligation has been present from these early statutes onwards. The word 'owner' may have crept into use as an alternative to the prevailing French and Roman terms to describe the beneficial interest (these terms were evidently thought to be inapt for the beneficial interest), but the assignability of this interest was rolled back as early as the 1500s under Henry VIII.[254] Of particular importance are the case of *Re Lord Dacre of the South*,[255] a case showing considerable

[251] I am grateful to Professor Mike Macnair for the statutory sources below. For further detail, see M Macnair 'Development of Uses and Trusts: Contract or Property, and European Influences and Images' (2015) 66 Studi Urbinati 305-333.

[252] Sir John Baker *Oxford History of the Laws of England volume VI* (OUP Oxford 2003), 658.

[253] Statute of Mortmain 1279; M Macnair 'Development of Uses and Trusts' (2015) 66 Studi Urbinati 305, 313.

[254] JH Baker *The Oxford History of the Laws of England Vol VI 1483-1558* (OUP Oxford 2003), 418 *et seq* and 671 *et seq*.

[255] *Re Lord Dacre of the South* (1535) in JH Baker *Baker and Milsom's Sources of English Legal History* (2nd Ed OUP, Oxford 2010) 127-32.

pressure by the King on the judges,[256] holding that a use could not be devised by will, and the subsequent Statute of Uses 1536 which enforced the position of this judicial step by transferring title to the land to the beneficiary, or 'executing the use'.[257]

The post-1536 trust then appears to have been a personal obligation far more profoundly than we would say of the modern trust – initially the obligation did not even survive from one trustee to another: one 'cannot have any trust or confidence in those he does not know',[258] and 'there cannot be a trust without privity, for in common sense a man cannot trust one whom he does not know'.[259] Eventually Lord Nottingham LC resolved this issue in the 1674 case of *Stutville v Rossell*, where his Lordship stated that 'where one of the executors died, the land ought to be sold [as per authority of the will], for though the authority be determined, yet a trust is *fixed upon the land* and the heir at law being a party is compellable to join in the conveyance' (emphasis added).[260] That is, the trust started life as so strongly a personal obligation that it took Lord Nottingham's express judicial intervention to attach it to the land and not the person of the trustee, so that it may survive the death of the trustee. Lord Nottingham's judicial developments were later thought to be the principled foundation of the trust device.[261]

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[256] see JH Baker *The Oxford History of the Laws of England Vol VI 1483-1558* (OUP Oxford 2003), 418 *et seq* and 671 *et seq*.

[257] *Ibid*, 674 *et seq*. The practical operation of the statute of uses was of course adapted by the Statute of Wills (32 Hen VIII, c 1) but this is not pertinent to the present discussion.

[258] Weston J in *Anon* (1564) Moo KB 61. See also NG Jones 'Wills, Trusts and Trusting from the Statute of Uses to Lord Nottingham' (2010) 31 J Legal Hist 273, 291-92.

[259] Thomas Egerton in *Bullesden's Case (Anon. d. Chester v Englande)*, Huntington Library MS EL 482 fo.59v.

[260] *Stutville v Rossell* (1674) in DEC Yale (ed.) *Nottingham's Chancery Cases Vol 1* (Selden Society vol 73, London 1957), 49 no.86.

[261] See below, in the discussion of *Burgess v Wheate* (1759) W Bl 123, 96 ER 67; 1 Eden 177, 28 ER 652.

The beneficiary's interest under a trust was formally made available to creditors by the Statute of Frauds 1677, ss. 10-11,[262] but this is by no means an end to the debate on the various facets of the beneficial interest. A test of the analytical maturity of these developments came in 1759, in the landmark case of *Burgess v Wheate*.[263]

2. Trustee as Owner and the 'True Owner' Issue – Burgess v Wheate

An extensive review of *Burgess v Wheate* has been conducted by Paul Matthews,[264] emphasising the politically sensitive time and the various inclinations of the three judges, as well as the delay in reporting and arguments put forth on both sides. Notably Matthews makes a convincing case that the first two of the judges are really providing advisory opinions rather than binding judgments. Only the Lord Keeper Henley is giving a real judgment, while the Master of the Rolls and the Lord Chief Justice are advising his Lordship, in keeping with the usual practice that Chancery judgments were delivered by a sole judge. This unusual advisory procedure was followed because the case was extremely complex, both conceptually and politically, and the Lord Keeper Henley felt it necessary not only to take advice but also to spread the responsibility for this important decision in which the future of the trust itself was at stake.[265]

Noteworthy from the outset is that our interest is in the assignability and exigibility of the various equitable interests in the case. The effect of the decision is that a trustee whose conscience is no longer bound does not have to surrender his interest to the crown under

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[262] See discussion by DEC Yale 'Introduction' in *Nottingham's Chancery Cases Vol 2* (Selden Society vol 79, London 1961), 95-99.

[263] *Burgess v Wheate* (1759) W Bl 123, 96 ER 67; 1 Eden 177, 28 ER 652.

[264] P Matthews 'Burgess v Wheate' in C Mitchell and P Mitchell (eds) *Landmark Cases in Equity* (Hart Publishing, Oxford 2012), 115.

[265] See below, n 268 and accompanying text.

escheat or (now) as *bona vacantia*, affirming that the trustee is indeed the full legal owner of the trust property and supporting the view put forward in this thesis that the trustees powers to deal with outsiders do not arise out of agency but are simply incidental to this legal ownership.[266] However, what has received less attention is the behaviour of the equitable interest in this case. In essence, the case also decided that the beneficial interest is proprietary as between the beneficiary and trustee, in the sense that it can be assigned in a way that preserves the trust but, as the beneficial interest is not subject to escheat, this does not entail that the beneficiary is the the ultimate residual or 'true' owner as regards the outside world, with similar rights of exclusory control as the holder of a legal estate. This foundational principle, hotly contested throughout trust law's history, has an important effect on the law regarding beneficiaries' creditors in cementing the assignability of trusteeship and of the beneficial interest without making the beneficial interest into a legal estate.

The case itself involved a manor and adjoining lands, one part of which lands was transferred over to trustees for a 1000-year term to assign to such persons as the original owner (Lawrence Bathurst) directed, or in the absence of direction to himself. The purpose of this transaction was to obtain loans in exchange for security interests in the 1000-year term, ensuring the transferability of these loans – in essence this case therefore is about an early rudimentary form of structured finance,[267] where the trustees act as an intermediate entity between the borrower and the lenders, converting the illiquid term of years into liquid financial assets and acting as a point of contact between various lenders and the borrowers. Two years after this

[266] On this point see 'Agency Liability' below on page 116.

[267] Though the term did not exist at the time, form used in *Burgess* is structurally similar to the devices discussed in T Frankel *Securitization* (Ann Taylor Schwing ed, Fathom Publishing Co, 2nd ed 2005), §2.1; T Frankel and M Fagan *Law and the Financial System* (Vandeplas Publishing 2009), 17-20.

structure was put in place, Lawrence Bathurst mortgaged the lands held under a trust for a 500-year term.

After Lawrence Bathurst's death the premises descended to his widow, Susannah. She obtained further financing using the structure in place for the remaining 500-year term. These different mortgage interests were later both assigned to one John Chandler, and later descended to his son James Chandler.

Lawrence's and Susannah's son Edward died an infant, and the manorial title descended to Edward's two sisters, Ann and Mary. Both later married.

Mary and her husband George Coxeter filed a bill to have the lands divided between Ann's and Mary's families, and to have it declared that the mortgages were to be paid in equal shares by both estates. This was eventually executed. In order to pay the debt to Chandler, Mary later conveyed her equity of redemption in the mortgage properties to trustees, to hold for Chandler.

Ann did not have children and died before her husband, so her interest descended to her husband's niece after the husband's death. The niece, Elizabeth, married one Nicholas Harding. When Mary conveyed her mortgage interest on trust for Chandler to satisfy the debt, Elizabeth and Nicholas also conveyed theirs to the trustees for Chandler on the understanding that the trustee re-conveyed upon request the two leasehold terms to Nicholas and Elizabeth and their heirs. This was never done.

The two made an agreement with Sir Francis Page and Robert Simmons, the trustees, for them to hold the Harding interest on trust for Elizabeth if there were no daughters from the marriage. Elizabeth died without leaving daughters. Sir Francis Page took possession of the premises.

The plaintiff, Richard Burgess, was Elizabeth Harding's heir but not a direct descendant. The defendant, Wheate, was the personal representative (executor) of Sir Francis Page, the last surviving trustee (now deceased). Burgess claimed to have Sir Francis Page's interest conveyed to him. At first instance Lord Hardwicke C ensured that the Attorney General was also made a party to the suit, to determine whether the Crown is entitled to the property under escheat.

The answer to both these broad questions, namely whether Burgess is entitled to the premises either through inheritance of an interest or the creation of one in equity, and whether the Crown becomes the beneficial owner under escheat, was in the negative. Burgess could not inherit the legal interest as this was never re-conveyed to Elizabeth, and he had no interest arising in equity as 'equity sees as done that which ought to be done' did not apply to a missed opportunity on part of a deceased to have the trustees re-convey a legal interest.[268]

Interestingly for our purposes, arguments of the Crown seem to have included that the land was subject to escheat because equity should be a 'thing of the past' and that the development of trusts after the execution of uses in the Statute of Uses of 1536 had not reached any maturity by the 1700s.[269] In other words, the Crown was not only arguing that a trust behaves in a certain way as to ensure escheat, but in fact trying to argue that the trust concept as a whole amounted to nothing more than a legal estate carved out of the settlor's legal rights, and when it ceased to exist it would be subject to escheat just as any other feudal title. This was therefore a case where nothing short of the future of trust law as a whole was at stake – the equivalent test case for uses was *Re Lord Dacre of the South* in 1535,[270] leading to the Statute of

[268] *Burgess v Wheate* (1759) 1 Eden 177, 186. This is, of course, the same principle we find in *Milroy v Lord* (1862) De GF & J 264, 274 per Turner LJ and *Richards v Delbridge* (1874) LR 1 Eq 11, 14, per Sir George Jessel.

[269] *Ibid*, 194.

[270] *Re Lord Dacre of the South* (1535) in JH Baker *Baker and Milsom's Sources of English Legal History* (2nd Ed OUP, Oxford 2010) 127-32.

Uses in 1536 and the collapse of the use into a legal estate as noted above. It appears the Statute of Uses and the various mischiefs it was meant to remedy were heavily relied upon by the Attorney General in his arguments, as the various judges made continuing references to the statute and its policies (see quotations below).

The court was in an extremely precarious position, with three options: 1) the beneficial interest has not vanished, as Richard Burgess now holds it. The problem with this is that Burgess could not have inherited such an interest, so if he were to hold one now it would mean the court would create it by the very act of giving judgment – it would be 'the execution of a trust that does not exist'[271]; 2) the beneficial interest has collapsed, and as it is in function no different to a right of possession and bears sufficient proprietary indicia, it goes to the Crown under escheat on a proprietary use analogy because the trustee was never intended to take beneficially.[272] The issue here is that this would make the trust concept meaningless, as the trustee would simply be holding something they really have no title to and all rights are really held by the beneficiary, who is the true owner – the instrument of trust would be 'a mere nullity'[273]; 3) the trust creates a relation between the trustee and beneficiary, just as uses did before the execution of uses under the statute, and although the rights of the beneficiary act as though they were property rights as between the trustee and the beneficiary and are assignable, they are not identical to the trustee's legal title and the trustee is not a mere front for the beneficiary, meaning the trust instrument does have legal effects.[274] The binding judgment opted for this third view, which should properly

[271] *Burgess v Wheate* (1759) 1 Eden 177, 250-51.

[272] *ibid*, 250.

[273] *ibid.*

[274] *Ibid*, 251.

be appreciated as the basis of trust law as we know it today, though strong support was voiced for the second by the dissent.

Siding with option two, Lord Mansfield CJ, advised that a beneficial interest *is* subject to escheat, on the following basis:

> [U]ses before the statute of [Henry VIII] were considered as (…) a chose in action, and now trusts are considered as real estates, as the real ownership of the land (…) Great invonveniences arose from so narrow and contracted a system [before the statute]; that the *cestuy que use* should enjoy and dispose, and yet not be owner to all purposes; and that the feoffee, who really had nothing, should be deemed owner so as to convey estates out of his seisin by legal conveyance not subject to the trust. [citing Bacon] "The wife was defrauded of her thirds; (…) the lord of his lordship (…); the creditor of his extent for debt". (…) Many acts were made to cure these mischiefs in part; and all looking on *cestuy que use* as the true owner.[275]

Later his Lordship continued:

> [T]rusts were not on a true foundation till Lord Nottingham (…) By steadily pursuing, from plain principles, trusts in all their consequences, and by some assistance from the legislature, a noble, rational, and uniform system of law has since been raised. Trusts are made to answer the exigencies of families, and all purposes, without producing one inconvenience, fraud or private mischief, which the statute of [Henry VIII] meant to avoid. Trusts are here considered as between *cestuy que trust* and trustee (and all claiming by, through or under them, or in consequence of their estates) as the ownership of legal estate (…) [T]he trust is the estate at law in this court, and governed by the same rules in general (…).[276]

Lord Mansfield's view on the result was ultimately defeated by Lord Keeper Henley's judgment upholding the third, personal model of the trust interest. However, the views of the various judges on the development of uses and trusts were in parts quite uniform, notably on the view that as between the trustee and beneficiary, the beneficial interest acted as an assignable property right. Lord Keeper Henley also took the time to analyse the basis of trusts mostly in keeping with Lord Mansfield, but with a differing conclusion:

> An use *(sic)* (…) was neither *jus in re* nor *ad rem*, but a confidence resting in privity of person and estate, without remedy, but in a court of equity. What else is a trust? What

[275] *Ibid*, 227-220.

[276] *Ibid*, 223-24.

> other definition can be given of it? No other is attempted. But it is said since the existence of trusts (since the statute [of uses in 1536]) equity has modelled them into the shape and quality of real estates (…) it is equity that [the beneficiary] should be considered as formally possessed of that estate of which he is and appears substantial owner. But this is only the effect of the equitable jurisdiction's growing in maturity.[277]

His lordship continued:

> [W]here there is a trust, it should be considered in this court as the real estate, between the *cestuy que trust* and the trustee, and all claiming by and under them; and the trustee should take no beneficial interest that the *cestuy que trust* can enjoy (…).[278]

That is, as between the parties the beneficial interest operates as real estate, in that it can be assigned and enforced by the assignees. But it does not amount to absolute ownership, with the exclusionary powers associated with a legal right, or an estate that would be subject to escheat.

These foundational judicial statements of the nature of the beneficiary's interest, after a long period of gestation and incremental development of key concepts since the Statute of Uses, paint a subtle picture of this basic feature of trusts. As between the beneficiary and the trustee, the right of the beneficiary operates as though it was a legal property right. This principle extends to anyone who is claiming 'by, through or under them or in consequence of their estates' – the rights of the beneficiary were assignable, and any creditor claiming through the beneficiary's right, or as a consequence of their estate, could enforce the beneficiary's right against the trustee. This is the basis of creditor access to this day. But in the Lord Keeper's judgment, this did not mean a beneficial title was the equivalent of a legal estate, binding on the rest of the world. This was shown by the fact that the trust instrument was not a mere formality without effects, but could in fact lead to the extinguishing of the beneficial title under certain circumstances.

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[277] *Ibid*, 248-49.

[278] *Ibid*, 251.

Lord Keeper Henley concluded that 'the creator of the trust determines to take the convenience of a trust, with its inconveniences. It is most certain that every man who creates a trust puts his estate into the power of his trustee; for if the trustee sells for a valuable consideration without notice, no court can relieve him from his misfortune.'[279] In other words, the trustee was made the legal owner, and where the beneficiary's entitlement is extinguished, because of a sale or a bona fide purchaser or because of death, the trustee's legal ownership is unencumbered. This in essence decided the case as to the escheat point.

This, of course, does not mean that the beneficiary is the owner in all things – this was, after all, the main thrust of the failed escheat argument. Rather, the case establishes the complex nature of the beneficial interest that we are still grappling with in trust law today, whereby the right is assignable, generally available to the beneficiary's creditors, and in some situations can bind third party assignees of the trustee's rights, while still being best described as being binding 'as between the beneficiary and the trustee'. It is this complex nature of the beneficial interest which determines the law of beneficiary's creditors.

3. Origin and Nature of *Saunders v Vautier* Powers

While *Burgess* tested the state of evolution of the beneficial interest, another seminal development was already under way and would later add further layer of complexity to the question of the nature of a beneficial interest and the power of a beneficiary to deal with that interest. *Saunders v Vautier* appeared in 1841,[280] and looks in hindsight to be a subsequent rewriting of the trustee-beneficiary relation discussed in *Burgess*. The case is well known for

[279] *Ibid*, 246.

[280] *Saunders v Vautier* (1841) 4 Beav 115, 49 ER 282; Cr & Ph 240, 41 ER 482.

having established that a beneficiary can dissolve the trust and have legal title transferred to him if he is the certain recipient of that property,[281] suggesting that the beneficiary does have a right *ad rem* as the true owner. It is argued below, however, that this is not the case, and that a *Saunders v Vautier* power to collapse a trust turns on *whether* the beneficiary of a trust has a vested interest in the trust property, which is an exercise in construction of the specific trust.

The principle had been established at least 114 years before *Saunders*, in the House of Lords case of *Love v L'Estrange*,[282] and traces of it are visible from as early as 1587 in *Boraston's Case*,[283] discussed in more detail below. These foundational cases, in turn, show clear influences from Roman law:

> Seius Saturninus, a chief pilot of the British fleet, by his testament left Valerius Maximus, a captain, his fiduciary heir and demanded of him that he restore the inheritance to Seius Oceanus, the testator's son, on his attaining the age of sixteen. Seius Oceanus died before he had attained that age. (…) If Seius Oceanus to whom the fideicommissary inheritance should have been restored under the testament of Seius Saturninus at his age of sixteen by Valerius Maximus, the fiduciary heir, has died before he attained the prescribed age, the fiduciary inheritance belongs to him who was entitled to the other goods of Oceanus; for the fideicommissum vested in the life of Oceanus, that is, if he be deemed by deferring the time of payment to have allowed the fiduciary heir the guardianship of the goods, rather than to have made the fideicommissum payable upon an uncertain day.[284]

The basic principle here is that title to the property under the fideicommissum had vested immediately, and not when Seius Oceanus turns 16. This latter date is only the deferred date of payment. Thus if Oceanus dies before he turns 16, his next of kin shall receive his share in the

[281] E.g. L Tucker, N Le Poidevin, J Brightwell (eds) *Lewin on Trusts* (19th ed Sweet & Maxwell, London 2015) consistently cite *Saunders* as the basis of these principles; see e.g. paras 1-037; 24-008 to 20-017. 'of course can also operate against proximate equitable title'

[282] *Love v L'Estrange* (1727) 5 Bro PC 59; 2 ER 532.

[283] *Boraston's Case* (1587) 3 Coke 16a; 76 ER 664.

[284] Digest of Justinian, Book 36, Title 1, s. 46; see also Title 2, s. 22. Translation from A Watson (ed) *The Digest of Justinian, Volume 3* (University of Pennsylvania Press, 2011 Philadelphia), 224.

property under fideicommissum. This is, in essence, the fact pattern of the early cases that led to *Saunders v Vautier*.

In *Boraston's Case*, a testator, Thomas Boraston, had left his lands to Thomas Amerie and his wife to hold on certain conditions for a term of eight years to satisfy a debt. After this the land was to go to the testator's executors to hold and transfer to his grandson, Hugh Boraston, when he turns 21. Hugh died when he was nine years old. Hugh's brother and next of kin Philip assigned the land to William Ambrye, the defendant. William Ambrye forcibly took possession from one Richard Hynde, the claimant, who had been assigned the right to possession by Thomas and Constance Brand. Constance was Thomas Boraston's granddaughter by his older son Humphrey, and therefore the testator's heir at law. The question was whether William Ambrye's actions were a 'good and lawful re-entry'.[285]

The court of Queen Elizabeth at Westminster held that the re-entry was lawful, because Hugh's interest the land under the trust was not contingent. The stipulation that the executors are to hold the property until he is 21 only denoted the time at which the interest took effect in possession, and not when it would vest.[286]

In *The Lord Pawlet's Case*,[287] the court reasoned directly in line with the Roman law foundations cited above. The case involved a testamentary bequest of £4,000 to a daughter, the money to be raised by a charge over the testator's land, the payment of which would be made when she turned 21. She died before that date, and the court held:

> [I]f this had been a legacy, or a sum of money bequeathed by the will, altho' *(sic)* the party had died before the age of 21 or marriage, the administrator should have had it (…) The legatee in such case is taken to have a present interest, tho' the time of payment be

[285] *Boraston's Case* (1587) 3 Coke 16a, 18a.

[286] *ibid*, 19a.

[287] *The Lord Pawlet's Case* (1674) 2 Ven 366; 86 ER 489.

> future. My Lord Keeper mentioned the reason to be, because it charges the personal estate which is in being at the time of the testator's death, and if the legacy should by such an accident be discharged, it would turn to the benefit of the executors, whereas the testator did not probably so intend it: and further it has been ruled, that altho' a sum of money be devised out of lands to be so paid at a future day, the death of the legatee doth not lose it. (…) But here this sum of money is appointed to be paid by the deed, and is a trust charged upon lands, and trusts are governed by the intention of the party, and that the personal estate is not charged, and this sum of money doth not lie in demand by a suit, as where a legacy is devised; but only a bill may be preferred, to have the trusts performed.[288]

The court in *The Lord Pawlet's Case* therefore refused to pay the money to the executor, because the beneficiary of a trust has no present interest in the property (unlike in *Boraston's Case* which was a bequest by will) but only a right to have the trust performed. This is clear indication that the foundations of the *Saunders* doctrine lie in probate law, and not in trusts.

The transition from a probate law principle to being applicable to trusts was made some 50 years later. In *Love v L'Estrange*,[289] a testator had left property to one Walter Nash, to be held on trust for him until he attains the age of 24. Walter Nash died before he reached 24, and his administrators claimed his interest from the trustee, L'Estrange. Lord Chancellor King ordered the trust property to be handed over to Walter Nash's administrators, to be divided equally among his next of kin. This was confirmed on appeal by the House of Lords.

There is no reasoning in the case report as to why Walter Nash, or his estate, was to be given the trust property before he turned 24. The arguments on appeal are recorded in the report, which gives some clue as to what the court found persuasive. The appellant trustee argued that the testator never intended for Walter Nash to have any "advantage by the bequest" apart from an annuity of £10, and that the trust property did not vest in him until he was 24.[290] The winning arguments of the respondents included that 1) the bequest was absolute and

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[288] *Ibid*, 366-7

[289] *Love v L'Estrange* (1727) 5 Bro PC 59; 2 ER 532.

[290] *Ibid*, 534.

unconditional, 2) that the "equitable right to [the property] vested in him immediately upon the testator's death", and 3) that the right was transmissible to the administrators of Walter Nash's estate.[291]

While the reason for the existence of this principle in trust law is difficult to digest from *Love v L'Estrange*, further cases had also elaborated on the principle before *Saunders* came before the court. *Love v L'Estrange* was followed, though without express citation, in *Barnes v Rowley*,[292] where the beneficiary took her own life two days after the death of the testator, who had left her a legacy of stock laid out in annuity for her life. In upholding her administrator's claim for the money, Lord Chancellor Loughborough stated: 'Could I have prevented her selling the annuity the next day, if it had been laid out in an annuity for her ? The whole £252 [capital] would have been gone. (…) The legacy vested by her surviving the testator however short a time.'[293] The reasoning in this case suggests that because the beneficiary has the power to sell her annuity the next day, the capital must have been vested at the death of the testator with a delayed payment in annuity for her lifetime. No other reasoning is apparent, and of course the ability to sell the annuity already assumes the conclusion that the interest has vested. Here again the legatee has already died, as is the familiar fact pattern before *Saunders*.

The issue of whether the payment could be accelerated *before* the death of the beneficiary came up in *Booth v Booth*,[294] with no conclusive answer. The testator had left property to trustees to invest for, and to pay dividends to, his great-nieces Phoebe and Ann Booth, until they are married. At their respective marriages, the property was to be assigned absolutely to Phoebe and

[291] *Ibid.*

[292] *Barnes v Rowley* (1797) 3 Ves 305; 30 ER 1024.

[293] *Ibid*, 306.

[294] *Booth v Booth* (1799) 3 Ves Jr 399; 31 ER 203.

Ann. Phoebe died without ever having been married. She left her residue to Ann, with Ann and her brother Richard as the executors. The issue was whether Ann could take the interest under the original will, or whether it went to the testator's next of kin. Sir Richard Arden MR[295] held in favour of Ann.

The key question for the Master of the Rolls was whether the interest had vested or was given under a condition.[296] In essence, the argument was that the marriage was not a condition precedent for the vesting of an interest, but merely fixed the time at which payment was made.[297] *Love v L'Estrange* was mentioned as the main authority,[298] and the case was explained as turning on whether the words in the trust deed are "words of reference to the time at which possession is to be given, and not words of condition", as a matter of construction,[299] in line with the basic Roman law position.

Interestingly, after Sir Richard Arden MR had decided that the claimant had a vested interest, the counsel for Ann Booth asked for her moiety to be paid over together with Phoebe's. Arden MR hesitated:

> In all these cases the Court has never yet accelerated the payment. It may be a vested interest and disposable, but not tangible in the mean time (*sic*). It is worth consideration (…) whether the survivor has any right to demand payment and to be put in possession of this vested interest until the day of her marriage. (…) [The provision in the trust deed] may not be a wise provision, intended for the benefit of the legatee.[300]

[295] Later known as Lord Alvanley.

[296] *Booth v Booth* (1799) 3 Ves Jr 399, 404-405.

[297] *Ibid*, 405-406; 409.

[298] *Ibid*, 408.

[299] *Ibid*.

[300] *Ibid*, 410.

The judgment ends with this, the only further paragraph mentioning what was actually ordered: that Phoebe's share be paid to Ann, and Ann's own share left with the trustees.

The end result may seem a little paradoxical, as on the one hand Ann is allowed to take possession of Phoebe's share but cannot take her own share because she is not married. It appears from his last comments that Arden MR reasoned that the beneficiary's right to claim possession of their interest was limited by whether the possession-delaying provision was for the benefit of the beneficiary. When the interest is assigned to someone else, it does not matter anymore whether it does so benefit, and the assignee can take possession immediately. However, there is very little to go by in the report itself, except that Arden MR did not feel he could accelerate the payment.

The relevant principles would be further clarified two years later in *Hanson v Graham*.[301] Importantly, these clarifications were taken to be authoritative in *Saunders*.[302] In the case a testator gave the whole residue of his estate to his son, to pay to his grandchildren when they either turn 21 or are married. Again, one of the grandchildren, Rebecca Graham Hanson, died before either event took place.

Sir William Grant MR again started the judgment by identifying that 'the question is, whether this legacy is vested'.[303] After a discussion of the relevant Roman law principles of construction of legacies,[304] Grant MR held that as with Roman law, 'when' on its own denoted a

[301] *Hanson v Graham* (1801) 6 Ves Jr 238; 31 ER 1030.

[302] See below.

[303] *Ibid*, 242.

[304] *Ibid*, 243-245. See n 283 above.

condition, but if coupled with other words making reference to a time at which possession is to take place the interest is vested.[305] *Love v L'Estrange* was discussed in the following terms:

> It was not a simple, unqualified gift; but there were many circumstances to shew, that Walter Nash was meant to have the benefit absolutely; and that the enjoyment only was postponed; the testator giving it to trustees in the mean time (…). But he gives it to trustees entirely and absolutely for the benefit of Walter Nash; to improve it for his benefit; to transfer the whole to him, when he arrives at that age: and to make him a certain allowance in the mean time. That is very different from a simple bequest to him, when twenty-four.[306]

For the case itself, Grant MR held that 'by this will it is clear, the whole interest is given. (…) All that is left to the trustees is to determine in what manner it may be best employed'.[307] These statements suggest that the key question for a full exercise of the power to obtain legal title is in two parts: 1) whether the interest has vested or conditional, and 2) whether the limitation in time benefits the beneficiary. If not, the provision is 'unwise' and payment can be accelerated, as would be consistent with the finding in *Booth v Booth* and *Saunders*, below. In *Love v L'Estrange*, as interpreted in *Hanson v Graham*, the limitation was to obtain capital gains, which benefited the beneficiary. His personal benefit, of course, becomes irrelevant when his vested interest has been assigned to his executors, which is why they can collapse the trust.

We now arrive at *Saunders v Vautier* itself.[308] When appreciated in the context of this wealth of previous authority, the well-known result may not seem as striking – it really only extends the principle of delayed-but-unconditional interests under a trust being fully vested interests to giving the court the power to 'accelerate the payment', which Grant MR was already pondering at the end of *Booth v Booth*, 42 years earlier.

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[305] *Ibid*, 246-47.

[306] *Ibid*, 248.

[307] *Ibid*, 249.

[308] *Saunders v Vautier* (1841) Cr & Ph 240, 41 ER 482.

The testator in *Saunders v Vautier* left East India stock to his executors to hold on trust for his son, Daniel Wright Vautier. The stock was to incur dividends until Daniel was 25, at which time the principal and accumulations were to be paid to him. He successfully applied to the court to receive an annuity from the trust property in 1835. When he was 21 and as he was about to be married, he presented a petition asking for the principal sum to be transferred to him. The actual petition was by the residuary legatees, asking that the order of 1835 be declared erroneous on the basis that Daniel Wright Vautier did not have a vested interest in the property.

Lord Cottenham LC stated at the start of his judgment that 'I should not have thought this a case of any difficulty [but for the form of the petition]'.[309] This statement seems apt in light of the centuries of authorities briefly introduced above. It was once again argued that Daniel Wright Vautier did not take a vested interest in the stock, which again was the key question.[310] The Lord Chancellor was of the opinion that Daniel Wright Vautier was entitled to the property.[311]

In holding so, the Lord Chancellor made explicit reference to *Booth v Booth, Love v L'Estrange* and particularly to the reasoning of Sir William Grant MR in *Hanson v Graham*. His Lordship stated of that case that *Hanson* was a case of a circumstantial inference

> that the fund was intended wholly for the benefit of the legatee, although the testator intended that the enjoyment of it should be postponed (…). Such, I think, was clearly the intention of the gift in this case. (…) The order for a transfer of the funds, upon the regular evidence of the legatee having attained twenty-one, will follow this decision upon the construction of the will.[312]

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[309] *Ibid*, 247.

[310] *Ibid.*

[311] *ibid*, 248.

[312] *Ibid*, 282-49.

The order for accelerated payment was therefore thought of as a simple consequence of the beneficiary having a vested interest and the fund being intended wholly for his benefit. While this represents an extension of the previous cases from merely a 'vested interest' to 'accelerated payment', it seems to be in line with Arden MR's ponderings as to whether to pay over the other beneficial share on the basis that its delay until marriage 'may not be a wise provision, intended to benefit [the beneficiary]'.[313]

It seems therefore that the real question in an application for the exercise of a beneficiary's *Saunders v Vautier* power is *whether* the will or trust document gives the beneficiary an immediately vested interest in the trust property, and whether the delay of enjoyment was for the benefit of the beneficiary, though the importance of this latter point is admittedly unclear. The case of *Saunders* itself, and the long line of authority it is based on, do *not* establish that the beneficiary has such right in the general case.

This is also evident from how *Saunders v Vautier* is applied. The 2010 case of *Thorpe v HMRC* involved a pension trust,[314] of which Mr Thorpe was the sole beneficiary as the only employee of the relevant company (he was also the only shareholder). He took out the money from the pension fund for his own use, and was assessed for tax. He argued that he had been entitled to do so under *Saunders v Vautier*, and that the tax assessment were therefore to be set aside.

The Court of Appeal held that he was not so entitled.[315] This was because there was a possibility that the pension trust could have had further beneficiaries, for example Mr Thorpe's

[313] *Booth v Booth* (1799) 3 Ves Jr 399, 410.

[314] *Thorpe v HMRC* [2010] EWCA Civ 339.

[315] *Ibid,* para 22 *et seq*.

grandchildren had he died in service, or his widow had he remarried.[316] It was, of course, also theoretically possible that the company would hire new employees. The list of beneficiaries was therefore not closed, and Mr Thorpe was not absolutely entitled to the trust property, and did not have the power to dissolve the trust on his own – he could only receive benefits under the trust scheme, as duly administered by the trustee.

Furthermore, the beneficiaries, even if absolutely entitled, must actually apply to the court to have the trust property transferred to them, and before that occurs they cannot be said to be the true owners of the property – they cannot control trust administration or interfere with the trustees' exercise of their powers while the trust exists. This can be supported using the modern law on the application of *Saunders v Vautier* powers.

In Re Brockbank[317] involved a dissentient trustee who did not want to exercise a power of appointment to make Lloyds Bank a new trustee. The claimants asked for the court to compel the trustee to concur. They argued that the beneficiaries together were absolutely entitled to the trust property,[318] and could therefore take the trust property and declare it on new trust with Lloyds Bank as trustee. Vaisey J agreed,[319] but noted that such exercise did not mean they could direct the existing trustees while the trust was in existence. Vaisey J stated: 'the claim of the beneficiaries to control the exercise of the defendant's fiduciary power (…) is, in my judgment, untenable. (…) [T]hey can put an end to the trust if they like; nobody doubts that; but they are not entitled, in my judgment, to arrogate to themselves a power which the court itself disclaims

[316] *Ibid,* para 25.

[317] *In Re Brockbank* [1948] Ch 206.

[318] As we know from *Re Smith* [1928] Ch 915.

[319] *In Re Brockbank* [1948] Ch 206, 209.

possessing'.[320] The court itself cannot interfere with lawful exercises of a trustee's powers in the due administration of the trust, and while the trust exists neither can the beneficiaries: 'as long as the trust subsists, the trust must be executed by persons duly, properly and regularly appointed to the office'.[321] In other words, while the trust exists the beneficiaries are bound by its terms, even if they have a vested interest in the trust property and can therefore exercise *Saunders v Vautier*.

In *Stephenson v Barclays Bank Trust Co Ltd*,[322] the issue was whether the trustees were liable for capital gains tax on trust property that they had failed to pay over to the grandchildren of the settlor. For this the relevant question was whether the beneficiaries were 'absolutely entitled as against the trustee' to the trust property, under s. 22(5) of the Finance Act 1965. The trustees argued that this was not the case, as the trust property had not been distributed to the beneficiaries and they still had powers to deal with the property according to the trust deed. The special commissioners had agreed with this argument.

On appeal to the High Court, Walton J held that the grandchildren had become 'absolutely entitled as against the trustees' when the deed was executed.[323] However, in so finding Walton J also stated that while beneficiaries who together held the entire beneficial interest were:

> [E]ntitled to direct the trustees how the trust fund may be dealt with. This does not mean, however, that they can at one and the same time override the pre-existing trusts and keep them in existence. (…) nor direct the trustees as to the particular investment they should make of the trust fund. (…) Those trustees can of course be compelled to hand over the entire trust assets to any person or persons selected by the beneficiaries

[320] *Ibid*, 209-210.

[321] *Ibid,* 210.

[322] *Stephenson v Barclays Bank Trust Co Ltd* [1975] 1 WLR 882.

[323] *Ibid*, 891.

> (…) but they cannot be compelled (…) to do anything else with the trust fund which they are not in fact willing to do.[324]

These cases show that while the beneficiary in certain circumstances can be said to be 'absolutely entitled' to the trust property, this does not in fact mean that they are the 'true owner' of the property until they exercise their power to have legal title transferred to them. Until that takes place, they must act in accordance with the trust deed, and cannot interfere in the trustee's exercises of his powers in due administration of the trust.

4. Basis of Creditor Access

As far as creditors' rights are concerned, the issues canvassed in *Burgess v Wheate* and the nature of the *Saunders v Vautier* power are of great significance. Creditor access to trust assets through the beneficiary is dependent on the nature of the beneficiary's own access to those assets. As will be seen in the following chapter, the beneficiary's creditor becomes (expressly or impliedly) an assignee of the beneficiary's rights, duties and powers, and by notification to the trustee makes his new position as beneficiary enforceable against the trustee.

The origin of creditor access is the analysis of the beneficial interest in *Burgess.* The basic mechanism of assigning the beneficiary's right to due administration to a stranger while preserving the central trust relation is what *Burgess v Wheate* (perhaps inadvertently) establishes, in that Lord Keeper Henley analyses the core feature of the relationship between the trustee and beneficiary as being proprietary 'as between them and all claiming under them', meaning the relationship survives even where the identities of the parties in the positions of trustee and beneficiary change. It will be seen in the following chapter that this basic feature of trusts, the transmissibility of the trustee's and beneficiary's respective interests, lies at the heart of what is

[324] *Ibid*, 889.

meant by the simple phrase that the 'beneficiary's interest is subject to the claims of his creditors' – the beneficiary only assigns his position as beneficiary and any concurrent right to distributions of the trust corpus, not any direct right in the trust assets.

The availability of *Saunders v Vautier* powers is sometimes seen as challenging this basic structure. In cases where *Saunders* applies, any assignee of the beneficiary's vested interest will also be equipped with powers and can therefore demand transfer of the entire legal interest. However, it is evident from the developmental roots of *Saunders v Vautier* above, that the case did not involve a rewriting of the basic features of *Burgess v Wheate*, and that *Saunders* is therefore not the recast-foundation upon which creditor access is built. The basic features of the beneficiary's credit relations are still based on the transmissibility of the beneficiary's position while preserving the central trust relation—the power to collapse that relation is a limited superstructure, and only applicable under certain much-litigated conditions.

5. Agency Liability

The dual nature of the beneficiary's interest that had taken root in *Burgess* has never been fully reconciled in trust law. One backchannel way of asserting the beneficiary's liability as the 'true owner' has been to argue that the trustee is merely an agent for the beneficiary, and the case law is closely intertwined with that regarding *Saunders v Vautier* powers. While in the general case (i.e., that *every* trustee is an agent for their beneficiary) this has been denied, the argument has at times been successful. In essence, therefore, the personal liability of the trustee can be transferred over to the beneficiary where the trustee is acting directly as the beneficiary's agent.

The principle can be traced to *Smith v Anderson.*[325] The case was an appeal from Jessel MR's first instance application of s. 4 of the Companies Act 1862, which outlawed all companies, associations and partnerships of more than twenty persons carrying on a business for the purpose of acquiring a gain that had not been registered under the act. The case involved a trust investment scheme, whereby subscribers would pay £90 to receive a certificate of a nominal value of £100. The trustees were to use the money to purchase shares in telegraph companies, apply the income from the shares to pay 6 percent interest on the nominal value of the certificates and use all surplus to redeem the certificates. The certificate holder-beneficiaries had the power to appoint auditors, inspect reports from the trustees, and appoint new trustees in place of trustees who died, retired or were incapacitated. There were more than twenty certificate holders. Jessel MR held that this was an association under s. 4 of the Companies Act, and ordered it to be dissolved.

The Court of Appeal disagreed. Of importance for our purposes is the argument made by counsel that the business is really carried out by the certificate holders, because the trustees "invest as servants of the association".[326] In the judgment of James LJ this argument is discussed as follows:

> The Master of the Rolls appears, from his judgment, to have considered that these trustees were, *in substance and in law*, directors. (…) [T]hat appears to me a fallacy. To my mind the distinction between a director and a trustee is an essential distinction founded on the *very nature of things*. A trustee is a man who is the *owner of the property and deals with it as principal, as owner, and as master*, subject only to an equitable obligation to account to some person to whom he stands in the relation of trustee. (…) The office of a director is that of a paid servant of the company. A director never enters into a contract for himself, but enters into contracts for his principal, that is, for the company (…). (Emphases added.)[327]

[325] *Smith v Anderson* (1880) 15 Ch D 247.

[326] *Ibid*, 271.

[327] *Ibid,* 275-76.

Brett LJ echoed these statements:

> The persons called trustees in the deed are clearly trustees as distinguished from agents and from directors. (…) [The beneficiaries] could not have been made liable for any contract made by the trustees. It was of course urged that they would be liable as undisclosed principals. But that assumes that the person who made the contracts upon which they are to be liable are their *agents* authorised to bind them by their contracts, which is obviously not true. (Emphasis added).[328]

While these judgments are clear that in the general case a trustee is not an agent for their beneficiaries (and therefore a trust is not a company within the meaning of the act), the statements left open the possibility of the beneficiary being bound by the trustee's actions where a separate agency relationship is found. This is supported by dicta in the analogous Court of Appeal case of *Crowther v Thorley*,[329] discussing *Smith v Anderson*: 'Now, what is the principle which is to determine whether such trustees are trustees only, or trustees and agents as well for their [beneficiaries]. An agent for a principal is a person who, having no interest of his own, is bound to observe and obey the orders of his principal.'[330]

The possibility that a trustee might also be an agent was expressly approved in the ratio of *In Re Thomas*,[331] where Cave J stated of a society whose purpose was to lend money to its members that the committee of seven trustees 'are to carry on as agents the business which the individual members cannot carry on. The committee are not to carry on business as trustees, like those in *Crowther v Thorley*, but as the agents and officers of the society. (…) In this case the committee do not carry on the business in their own names, and are not themselves responsible in any way (…)'.[332]

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[328] *Ibid,* 280.

[329] *Crowther v Thorley* (1884) 50 LTR 43.

[330] *Ibid*, 46.

[331] *In Re Thomas, Ex parte Poppleton* (1884) 14 QBD 379.

[332] *Ibid*, 383.

However, the view that a trustee in the general case is not a director or agent was again followed by the Court of Appeal (with some reluctance) in the case of *In Re Siddall*,[333] still another petition to have a trust recognised as a business carried on for the object of acquisition of a gain by more than 20 persons. Baggallay LJ stated that 'I must confess that, if I had had to decide *Smith v Anderson*, I possibly should not have entirely agreed with all that was decided in it. My views would to some extent have gone with those of the late Sir George Jessel (…). However, *Smith v Anderson* stands, and also *Crowther v Thorley*.'[334]

With these cases stands the view that the trustee is the full legal owner with conceptually linked powers to deal with third parties, and not just a front for the beneficiary who is the true owner, in line with the seminal *Burgess v Wheate*. This view may not have commanded unqualified support in the Victorian judiciary, as it still does not,[335] but the position on the authorities was clear. The trustee is not an agent, except where he is specifically made so.

This is not to say the court does not lay liabilities on the beneficiary on the basis of agency, or some residual version of the 'true owner' argument. Such has been the case particularly with regard to tax liabilities.

In the well-known case of *Baker v Archer-Shee*,[336] these issues resurfaced in the context of foreign investment income tax. The case is widely cited in American trust jurisprudence as establishing the beneficiary's property right over the trust assets in the general case,[337] which

[333] *In Re Siddall* (1885) 29 Ch D 1.

[334] *ibid*, 6

[335] See *Shell v Total* [2010] EWCA Civ 180, [2011] QB 86, para 132 calling the beneficiaries the '"real" owners' of the property.

[336] *Baker v Archer-Shee* [1927] AC 844.

[337] The definitive treatise on trust law in America, (Current edition: ML Ascher (ed) *Scott and Ascher on Trusts* (4th ed Aspen Publishers 2007), 808 at § 13.1) states: 'The beneficiary of a trust has a property interest in the subject matter of the trust, a form of ownership,' and some pages

proposition then affects the law of beneficiary's creditors and therefore deserves analysis. We will find that in light of the theoretical exposition above, the case does not establish anything of the sort. Instead, the case relied on the agency exception, which was well established at the time.

Baker involved a trust estate in the United States, and a beneficiary in the United Kingdom. The trustees were a company in New York, and the beneficiary was the daughter of the American testator who had left his estate to the trustees to hold for the daughter. The trustees were to gather income from various investments, deduct their expenses, and pay the money over to the daughter's New York account.

The daughter's husband was assessed for tax in the United Kingdom, where he was resident, to the full amount of his wife's overseas income. The Court of Appeal overturned the High Court decision (Rowlatt J) and held that the husband was not to be assessed for the wife's New York income. The House of Lords overturned this finding by a 3-2 majority.

The first judgment was given by Viscount Sumner, the leader of the dissent. He is the only judge who chose to include a reasoned argument as to the basic features of trusts and the nature of the beneficiary's interest. The relevant section reads:

> My Lords, the position (…) is so clear, both in law and equity, that apart from any special prescriptions (…) there can, I think, be no doubt about them. The trustee has the full legal property in the whole of the trust fund and the beneficiary has not. Apart from special provisions in particular settlements, which do not affect the general principle, the trustee is not the agent of the beneficiary, who can neither appoint nor dismiss him. (…) It is the trustee alone who can give a discharge for interest, rent or dividends to the parties who have to pay them in respect of the invested trust estate, nor need they know the beneficiary in the matter. All that the latter can do is to claim the assistance of a Court of equity to enforce the trust and to compel the trustee to discharge it. This right is quite as good and often better than any legal right, but it is not in any case one, which for all purposes makes the trust fund "belong" to the beneficiary (…). I do not understand that, so far, there was any contest.[338]

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later cites *Baker* in support of 'the proposition that a trust beneficiary has a proprietary interest in the trust assets' (at 811, § 13.1).

[338] *Baker v Archer-Shee* [1927] AC 844, 850.

Viscount Sumner then proceeded to an analysis of the facts, concluding that this case did not fall within the special settlements where the trustee acts as agent. The other minority judge, Lord Blanesburgh, cited with approval the first instance judge stating '"what [the beneficiary] has is a right to call upon the trustees, and, if necessary, to compel the trustees, to administer this property during her life (…) according to the provisions of the trust. (…) it is not an interest in the specific stocks and shares constituting the trust fund at all. There is no doubt about the correctness of that proposition".'[339]

It does not appear from the judgments of the other Lords that anyone disagreed with this basic analysis, though the conclusions differed. The leading majority judgment by Lord Atkinson cites several special circumstances, essentially enumerating various powers that the daughter has over the trustees. Among these are the fact that when the original trustee retired, the daughter (then named Miss Pell, now Lady Archer-Shee) who 'it is contended, has now no property in or rights to this fund beyond the right in equity, by suit presumably, to compel the trust company to pay her the portion of income (…) dominating the situation and (…) appointing [the trustee company she wished].'[340] Additionally, the daughter's consent was necessary for any investment or reinvestment in securities.[341] Lord Atkinson concluded that 'it is not an unreasonable *inference from these matters* that the life interest given to her by her father's will had become vested in her, and that the trust company which she had appointed were merely her agents to administer the fund for her and in her interest'.[342]

[339] *Ibid*, 877-78.

[340] *Ibid*, 858.

[341] *Ibid*, 859.

[342] *Ibid*.

It does not appear from this judgment that Lord Atkinson *disagreed* about a beneficiary in the general case having no right except to compel due administration of the trust – in fact, it appears to be one of the premises of his judgment. His Lordship merely concludes that in *this* case the trust property has become vested in the daughter with the trustees as agents, because she had such strong control powers.

Lord Wrenbury did not think it necessary to analyse the general position, merely holding that 'under Mr. Pell's will Lady Archer-Shee (…) is, in my opinion, as a matter of construction of the will, entitled in equity specifically during her life to the dividends upon the stocks'.[343] Lord Carson in turn relied on the specific context of income tax, stating that when the residue of the testator's estate became 'specifically ascertained, the respondent's wife was the sole beneficial owner of the interest', and, following the Master of the Rolls in the Court of Appeal case, that when money is held by trustees 'for the purpose of paying income to beneficiaries, for the purposes of the Income Tax Acts you may eliminate the trustees'.[344]

Thus the majority was formed, and some references were made to the agency exception. However, not a single judge explicitly held that in the general case a beneficiary has a property right in the assets or that a trustee is the beneficiary's agent.

The issue of the beneficiary's interest was raised more directly in the further tax cases of *Gartside v IRC*,[345] and *Sainsbury v IRC*.[346] In *Gartside*, the House of Lords was confronted with the question of whether the beneficiary of a discretionary trust had an 'interest in possession' in the trust assets – if so, the beneficiary would be subject to estate duty.

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[343] *ibid*, 866.

[344] *Ibid*, 870.

[345] *Gartside v IRC* [1968] AC 553.

[346] *Sainsbury v IRC* [1970] Ch 712.

The Court of Appeal led by Lord Denning MR had decided that the beneficiary did have such an interest, but not on the basis that the beneficiary has a direct property right in the trust assets. Lord Denning described the interest that the beneficiary possesses as analogous to the interest of a participant in a beauty pageant in the prize money,[347] which after *Chaplin v Hicks*[348] counts as an interest whose value is quantifiable by a court and therefore an 'interest in possession'.[349] Salmon LJ likewise described the beneficiary's right as one to have the trustees 'honestly and fairly consider whether any (…) income shall be allotted to him.'[350] The House of Lords went even further, and stated in clear terms that the beneficiary has no interest in the trust assets, only a right to require the trustees to exercise their power.[351]

In *Sainsbury* the question came before Ungoed-Thomas J, with the exception that the trust in question was an exhaustive discretionary trust, where the trustees were required to distribute the whole of the income to specified beneficiaries, but with a discretion as to how to divide it among those beneficiaries. The Crown had argued that when taken as a group, the beneficiaries were absolutely entitled to the trust property, and therefore could be assessed for tax on that basis. Ungoed-Thomas J followed *Gartside*, and held that there was no interest in possession, nor any group interest.[352]

This last finding is not explained in any way, but seems to be a related argument to the *Re Smith* position that a group of beneficiaries can use their *Saunders v Vautier* powers and collapse

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347 *Gartside v IRC* [1968] AC 553*,* 566-67.

348 *Chaplin v Hicks* [1911] 2 KB 786.

349 *Gartside v IRC* [1968] AC 553, 566.

350 *Ibid,* 575.

351 *Ibid*, 608 per Lord Reid.

352 *Sainsbury v IRC* [1970] Ch 712, 725.

the trust as a group – the idea being that while no individual beneficiary has an ascertainable right in a discretionary trust, the group of beneficiaries as a whole will necessarily receive the entire trust fund. The point was not subject to detailed discussion, but the finding is consistent with the case law introduced above regarding the nature of the beneficiaries' right *before* the *Saunders* power is exercised; the trust remains in force, and the beneficiary is not the true owner, until he actually goes to court and invokes *Saunders*.

Finally, in the recent case of *Shell v Total*,[353] these old questions of the nature of the beneficiary's position in relation to the trustee and the trust property resurfaced. The case involved the Buncefield oil storage terminal explosion. Total UK Ltd had negligently overfilled a fuel storage tank and caused the explosion. Legal title to the damaged property was held by two trustee companies, which the beneficiary-claimant Shell UK Ltd controlled together with the other claimants. The trustee was therefore nothing more than a holding vehicle for Shell, for which relation Shell had chosen to use the trust structure. Shell claimed for damages for its loss of profits caused by the explosion.

The Court of Appeal held the defendant liable for Shell's loss and awarded damages, despite the fact that Shell was not the legal owner. As noted above, Waller LJ (on behalf of a unanimous bench) openly described Shell as the 'real owner' (together with the other beneficiaries), and stated that it would be 'legalistic to deny Shell a right to recovery'.[354]

Much has been said about this case on the pages of law reviews,[355] and most comments are negative. I only wish to add this: *Burgess v Wheate* relied heavily on the fact that a trust is not a

[353] *Shell v Total* [2010] EWCA Civ 180, [2011] QB 86.

[354] *Ibid,* 99 at para 132F.

[355] See e.g. PG Turner 'Consequential Economic Loss and the Trust Beneficiary' [2010] CLJ 445; KFK Low 'Equitable Title and Economic Loss' (2010) 126 LQR 507; E Hargreaves 'The Nature

non-existent legal form that has no real effects – the argument that it is void of content was made and pressed by the Attorney General on behalf of the King, and had it been successful it would have spelled the end of the trust device just as it had with uses with *Re Lord Dacre of the South* in 1535 and the subsequent Statute of Uses of 1536. In a sense the *Shell v Total* argument that the trustee is merely a front, and that it would be legalistic to give effect to the declaration of trust when the beneficiary is clearly the true owner, was at the heart of *Burgess* and it is what established trust law as we know it today. While *Shell* could be an instance of the agency exception (the beneficiaries had full control over the trustee-vehicle through their shareholdings), the point was not raised and as it stands the decision is clearly against some of the most basic features of trusts, as settled by centuries of authority.

6. Conclusion

This chapter has sought to clarify some of the conceptual structure of the trust central to the nature of the beneficiary's liability to external creditors. In essence, the view presented here is that treating *Brandon v Robinson* as the origin of the beneficiary's ability to alienate his interest to creditors and of the settlor's inability to restrain this right of alienation is a misinterpretation of the case, probably of American origin.[356] The case does not appear to have been cited much in England, and the reading given to the case by the key American authorities does not find an unequivocal basis in the judgment itself.

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of Beneficiaries' Rights under Trusts' (2011) 25 TLI 163; J Edelman 'Two Fundamental Questions for the Law of Trusts' (2013) 129 LQR 66.

[356] More on this last point in the chapter on the American position on beneficiary liability to creditors.

In truth, the availability of the beneficiary's interest to his creditors has statutory roots, developed in lockstep with the development of the trust itself. The interest of a *cestui que use* was gradually made available in The Fraudulent Conveyances Act 1376 c. 6, The Maintenance, etc. Act 1377 c. 9, Fraudulent Deeds Act 1378 c. 3 and The Statute Concerning Grants by Cestuy que Use 1484 c. 1, which allowed the *cestui que use* to convey title to the property. Under heavy pressure from King Henry VIII, uses collapsed after the case of *Lord Dacre of the South* (1535) and the subsequent Statute of Uses 1536, which 'executed the use', meaning legal title was vested in the beneficiary of the use.

The trust device then took root, first as an entirely personal obligation that would not even survive the death of the trustee, and judicially pieced together by Lord Nottingham in cases including *Stutville v Rossell* in 1674, where the trust was tied to the land as opposed to the person of the trustee. The beneficial interest under a trust was made available to creditors soon afterwards, by Statute of Frauds 1677, ss. 10-11.

The seminal *Burgess v Wheate* cemented the central features of the trust that give trust law its dual nature of proprietary and personal rights – the Crown's argument appears to have been, in all its boldness, that the trust was nothing more than an ineffectual front and should meet the same fate as uses. The beneficiary would then become the legal owner of the property, giving effect to the view that she is the true owner and the trustee merely a front. The court in *Burgess* did not accept this, and instead upheld and added to Lord Nottingham's contributions, stating that as between the beneficiary and trustee the right behaves as though it were property and both can assign their interests, but this does not entail the view that the beneficiary has the equivalent of legal title. The trust is not a nullity, and the beneficiary is not the true owner.

The 'true owner' argument – i.e., that the beneficiary is the true owner of the trust property and the trustee is merely a legalistic front – has been made and made again, but the judiciary from *Burgess* onwards has accepted (sometimes reluctantly) that it cannot be so, except in special circumstances. In such special circumstances the trustee can also be considered the agent of the beneficiary, whereby the beneficiary *does* become the de facto owner. However, this has never been held to apply in the general case.

Neither does the *Saunders v Vautier* principle, whereby a beneficiary may collapse the trust early if he is the certain recipient of the trust property, diminish the basic nature of the beneficial interest as it relates to the law of beneficiary's creditors. The *Saunders* doctrine has its long roots in Roman Law and has been developed gradually from at least *Boraston's Case* in 1587 to eventually include trusts and a right to accelerated payment, once a vested interest is found as a matter of construction of the trust document and the delay is found not to be in the beneficiary's best interests. The courts have not treated the *Saunders* power as a property right in itself – before the beneficiary actually goes to court and has legal title transferred to himself, his right is still only to require due administration of the trust.

Many of the central cases on liability to creditors of both the trustee and the beneficiary depend on the trust having a real effect of handing over legal ownership to the trustee,[357] and consequently on the nature of the beneficiary's interest being in essence a right to require the trustee to duly administer the trust. We can now move on to explore the detailed doctrinal operation of the law of beneficiaries' creditors.

[357] Even *In Re Johnson* (1880) 15 Ch D 548, the modern basis of most of the law of trustees' creditors, is premised on the fact that the trustee is not a 'man of straw' (at 552, per Sir George Jessel MR) – see n 113 and accompanying text.

Chapter 5: Beneficiaries' Creditors in English Law II - Doctrine

This chapter deals with the doctrinal operation of how beneficiaries' creditors gain access to the trust assets. In essence, the position of the creditor depends on the rights of the beneficiary – both their extent under the trust, and their assignability under general law. Therefore, while the specific doctrinal operations might differ, the law of beneficiaries' creditors uses the same starting point as the law of trustees' creditors. The creditor will only have what the trustee/beneficiary can give them, and only if they have the power to give it. The nature of the beneficial interest under a particular trust and the ability of the beneficiary to assign that interest are therefore the first considerations in determining the creditor's right, and the doctrine on creditor access can be reverse-engineered to make conclusions about this specific nature in Chapter 8.

As regards the first question, the nature of the beneficial interest eludes a neat doctrinal solution as it is subject to continuous conceptual evolution as the previous chapter has shown. But the historical account provides an adequate basis for discussion of the position of the beneficiary's creditors.

The second question, namely the ability of the beneficiary to assign their interest, has been subject to interesting judicial developments, particularly as regards assignments against the will of the settlor, which impact the rights of a purported creditor. These will be discussed below.

Third, as with the law on trustee's creditors, the law on the beneficiary side has had to grapple with competing interests in the same assets. These range from assignments of the same beneficial interest to multiple creditors, to multiple beneficiaries having claims in the trust assets. Some of the doctrinal requirements for the availability of an asset to a given creditor appear to be a response to these sorts of competing interests, a prime example being the requirement of notice to the trustee serving the function of determining that the assignee first to notify the trustee has made his interest enforceable against that trustee, to the exclusion of a later notifier. In these areas trust law has quietly retreated to its basic conceptions, discussed in the previous chapter.

1. Power to Transfer

As mentioned in the chapter above, the ability of a beneficiary to transfer the beneficial interest was developed judicially and by statute in lockstep with the development of the trust devise itself. The question of the assignability of the beneficial interest came before the court in 1628 in *Warmstrey v Dominam Tanfield*,[358] where a testator had settled his interest in land on trust for him and his wife, and bequeathed his beneficial interest in his will to their son, to have after the testator's wife dies. The son in turn assigned it to the plaintiff Warmstrey. The trustee's legal title was meanwhile conveyed to two other trustees and, after the death of the testator's wife, released to Warmstrey. The defendant, Lady Tanfield, was in possession of the premises, and traced her title to a lease that had been granted by the testator's son to a third party two years after the assignment in equity to the plaintiff. The lease had then been assigned to Lady Tanfield (in another trust arrangement, immaterial for the case).

The issue appears to have been that the son's original assignment to the plaintiff was an 'assignment of a future possibility', as the mother was still alive and he was only a residual beneficiary. The court held that such an interest cannot be assigned in law, but can in equity if it is a beneficial interest under a trust. This states the basic position that a beneficial interest under

[358] *Warmstrey v Dominam Tanfield* (1628) 1 Ch Rep 29.

a trust is assignable, although it is by its nature a future possibility of obtaining a legal interest in property as opposed to an interest in that property in itself (as seen in the discussion of *Saunders v Vautier* in the previous chapter).

An interesting facet of the ability of a beneficiary to assign his interest is when the beneficiary attempts to split his powers and assign only part of them. This happened in *Hill v Boyle*,[359] where the plaintiff Hill had once been a beneficiary but had assigned his beneficial interest under a mortgage agreement. However, Hill argued that the trustees had mismanaged the trust between him becoming a beneficiary and his assignment of the beneficial interest to the mortgagees, and therefore that the trustees owed an amount of money ascertainable by taking account. The mortgagees refused to claim for these arrears or to ask for an account, but agreed to sell for five shillings the right to sue and recover from the trustees to Hill. Hill then sued for the account and any subsequently discovered arrears.

Sir John Stuart VC noted that Hill did 'not sue as assignee of the trust estate (…). He is assignee of nothing but a right to sue the trustee for the chance of recovering from him (…).'[360] He then held that 'such an interest is not assignable, nor a suit in respect of it maintainable in this Court. The [beneficiaries] (…) have, in consideration of five shillings, assigned the moneys recoverable in respect thereof to the plaintiff.'[361] The benefit of any suit to enforce the terms of the trust had been assigned, but the beneficiary cannot assign his powers of enforcement without assigning the beneficial interest itself.

This short but interesting judgment yields insights about the nature of the beneficiary's powers. The case could simply mean that an attempt to assign merely the right to sue and

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[359] *Hill v Boyle* (1867) LR 4 Eq 260.

[360] *Ibid*, 263.

[361] *Ibid*, 264.

recover is void generally – this was what the case was taken to mean in *County Hotel & Wine Co Ltd v London & North Western Railway Co*.[362] But as that case itself notes, this would mean that a debtor could practically destroy the assignability of a debt by not paying it.[363] The creditor's rights are thereby reduced to the secondary right to sue for enforcement of the primary right of repayment. If that right cannot be assigned in the general case, then a debt should not be assignable. This is therefore unlikely to be the correct interpretation of *Hill v Boyle*, particularly in light of *Park Gate Waggon Works Co*,[364] below.

A telling detail is the Vice Chancellor's holding that the beneficiaries *had* managed to effect an assignment of the proceeds of any suit, though not the right to sue itself which remained attached to the beneficial interest. Consistently with *Warmstrey*, this means that a beneficiary can assign any part of their 'future possibility' of receiving trust assets, but attempting to assign the mere right to sue without assigning the entire beneficial interest is ineffective. It is submitted that this is because the beneficial interest is in essence the right to the due administration of the trust,[365] and the right to sue and recover from the trustee cannot exist separately without the person holding that right becoming a beneficiary.

The decision is broadly in line with the nature of the beneficary's interest as noted in the previous chapter. In *Morice v Bishop of Durham* Sir William Grant MR held that a trust cannot be 'too indefinite to be executed by this Court',[366] which means that 'there must be somebody in

[362] *County Hotel & Wine Co Ltd v London & North Western Railway Co* [1918] 2 KB 251, 258.

[363] *Ibid.*

[364] *In Re Park Gate Waggon Works Co* (1881) 17 Ch D 234.

[365] In line with *Morice v Bishop of Durham* (1805) 10 Ves. 522, see below.

[366] *Ibid,* 404.

whose favour the court can decree performance'.[367] Lord Eldon (in the subsequent appeal) stated:

> As it is a maxim, that the execution of a trust shall be under the controul (*sic*) of the Court, it must be of such a nature that it can be under that controul; so that the administration of it can be reviewed by the Court; or, if the trustee dies, the Court itself can execute the trust [and if the beneficiaries cannot be ascertained] it must be decided, that the Court can neither reform mal-administration, nor direct a due administration.[368]

It is submitted therefore that the reason the mere right to sue and recover cannot be transferred without transferring the entire beneficial interest is that the beneficial interest includes both the power to enforce the trustees' duties in court and the performance of those duties in one's favour. To hold otherwise would make the trust too indefinite for the court to execute and control – in other words, separating enforcement and enjoyment has the potential to change the nature of the trustees' duties and make them too vague for the court to enforce. A trustee might make a different decision if acting in the best interest of Alfred as opposed to Belinda, and so if Belinda sues to make the trustee act in the best interest of Alfred but whatever Alfred gets from that enforcement goes to Belinda, how does the trustee know whether he is supposed to make the right decision for Alfred or for Belinda? How could the court look at the trustees' actions and decide whether they were correct? Either Alfred is the beneficiary, or Belinda is. The power to enforce must be aligned with the claim to enjoy: this is the essence of the beneficiary principle which lies at the foundation of the English trust.[369]

Conversely, where the beneficial interest is transferred, the right to require due administration of the trust is also transferred even as regards breaches prior to the transfer. In

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367 *Ibid,* 405.

368 *Morice v Bishop of Durham* (1805) 10 Ves. 522, 539-540.

369 See further P Matthews 'From Obligation to Property and Back Again' in DJ Hayton (ed) *Extending the Boundaries of Trust and Similar Ring-Fenced Funds* (Kluwer Law International, the Hague 2002) 203, 225-8 (arguing that separating enforcement and enjoyment would mark a 'radical change in the legal institution [of the trust], at 225).

Park Gate Waggon Works Co,[370] directors of the Park Gate Waggon Works Company had committed breaches of their fiduciary duties by failing to disclose their prior interest in land they sold to an intermediary company, which then sold it at an inflated price to the Park Gate company ('first transaction'), and subsequently sold the land onwards after substantial development at an undervalue to what appears to be another company they controlled ('second transaction').[371] The claimants had purchased the company and all its assets and liabilities from its liquidators, and claimed for the difference in price of the true price and the inflated price (some £4,000) in the first transaction, and the difference between the undervalued price and the market price in the second transaction (a further £13,000).

The defendants, attempting to rely on *Hill v Boyle*,[372] argued that the claimants' claim was not for a debt owed by the directors for breach of fiduciary duty to the company but merely the right to sue and recover damages, and as such it could not be assigned by the liquidators to the claimants. Sir George Jessel MR held that the Companies Act empowered the liquidators to sell any and all assets of the company, which they had done in this case. Along with all property and outstanding contracts of the company, the claimants had successfully been assigned the right to sue for breach of fiduciary duty.[373] In essence the claimants had been transferred the company as a going concern, and were therefore entitled to the due administration of the directors' fiduciary duties, past and present.

This fits nicely with the basic features of trusts discussed in the previous chapter. As noted, the beneficiary's right 'should be considered in this court as the real estate, between the

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[370] *In Re Park Gate Waggon Works Co* (1881) 17 Ch D 234.

[371] *Ibid*, 237.

[372] *Ibid*, 238.

[373] *Ibid,* 239-40.

cestuy que trust and the trustee, and all claiming by and under them'.[374] The right of the beneficiary is to the benefit of the fiduciary's performance of his duties, and where a new beneficiary has been assigned the right to that performance, they get the whole benefit regardless of whether the breach occurred before they were beneficiaries.

These are the basic features of the beneficiary's power to transfer his beneficial interest, which in turn forms the basis of creditor access. What is really being transferred is the benefit of the trustee's performance together with the right to enforce that performance. Such transfer – an equitable assignment – has two elements; the beneficiary's intention to effect a transfer (or to rid himself of the benefit of performance), and notice to the trustee that the beneficial interest has been transferred by the new beneficiary (or trustee's knowledge of the new object of the trustee's duty). The specific doctrinal position is introduced below.

2. Intention to Transfer

Assignment of debts, in equity or through the issuing of a negotiable instrument such as a bill of exchange, had already been thoroughly litigated by mid-19th century,[375] and a substantial jurisprudence on equitable assignments was developed. The requirements of an intention to

[374] *Burgess v Wheate* (1759) 1 Eden 177, 251.

[375] See *Henry Haydock v Roger Lynch* (1729) 2 Ld Raym 1563, 92 ER 512; *Ruff v Webb* (1794) 1 Esp 129, 179 ER 301; *Jones and Hirst v Simpson* (1823) 2 B&C 318, 107 ER 402; *Green v Davies* (1825) 3 B&C 235, 107 ER 1046; *Lord Braybrqoke v Meredith* (1842) 13 Sim 271, 60 ER 106; *Lucas v Jones* (1844) 5 QB 949, 114 ER 1506; *Russell v Powell* (1845) 14 M&W 418, 153 ER 538; *Parsons v Middleton* (1847) 6 Hare 261, 67 ER 1164; *L'Estrange v L'Estrange* (1850) 13 Beav 281, 51 ER 108; *Diplock v Hammond* (1854) 5 De G M & G 320, 43 ER 893.

transfer a beneficial interest and notice to the trustee build on this analogous jurisprudence. Indeed, the benefit of the trustee's duties is sometimes described as an 'equitable debt'.[376]

In *Ex Parte South*,[377] the claimant creditor had been assigned a debt by Jane Row, their debtor. Jane Row was a trader, and a creditor of one John Fish to the amount of £417. To pay off part of her £530 debt to the claimants, she sent a draft to the executors of John Fish's estate, requiring them to pay the claimants. There was delay in the payment, and the claimants arrested Jane Row. The executor of John Fish declined to pay without the Chancellor's order, which the claimants petitioned for and obtained with a *pro tanto* reduction in their proof of debt in Jane Row's bankruptcy. One of the claimants was dissatisfied with the order, and claimed that the payment should have been made out of Jane Row's general estate (and not as the enforcement of an equitable assignment). Lord Eldon LC upheld the Vice Chancellor's order, stating that 'if a creditor gives an order on his debtor to pay a sum in discharge of his debt, and that order is shown to the debtor, it binds him (…).'[378] The notice upon the trustee is therefore the thing that transfers a trustee's (or debtor's) duty from the previous beneficiary to the new one as a trustee's awareness of the object of his duties determines, in part, its content.

The House of Lords, nearly a 100 years later, discussed the case in more general terms that later come to apply in cases of assignments of equitable interest under a trust. In *William Brandt's Sons & Co v Dunlop Rubber Company Ltd,*[379] merchants had operated under a finance agreement whereby a bank would finance individual purchases of stock, hold beneficial interest over the stock under a trust arrangement while the merchant searched for an approved buyer,

[376] *Ex Parte Adamson; In Re Collie* (1878) 8 Ch. D. 807, at 819

[377] *Ex Parte South* (1818) 3 Swan 382, 36 ER 907.

[378] *Ibid*, 393.

[379] *William Brandt's Sons & Co v Dunlop Rubber Company Ltd* [1905] AC 454.

and took payment from the purchaser directly once the stock had been resold. In the trade that led to the dispute, Dunlop, a purchaser, had been given an invoice directing payment to the claimant bank. Unfortunately this invoice had a small mistake in the amount, and a new one was sent without the direction to pay the bank directly. The bank later sent some correspondence which made it clear that payment was to be sent to them directly, but only the invoice without this direction was sent to Dunlop's head office where payments were handled. Consequently Dunlop paid the money to another bank, Kleinwort & Co, which they had paid in previous occasions but which had nothing to do with this transaction. The claimants sued Dunlop for the purchase money.

Lord Macnaghten held that the case was very simply one where an equitable assignment had clearly been made to the claimants.[380] The merchants had clearly intended to assign the right to the purchase money to the claimant bank, and the purchaser had been notified by the bank. As to *Ex Parte South*, his Lordship noted that an equitable assignment by way of notice operates outside any statutory framework and does not require the debtor to enter into a contract to pay the assignee rather than the original creditor.[381] It is for this latter proposition that *Ex Parte South* was cited, but it was used to reach the broader conclusion that an equitable assignment does not depend on a specific form, statutory or otherwise: 'all that is necessary is that the debtor should be given to understand that the debt has been made over by the creditor to some third person.'[382] This principle has lasted another 100 years,[383] and is still the law. So long as the transferor 'sufficiently manifests' an intention to transfer, and the transfer is made enforceable[384] by notice

[380] *Ibid*, 460-61

[381] *ibid,* 461.

[382] *Ibid*, 462.

[383] Applied in *Technocrats International Inc v Fredic Ltd (no 1)* [2004] EWHC.

[384] *Technocrats v Fredic* holds that notice served on the debtor is 'not necessary for there to be a perfected equitable assignment as between the assignee and assignor' at para 57. This may seem

to the debtor, no specific form is required for equitable assignments and such assignment need not conform to any specific statutory requirements unless expressly applicable to the type of transfer (e.g. dispositions of a subsisting equitable interest under s. 53(1)c of the Law of Property Act 1925).

In the context of assignments of equitable interests under a trust, the analogous position (where the trustee is in place of the debtor, the beneficiary in place of the creditor and the assignee remains) appears to have been quietly assumed without need for express citation.[385] This is logically coherent – an assignment of an equitable interest under a trust can never be anything other than an equitable assignment, and should thus follow the same rules. Further, it seems the two strands of equitable assignment share common roots in *Warmstrey v Tanfield*; transfers of both an equitable interest under a trust and a debt are 'assignments of future possibilities' which is what necessitates their assignment in equity in the first place.

Before the law regarding equitable assignments generally and assignments of beneficial interests were expressly brought together, the 19th century cases on assignments of beneficial interest under a trust shared the fact pattern whereby the beneficiary directed the trustee to hold the interest for another.

In *Rycroft v Christy*,[386] the beneficiary of a testamentary trust, Ann Rycroft, issued written direction to the trustee William Christy that he is to pay one Ann Elf (with whom the testator had had another child) 7s a week until the child attains 16 years. The trustee accepted the

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contradictory, but is in line with the legal effects of notice discussed below—the assignment can be perfected as between the assignee and assignor without notice, but is enforceable against the trustee after notice only.

385 *Rycroft v Christy* (1840) 3 Beav 238, 49 ER 93; *Bentley v Mackay* (1851) 15 Beav 12, 51 ER 440; *Paterson v Murphy* (1853) 11 Hare 88, 68 ER 1198; *Harding v Harding* (1886) 17 QBD 442; discussed below.

386 *Rycroft v Christy* (1840) 3 Beav 238, 49 ER 93.

direction and acted on it. Ann Rycroft later separated from her husband, and filed a bill against the trustee and her husband, asking the testator's estate to be administered. The husband disclaimed all interest in the trust assets. The question arose whether the agreement between Ann Rycroft and William Christy was binding on Ann. Lord Langdale MR held that it was. The husband's disclaimer of any rights in the trust was evidence that Ann Rycroft was entitled to deal with her beneficial interest as she saw fit (this was unclear on the face of the will),[387] and she had executed a written instrument directing the trustee to pay Ann Elf. Lord Langdale MR stated that 'from the moment when that direction was signed and accepted by Christy, it became his duty to pay the sum directed to Ann Elf.'[388]

Though the cases on assignment of debts are not cited, the requirements for assignment of equities appear to be essentially the same. The beneficiary must show a clear intention to transfer her interest (or part of it), and the trustee must be notified so they may know what the content of their duty is.

The direction signed by the trustee in *Rycroft* was described as 'an agreement' in how the issue was framed for the court,[389] and appears to have involved an executed deed reciting that the upkeep of the child was the unexpressed will of the testator.[390] The question then arose (as it had in the cases dealing with assignments of debts)[391] whether a voluntary transfer for no consideration or not done by deed would also be effective.

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[387] *Ibid*, 241.

[388] *Ibid*, 242.

[389] *Ibid,* 240.

[390] *Ibid*, 241.

[391] See Lord Eldon LC in *Ex Parte South* (1818) 3 Swan 382, 393: 'this doctrine [of equitable assignment of debts by clear intention and notice] has been brought into doubt, by some decisions in the courts of law, who require that the party receiving the order should in some way

This was the issue in *Bentley v Mackay*.[392] A father had settled on the marriage of his son consols (bonds) on trust, so that the dividends would be paid to himself during the life of his son Thomas Mackay, and after Thomas's death to his wife and children. The father had made voluntary payments to Thomas of £1,000 per year. He later desired to transfer his interest in the dividends of the marriage settlement to Thomas, together with dividends of further consols to make up an income of £1,000 per year in lieu of his voluntary payments. Acting on this intention, the father instructed his trustees to hold his dividends from the marriage settlement and pay them to Thomas Mackay. The trustees received only one half-yearly dividend before the death of the father, but paid this dividend to Thomas Mackay. The residuary legatees of the father sued Thomas for the money, but the court of first instance found that the dividends had no longer formed part of the father's estate.

This case is therefore an earlier form of the well-known case of *Milroy v Lord*,[393] and was argued in the same way; 'a voluntary but incomplete gift cannot be perfected or enforced in a Court of Equity.'[394] Sir John Romilly MR held that there are two distinct classes of cases of voluntary gifts: one where legal title is being transferred (which would later become the *Milroy v Lord* issue), and another where a beneficiary wishes his trustee to become a trustee for another,[395] or transfer his equitable interest. In the former case, 'the court requires everything to be done

enter into a contract (…) That has been the course of their decisions, but is certainly not the doctrine of this Court'.

[392] *Bentley v Mackay* (1851) 15 Beav 12, 51 ER 440.

[393] *Milroy v Lord* (1862) De GF & J 264.

[394] *Bentley v Mackay* (1851) 15 Beav 12, 16.

[395] *Ibid*, 18.

which is requisite to make the legal transfer complete; for if anything remains to be done, this Court will not be made an instrument for perfecting it.'[396] This did not apply here.

In the second case, what is required is clear evidence of a declaration of trust, for which the court will not only look at the words used by the beneficiary wanting to transfer his interest but also whether his actions are in conformity with the alleged declaration of trust.[397] In this case, the Master of the Rolls found clear evidence that the father had intended to divest himself of his beneficial interest, and create a trust in favour of his son.[398] Every act of the father had been consistent with the existence of a trust.[399]

Despite no express judicial acknowledgement of the cross-fertilisation between debts and equitable interests, equitable assignments of debts were seen as logically indistinct from equitable assignment of a beneficial interest. This is evident from *Paterson v Murphy*.[400] In that case Paterson had borrowed money from the testatrix under a mortgage agreement, and the testatrix had Paterson draw up repayment conditions that Paterson was to pay £70 in £10 instalments to the testatrix, and thereafter invest £200 in £10 instalments in consols. These bonds were then to be held for the testatrix's children. The testatrix later had Paterson draw up another memorandum, asking instead for payment of the £200 for herself. Paterson complied with the latter memorandum. The testatrix's children claimed compensation for the value of the bonds and their dividends on the basis that the first memorandum amounted to a declaration of trust in

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[396] *Ibid*, 18.

[397] *Ibid*, 19. This is consistent with the modern version of this principle found in *Paul v Constance* [1977] 1 WLR 527, where the settlor had not only stated the well-known phrase that 'the money is as much yours as it is mine', but the settlor and beneficiary had also clearly acted as though the money belonged to both of them.

[398] *Ibid*, 21.

[399] *Ibid*.

[400] *Paterson v Murphy* (1853) 11 Hare 88, 68 ER 1198.

favour of the children of which Paterson had notice as trustee (as he had drawn up the first memorandum), and that the testatrix had not reserved a power to revoke the trust.

Sir William Page Wood VC upheld the trust. He reasoned that there had been a debt due from Paterson to the testatrix, which the testatrix had in part validly assigned in equity to the children with notice of the assignment to Paterson. It was therefore a case where the equitable assignment of a debt actually created a trust in its own right. It is notable that the bonds were never actually purchased, as the second memorandum was written before the initial £70 had been paid. The only property that was the subject matter of the trust was therefore the outstanding debt of £200, which the testatrix had directed to be used to buy the bonds.

The beneficiary's power to transfer his equitable interest without specific form was finally confirmed in *Harding v Harding*,[401] putting to rest the idea that such transfers must be made under a contract or deed. In that case the trustees of James Harding's will sent a notice to one of the residuary legatees, George Harding, detailing what he was entitled to. He sent the account to his daughter Laura Harding, having written instructions at the foot of it that Laura was to be entitled to it. Laura Harding then sued for the money. The trustees resisted, claiming that a voluntary transfer without consideration could not be a valid equitable assignment.[402] Wills J (with whom Grantham J agreed) stated:

> The rule in equity comes to this; that so long as a transaction rests in expression of intention only, and something remains to be done by the donor to give complete effect to his intention, it remains uncompleted, and a Court of Equity will not enforce what the donor is under no obligation to fulfil. But when the transaction is completed, and the donor has created a trust in favour of the object of his bounty, equity will interfere to enforce it.[403]

[401] *Harding v Harding* (1886) 17 QBD 442.

[402] *Ibid*, 443.

[403] *Ibid*, 444. This of course is later made into the rule in *Re Rose* [1952] Ch 499.

It is clear from this passage that an intention to divest oneself of an equitable interest is not effective because no obligation is created in the donor by mere expressions of intention. What is needed is 1) an assignment of property; 2) authorising the assignee to sue and recover the property from the trustee; 3) the assignee must give notice to the trustee and 4) the trustee must accept the notice and act on it.[404] There need not be a contract or deed, but notice on the trustees that their obligation is now owed to someone else is enough.

The case of *German v Yates* later clarified that consideration is needed for an equitable assignment of rights to property which are not yet in existence to make such assignment invulnerable to revocation – an equitable assignment of future property that is not supported by consideration can be revoked during the lifetime of the assignor, but if not revoked is binding.[405]

The case of *In Re Chrimes*[406] illustrates the remarkable effects that this power to effect voluntary transfers of the equitable interest can have on the beneficiary's powers. In that case the beneficiary was entitled to a reversionary interest in her father's will, subject to a restraint on anticipation in the event of her marriage. She herself executed (by deed poll) a direction to the trustees that in the event of her marriage she was entitled to charge her equitable interest as she saw fit, while leaving the restraint otherwise intact. During her marriage she had mortgaged her equitable interest. The beneficiary sought directions from the court as to the validity of the mortgages, and her power to make further mortgages.

Sargant J held that the mortgages were valid and therefore that the beneficiary had herself managed to modify the restraints that the settlor had imposed on her powers. The reasoning is that the beneficiary could have destroyed the restraint by complete assignment of

[404] *Ibid*, 446, per Grantham J.

[405] *German v Yates* (1915) 31 TLR 52.

[406] *In Re Chrimes* [1917] 1 Ch 30.

her interest to a third party; if the deed poll had concerned a transfer to a third party, it would have clearly operated as an assignment of the equitable interest as it was intended to effect a transfer and was communicated to the trustees; and there is no reason why such a transfer of a modified trust should not be effective from the beneficiary to herself.[407] The beneficiary thereby shook off her alienation restraints, and the mortgages were valid.

The case of *In Re Wale*[408] summarised the relevant lines of case law and made express what had until then been quietly assumed – that the equitable assignment of a debt and that of an equitable interest are one and the same, at least in how they operate. In that case the settlor had forgotten the trust settlement she had created in favour of her daughter, and failed to transfer her interest in the trust property to the trustees (her sons). The settlor had two classes of investment assets: 'A', which she owned outright, and 'B', which she was entitled to under her late husband's will, of which she and the two sons were (forgetful) trustees. In her will she left her estate in equal shares to her children. After her death, the family solicitor produced the original settlement, which the sons had forgotten and the daughter had never before seen. The sons asked the court for direction.

The sons relied on the *Milroy v Lord*[409] and *Richards v Delbridge*[410] line to argue that the court could not construe an imperfect gift as a trust. The settlement was, in their view, to be construed as taking effect as a declaration of trust with the pre-requisite that a transfer of the legal title to the trustees must be perfected before the trust takes effect (this element was absent in *Milroy*, leading to the trust being ineffectual). After initially conceding the attractiveness of this

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407 *Ibid*, 36-37.

408 *In Re Wale* [1956] 1 WLR 1346.

409 *Milroy v Lord* (1862) De GF & J 264.

410 *Richards v Delbridge* (1874) LR 1 Eq 11.

argument,[411] Upjohn J held that the settlor had in fact validly assigned her equitable interest in the 'B' investments to the daughter. This was in large part due to the fact that the sons already held the legal title to these assets as trustees. Upjohn J stated that the assignment need not take any specific form,[412] and a voluntary direction by the beneficiary to the trustees to hold an interest on trust for another person is a valid equitable assignment of an equitable interest.[413] As to the 'A' shares, in which the trustees never held legal title and such title was never transferred to them, the court was bound by *Milroy*.[414]

3. Formalities

The fact that no specific form is required to effect an equitable assignment has its limits – at the very least it must be clear that a transfer is intended and that the trustee is notified. If the beneficiary contracts to transfer his equitable interest instead, this contract must follow the usual requirements of valid contracts, including consideration. This was decided in the case of *In Re McArdle*.[415]

In the case the claimant made improvements to a bungalow that was part of the trust property. After the works were completed, the claimant's husband (one of the beneficiaries)

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[411] *In Re Wale* [1956] 1 WLR 1346, 1351.

[412] *Ibid,* Upjohn J at 1350 relying on the case law on equitable assignment of debts such as *William Brandt's Sons & Co v Dunlop Rubber Company Ltd* [1905] AC 454.

[413] Here Upjohn J cites a passage of *In Re Chrimes* [1917] 1 Ch 30, 36; in this passage Sargant J in turn cites *Paterson v Murphy* (1853) 11 Hare 88, *Bentley v Mackay* (1851) 15 Beav 12, and *Rycroft v Christy* (1840) 3 Beav 238, introduced above.

[414] *Ibid*, 1956. The case as regards the 'B' shares is therefore similar to the more recent *T Choithram International SA v Pagarani* [2001] 2 All ER 492, where the deathbed statements of a wealthy businessman that he wanted to transfer all his wealth to his charitable foundation, of which he was one trustee, managed to effect the transfer.

[415] *In Re McArdle* [1951] Ch 669.

caused the other beneficiaries to sign a document purporting to repay the expenses of the improvements 'in consideration for your carrying out certain alterations and improvements'. They later refused to pay.

The High Court initially held that the contract was a valid equitable assignment which does not require consideration, and the claimant had been transferred a share of the equitable interest equal to the costs of the improvements.

The Court of Appeal (Evershed MR, Jenkins LJ and Hodson LJ) disagreed. The document was clearly drafted as a contract,[416] and was thus subject to all the requirements of contract including consideration. The works having been done before the contract was entered into, there was no consideration. If an equitable assignment is intended to take effect without consideration, it must take effect as a gift and the donor must have done 'everything in his power to do to make it complete and perfect'.[417] Jenkins LJ accepted that no consideration is needed for an equitable assignment, but 'a voluntary equitable assignment, to be valid, must be in all respects complete and perfect so that the assignee is entitled to demand payment from the trustee or holder of the fund and the trustee is bound to make payment to the assignee, with no further act on the part of the assignor remaining to be done to perfect the assignee's title'.[418] In other words, if the form of assignment is by contract, the contract must be valid and enforceable to give the purported assignee the right to demand due administration from the trustee.[419]

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[416] *Ibid*, 674.

[417] *Ibid*, 676. It is notable that *Re Rose* [1952] Ch 499 would be decided only a year later, and both cases included Evershed MR and Jenkins LJ giving lead judgments in very similar terms as here.

[418] *Ibid*, 677.

[419] This mirrors *Holroyd v Marshall* (1862) 10 HLC 191, holding that a specifically enforceable contract can give rise to a trust.

Additionally, if specific statutory formalities are required to effect a transfer, the beneficiary must comply those requirements. This area of law is therefore governed by the requirements of s.53(1) of the Law of Property Act 1925 and accompanying case law.

In *Tierney v Wood*,[420] a case regarding s.7 of the Statute of Frauds 1677 (the precursor to s. 53(1)(b)), Alexander Wood had purchased a house and transferred legal title to a trustee to hold for him. He later instructed the trustee in writing to hold the house for his wife after his death, and after her death to their daughter. The trustee, after Alexander Wood's death, asked the court for direction as to the effect of this letter. Wood's son claimed that s. 7 of the Statute of Frauds required the legal title holder to create the trust in land, and that the beneficiary could not do so.

Sir John Romilly MR stated that authority was against the son's proposition,[421] and reasoned that if the trustee had attempted to create a trust in favour of anyone, it would be subject to Alexander Wood's rights and only effective to the extent of Alexander Wood's instructions.[422] It therefore followed that the beneficiary was the only person truly able to create this trust by transferring his own interest. This shows that it is the beneficiary, and not the trustee, who is subjected to statutory formalities when transferring his interest. This of course is confirmed by the well-known case of *Gray v IRC* ,[423] though apparently not where the beneficiary has the capacity to influence both the legal title and equitable interest as discussed in *Vandervell*.[424]

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[420] *Tierney v Wood* (1854) 19 Beav 330, 52 ER 377.

[421] *ibid*, 335

[422] *ibid*, 336.

[423] *Gray v IRC* [1960] AC 1.

[424] *Vandervell v IRC* [1966] 2 AC 291. The extent to which this case is truly factually distinguishable from *Gray* is debatable. See also G Battersby 'Formalities for the Disposition of Equitable Interests Under a Trust' [1979] Conv 17.

4. Notice to Trustee

Assuming the beneficiary has clearly intended a transfer and the requisite formalities are followed, what remains is that the beneficiary notify the trustee of the transfer. We have already seen some of the basic case law above, such as *Paterson v Murphy* where the requisite notice was found because the trustee had been the one who wrote on behalf of the beneficiary the instruction to transfer the interest. In such cases the creditor of a beneficiary has an enforceable right against the trustee as the beneficiary's assignee.

More problematic are situations where the trustee has not been notified by one or more of successive assignees, or there are competing notices. These fact patterns have been present from early foundational cases onwards.

In *Dearle v Hall*,[425] the beneficiary, Zachariah Brown, had sold (under a valid contract) part of his right to investment income from the trust to William Dearle, the first claimant. Brown then made another contract to sell another part of his interest to Caleb Sherring, the second claimant. Regular payments were made under these arrangements for three and two years respectively, until there was a default.

Brown then contracted again to sell his entire interest to Joseph Hall, the Defendant. Joseph Hall purchased the entire interest without knowledge of the previous two assignments. Hall served notice to the trustees and received one payment of interest. Soon afterwards the first two purchasers gave notice as well, and the trustees declined all payments until the rights of the assignees would be ascertained. Both the Master of the Rolls (Sir Thomas Plumer) at first instance and Lord Chancellor Lyndhurst on appeal upheld the defendant's interest. The Master of the Rolls relied on the principle that the claimants had, by neglecting to give notice to trustees,

[425] *Dearle v Hall; Loveridge v Cooper* (1828) 3 Russ 1; 38 ER 475.

enabled Brown to commit this fraud,[426] and did not therefore have 'title to call on a court of equity to interpose on their behalf and take the fund from an individual who has used due diligence, in order to give it to those whose negligence has occasioned all the mischief.'[427] The Lord Chancellor agreed,[428] and reasoned that where personal property is assigned, delivery must occur for valid title to pass and that this principle also applied to choses in action.[429] His lordship further stated that 'the act of giving the trustee notice is, in a certain degree, taking possession of the fund: it is going as far towards equitable possession as it is possible to go (…)'.[430]

The analogy to possession is interesting – the notice requirement, as seen in previous cases, is what transfers the trustees' duties from one beneficiary to another. As the beneficiary's right is to the administration of those duties, it is a good analogy to say this is 'going as far towards equitable possession as it is possible to go'. A duty cannot be 'possessed', but it can be transferred from one object to another by notifying the person who owes the duty to perform on behalf of another.

The position is therefore that in cases of competing equitable assignments, the first to give notice to the trustees will prevail over the first assignee. This was confirmed by the same Lord Chancellor in *Foster v Cockerell*,[431] relying entirely on *Dearle v Hall*.[432]

[426] *Ibid*, 22 onwards.

[427] *Ibid*, 29.

[428] *Ibid*, at 57.

[429] *Ibid*, 58.

[430] *Ibid*, 58-59.

[431] *Foster v Cockerell* (1835) 9 Bli NS 332; 5 ER 1315.

[432] *Ibid*, 375-77.

However, where the case is of competing declarations of trust, the notice requirements are not applicable. This is because a 'declaration of trust [is] not an assignment or transfer but the creation of the relationship of trustee and [beneficiary].[433] This same reasoning, albeit in a very different context, was confirmed in *Vandervell (no 2)*.[434]

i) Legal Effect of Notice

The distinction between declarations of trusts and assignments of beneficial interest may be explained by the courts' development of what the effect of notice is. In essence, the transfer of an equitable interest can be effective as between the parties to the transaction, despite no notice having been given – notice is only needed to make the transfer enforceable against the trustee, consistently with the argument developed above that the notice only effects the trustee's duties and who they are owed to.

In *Re Way's Trusts*,[435] a residuary beneficiary purported to assign her interest to her sisters during their lives, and certain residuary beneficiaries after their death. The beneficiary effected this transfer by deed, which was duly signed, sealed and delivered. She kept possession of the deed, and later destroyed it. Its execution was never communicated to her trustees. Some correspondence passed between the solicitor who had drafted the deed and the beneficiary, but no further legally effective transfers were made before the beneficiary's death.

The Attorney-General, representing the charitable trusts made under the destroyed deed, brought the suit and appealed it after the Master of the Rolls had found the transfer to be

[433] *Hill v Peters* [1918] 2 Ch 273, 279.

[434] *In Re Vandervell's Trusts (No 2)* [1974] Ch 269, 320.

[435] *Re Way's Trusts* (1864) 2 De G J & S 365; 46 ER 416.

ineffective due to lack of notice. Knight Bruce and Turner LLJ both held the new trust to be effective, despite lack of notice, because the deed had been subject to all necessary formalities and duly executed.[436]

The judgment gives no real reasoning for the finding, only stating that there is no reason to suspect the deed had been made under a mistake.[437] To understand this striking contradiction to the usual requirement of notice in cases of equitable assignment, the earlier cases of *Kekewich v Manning,*[438] and *Donaldson v Donaldson*,[439] the latter cited with approval by Turner LJ in *Re Way*, deserve exposition.

The two cases together establish that notice only affects the enforceability of the assignment as against the trustee or third parties. As between the original and new beneficiaries, the transfer is effective before notice. In *Kekewich v Manning,* Susannah Kekewich was a residuary beneficiary of a trust made in her father's will. Susannah and her mother, Elizabeth Kekewich, were also the trustees. Susannah entered into a marriage settlement whereby she agreed to transfer her future (absolute) interest in the trust property to the trustees to hold for her and her children. If the marriage did not result in any children, the property was to go to Susannah's niece after Susannah's death. The mother, Elizabeth, was aware of the settlement, but no request of a transfer of property was ever made.

Susannah (now called Lady Farrington) then married Mr Manning, and another settlement was made on similar terms as the first. The second marriage produced a child. Elizabeth Kekewich died, and the niece, Elizabeth Bradney, brought a claim against the trustees

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[436] *Ibid,* 371-72.

[437] *Ibid* 371.

[438] *Kekewich v Manning* (1851) 1 De G M & G 176; 42 ER 519.

[439] *Donaldson v Donaldson* (1854) Kay 711; 69 ER 303.

of the first settlement, Lady Farrington and the child, asking that the first settlement be put into effect, and that Lady Farrington be restrained from putting the second settlement into effect. The defendants argued that Miss Bradney was a volunteer and not within the marriage consideration of the first settlement, and that the gift was imperfect. Lord Justice Knight Bruce stated:

> Suppose stock or money to be legally vested in A. as a trustee for B. for life, and, subject B.'s life interest, for C. absolutely; surely it must be competent to C. in B.'s lifetime, with or without the consent of A., to make an effectual gift of C.'s interest to D by way of mere bounty, leaving the legal interest and legal title unchanged and untouched. (…)[W]hatever rule there may be against "volunteers" it does not apply to the case of one who, in the language of this Court, is termed a *cestui que trust*, claiming against his trustee.[440]

In deciding the case for the claimant, Knight Bruce LJ reasoned that Lady Farrington was a trustee together with her mother and had a beneficial interest. One of the trustees was a party to the settlement directly, and the other had notice of the transfer of a beneficial interest to the niece. Both trustees were therefore notified of an effective transfer of equitable interest; 'what more could have been done that it was within the power or competency of (…) Lady Farrington to do to enforce?'[441] The only remaining question was whether a trustee can refuse trusteeship to the new beneficiary when notice is given – 'surely not'.[442]

Kekewich is therefore a straightforward application of the notice principle in a novel context, though interesting principles were developed in the process. *Donaldson*, in its application of those principles,[443] is more striking. The case involved a deed of settlement, whereby Thomas Hudson assigned a large amount of property to trustees to hold for certain beneficiaries under a

[440] *Kekewich v Manning* (1851) 1 De G M & G 176, 188-89.

[441] *Ibid*, 198.

[442] *Ibid.* 'Surely' is here used the way we would use the word 'definitely' now.

[443] *Donaldson v Donaldson* (1854) Kay 711, at 717-18 takes *Kekewich* to be the case from which the relevant principle is derived and the case to be decided accordingly.

deed. Within a schedule to the deed, detailing all the various types of property to be transferred to the trustees, was listed some £29,400 of bank shares, which Thomas Hudson had gained in a marriage settlement. In the deed he declared that this property held by the marriage settlement trustees was to be transferred to the trustees listed in the voluntary deed. This transfer was not in fact made before Thomas Hudson died, because the trustees of the marriage settlement had not been duly notified of the transfer. The issue in the case was whether the shares were subject to probate tax as being part of his estate, or whether they formed part of the trust property under the deed.[444]

Sir William Page Wood VC relied on a distinction drawn in the earlier case of *Dillon v Coppin*,[445] to the effect that:

> Stock being in the name of the donor himself, and there being no declaration of trust but a mere assignment, which would not pass the stock at all (…) the Court (…) cannot call upon the donor to transfer the stock or complete the gift. But in the case of an assignment of the equitable interest in stock standing in the name of trustees, the deed of assignment passes the whole equitable interest of the donor, and the donee may go with that deed to the trustees, and say, transfer to me the interest in this sum of stock (…).[446]

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[444] At its bare bones the case bears striking resemblance to the modern *Re Rose*, where the settlor had died before shares had been registered in the name of the recipient and the court was asked whether the settlor's estate was to be assessed for estate duty. More on this to follow in the main text.

[445] *Dillon v Coppin* (1839) 4 My & Cr 647; 69 ER 303.

[446] *Donaldson v Donaldson* (1854) Kay 711, 718. In fact this distinction can be traced through *Dillon v Coppin* (1839) 4 My & Cr 647, 671 ('So far from making himself a trustee of the stock, he states, upon the instrument, his intention of perfecting the gift by a transfer of the stock, and endeavours to provide the means by which the grantee may obtain the legal title.'); through *Ellison v Ellison* (1802) 6 Ves Jr 656, 662 ('as upon a covenant to transfer stock, &c, if it rests in covenant, and is purely voluntary, this Court will not execute that voluntary covenant: but if the party has completely transferred stock, &c, though it is voluntary, yet the legal conveyance being effectually made, the equitable interest will be enforced by this Court.'); and to *Colman v Sarrel* (1789) 1 Ves Jr 50, 54-55, in which Lord Chancellor Thurlow stated: 'Where a deed is not sufficient in truth to pass the estate out of the hands of the conveyer, but the party must come into Equity, the Court has never yet executed a voluntary agreement'.

As the case concerned an assignment of an existing equitable interest, as opposed to an assignment of legal title voluntarily and without consideration, the relevant question became whether an equitable assignment without notice to the trustees was effective and enforceable.[447] The Vice Chancellor answered that it was.

In so doing, Sir William Page Wood VC reasoned that a gift is complete when no further action is required to be done by the donor or the donee, and the assignment had completely passed the interest of the donor. The fact that no notice had been given to the trustees only meant that the trustees could have transferred the property to the original beneficiary and there would not have been any remedy against them, but it was within the new beneficiaries' power to give notice at any point to make their title complete. There was no need to come to court and ask for the transfer to be made effective, unless the trust property was transferred to someone else.[448] The interest was therefore not with the settlor at the time of his decease, and probate tax was not due.

As between the donor and donee the transfer had been completely effected, because no further act was required on the donor to effect it. Put another way, the donee had obtained a power to bind the trustees to the new settlement, but notice had to be served before this could have any third party effects. The first beneficiary had completely divested himself of the benefits of the due administration of the trustees' duties, but the trustees were not yet bound in their duties to act in the best interests of the second beneficiary. Payment to the first beneficiary would have been within their powers, but the first beneficiary would have been bound to hand over the payment to the second. In line with *Kekewich*, 1) the beneficiaries of a trust were not caught by the rule against volunteers, and thus Thomas Hudson could transfer to the new

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[447] *Donaldson*, *ibid*, 719.

[448] *Ibid*.

beneficiaries without consideration, and 2) they did not need to seek approval of the trustee to effect the transfer and the new beneficiaries could therefore bind the trustees by notice, or make the trustee's obligation to give due administration owed to them.

In *Re Way* there was therefore no need to give any reasoning to why the transfer of beneficial interest was effective when all necessary formalities had been complied with, even when notice had not been delivered to the trustees. An equitable interest could be transferred without notice, the notice to the trustees only making the transfer enforceable against them by the new beneficiary's and for his benefit.

This somewhat striking operation of the notice to the trustee is completely in line with the features of the trust and of the beneficial interest briefly discussed in the previous chapter – the trust is 'but a confidence resting in privity of person and estate',[449] but it 'should be considered in this court as the real estate, between the *cestuy que trust* and the trustee, and all claiming by and under them'.[450] The future benefits of an equitable interest held by a beneficiary can be transferred onto another without notice, but as the trustee is fundamentally a obligational relation in privity, the notice to a trustee is what transfers the trustee's obligations to another beneficiary.

The issue was well-settled before the well-known *Milroy v Lord*,[451] where Turner LJ stated the famous phrase that 'there is no equity in this Court to perfect an imperfect gift'[452]. That is, if

[449] *Burgess v Wheate* (1759) 1 Eden 177, 248. See also Thomas Egerton in *Bullesden's Case (Anon. d. Chester v Englande)*, Huntington Library MS EL 482 fo.59v.

[450] *Ibid*, *Burgess,* 251.

[451] *Milroy v Lord* (1862) De GF & J 264. The judgment is given by Knight Bruce LLJ and Turner LJ, the same panel that decided *Re Way* two years later.

[452] *Ibid*, 274 per Turner LJ.

a gift is intended and that gift fails, the court cannot convert it to a trust.[453] A 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',[454] in this case meaning the legal transfer of the shares of the Bank of Louisiana should have been registered in the books of the bank. *Milroy* could in fact be entirely disposed of by referring to *Dillon v Coppin*,[455] where East India stock that could not be transferred in law except by an entry to the books of the East India Company did not form the subject matter of a trust – the issue is exactly the same. Where no trust is in existence and legal title has not been validly transferred, the court will not imply a trust.

The result of all this is that a creditor of a beneficiary under an express assignment is in a good position – the creditor can either make herself a full beneficiary by giving notice to the trustee, or (provided there are no other assignments) enforce her assignment against the original beneficiary. The latter course obviously leaves the creditor vulnerable to fraud by the beneficiary, who can then assign the interest to a new creditor and so on, until one of them actually notifies the trustee of the change in their duties.

5. Rights of General Creditors

Assuming a valid assignment of the equitable interest has been made by the beneficiary to a third party creditor, it only remains on that third party to serve notice and enforce the trust

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453 This was strongly taken up by Sir George Jessel MR in *Richards v Delbridge* (1874) LR 1 Eq 11, 14.

454 *Milroy v Lord* (1862) De GF & J 264, 274.

455 *Dillon v Coppin* (1839) 4 My & Cr 647; 69 ER 303.

for their benefit. Where, however, the question is of the beneficiary's general creditors (i.e. creditors who have not been expressly assigned the beneficial interest), the position is more complicated. In essence, where the trust deed does not limit the instances where a creditor might reach the beneficial interest, the creditor can claim against that interest. It will be argued below that this is based on an implied assignment, either to the creditor (in cases of a still-solvent beneficiary) or the trustee-in-bankruptcy (in the case of insolvency).

The basic position is exemplified in *Davidson v Chalmers*.[456] In that case, a testatrix, Sophia Forbes, had settled her residual estate on trust for his son, Daniel Mitchell Davidson, during his life. The trustees were given 'uncontrolled discretion' to provide for the son, except that the son should not be entitled to have any right in the trust property. The trust deed also contained a term that in the event of bankruptcy, Daniel Mitchell Davidson was to obtain a certificate of discharge before any payments would be made. At the time of Sophia Forbes' death, her son was bankrupt. In March of 1863, Daniel Mitchell Davidson obtained a discharge under the Bankruptcy Act 1861, discontinuing any action by creditors against him, and in June of the same year he applied to the court for a declaration that he was entitled to receive income under the trust. The creditors joined in the action to claim that they would be entitled to the income as Daniel Davidson's assignees.

Sir John Romilly MR stated that 'I did not require any authority for the proposition that the contingent interests of a bankrupt pass to his assignees, and that where there is a gift to a man on the happening of a contingency, and he becomes bankrupt, his contingent interest may be disposed of by his assignees.'[457] As to the argument that the settlor in the will intended that the son's interest would not be available for his creditors, the Master of the Rolls noted that it cannot be the true construction of the will – 'if it were, the answer is, that that time [when the

[456] *Davidson v Chalmers* (1864) 33 Beav 653; 55 ER 522.

[457] *Ibid*, 658.

interest becomes available to the beneficiary] will never arrive, for it is not permitted by law to give property in that manner. It is simply an attempt to give a life interest in property to a man in such a manner as to not be subject to his debts (…)'[458]

In this brief judgment Sir John Romilly MR states those basic principles that *Brandon v Robinson* is known for. The beneficiary's rights under a trust are subject to the claims of his creditors, and that the trust deed cannot validly protect a beneficiary's interest from his creditors in bankruptcy.[459] Neither is really subject to any analysis in the judgment, though Romilly MR's statement about restraints on alienation is a clear example of Sir Edward Coke's conceptual argument on such restraints—they are out of bounds with the logic of property rights.[460] This will be discussed further in Chapter 7 on the US position on these restraints.

The creditors of Daniel Davidson sued as his 'assignees', but there was never an assignment of the equitable interest to the creditors. The word 'assignee' could therefore simply mean 'creditor', but it is undoubtedly the case that the creditors ended up in the same position as though they were equitable assignees of Daniel Davidson – they have an interest against Daniel Davidson to have the income from the trust transferred over to them, and would simply have to notify the trustees to make this right enforceable against them as well.

Another instructive case is *In Re Coleman*.[461] In this case the trustees of a testamentary trust were given broad discretion to apply the testator's residuary estate towards the maintenance, education and advancement of his children until the youngest turns 21. In that

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[458] *Ibid,* 659.

[459] In the case of *Younghusband v Gisborne* (1844) 1 Coll 400; 63 ER 473, at 402 Sir James Knight Bruce VC disapproved of the two main authorities for allowing trusts that restrict alienation in bankruptcy, *Godden v Crowhurst* (1842) 10 Sim 642; 59 ER 765 and *Twopeny v Peyton* (1840) 10 Sim 487; 59 ER 704. Notably, these two authorities are both significantly later than *Brandon v Robinson*, so the issue appears to not have been resolved by that case.

[460] Sir Edward Coke in *Sir Anthony Mildmay's Case*, (1606) 6 Co. 40a, 41b.

[461] *In Re Coleman* (1888) 39 Ch 443

event, the whole estate was to be divided equally between the children, absent any special division by the testator's wife (who did not exercise this power in her lifetime). The testator had four children. Since the wife's death the trustees had applied the income equally between the children, two of whom were adults by the time of trial.

One of the adult children, John Soy Coleman, assigned his entire interest to one David Henry, and Mr Henry gave notice to the trustees that the payments be made to him instead. The trustees ceased all payments of J S Coleman's interest until the matter could be resolved by the court.

At first instance, North J held that the discretion given to the trustees meant that J S Coleman was not entitled to any given proportion of the income before the youngest child was 21. Mr Henry, his assignee, was therefore 'not entitled to call upon the trustees to hand over to him the one-fourth share of income'.[462] If the trustees decided to give something directly to J S Coleman, Mr Henry would be entitled to it, but there was nothing to stop the trustees from applying his share for his benefit in some other way.[463]

On Mr Henry's appeal, the Court of Appeal varied the order slightly,[464] but did not declare that Mr Henry now has a right in a quarter of the income because of the trustees' discretion. This was despite the fact that J S Coleman was the certain recipient of one quarter of the entire set of trust assets when his youngest sibling turns 21. Although the point was not explicitly argued, this seems to suggest that the creditor's powers to have the trust property used to satisfy his claims does not derive from *Saunders v Vautier*,[465] but are simply an assignment, actual or implied, of whatever right the beneficiary himself has at the time.

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[462] *ibid*, 447.

[463] *Ibid.*

[464] The order is found *ibid*, at 450, affirmed at 452.

[465] *Saunders v Vautier* (1841) 4 Beav 115, 49 ER 282; Cr & Ph 240, 41 ER 482.

If the creditor's power was dependent on the power under *Saunders v Vautier* to have legal title transferred to the beneficiary (or here, his assignee), the result in *In Re Coleman* would either have been that the assignee gets nothing, because the beneficiaries have not got together and decided to have the interest transferred to them, or that the assignee now has a one-quarter interest in the property because the court treats him as a certain recipient of that one-quarter and therefore entitled to force the trust to come to an end. Instead, the assignee only got whatever interest the beneficiary has in the trust as a going concern.[466] The trust was kept alive, and whatever interest the beneficiary has is what the creditor has. *In Re Coleman* is a case of an express assignment, but there is no reason such assignment could not be implied.

A useful illustration of the procedure by which a creditor reaches trust assets under an implied assignment is given in *In Re Ashby, Ex Parte Wreford*.[467] In that case a trust had been settled to raise money to pay the debts of George Ashby, as long as George Ashby does not attempt to assign the interest or become bankrupt. In these events, the power to pay his debts is revoked, and the trust property was to be paid to George Ashby under a discretionary trust. This is known as a 'protective trust', briefly discussed below. The trustees raised the money needed to pay the debts (£1050) and paid some of them, when George Ashby went bankrupt. The trustee in bankruptcy claimed the life interest of George Ashby on the ground that the resettlement into a discretionary trust was void, and claimed also what remained of the £1050.

Vaughan Williams J held that the resettlement was valid, and not a 'fraud on the bankruptcy laws', on the basis that his interest under the first trust was not 'his own property' that he had resettled.[468] However, whatever money was to be paid to George Ashby would have

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[466] Which, of course, is not an interest in the trust property itself; see *Gartside v IRC* [1968] AC 553

[467] *In Re Ashby, Ex Parte Wreford* [1892] 1 QB 872.

[468] *Ibid.*, 876.

to be accounted to the trustee in bankruptcy,[469] and that the trustees had to hand over what remained of the £1050 to be dealt with as part of the general estate of the bankrupt.[470] This last point meant, in essence, that the creditors to whom the £1050 was to be paid were not beneficiaries of that settlement – they had 'no interest in the matter whatsoever and no locus standi at all'.[471]

The validity of these sorts of settlements and their constituent elements will be discussed in detail below, but for our purposes the case serves as a useful highlight of the process of creditor access to trust assets. The beneficiary's trustee in bankruptcy does not get the trust property, but is entitled to the benefit of the beneficiary's interest regardless of whether that interest has actually been assigned expressly or not. In *Ashby* the beneficiary would have to pay over any money he got under the trust, and as he would never have been entitled to the £1050 anyway and the creditors to whom it was going were not beneficiaries themselves, this money was also assigned to the trustee in bankruptcy to be dealt with as part of the general estate.

It is therefore the position that where a creditor has been assigned the trust interest itself, they can straightforwardly enforce the assignment against the beneficiary and extend that enforcement by notice to the trustee. Where that creditor has not been assigned the trust interest but is a general creditor, the beneficiary's interest passes on to the trustee in bankruptcy and will be dealt with as part of his general estate, as though an assignment of that interest had been made. In neither case is the trust brought to an end, or a *Saunders v Vautier* power invoked (unless specifically done so by the assignee after the assignment and the conditions of *Saunders* are satisfied). This is consistent with what has been argued about *Saunders v Vautier* in the

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469 *Ibid.*, 877.

470 *Ibid.*, 878.

471 *Ibid.*

previous chapter, that it does not affect the existing trust in any way until it is invoked. This quality as a power ad rem reflects its developmental roots in Roman probate law.

The corollary is that the creditor's power to reach trust assets is an express or implied assignment made enforceable by notice to the trustee, though that notice can of course be the very act of enforcement itself. These principles are also fundamental to the trust concept, as any attempts to give property in ways that disrupt this machinery of creditor access through assignment are void under English law.

6. Permissible Restraints on Alienation

The cases carving out exceptions to the above conclusion are as telling evidence as the cases establishing it. As we have already seen, the cases on creditor access are closely tied with restrictions on that access, and in the above cases the implicit rule is that as long as the assignment mechanisms of the trust are left intact by the trust deed, the settlement is valid.[472] This is confirmed by case law dealing with the issue directly. The permissible forms of restrictions of creditor access in English law are therefore 1) discretionary trusts, 2) forfeiture provisions and 3) protective trusts (which are a combination of the first two). Each is broadly consistent with creditor access being based on an implied assignment.

i) Discretionary Trusts

One permissible way to restrict the availability to creditors of a beneficiary's entitlement is by discretionary trust. As in *Re Ashby*, the device leaves the assignment mechanisms of the trust

[472] Compare *Davidson v Chalmers* (1864) 33 Beav 653; 55 ER 522 and *In Re Ashby, Ex Parte Wreford* [1892] 1 QB 872.

intact, in that the beneficiary may still assign their interest, but the interest can be denied true content by the greater dispositive discretions of trustee.

In *Chambers v Smith*,[473] the principle in *Ashby* was brought to its logical conclusion – because the creditor is not assigned the trust property but only whatever right the beneficiary has, the trustees' powers to deal with trust property are left intact even if they include the right to withhold payments from the creditor or change the terms of the trust. In the case the testator had given the trustees a power to postpone payment indefinitely, together with a power to appoint new trustees and vary the trust payment terms. The testator had also included a clause that the interests under the trust 'shall not be arrestable or attachable for the debts or deeds of the persons in whose favour the same are conceived'.[474]

One of the beneficiaries was the testator's son, who had been made certain payments from the trust capital and interest. The son's general creditors attempted to seize the future trust payments through the court, at which time the trustees stopped all payments. The trustees then executed a deed vesting the trust property in themselves, allowing only a living allowance for the son – in essence varying the trust deed in accordance with their powers of appointment and variation.

Lord Hatherley essentially reasoned that the 'arrestment' by the creditors cannot in any way affect the trust as a going concern, and thus the powers of the trustees are preserved. Because the debtor cannot convey to a creditor what he does not have himself, the creditor cannot enforce against the trust assets in the hands of the trustees. This would amount to changing the terms of the trust, which empower the trustees to withhold payments or change its terms.[475] Lord O'Hagan stated: 'What the debtor had, was attached for the benefit of the creditor; what he

[473] *Chambers v Smith* (1878) 3 App Cas 795.

[474] *Ibid*, 797

[475] *ibid*, 806.

had not, the arrestment could neither give them nor take from him'.[476] Lord Blackburn and Lord Gordon similarly concurred. None of the House of Lords expressed an opinion on the validity or effect of the clause restricting creditor access, as it was unnecessary.[477]

If a settlement is made in an attempt to defraud creditors, i.e., 'where there are unpaid debts (…) existing at the time of making the settlement, and the settlor (…) [is] so largely indebted as to induce the court to believe that the intention of the settlement, taking the whole transaction together, was to defraud (…) creditors',[478] it is of course open to the creditor to have it set aside in accordance with the usual anti-deprivation rules.[479]

It should be noted also that preservation of the trustees' powers does not change the basic position that the creditor can claim anything the beneficiary eventually gets from the trust. In *Lord v Bunn*,[480] a trust deed was drafted to pay rents and profits to the settlor's son, and to change into a maintenance trust should the son go bankrupt. The son went to debtor's prison (from which he was later released) and the creditor, Mr Silver, was appointed by the court to be the assignee of his estate. The son's children asked the court to determine that the trustees were entitled to exercise their power in favour of them, and exclude the insolvent.

Sir James Knight Bruce VC agreed that they were so entitled and therefore that their discretion had been left intact by the bankruptcy and assignment of the debtor's estate to Mr Silver.[481] The Vice Chancellor also held that 'any benefit which the bankrupt may take will belong

[476] *Ibid*, 811.

[477] *Ibid*, 813, 830.

[478] *Holmes v Penney* (1856) 3 K & J 90; 69 ER 1035, 1039.

[479] *Higginbotham v Holme* (1812) 19 Ves 88.

[480] *Lord v Bunn* (1843) Y & CCC 98; 63 ER 43.

[481] *Ibid*, 103.

to his assignee'.[482] In essence, therefore, the case is authority for the later House of Lords decision in *Chambers v Smith*, though perhaps the result in that case is more striking due to the specific nature of the discretion. This was again affirmed by the House of Lords in *Train v Clapperton*,[483] where assignees of a beneficiary's interest were attempting to force the trustees to exercise their discretion to transfer trust capital to them. The Lord Chancellor dealt with the case swiftly in one paragraph, saying it depended on an argument that the trustees had not exercised their discretion or had acted improperly, which was not the case on the evidence.[484] The trustees were therefore within their rights to withhold payment under their discretion.

It is against this background that the well-known case of *Re Smith*, expanding on *Saunders v Vautier* powers, must be seen.[485] In the case the testator left one fourth of his residuary estate on discretionary trust for Lilian Aspinall and her children. Mrs Aspinall had three children, all of whom were adults and one of whom had died. She was too old to have any further children. Mrs Aspinall, the two surviving children and the deceased child's executor joined in executing a mortgage, whereby they assigned their interest in the trust to the Legal and General Assurance Company. The trustee of the discretionary trust asked the court whether he was obliged to pay the money to Legal and General.

Romer J reasoned that all the beneficiaries together could demand the trustee to hand over the trust property.[486] It does not matter that the individual shares of each beneficiary were not set, as together they are entitled to the entire trust property and therefore they are to be treated

[482] *Ibid*, 104.

[483] *Train v Clapperton* (1908) SC (HL) 26.

[484] *Ibid*, 27.

[485] *Re Smith* [1928] Ch 915.

[486] *Ibid*, 918.

together as one person.[487] Legal and General therefore had the power to demand payment, as it now held the entire beneficial interest in the trust property.

This again shows that a *Saunders v Vautier* power, the unnamed mechanism in *Re Smith* that enables a beneficiary to demand accelerated payment of the trust property where he is the certain recipient of it, is an additional layer of powers on top of the existing machinery of express or implied assignment. Only where the creditor has gained the entire beneficial interest of all the beneficiaries can he effect a change in the powers of the trustee – otherwise he simply gets what the beneficiary has, which can amount to nothing where the trustees' powers to administer the trust are left intact.

ii) Forfeiture

Another form of permissible limitations on the creditors' rights in English law is through forfeiture provisions. It is here that the limits of the rule against restraints on alienation (erroneously thought to originate from *Brandon v Robinson*) have been most closely contested – a clause purporting to give a life estate under a trust but which is stipulated to end at a given event such as the beneficiary's bankruptcy or an assignment could be seen as antithetical to that rule. However, it remains the case that broadly speaking these clauses are valid, and this is a telling sign that the rights of beneficiaries' creditors are dependent on the conceptually necessary mechanism of assignment. In other words, a forfeiture clause does not purport to destroy the power to assign one's equitable interest *only* (as opposed to destroying the whole equitable interest entirely), and that is why the trust concept tolerates it.

[487] *Ibid*, 919.

An early case framing the debate expressly in terms of *Brandon v Robinson* is *Rochford v Hackman*.[488] In the case a trust was declared for the benefit of the testator's children and grandchildren. The trust contained a provision that sought to make the trust interest void for any beneficiary who attempts to assign their interest, as though that person were dead. One of his sons, Richard Rochford, became insolvent and went to debtors' prison, and Mr English was appointed as his assignee. The other beneficiaries of the trust brought the case, arguing that Richard Rochford's interest had come to an end.

Sir George Turner VC (as he then was) took care to analyse the judgment in *Brandon v Robinson* much in the same way as it has been analysed above.[489] Turner VC's considered *Brandon* to only say that a life interest must have the indicia of a life interest including the power to assign. Anything in the trust deed transferring the beneficiary's right to someone else in the event of his bankruptcy would have the effect that it was not available to his creditors. The proviso that the beneficiary cannot assign his interest is valid if it is expressed '[so] as to amount to a limitation reducing the interest short of life-estate [to the effect that] neither the man nor his assigns can have it beyond the period limited'.[490] The rest of *Brandon* is Lord Eldon's construction of the will in order to decide whether this had happened.

Thus there is nothing in *Brandon v Robinson*, as interpreted, that restricts the termination of an equitable interest in the event of bankruptcy or alienation. As such, the forfeiture clause in *Rochford v Hackman* was valid. The conceptual validity of similar provisions has been confirmed numerous times since.[491]

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[488] *Rochford v Hackman* (1852) 9 Hare 474; 68 ER 597.

[489] See n 247 and accompanying text; *Ibid*, 482-83.

[490] *Ibid*, 482.

[491] *Billson v Crofts* (1872-73) LR 15 Eq 314; *In Re Detmold* (1889) 40 Ch D 585; *Metcalfe v Metcalfe* [1891] 3 Ch 1; *In Re Johnson* [1904] 1 KB 134.

By the early 20th century the bankruptcy laws had developed complexity and come to recognise settlements that sought to defraud creditors through forfeiture clauses upon bankruptcy. As a result, these clauses were void against the trustee in bankruptcy but would remain in force against anyone else[492] – e.g. as between a husband and a wife.[493] This created the peculiar problem of what is to happen to a forfeiture clause if the trust interest is taken by a trustee-in-bankruptcy and sold on to a third party. The issue was resolved in *Re Burroughs-Fowler*, where Peterson J stated that 'so far as the trustee in bankruptcy is concerned, the provisions as to bankruptcy and insolvency must be treated as excluded from the settlement and the trustee is therefore in a position to deal with the interest (…) under the settlement, whatever it may be (…). So far as [a third party] is concerned, forfeiture by reason of bankruptcy has already taken place (…). The result is that the trustee in bankruptcy is in possession of the life interest of the bankrupt, which is now incapable of being affected by any subsequent forfeiture.'[494]

The case is intriguing in its special facts. Normally, of course, the case would not arise whereby an assignment of an interest encumbered by a forfeiture clause is being questioned, as any attempted assignment would trigger the forfeiture. Here, however, we get to see behind the veil of forfeitures into whether assignment powers are still preserved in the interest subject to forfeiture, or whether the forfeiture clause destroys powers of assignment. The case is special, but seems to confirm that there is a logical space between forfeiture of the interest on assignment and the inability to assign entirely. The forfeiture was deemed to have taken place, and after the protective shell of the forfeiture clause is pierced by a forfeiture event the full assignability of the beneficial interest is revealed.

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[492] *In Re Burroughs-Fowler* [1916] 2 Ch 251.

[493] *In Re Johnson* [1904] 1 KB 134.

[494] *In Re Burroughs-Fowler* [1916] 2 Ch 251, 255.

On the argument advanced here, that assignment of the equitable interest is a conceptual feature of that interest and therefore cannot directly be attacked, might so far seem unconfirmed or doubtful in light of the forfeiture clauses. So far all the cases have established that a forfeiture clause is unaffected where it does not attempt to destroy the assignability of a right. But this does not establish that it will be affected where it does so attempt.

In fact, this is just what we find in the case law. In *Re Brown*,[495] the testator had included a forfeiture clause in a trust for his four sons, whereby an assignment to anyone other than another son would trigger forfeiture. One of the sons wanted to assign the interest outside the family, so the trustees asked the court to determine whether they were bound by the forfeiture clause. Harman J began his analysis as follows: 'The view from the outset is that anything which seeks to deprive the [beneficiary] of his rights [of alienation] is void, but there is no doubt that some degree of restriction may be put upon him. (…) One may not, therefore, restrict his right of alienation to one person (…) That is, in substance, although not in form, an absolute bar.'[496] Harman J went on to hold that the class is too small for meaningful power of alienation to exist, and therefore the clause restricting alienation was void.[497]

This case cited and relied on the ancient authority of *Muschamp v Bluet* in which it was stated:

> if a feoffment be made on condition that the feoffee shall not alien, the condition is voyd, for the feoffee hath power to alien to whom he will, or if the condition were good, that would take from him the power which the law gives him, which would be against reason (…).[498]

The principle of alienation is therefore seen as a fundamental conceptual feature of a beneficial interest.

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[495] *Re Brown* [1954] Ch 39.

[496] *Ibid*, 43.

[497] *Ibid*, 49-50.

[498] *Muschamp v Bluet* (1617) J Bridg 132; 123 ER 1253 at 136.

A further layer of protection from creditors is provided by the now-statutorily operative protective trusts.[499] The idea of a protective trust is simply that a primary trust with a forfeiture clause then transforms into a secondary trust (e.g. a discretionary trust or a trust for the benefit of some closely related party) upon the forfeiture event.[500] The protective trust therefore combines the effects of forfeiture clauses and discretionary trusts, and are in widespread use in, e.g., pension trusts.[501] Their operation, however, follows the usual behaviour of forfeiture clauses examined above. As noted above in discussion of *Re Ashby*, however, it remains the case that a beneficiary who has effected a transfer of his interest and thereby triggered forfeiture (whether under a protective trust arrangement or otherwise) will be bound by his own assignment even when his own interest has terminated. Whatever the beneficiary receives from the newly settled protective discretionary trust must go to the creditor to whom he assigned his interest or to his trustee in bankruptcy. This is perhaps strongest evidence of the fact that even forfeiture upon alienation in fact leaves the power to alienate intact, and the creditor's right depends on a) the content of the beneficiary's right and b) the ability of that beneficiary to assign his interest.

It seems therefore that while forfeiture clauses are permissible, they cannot consistently with the concept of beneficial interest oust the beneficiary's power to alienate his interest. The result in an operational forfeiture clause may be the same in most cases, but as we have seen in the special case of bankruptcy, the power to alienate survives a forfeiture clause; where forfeiture has been triggered but the law deems the event ineffectual, the power of alienation persists. Conversely, where a forfeiture clause seeks to undermine the power to alienate, as opposed to give an interest which ends at a prescribed event such as bankruptcy, such a clause is void for the

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[499] S. 33 of the Trustee Act 1925.

[500] See J Glister & J Lee *Hanbury & Martin Modern Equity* (20th Ed, Sweet & Maxwell London 2015), para 8-001 onwards.

[501] See *Re Scientific Investment Pension Plan Trusts* [1999] Ch 53.

express and ancient reason that it would go against the very concept of the beneficial interest, or be against reason.

7. Conclusion

This, then, is the basis of the law of beneficiary's creditors. The complex nature of the beneficiary's interest with the dual features of both an obligational relation with a privity requirement and proprietary effects on third parties sets the tone for how a creditor might gain access to the trust assets through the beneficiary, on the simple principle that a beneficiary can only give what he has and only in the way in which he has the power to effect a transfer. As between the trustee and the beneficiary, their rights operate as though they are in rem, meaning the identity of both the trustee and the beneficiary can change while still preserving the trust relation. The beneficiary can therefore assign his interest to a creditor and the creditor has the power to enforce against that beneficiary should the beneficiary get any distributions from the trustee, but in order to make himself a true beneficiary the creditor must notify the trustee and transfer the duties of the trustee from the original beneficiary to himself.

The law of trust creditors therefore grows out of the basic features of the trust concept, and how creditors of both trustee and beneficiary enforce their claims has much to teach us about that concept. To fully appreciate how these central asset partitioning rules affect the landscape of trust law, this thesis will now move on to consider comparative US law, where a change in these rules in the late 19th century has resulted in a fundamental shift in basic trust law axioms.

Chapter 6: Introduction to American Trust Law and Trustees' Creditors in the US

This chapter deals with the doctrinal structure under which trust creditors claim against trust assets in the United States. American trust law provides an illuminating example of how some of the central doctrinal and conceptual problems associated with asset partitioning in the trust, outlined in the previous chapters, are in fact at the heart of how trust law as a whole operates. The aim in this chapter is to give a short portrayal of asset partitioning rules of American trust law in order to show how the various problems identified in previous chapters have been solved in the US, and what impact those solutions have had for other related doctrines. Conceptual issues are then pursued further in Chapter 8.

1. Introduction to American Trust Law

As modern English and American trust law regimes share a common ancestor, their respective differences provide fertile ground for meaningful comparisons. Since asset partitioning lies at the very heart of the trust, comparison of the two systems' distinct techniques of asset partitioning qualifies almost as a laboratory experiment in different evolutions of the trust institution. The major doctrinal differences in the two systems are 1) the personal liability of the trustee and 2) the theoretical nature of the beneficial interest, which in turn reflect differing basic axioms of trusts and their utility. The two systems are both similar and different enough, in just the right ways, for our purposes.

However, as is usually the case, the rules of one legal system cannot meaningfully be compared with those of another without some context regarding how those rules are developed and applied. Superficially close as the two regimes might be, there are important differences in the structure of their legal systems that undermine obvious comparison. An example to illustrate this is the debate on remedial constructive trusts – it is said that English law does not have them, and that US law does, but this isolated doctrinal difference is the tip of a very large iceberg of differing trust law axioms.[502] Any evaluation of whether one system should follow the other is next to meaningless without an appreciation of how each system arrives at this isolated result.

It is therefore necessary to make a few introductory points before going on to the main doctrinal section of this chapter. Detailed differences in particular doctrines aside, we can divide the various differences in approach under the following headings: differences in i) Theoretical Justification; ii) Structure of the Legal System; iii) Structure of Trust Law. Further discussion and development of these differences will be found in Chapter 8.

i) Theoretical Justifications

A striking feature of English trust law is the dual obligational and proprietary nature of the beneficial interest.[503] In normal circumstances the beneficiary can only sue the trustee, and his only remedy is to have the trust duly executed,[504] or to collapse the trust in certain

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[502] It is really that in American law a constructive trust can only ever be a remedy and only analogous to a trust in its effects, as US trust law holds the settlor's donative intent to be the central necessary condition to the creation of trusts – of which further below. Such donative intent is obviously absent in the context of constructive or resulting trusts.

[503] For enlightening studies of this dual nature, see JW Harris 'Trust, Power and Duty' (1971) 87 LQR 31; and RC Nolan 'Equitable Property' (2006) 122 LQR 232.

[504] *Morice v Bishop of Durham* (1804) 9 Ves 399, at 405: 'There must be somebody in whose favour the court can *decree performance*.' (Emphasis added); and (1805) 10 Ves 522 at 540 '[where no beneficiary is found] the Court can neither reform mal-administration, nor *direct a due administration*.' (Emphasis added); *Re Abbott Fund* [1900] 2 Ch 326 (where the beneficiaries of a trust (two ladies in financial need) were described as not having a right to the assets but '[if the money were not given to them] the ladies might successfully have applied to the court to have the fund administered according to the terms of the circular', per Stirling J at 331); see also discussion in Chapter 3.

circumstances.[505] All dealings with parties external to the trust are handled through the trustee, as he is the legal owner of the property in question.[506] However, this basic model can be difficult to reconcile with the fact that a beneficiary can enforce against third parties in certain limited circumstances,[507] such as accessory liability to breach of trust.[508]

American trust law on the other hand sides rather more strongly with the view that the beneficial interest is a species of property right,[509] and has so been viewed at least from Scott's first *Restatement of Trusts* (1935) onwards. The corollary of this is that when a settlor sets up a trust, it is viewed as the settlor carving out a proprietary interest in his own property, analogous to granting a lease over one's land,[510] or giving a gift.[511]

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505 *Saunders v Vautier* (1841) 4 Beav 115; *Re Smith* [1928] Ch 915.

506 *Burgess v Wheate* (1759) 1 WmBl 123, 1 Eden 177.

507 For more extensive debate on this third party enforcement feature of the trust and how it might be modelled, see AW Scott 'The Nature of the Rights of the *Cestui Que Trust*' (1917) 17 Columbia L Rev 269; JW Harris 'Trust, Power and Duty' (1971) 87 LQR 31; RC Nolan 'Equitable Property' (2006) 122 LQR 232; B McFarlane and R Stevens 'The Nature of Equitable Property' (2010) 4 J Equity 1.

508 See generally, PS Davies *Accessory Liability* (Hart Publishing, Oxford 2015), Chapter 4.

509 The definitive treatise on trust law in America, (Current edition: ML Ascher (ed) *Scott and Ascher on Trusts* (4th ed Aspen Publishers 2007)) describes the beneficiary as having a 'form of ownership' of the subject matter of the trust. The scholarly debate continues (see, for example, JH Langbein 'The Contractarian Basis of the Law of Trusts' (1995) 105 Yale LJ 625, 644: "The central figures in this dialogue were Frederic W. Maitland, the greatest scholar of the common law, who got the contractarian basis of the trust right; and Austin W Scott, who got it wrong, but had the fortitude to write his error into the *Restatement of Trusts*."), but is somewhat marginal to the main debates concerning structural reforms of trust law.

510 The first two *Restatements of Trusts* (First 1935 & Second 1959) § 197 cmt state: "The creation of a trust is conceived of as a conveyance of the beneficial interest in the trust property (…)" .

511 Bernard Rudden's comment (taken from his review 'John P. Dawson, Gifts and Promises (1981)' (1981) 44 MLR 610, 610) that '[t]he normal private trust is essentially a gift projected on the plane of time and so subjected to a management regime' has blossomed from a remark in a book review to a central statement of principle, cited regularly by leading commentators such as John Langbein (in 'The Contractarian Basis of the Law of Trusts' (1995) 105 Yale LJ 625, 632; 'Mandatory Rules in the Law of Trusts' (2004) 98 Northwestern U LR 1105, 1109; 'Burn the

The effect of this is that the principle of freedom of disposition features in many if not most of the theoretical justifications of various doctrines.[512] In essence, a trust is seen as a species of donative transfer, and as the Restatement (Third) of Property explains:

> The organising principle of the American law of donative transfers is freedom of disposition. Property owners have the nearly unrestricted right to dispose of their property as they please (…). American law does not grant courts any general authority to question the wisdom, fairness, or reasonableness of the donor's decisions (…). American law curtails freedom of disposition only to the extent that the donor attempts to make a disposition or achieve a purpose that is prohibited or restricted by an overriding rule of law (…).[513]

The relevant question in American trust law is not what rights does the beneficiary have, but what powers does the settlor have in disposing of his property, and what, if any, policy limitations are there on his powers.[514] §10.1. of the Restatement (Third) of Property thus continues: "Among the rules of law that prohibit or restrict freedom of disposition (…) are those relating to spousal rights; creditors' rights; unreasonable restraints on alienation or marriage; (…) provisions encouraging illegal activity; and the rules against perpetuities and accumulations."[515] If nothing limits the settlor's power to deal with his property as he sees fit, nothing will invalidate the trust he chooses to create.

Rembrandt? Trust Law's Limits on the Settlor's Power to Direct Investments' (2010) 90 Boston U LR 375, 380)

[512] The leading student textbook, J Dukeminier & R Sitkoff *Wills, Trusts, and Estates* (9th Ed, Wolters Kluwer Law & Business, New York 2013) includes an entire chapter on the principle of freedom of disposition.

[513] Restatement (Third) of Property (2003): Wills and Other Donative Transfers, §10.1 cmt.

[514] A reflection of this is how trust law is taught – it is part of the course on wills and estates. See RH Sitkoff 'Trusts and Estates: Implementing Freedom of Disposition' (2013-14) 58 St Louis U LJ 643. See also Restatement (Third) of Property (2003), ibid.

[515] Restatement (Third) of Property (2003): Wills and Other Donative Transfers, §10.1 cmt.

In the parlance of American legal scholarship, this means that most of trust law's central features are default rules,[516] i.e., rules that will yield to contrary expressions of intention by the settlor. Section 105 of the Uniform Trust Code 2000 ('UTC') expressly uses the terms 'default and mandatory rules', citing as 'mandatory' such central features of trust law as the fact that the trust must be for the benefit of its beneficiaries (s.105(b)(3)) and that the court's supervisory jurisdiction (as it would be called in England) cannot be ousted (s.105(b)(13)).

Interestingly, John Langbein has suggested that there is in fact a back channel by which the beneficiary's entitlement may limit the settlor's freedom of disposition in American trust law, much as it does in England.[517] In essence, Langbein argues that because it is a mandatory rule that the trust must be for the benefit of its beneficiaries, the settlor cannot impose restrictions on the beneficiary's interest that would be contrary to this basic requirement. This obviously restricts the 'crackpot' settlor who wants to have her house bricked up,[518] or heroic statues of himself and his family erected,[519] but Langbein maintains it could also set the limits of how far a

[516] The taxonomy of rules into 'default' and 'mandatory' rules is common in the American law and economics movement, applied particularly in the context of contract and corporate law: see I Ayres and R Gertner 'Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules' (1989) 99 Yale LJ 87; I Ayres 'Valuing Modern Contract Scholarship' (2003) 112 Yale LJ 881, 885; B Black 'Is Corporate Law Trivial?: A Political and Economic Analysis' (1989) 89 Colum LR 1549; R Romano 'Answering the Wrong Question: The Tenuous Case for Mandatory Corporate Laws' (1989) 89 Colum L Rev 1599.

[517] JH Langbein 'Mandatory Rules in the Law of Trusts' (2004) 98 Northwestern U LR 1105.

[518] *Brown v Burdett* (1882) 21 Ch D 667.

[519] *M'Caig v University of Glasgow* (1907) SC 231.

settlor can direct investments in an investment management trust.[520] In a subsequent paper,[521] Langbein has taken this argument further to include a notion of equitable title: "A quite distinct explanation [from anti-dead-hand policy reasons] for why the law restricts the unilateral dominion of the settlor (…) is that trust law is also concerned with protecting the ownership interests of the beneficiaries (…) and that entitlement sets outer limits on trust law's willingness to enforce settlor-imposed terms that are harmful to the beneficiaries."[522]

While this model is intriguingly close to coming full circle back to the English position where the rights of the beneficiary provide conceptual limits to the settlor's powers, for example by prohibiting the settlor from setting up spendthrift trusts (trusts overriding *Saunders v Vautier* powers) or inalienable beneficial interests, a few things must be noted about Langbein's argument. Firstly, it does not divert from US trust law's basic premises that 1) the trust is a species of gift or an interest carved out of the settlor's property, and that 2) the settlor's donative powers reign supreme in setting the content of a trust and are limited only under special justifications. Indeed, these are still Langbein's starting points.

Secondly, Langbein's model does not command uniform acceptance in American trust law scholarship. The model was attacked by Jeffrey Cooper,[523] stating that the UTC and Langbein's view would be a 'potentially revolutionary change' and that trust law would be better

[520] JH Langbein 'Mandatory Rules in the Law of Trusts' (2004) 98 Northwestern U LR 1105, 1111. This is reminiscent of the English decision of *Cowan v Scargill* [1980] Ch 270, where Megarry VC directed that the trustees of a pension trust cannot create investment policy that would conflict with the beneficiaries' financial best interest (as opposed to what most benefits the coal miners' industrial employment), as the purpose of a pension trust is to obtain the largest possible financial gain.

[521] JH Langbein 'Burn the Rembrandt? Trust Law's Limits on the Settlor's Power to Direct Investments' (2010) 90 Boston U LR 375.

[522] *Ibid,* 379.

[523] JA Cooper 'Empty Promises: Settlor's Intent, The Uniform Trust Code, and the Future of Trust Investment Law' (2008) Boston U LR 1165.

served if it 'provide[d] no aid in cases where a settlor intentionally and thoughtfully impaired the beneficiaries' economic rights'.[524] This is essentially because the starting point in American trust law is the settlor's 'nearly unfettered latitude' in setting up the terms of the trust, which the UTC (under Langbein's reading) denies, according to Cooper.[525]

Thirdly, Langbein' argument is not trying to create any fundamental change in the basic assumptions of American trust law. It is only concerned with redefining what is known as the rule against capricious purposes (as pointed out in the subsequent response paper to Cooper's point[526]) – limiting the powers of the infrequent 'crackpot' settlors – and therefore presumably only affects a vanishingly small number of cases.[527]

With these points in mind, it is highly unlikely that the argument represents a great shift in how American legal scholarship sees the central landscape of trust law. The trust remains a kind of donative transfer analogous to a gift, and subsequently the law concentrates on the settlor's dispositive powers and not the nature of the beneficiary's interest.

Important theoretical and doctrinal consequences follow. While American law pays lip service to the idea central in English trust law that the trustee is the legal owner of the property in question, in practice this is mostly an empty phrase. The trustee is said to have 'all the powers over trust property that a legally competent, unmarried individual has in respect to individually owned property',[528] but American trust law has abandoned some of the key indicia of ownership

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[524] *Ibid.,* 1166

[525] *ibid.*, 1168.

[526] JH Langbein 'Burn the Rembrandt? Trust Law's Limits on the Settlor's Power to Direct Investments' (2010) 90 Boston U LR 375.

[527] Langbein says as much in *ibid.*, 395.

[528]Restatement (Third) of Trusts § 85(1)(a) (2003); see also UTC § 815(a)(2)(A) (2000).

as far as the trustee is concerned. The most striking doctrinal evidence for this is that the trustee's personal liability, a feature of the trustee's holding of legal title, has been abolished in the US. [529]

The most recent edition of *Scott on Trusts* states that 'there is a growing tendency, however, to regard the trustee as merely the trust's administrator, and not the owner of the trust estate, when the rights of third persons are at issue'.[530] It is submitted that this is a direct consequence of the theoretical emphasis on the settlor's dispositive powers and the subsequent emphasis on giving substance to his residual control over the trust assets as evidenced in his expressions of intention. In the US the trustee is thought of as more like a manager or analogous to a company director, and only holds legal title for that purpose.[531]

This residual control interest of the settlor deserves exposition, as it is foreign to the English trust lawyer. Robert Sitkoff writes that '[trust] law should minimise the agency costs inherent in locating managerial authority with the trustee (T) and the residual claim with the beneficiaries (B1 and B2), *but only to the extent that doing so is consistent with the ex ante instructions of the settlor (S).* This qualification gives priority to the *settlor over the beneficiaries* as the trustee's *primary principal*' (emphases added).[532]

[529] See RH Sitkoff 'Trust Law as Fiduciary Governance plus Asset Partitioning' in L Smith (ed) *The Worlds of the Trust* (CUP, Cambridge 2013),428, 436. See the main doctrinal section below for more details on the specific operation of this doctrine.

[530] ML Ascher (ed) *Scott and Ascher on Trusts* (4th ed Aspen Publishers 2007), 1870.

[531] See generally: AI Ogus 'The Trust as Governance Structure' (1986) 36 Toronto LJ 186; H Hansmann & U Mattei 'The Functions of Trust Law: A Comparative Legal and Economic Analysis' (1998) 73 NYU LR 434; RH Sitkoff 'An Agency Costs Theory of Trust Law' (2003-04) 89 Cornell LR 621; RH Sitkoff 'Trust Law as Fiduciary Governance plus Asset Partitioning' in L Smith (ed) *The Worlds of the Trust* (CUP, Cambridge 2013), 428.

[532] RH Sitkoff 'An Agency Costs Theory of Trust Law' (2003-04) 89 Cornell LR 621, 624.

In other words, the trustee is an agent (in a broad, non-legal sense) of both the beneficiaries and the settlor, but the beneficiaries are described as 'residual claimants', meaning claimants in the remaining assets of the enterprise once those with fixed claims (such as external creditors) are satisfied, drawing an analogy to shareholders of a company.[533] This justifies the beneficiaries' enforcement powers (arising by virtue of the fiduciary obligations owed to them by the trustee) in terms of a residual claim (based on the fact that the beneficiaries bear the residual risk associated with the trustee's management regime), and leaves a logical space for prior enforcement interests. These naturally include established legal rights of the trust creditors and the trustee's right of remuneration and indemnity for costs, but interestingly the most prior interest is then found in the settlor – it is actually the *settlor's* ex ante intention that is being safeguarded, though indirectly as the settlor is denied standing to enforce the trust.[534] As this settlor enforcement interest lacks specific legal form, let us call it 'an evanescent interest'.[535]

While to an English equity lawyer it may seem strange or academic to entertain a discussion about an interest without a specific legal form, it is nevertheless a natural consequence of the basic approach of American trust law jurisprudence, perhaps deriving from the overriding spirit of functionalism. From time to time the case has been made to give the settlor standing to enforce directly, showing a clear academic recognition of the settlor's evanescent interest. This, it is submitted, is a direct result of American law's refocusing the central question of trust law away from the beneficiary's right and towards the settlor's powers.

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[533] Described as 'residual claimants' in (among others) the seminal work of FH Easterbrook and DR Fischel *The Economic Structure of Corporate Law* (Harvard University Press, Cambridge MA, 1991), 67.

[534] Restatement (Second) of Trusts § 200 cmt. b (1959).

[535] After John Langbein in 'Burn the Rembrandt? Trust Law's Limits on the Settlor's Power to Direct Investments' (2010) 90 Boston U LR 375, 379: 'Indeed, the settlor's interest in the transferred trust property is so evanescent that trust law denies the settlor standing to enforce the trust.'

John Langbein in his seminal 'Contractarian Basis' piece of 1995 discusses the possibility of direct settlor enforcement, and criticises the then existing Restatements for failing to consider that a settlor may have an interest in enforcing the trust terms. Under the contractarian basis of trusts, he argues, the case for the opposite default rule is made as the contractarian basis imports an 'intention-seeking standard', whereby the 'parties [to the trust contract] are routinely assumed to have intended enforcement by the promisee (the settlor-equivalent person) as well as the beneficiary'.[536]

Robert Sitkoff likewise discusses the possibility of direct settlor enforcement, agreeing with Langbein that trust law 'has obscured the relevance of the parties' probable intent'.[537] Sitkoff notes, however, that settlor standing possibly increases agency costs,[538] as the trustee would be 'told to serve two masters [and thus be] freed of both and (…) answerable to neither'.[539] On the other hand, as beneficiaries are often not the best-informed enforcers of the trust terms,[540] settlor standing might act to minimise agency costs by providing a greater

[536] JH Langbein, 'The Contractarian Basis of the Law of Trusts' (1995) 105 Yale LJ 625, 664.

[537] RH Sitkoff 'An Agency Costs Theory of Trust Law' (2003-04) 89 Cornell LR 621, 667

[538] Costs that arise as a result of unobservable decision-making authority of the agent that affects the wealth of the principal, together with the fact that the agent's and the principal's interests are not perfectly aligned. E.g. a real-estate agent will not spend £10 on an improvement that would produce a £100 increase in the value of the property if the agent gets a 5% commission – the agent would spend £10, but only get an additional £5 for the effort. See RH Sitkoff 'An Agency Costs Theory of Trust Law' (2003-04) 89 Cornell LR 621, 636-37; MC Jensen and WH Meckling 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure' (1976) 3 J Fin Econ 305, 308.

[539] FH Easterbrook and DR Fischel *The Economic Structure of Corporate Law* (Harvard University Press, Cambridge MA, 1991), 38. Sitkoff, *ibid*, at 668

[540] DR Fischel and JH Langbein, 'ERISA's Fundamental Contradiction: The Exclusive Benefit Rule' (1988) 55 U Chi LR 1105, 1114-15 and 1118-19; JN Gordon 'The Puzzling Persistence of the Constrained Prudent Man Rule' (1987) 62 NYU LR 52, 82.

incentive to act appropriately and by reducing the possibility of the beneficiaries and the trustee entering into a side bargain to avoid the constraints set by the settlor.[541]

The evanescent interest of the settlor may lack specific legal form, but it is not without legal effects. The Uniform Trust Code provides in Section 411(a) that a private trust may be terminated or modified 'upon consent of *the settlor* and all beneficiaries, even if the modification or termination is inconsistent with a material purpose of the trust'.[542] This is a recent codification of the so-called *Claflin* doctrine,[543] which places limits on the exercise of what in England is the beneficiary's *Saunders v Vautier* powers.[544] In essence, under the *Claflin* doctrine a trust may be terminated prematurely by the beneficiaries only with the consent of the settlor or if its termination does not go against a 'material purpose' of the trust.[545]

It is here, and in similar doctrines such as trustee removal, that Sitkoff finds evidence of American trust law's viewing of the settlor as the true principal for whom the trustee is acting: 'The upshot of the *Claflin* doctrine is that it helps align the interests of the settlor and the trustee. The rule allows the trustee to preserve the settlor's original design, regardless of the beneficiaries' wishes, which is what the settlor would have wanted. (…) Thus the *Claflin* doctine is consistent with the model of the settlor as the primary principal.'[546]

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541 Sitkoff, *ibid*, 669.

542 UTC § 411(a), 7C ULA 497-98. See also Restatement (Second) of Trusts, § 338(2) (1959).

543 From *Claflin v Claflin* (1889) 20 NE 454 Mass.

544 See the next chapter on the beneficial interest under American law for more details.

545 See Restatement (Third) of Trusts § 64 & cmt. a (2003); Restatement (Second) of Trusts § 337 (1959).

546 RH Sitkoff 'An Agency Costs Theory of Trust Law' (2003-04) 89 Cornell LR 621, 659.

John Langbein has recently argued a corollary point with respect to *Saunders v Vautier*. He writes:

> Perhaps the most striking feature of the rule in *Saunders v Vautier* is its disregard for the intent of the donor, even though "donative intent is the essence of a gift."[547] (…) The logic of *Claflin* is that the settlor's 'right' to condition his gift as he did was an incident of his ownership of the property he was transferring in trust. (…) The *Claflin* rule frames the relevant property rights at the time that the property is still in the hands of the donor, whereas the rule in *Saunders v Vautier* ignores rights claimed to have arisen at that time, waits for the transfer to have taken place, and then reckons the property in the hands of the donee as the sole source of property rights.[548]

This recent paper puts its finger on the key difference between English and American law, and how that difference is reflected in the *Saunders* – *Claflin* conflict; American law looks to settlors and English law looks to beneficiaries in determining the content of trust law doctrine.

Interestingly and in a parallel academic development to Langbein's Benefit-the-Beneficiaries rule introduced above, the *Claflin* doctrine in its strong settlor deference has come under scrutiny in American trust law scholarship, particularly as the rules against perpetuities are relaxed and thus property is tied up in trust for longer time periods.[549] Again, however, the relaxation of the *Claflin* doctrine is perhaps a less than revolutionary shift in American trust law's emphasis. The theoretical basis on which relaxations of the *Claflin* doctrine have been

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[547] Citing the Restatement (Third) of Property: Wills and Other Donative Transfers §6.1 cmt b (2003).

[548] JH Langbein 'Why the Rule in *Saunders v Vautier* is Wrong' in PG Turner (ed) *Equity and Administration* (CUP Cambridge 2016) 189, 196-198.

[549] EC Halbach 'Significant Trends in the Trust Law of the United States' (1999) 32 Vand J Transnat L 531, 538; EC Halbach 'Uniform Acts, Restatements, and Trends in American Trust Law at Century's End' (2000) 88 Cal LR 1877, 1899-1901; GB Bird 'Trust Termination: Unborn, Living and Dead Hands – Too Many Fingers in the Trust Pie' (1985) 36 Hastings LJ 563; R Chester 'Modification and Termination of Trusts in the 21st Century: Uniform Trust Code Leads a Quiet Revolution' (2001) 35 Real Prop Prob & Tr J 697; J Getzler 'Transplantation and Mutation in Anglo-American Trust Law' (2009) 10 Theoretical Inq 355; LW Waggoner 'US Perpetual Trusts' (2011) 127 LQR 423.

determined has been interpreted in favour of American trust law's deference towards settlor's powers.

Langbein writes that the trust modification and termination rules are 'imputed intention doctrines, which empower the court to modify the trust as the settlor would have wished. (…) The deviation doctrine is meant to be intent-serving, on an imputed intention standard.'[550] Similarly, Sitkoff argues that 'these liberalizations are designed to advance the settlor's probable intent,' giving the example of modification of a trust to minimise tax liabilities where new tax law has come into force after the declaration of trust.[551] Halbach also describes the relaxation of the rule as being limited by respect of the 'settlor's objectives and probable intentions',[552] and Bird frames his discussion of the issue of modification or termination by reference to the settlor changing his mind and wanting to withdraw support from an improvident grandchild or to give additional money to a grandchild in financial need.[553] While more general liberalisations have been suggested,[554] the UTC §412(a) itself continues: 'to the extent practicable, the modification must be made in accordance with the settlor's probable intention'.[555]

The settlor's evanescent interest is therefore indirectly recognised in law and provides the basis for academic discussion in American trust law scholarship. The evanescent interest is in turn a direct consequence of the basic tenet of American trust law, whereby the trust is seen as a

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550 Mandatory Rules in the Law of Trusts' (2004) 98 Northwestern U LR 1105, 1117-18.

551 RH Sitkoff 'An Agency Costs Theory of Trust Law' (2003-04) 89 Cornell LR 621, 661

552 EC Halbach 'Uniform Acts, Restatements, and Trends in American Trust Law at Century's End' (2000) 88 Cal LR 1877, 1901.

553 GB Bird 'Trust Termination: Unborn, Living and Dead Hands – Too Many Fingers in the Trust Pie' (1985) 36 Hastings LJ 563, 564.

554 R Chester 'Modification and Termination of Trusts in the 21st Century: Uniform Trust Code Leads a Quiet Revolution' (2001) 35 Real Prop Prob & Tr J 697.

555 UTC §412(a).

species of donative transfer analogous to a gift, which tenet refocuses the discussion away from what the nature of the beneficial interest is and towards what limits, if any, are to be placed on the settlor's freedom of disposition.

ii) Structure of Legal System & Role of Trust Law Academia

In order to fully appreciate the peculiarities of American trust law, some points must be made about the way it is brought about.

The development of English trust law has been judge-led ever since Chancery courts' first inception,[556] and largely remains so to this day. There is no one central treatise on how trust law works and legislation does not deal with central structural issues, only isolated incidents such as trustee remuneration[557] or isolated formality requirements.[558]

American law is markedly different, in that judges have less of a role than the various legislatures and even academics. The publication of Scott's first Restatement of Trusts marks a watershed in the development of American trust law.

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[556] See, e.g., the Chancery-led development of group enterprise using equitable doctrine explained in J Getzler and M Macnair 'The Firm as an Entity Before the Companies Acts' in P Brand, K Costello and WN Osborough (eds) *Adventures of the Law: Proceedings of the Sixteenth British Legal History Conference, Dublin 2003* (Four Courts Press, Dublin 2005), 267.

[557] Ss. 28 – 32 of the Trustee Act 2000.

[558] E.g. s.53 of the Law of Property Act 1925.

In the 1920s Scott published journal articles railing against the obligational view of trusts[559] and personal liability of trustees,[560] and in 1935 he codified his view into the restatement of which he was the industrious author. Scott's own textbook treatise follows the structure of the restatement,[561] even having the same section numbers for the same topics, and reads as a further elaboration with additional case law to the restatement.

The restatement, in turn, was very influential in trust law practice across the United States. Decisions in various state Supreme Courts are of interest mostly in that they affirm or unexpectedly depart from the restatement, particularly in the case of the first two editions. This shows up in the reasoning as well – the courts do not engage in conceptual discovery (as they do in the English House of Lords and Supreme Court, at least at its finest moments), but rather cite and interpret the restatement as if it were a statute. As the author of both the restatements (1 and 2) and the central multivolume treatise was Scott, the influence of his views in American trust law can hardly be overestimated.

It is submitted that the reliance on Scott's treatise and restatements is what moved the courts away from conceptual rigidity that we still adhere to (or try to) in England, and that this in turn gradually opened the door to legislative intervention. When trust law is simply a collection of sections in a restatement, even rather looking like statutes, there seems no reason why these rules could not be changed to suit the needs of interested groups in the same way as legislation is passed normally.[562] This trend has culminated in the passing of the Uniform Trust Code, which

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559 AW Scott 'The Nature of the Rights of the *Cestui Que Trust*' (1917) 17 Columbia LR 269; note how at this stage the debate was still genuine and ongoing: see HF Stone 'The Nature of the Rights of the *Cestui Que Trust*' (1917) 17 Columbia LR 467.

560 AW Scott 'Liabilities Incurred in the Administration of Trusts' (1915) 28 Harv LR 725.

561 AW Scott *The Law of Trusts* (1st ed Little, Brown and Co, Boston 1939).

562 One example of the partisan legislative process is given in the following chapter – see section on the Schumer amendment.

codified such striking doctrines as the permissibility of restraints on alienation,[563] and abolition of personal liability of the trustee.[564] The UTC has been adopted in the majority of states.

Another aspect of legislative intervention is the matter of state legislatures. As the states compete with each other to attract trust business, a pressure for constant trust law reform arises,[565] pushing trust law into ever more business friendly forms.[566] Examples include the Alaskan Trust Company with fully-blown limited liability, quickly mimicked in Delaware;[567] the Massachusetts Business Trust;[568] and Delaware's abolition of the rule against perpetuities in 1995, quickly followed by 28 other states and Washington DC.[569] There is now also a Uniform Statutory Trust Entity Act, which was promulgated in 2009 and revised in 2011. These specific legislative interventions are an important addition to the practice of asset partitioning under US trust law, though they are haphazard and difficult to classify in any coherent way.[570]

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563 UTC § 502

564 UTC § 1010-1013

565 On this phenomenon generally: CM Tiebout 'A Pure Theory of Local Expenditures' (1956) 64 J Pol Econ 416. This is a well-known and studied phenomenon in corporate law; see WL Cary 'Federalism and Corporate Law: Reflections upon Delaware' (1974) 83 Yale LJ 663.

566 D Bencivenga 'Push to Modernize: Lawyers See Need for Competitive Business Laws' (1998) 219 NYLJ 5.

567 In the Delaware Business Trust Act 1988, now the Delaware Statutory Trust Act 2001; see T Frankel 'The Delaware Business Trust Act Failure as the New Corporate Law' (2001) 23 Cardozo LR 325.

568 See SA Jones *et al*, 'The Massachusetts Business Trust and Registered Investment Companies' (1988) 13 Del J Corp L 421, 425-28 (reviewing the history of the Massachusetts business trust and its English roots.)

569 See RH Sitkoff & MM Schanzenbach 'Jurisdictional Competition for Trust Funds: An Empirical Analysis of Perpetuities and Taxes' (2005) 115 Yale LJ 356; MM Schanzenbach 'Perpetuities or Taxes? Explaining the Rise of the Perpetual Trust' (2005-2006) 27 Cardozo LR 2465.

570 See SL Schwarcz 'Commercial Trusts as Business Organizations: Unraveling the Mystery' (2003) 58 Bus Law 559, 568-69; and below.

iii) Structure of Trust Law

In the US, as in England, the trust was one of the primary ways in which business enterprise was organised before the rise of the company limited by shares,[571] described as an attractively flexible form of conducting business.[572] With hindsight and in light of the theoretical justifications outlined above, American law scholarship struggles to fit the business trust into the conception of the trust as an interest carved out of a given person's property.[573] The US common law business trust (as distinct from the statutory business trusts mentioned in the preceding section) is seen as something of a special case,[574] with a corresponding scholarship and teaching lacuna – neither the trust lawyers nor the business organisation lawyers see it as their subject.[575]

The answer to this problem is the same that English trust law sometimes sleepwalks towards,[576] which is simply to view 'commercial trusts' and 'traditional trusts' as somehow

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571 N Isaacs 'Trusteeship in Modern Business' (1929) 42 Harv LR 1048, 1060-61; JL Berger and CA Jones *Fletcher Cyclopedia of the Law of Private Corporations* (Revised edition 2003) §8227; RH Sitkoff 'Trust as "Uncorporation": A Research Agenda' [2005] U Ill LR 31, 32. Incidentally, this is why competition law is called 'antitrust' in the United States, denoting policies designed to combat monopoly trusts.

572 N Isaacs, *ibid*, 1052.

573 For example, Langbein writes: 'Although the trust device has found important uses in commerce, "[t]he normal private trust is essentially a gift (…)".' (in 'Mandatory Rules in the Law of Trusts' (2004) 98 Northwestern U LR 1105, 1109; quoting Bernard Rudden).

574 See JH Langbein 'The Secret Life of the Trust: The Trust as an Instrument of Commerce' (1997) 107 Yale LJ 165; SL Schwarcz 'Commercial Trusts as Business Organizations: Unraveling the Mystery' (2003) 58 Bus Law 559, 568-69 stating that the statutory business trust is 'not a "type" of trust' like its common law cousin (Schwarcz calls this a 'commercial trust'), but a specific statutory creation.

575 RH Sitkoff 'Trust as "Uncorporation": A Research Agenda' [2005] U Ill LR 31, 33.

576 E.g. in *Target Holdings Ltd v Redferns* [1996] AC 421, 435-36 Lord Browne-Wilkinson distinguishes 'traditional trust' and trusts used in commercial dealings as an element of a larger

vaguely separate, leading to differing considerations being given weight depending on the context. This approach has been taken to fruition in the United States. Leaving charities aside, American trust law is therefore divisible into the law of business trusts, the law of management trusts and the law of donative trusts.[577] The foremost is seen as being governed not by freedom of disposition (as the latter two are) but as essentially a matter of *freedom of contract*.[578]

The business trust is, however, a very different animal to the ordinary trust, in the statutory cases being a full entity capable of suing or being sued, with full asset partitioning. It seems therefore that a detailed study of various business trusts is not entirely within the scope of this thesis, which is attempting to solve conceptual questions about the nature of asset partitioning in the trust. It may therefore be better to leave specific legislatively created vehicles to one side, used as points of interest rather than detailed study.[579]

2. Trust Creditors' Access under US Law

i) American Law before the First Restatement

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commercial transaction with some ultimate purpose. See also Lord Toulson in *AIB Group (UK) Plc v Mark Redler & Co (A Firm)* [2014] UKSC 58, [2014] 3 WLR 1367, paras 71-74.

[577] This is rephrasing RH Sitkoff 'Trusts and Estates: Implementing Freedom of Disposition' (2013-14) 58 St Louis U LJ 643, 653; J Dukeminier & RH Sitkoff (eds) *Wills, Trusts, and Estates* (9th Ed, Wolters Kluwer Law & Business, New York 2013), 583

[578] RH Sitkoff 'Trusts and Estates: Implementing Freedom of Disposition' (2013-14) 58 St Louis U LJ 643, 653; J Dukeminier & RH Sitkoff (eds) *Wills, Trusts, and Estates* (9th Ed, Wolters Kluwer Law & Business, New York 2013), 583.

[579] Same could also be said of the unit trust, which combines limited liability companies and trusts with obvious asset partitioning consequences, common in England and Australia - see generally: KF Sin *The Legal Nature of the Unit Trust* (Clarendon Press, Oxford 1997); *Commissioner of Taxation v Electnet (Aust) Pty Ltd* [2015] FCAFC 178.

The law in the United States before the First Restatement and Scott's treatise more or less followed the same basic principles as English law. The trustee could similarly be sued for liabilities incurred in the administration of the trust, whether or not he was acting in accordance with the trust deed.[580] There is plenty of case law to suggest this also applied to torts.[581] There are both English and American authorities suggesting the trustee had access to his indemnity where he is not personally to blame for the tort, but not if he is.[582] Tort creditors could also access the trust assets through subrogation to the trustee's indemnity right,[583] though the claim may have been only against the trustee where the tortfeasor had assets that could be reached by an action at law.[584] The beneficiary was not liable as a principal for the torts committed by the trustee in administration of the trust.[585]

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[580] *Duvall v Craig* 2 Wheat (US) 45 (1817); *Taylor v Davis' Administrator*, 110 US 330 (1884).

[581] *Johnston v Long,* 18rP 2d 645 (Cal 1947); *Everett v Foley*, 132 Ill App 438 (1907); *Piff v. Berresheim*, 92 NE 2d 113 (Ill 1950); *O'Malley v Gerth*, 67 NJL 610, 52 Atl 563 (1902); *In re Estate of Davenport*, 2 NW 2d 17 (Neb 1942); *Keating v Stevenson*, 21 NY App Div 604, 47 NY Supp 847 (1897); *Boyd v U. S. Mortgage & Trust Co.*, 84 NY App Div 466, 82 NY Supp 1001 (1903); *Moniot v Jackson*, 40 NY Misc 197, 81 NY Supp 688 (1903); *Gillick v Jackson*, 40 NY Misc 627, 83 NY Supp 29 (1903); *Kirchner v. Muller*, 19 NE 2d 665 (NY 1939); *Martin v. Talcott*, 146 NYS 2d 784 (App Div 1955); *Miller v. Jacobs*, 65 A.2d 362 (Pa. 1949); *Ballou v Farnum*, 9 Allen (Mass) 47 (1864); *Baker v Tibbetts*, 162 Mass 468, 39 NE 350 (1895); *Fisheries Co. v. McCoy*, 202 SW 343 (Tex. Civ. App. 1918); *Parmenter v Barstow*, 22 RI 245, 47 Atl 365 (1900); *Sprague v Smith*, 29 Vt 421 (1857); *O'Toole v Faulkner*, 29 Wash 544, 70 Pac 58 (1902); *Fisher v McNeely*, 188 P 478 (Wash 1920); *Marion v Chandler*, 81 SE 2d 89 (W Va 1954); *Ross v Moses*, 179 SE 757 (SC 1935).

[582] *Benett v Wyndham* (1862) 4 DeG, F&J 259; *In re Raybould* [1900] 1 Ch 199; *In re Hunter*, 151 Fed 904 (1907).

[583] *In re Raybould* [1900] 1 Ch 199; *In re Hunter*, 151 Fed 904 (1907); *Miller v Smythe*, 92 Ga 154, 18 SE 46 (1893).

[584] *Owen v Delamere*, (1872) LR 15 Eq 134; *Dantzler v McInnis*, 151 Ala 293, 44 So 193 (1907); *Johnson v Leman*, 131 Ill 609, 23 NE 435 (1890); *Stern Bros. v Hampton* 72 Miss 555 (1895).

[585] *Falardeau v Boston Art Students' Association*, 182 Mass 405, 65 NE 797 (1903).

As with English law, the nature of the trustee's right was described as a lien.[586] This similarity extends to the idea that a trustee's right of indemnity is in priority to the beneficiaries' entitlements.[587] The doctrine in *Ex Parte Garland*, the idea that only those trust assets devoted to a trade are available for the claims of the trade creditors was also adopted in American law,[588] but there it was described as a presumption which may be overcome.[589]

The basic idea of dependence on the trustee's right appears to have had the same effect as in English law – an unconnected liability destroyed the creditor's right,[590] though these cases might be more unforgiving than English law to the creditor of a trustee who was ultra vires but without fraud. However, where such trustee acted to benefit the trust the right of indemnity persisted, as with English law (though this may only have been to the extent of the benefit conferred, which is not a feature of English law).[591] Where an executor-trustee continued a

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[586] *Stott v Milne* (1884) 25 Ch D 710; *Livingston v Newkirk*, 3 Johns Ch (NY) 312 (1818); *Woodard v Wright*, 82 Cal 202, 22 Pac 1118 (1889); *Perrine v Newell*, 49 NJ Eq 57, 23 Atl 492 (1892).

[587] *Williams v Allen*, (1863) 32 Beav 650; *In re The Exhall Coal Co.*, (1866) 35 Beav 449; *Dodds v Tuke*, (1884) 25 Ch D 617; *Perrine v Newell*, 49 NJ Eq 57, 23 Atl 492 (1892).

[588] *Burwell v Mandeville's Executor*, 2 How (US) 560 (1844); *Smith v Ayer*, 101 US 320 (1879); *Fridenburg v Wilson*, 20 Fla 359 (1883); *Wilson v Fridenburg*, 21 Fla 386 (1885). *McNeillie v Acton*, (1853) 4 DeG, M&G 774; *Lucht v Behrens*, 28 Oh St 231 (1876).

[589] *Blodgett v American National Bank*, 49 Conn 8 (1881); *Moore v McFall*, 263 Ill 596, 105 NE 723 (1914); *Willis v Sharp,* 113 NY 586, 21 NE 705 (1889); *Davis v Christian*, 15 Gratt (Va) 11 (1859).

[590] *Farmers' & Traders' Bank v Fidelity & Deposit Co.,* 108 Ky 384, 56 SW 571 (1900); *Bauerle v Long*, 187 Ill 475, 58 NE 458 (1900); *Tuttle v First Nat. Bank*, 187 Mass 533, 73 NE 560 (1905); *Mason v Pomeroy*, 151 Mass 164, 24 NE 202 (1890); *King v Stowell*, 211 Mass 249, 98 NE 91 (1912); *Wilson v Fridenburg*, 21 Fla 386 (1885); *Dantzler v McInnis*, 151 Ala 293, 44 So 193 (1907); *Wells-Stone Mercantile Co. v Aultman, Miller & Co.*, 9 ND 520, 84 NW 375 (1900).

[591] *Thomas v Provident Life & Trust Co.*, 138 Fed 348 (1905); *Deery v Hamilton*, 41 Iowa 16 (1875); *In re Estate of Manning*, 134 Ia 165, 111 NW 409 (1907); *De Concillio v Brownrigg*, 51 NJ Eq 532, 25 Atl 383 (1893); *Stillman v Holmes*, 9 Oh NPNS 193 (1909). *Hallock v Smith*, 50 Conn 127 (1882).

business bequeathed by will against the consent of the creditors of the testator, such creditors have priority to trust creditors.[592]

The *Muir* and *Re Robinson's Settlement* type of limitation by the trustee of his liability through contract was and is also possible in American law, and there is a wealth of case law about it.[593] The trustee appears to have had a power to charge the trust estate directly at least in some states,[594] which goes well beyond what the trustee can do in English law. However, some American decisions also reflected the English position (e.g. in *Clack v Holland*,[595]) that the trustee when contracting 'as trustee only' does not bind the estate which has no personality, but only limit their own liability to the extent of their indemnity right.[596]

The possibility of having direct recourse to trust assets to pay off liabilities incurred by the trustee, under *Blundell*, may have already been somewhat wider in American law prior to the first Restatement than it is in England, and might have provided the blueprint for the abolition

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[592] *Re Millard*, 72 LTNS 823 (1895); *Willis v Sharp*, 115 NY 396, 22 NE 149 (1889); *Morrow v Morrow*, 2 Tenn Ch 549 (1875).

[593] *Duvall v Craig*, 2 Wheat (US) 45 (1817); *Taylor v Davis' Administrator*, 110 US 330 (1884); *Hall v Jameson*, 151 Cal 606, 91 Pac 518 (1907); *Tucker Mfg. Co. v Fairbanks*, 98 Mass 101 (1867); *Rosenthal v Schwartz*, 214 Mass 341, 101 NE 1070 (1913); *McGovern v Bennett,* 146 Mich 558, 109 NW 1055 (1906); *Koken Iron Works v Kinealy,* 86 Mo App 199 (1900); *Germania Bank v Michaud*, 62 Minn 459, 65 NW 70 (1895); *Whalen v Ruegamer*, 123 NY App Div 585, 108 NY Supp 38 (1908); *Dunlevie v Spangenberg*, 66 NY Misc 354, 121 NY Supp 299 (1910); *Roger Williams Nat. Bank v Groton Mfg. Co.*, 16 RI 504, 17 Atl. 170 (1889); *Wardwell v Williamson*, 72 Vt 183, 47 Atl 786 (1900). *Thayer v Wendell,* 1 Gall (US) 37 (1812); *Glenn v Allison*, 58 Md 527 (1882); *Snow & Leather Nat. Bank v Dix*, 123 Mass 148 (1877); *Hussey v Arnold*, 185 Mass 202, 70 NE 87 (1904); *Packard v Kingman*, 109 Mich 497, 67 NW 551 (1896); *Brackett v Ostrander*, 126 NY App Div 529, 110 NY Supp 779 (1908).

[594] *Gisborn v Charter Oak Life Ins. Co.*, 142 US 326 (1892); *Noyes v Blakeman* 6 NY 567 (1852); *New v Nicoll* 73 NY 127 (1878); *O'Brien v Jackson* 167 NY 31, 33 (1901); *Fowler v Mutual Life Ins. Co.*, 28 Hun (NY) 195 (1882); *Wadsworth, Howland & Co. v Arnold*, 24 RI 32, 51 Atl 1041 (1902); *Bushong v Taylor* 82 Mo 660 (1884). *Bank of Topeka v Eaton* 100 Fed 8 (1900), affirmed SC 107 Fed 1003, 47 CCA 140 (1901).

[595] *Clack v Holland* (1854) 19 Beav 262.

[596] *King v Stowell* 211 Mass 246, 251 (1912).

of the trustee's personal liability that we find in modern American trust law. The pre-1935 jurisprudence cites some additional English cases,[597] in holding that the trustee or his creditor may bring a bill in equity to access the trust assets directly,[598] though *Strickland v Symons*[599] suggests that this can be done only where the trust engages in trade.

Some of the American cases in some states suggest that a bill in equity could only be brought if the trustee is first sued in law and no effective remedy was available,[600] though this appears not to have been the case in Massachusetts.[601] The Massachusetts Business Trust was in wide use even at the time,[602] and this may have influenced this key development.

The evolution of trust law in Massachusetts deserves special mention, as the trust device in that state came under such intense pressure from the needs of industry. Massachusetts was one of the last states to permit private incorporation in a form that we would recognise it today (i.e. self-incorporation without Royal charter, or in the US case a special legislative charter

[597] *In re National Financial Co.* (1868) LR 3 Ch 791; *Hobbs v Wayet* (1887) 36 Ch D 256; *Cruse v Paine* (1869) LR 6 Eq 641, LR 4 Ch 441; *Lacey v Hill* (1874) LR 18 Eq 182.

[598] *Fairland v Percy* (1875) LR 3 P & D 217; *In re Pumfrey* (1882) 22 Ch Div 255; *Moore v McGlynn* [1904] 1 IR 334; *Mason v Pomeroy* 151 Mass 164, 24 NE 202 (1890); *King v Stowell* 211 Mass 246, 98 NE 91 (1912); *Laible v Ferry* 32 NJ Eq. 791 (1880); *Paul v Wilson* 79 NJ Eq 204, 81 Atl 835 (1911); *Wells-Stone Mercantile Co. v Aultman, Miller & Co* 9 ND 520, 84 NW 375 (1900); *Cater v Eveleigh* 4 Desaus Eq (SC) 19 (1809); *Braun v Braun* 14 Manitoba 346 (1902).

[599] *Strickland v Symons* (1884) 26 Ch Div 245.

[600] *Blackshear v Burke* 74 Ala 239 (1883). See *Henshaw v Freer* 1 Bailey Eq (SC) 311 (1831); *Gates v McClenahan* 124 Ia 593, 100 NW 479 (1904); *Norton v Phelps* 54 Miss 467 (1877); *Field v Wilbur* 49 Vt 157 (1876).

[601] *Mason v Pomeroy* 151 Mass. 164, 24 N. E. 202 (1890); *King v Stowell* 211 Mass. 246, 98 N. E. 91 (1912)

[602] SA Jones *et al*, 'The Massachusetts Business Trust and Registered Investment Companies' (1988) 13 Del J Corp L 421, 427-29.

instrument) in 1851 even though it was a 'leader in industrial development'.[603] The pressure of industrial business activity coupled with the unavailability of a private incorporation drove individuals to form joint enterprise structures using the trust device, which in turn put pressure on the legislature and the courts to develop rules regarding these types of trusts.[604]

The Massachusetts Business Trust went from being described as a partnership in 1885,[605] to being a trust where the shareholders are beneficiaries in 1890,[606] to an enterprise capable of being enforced against directly in 1933 in *Larson v Sylvester*.[607] In that case the court reasoned that 'the trust is not a legal personality. (…) It differs from a corporation or a partnership. The former can be sued (…) in its own name [while the latter] must be sued, ordinarily, in the names of the partners.'[608] The court then continued by quoting the Massachusetts business trust statute: '[A] trust may be sued in an action at law for debts and other obligations or liabilities contracted by the trustees (…) and its property shall be subject to attachment and execution in like manner as if it were a corporation (…)'[609]

This, though a special case with a statutory footing, was strongly in keeping with Austin Scott's published views on the personal liability of trustees.[610] He writes:

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[603] EM Dodd 'Statutory Developments in Business Corporation Law 1886-1936' (1936) 50 Harv LR 27, 31; EM Dodd 'The Evolution of Limited Liability in American Industry: Massachusetts' (1947-48) 61 Harv LR 1351, 1353.

[604] SA Jones *et al*, 'The Massachusetts Business Trust and Registered Investment Companies' (1988) 13 Del J Corp L 421, 425-432.

[605] *Ricker v American Loan & Trust Co* (1885) 14 Mass 346, 5 NE 284, 286.

[606] *Mayo v Moritz* (1890) 151 Mass 481, 24 NE 1083, 1803.

[607] *Larson v Sylvester* (1933) 282 Mass 352, 185 NE 44.

[608] *Ibid.* 45-46.

[609] *Ibid*, Mass Gen Laws Ann ch 182 § 6.

[610] AW Scott 'Liabilities Incurred in the Administration of Trusts' (1915) 28 Harv LR 725.

> To the extent that the trustee has power to incur the debt he has power to charge the estate therefor. Since the claim of the creditor on such a contract is a claim directly against the trust estate, and not merely a right to proceed through the trustee, it is immaterial whether the trustee is indebted to the estate or not. To give the creditor a right against the estate it is necessary only that the trustee acted properly in incurring the debt.[611]

Scott, writing in 1915, confined this to contracts where the trustee has contracted 'as trustee', but followed this argument with a generally applicable doctrine of direct creditor access based on unjust enrichment of the estate: 'when a remedy against the trust is unavailing, there is no good reason why the estate should profit at the expense of the creditor'.[612]

Other American academics also approached the issue at the time. In a 1922 article Harlan Stone, who had also locked horns with Scott about the nature of the equitable interest in 1917,[613] essentially argued that the law at the time (with heavy use of the central English decisions) was correct in upholding the central principle of personal liability of the trustee, and could be applied creatively ('with precision and exactness') to erase problems such as the unconnected liability problem.[614] Stone found a way to use *Blundell v Blundell* and *In Re Richardson* to show that the creditor could compel the trustee to use his power of indemnity to meet a specific liability independent of the trustee's previous liability to the trust.[615] With this method, 'the unfortunate consequence of the doctrine in *In Re Johnson* and *Guerry v Capers*[616] will thus be

[611] *Ibid.* 739-40.

[612] *Ibid.* 740-41.

[613] AW Scott 'The Nature of the Rights of the *Cestui Que Trust*' (1917) 17 Columbia LR 269; HF Stone 'The Nature of the Rights of the *Cestui Que Trust*' (1917) 17 Columbia LR 467

[614] HF Stone 'A Theory of Liability of Trust Estates for the Contracts and Torts of the Trustee' (1922) 22 Colum LR 527.

[615] *Ibid*, 538-39.

[616] *Guerry v Capers* (SC) Baily Ew 159 (1830).

avoided and the law brought into harmony with prevailing economic tendencies as expressed in judicial decision.'[617]

ii) First Restatement and Legislative Reshaping of Trust Law

The first Restatement of Trusts formally preserved the basic position we still find in English law that the trustee is personally liable, and only has a right of indemnity out of the trust assets.[618] However, Scott did solidify his earlier theory that if a trustee contracts that the third party will only look to the trust estate, the creditor will have an equitable action against the trust estate directly.[619] These not only include the usual claim through subrogation to the trustee's right of indemnity, but also his earlier argument of a claim based on unjust enrichment of the estate.[620] By the early 1940s, when Harlan Stone was the Chief Justice of the United States and Austin Scott the author of the Restatement, there was already a trend towards liberalisation of the old rules, both academic[621] and judicial.[622]

Since the first Restatement a clear trend towards legislative intervention in this area is patent. The principle was codified as early after the first Restatement as in the Uniform Trusts

[617] HF Stone 'A Theory of Liability of Trust Estates for the Contracts and Torts of the Trustee' (1922) 22 Colum LR 527, 540.

[618] Restatement of Trusts § 262 (1935), AW Scott *The Law of Trusts* (Little, Brown and Co, Boston 1939), § 262.

[619] Scott, *ibid*, § 271.

[620] *Ibid.* §§ 267 et seq.

[621] E.g. Note 'The Contractual Liabilities of Trustees' (1940-41) 50 Yale LJ; CH Fulda and W Pond 'Tort Liability of Trust Estates' (1941) 41 Colum LR 1332.

[622] E.g. *Kirchner v Muller,* 280 NY 23, 19 NE (2d) 665 (1939) (disapproving of this trend); *E River Savings Bank v Samuels*, 31 NE 2d 906 (NY 1941) (citing Scott); *Chase National Bank v Engel,* 27 NYS 2d 201 (App Div 1941) (Citing Scott); *Terminal Trading Co v Babbit,* 109 P.2d 564 (Wash 1941) (citing Scott's views with approval).

Act 1937, §12: 'The addition of the word "trustee" or the words "as trustee" after the signature of a trustee to a contract shall be deemed *prima facie* evidence of an intent to exclude the trustee from personal liability'.[623] Note that such a contract under the Uniform Trusts Act 1937 does not simply limit the trustee's liability to the amount of remaining trust assets (as the principle is in England, see previous chapter), but altogether excludes his personal liability. The difference may seem subtle, but it in fact wholly dismantles the usual channel through which a creditor may gain access to trust assets (by subrogation to the trustee's right of indemnity). If the creditor is to be given any remedy, it would be by enforcing against the trust assets directly.

Further legislative reshaping followed. The Uniform Probate Code ('UPC') (promulgated in 1969) reads: 'Unless otherwise provided in the contract, a trustee is not personally liable on contracts properly entered into in his fiduciary capacity in the course of administration of the trust estate unless he fails to reveal his representative capacity and identify the trust estate in the contract.'[624] The UPC also deals with the question of tort liability: 'A trustee is personally liable (…) for torts committed in the course of administration of the trust estate only if he is personally at fault.'[625] The same principle also applies for ownership liabilities, such as taxes, calls on shares and environmental liabilities.[626] A following subsection codified the right to claim against the trust assets directly, whether or not the trustee is personally liable for them.[627] The Uniform

[623] Note that such a contract under the Uniform Trusts Act 1937 does not simply limit the trustee's liability to the amount of remaining trust assets (as the principle is in England, see previous chapter), but altogether excludes his personal liability. The difference may seem subtle, but it in fact wholly dismantles the usual channel through which a creditor may gain access to trust assets (subrogation to the trustee's right of indemnity). If the creditor is to be given any remedy, it would be by enforcing against the trust assets directly.

[624] UPC § 7-306(a).

[625] UPC 7-306(b).

[626] UPC 7-306.

[627] UPC § 7-306(c).

Probate Code is adopted in 16 states,[628] and several states have passed legislation specifically to abolish trustees' personal liability since.[629]

More recently, the Uniform Trust Code of 2005 has solidified this doctrine into American trust law canon: 'Except as otherwise provided in the contract, a trustee is not personally liable on a contract properly entered into in the course of administering the trust if the trustee in the contract disclosed the fiduciary capacity.'[630] While it seems that initially the judiciary tried to fight back the change by restrictive interpretation,[631] after all these statutory inroads into

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[628] Alaska Stat. § 13.36.095 (1985); Arizona Rer. Stat. Ann. § 14-7306 (1995); California Prob. Code § 18004 (West 1991) (modified version); Colorado Rev Stat. § 15-16-306 (1987); Florida Stat. Ann. § 737.306 (West 1995); Hawaii Rev Stats. Ann. § 560:7-306 (Repl. 1993); Idaho Code § 15-7-306 (1979); Kentucky Rev Stat. Ann. § 386.730 (Michie 1995); Maine Rev Stat. Ann. Tit. 18-A § 7-306 (West 1981); Michigan Comp. Laws Ann. § 700.818 (West 1995); Montana Code Ann. § 72-36-105 (1995) (modified version); Nebraska Rev Stat. § 30-2817 (West 1981); New Mexico Stat. Ann. § 45-7-306 (Repl. 1995); North Dakota Cen. Code § 30.1-34-06 (1976); South Carolina Code Ann. § 62-7-306 (Law. Co-op 1987); Utah Code Ann. § 75-7-306 (1993).

[629] Uniform Trusts Act §§ 12 (contracts) & 14 (torts) (1937); Uniform Probate Code §§3-808 (personal representatives), 7-306 (trustees); Uniform Custodial Trust Act § 12; Uniform Trust Code § 1010. Alabama Code §§ 19-3-100, 19-3-150 to 19-3-152; Arkansas Code Ann. §28-72-412 (contracts); California Prob. Code §§ 18000 to 18005; Connecticut Gen. Stat. §§45a-168, 52-570a; Delaware Code Ann. tit. 12, § 3328(a) (contracts) & (b) (torts); Florida Stat. Ann. § 737.306; Georgia Code Ann. §53-12-199; Idaho Code § 68-1312 (custodial trust); Illinois SHA 760 ILCS 5/4.12, 5/4.24; Indiana Code § 30-4-3-10; Iowa Code § 633A.4601(l); Kentucky Rev Stat. Ann. § 386.730; Louisiana Rev Stat. Ann. §9:2125; Massachusetts Gen. Laws ch. 195, § 17 (personal representatives), ch. 203, § 14A; See also *First E. Bank v Jones*, 602 NE 2d 211 (Mass 1992) (statute inapplicable to trustee of Massachusetts business trust; statute applicable only to trusts 'of the donative type'); Missouri Rev Stat. §456.10-1010; Montana Code Ann. §§72-36-101 to 72-36-106; Nevada Rev Stat. § 163.120; New Hampshire Rev Stat. Ann. §293-B:4, B:5 (investment trust); New Jersey Stat. Ann. §§ 3B: 14-32 to 3B: 14-34; New York Est. Powers & Trusts Law § 11-4.7 (personal representatives); North Carolina Gen. Stat. §36C-10-1010; North Dakota Cent. Code §§59-02-10, 59-02-13; Ohio Rev Code Ann. § 1339.65; Oklahoma Stat. Ann. tit. 60, §§ 174, 175.18; Oregon Rev Stat. § 114.405 (personal representatives). Pennsylvania 20 Cons. Stat. §§3331,7133; Rhode Island Gen. Laws §§9-2-9, 18-4-14; South Carolina Code Ann. §62-7-1010; South Dakota Codified Laws Ann. §§55-3-7, 55-4-19, 55-4-21.
Texas Prop. Code Ann. § 114.084; Washington Rev Code § 11.98.110.

[630] UTC §1010(a).

[631] JD Johnston 'Developments in Contract Liability of Trusts and Trustees' (1966) 41 NYU LR 483.

central areas of trust law there is precious little left of the trustees' personal liability, in England thought to be a conceptual consequence of his legal ownership of the trust assets. This general trend is nothing short of a fundamental shift in the trustee-beneficiary relationship,[632] making the trust estate into a 'quasi-corporation'.[633]

It should be noted that this legislative trend is ongoing. Giving creditors access to the trust assets directly without regard to the trustee's ownership rights has cleared the way for uniform legislation for full entification of the business trust in the style of the Massachusetts Business Trust;[634] if the trust is already functionally a quasi-corporation or legal entity, there is no reason this principle should not be enshrined in statute. Similarly, if the trustee is the owner of the property only in form but not in substance, there is no reason the investment powers of a trustee cannot be transferred onto someone else who is not formally a trustee. This is known as divided trusteeship, and the Uniform Law Commission (committee chaired by Robert Sitkoff) is working on a Divided Trusteeship Act, giving a framework for the operation of these types of trusts.[635]

iii) Modern American Law

[632] JJ Curtis 'The Transmogrification of the American Trust' (1996) 31 Real Prop Prob & Trust J 251, 277.

[633] WL Hoey 'Personal Liability of Trustees under the Comprehensive Environmental Response, Compensation and Liability Act' (1990) 68 U Det LR 73, 79.

[634] Uniform Statutory Trust Entity Act 2009, most recently revised in 2013.

[635] A recent draft is publically available at http://www.uniformlaws.org/shared/docs/divided%20trusteeship/2015oct_DTA_Mtg%20Draft.pdf, accessed 20 February 2016.

It is therefore clear that the trustee who is sued by a creditor is sued in his representative capacity and not as the true legal owner of the property. The agency metaphor employed by Robert Sitkoff[636] is therefore entirely appropriate in the American context, and not far from being the most legally accurate way to describe the trustee's position. There are, however, some lingering residual effects of the trustee's custodial role that set a trustee apart from an agent.

As a matter of theory, the creditor's access to trust assets is still governed by the idea that the trustee has a right of indemnity or exonoration from the trust assets, which the creditor is allowed to control the exercise of for his own benefit to the extent of the right.[637] It is not entirely clear how this apparent dependence on the trustee's right is theoretically reconciled with giving access regardless of whether the trustee is personally liable.[638]

This theoretical underpinning, while admittedly eroded by statute, has some residual effects in American trust law. Although American trust legislation grants access to trust assets regardless of whether the trustee is personally liable, a creditor's claim still appears to depend on the trustee's right of indemnity.

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[636] See above.

[637] Restatement (Second) of Trusts § 268 & cmt a (1959); *Galdjie v. Darwish,* 7 Cal Rptr 3d 178 (Ct App 2003); *Faulk v. Smith*, 148 SE 100 (Ga 1929); *King v. Stowell*, 98 NE 91 (Mass 1912); *Matter of Damsky*, 23 NYS 2d 897 (Surr Ct 1940); *In re Estate of Fisher* 337 A 2d 834 (Pa. 1975); *Prudential Ins. Co. v. Land Estates, Inc.*, 31 F Supp 845 (SDNY 1939).

[638] See above. *Scott on Trusts* (which is cited in several of the leading cases above) presents the story as one of diverging procedures in the common law and Chancery courts, whereby the trustee could only be sued in law personally and the trust estate could only be reached by a suit in equity. This, the treatise continues, is no longer relevant in a time of fused common law and equity jurisprudence, so there is no reason *not to* allow access to the assets directly. While this may give a true account of the jurisdictional difficulties associated with the division of common law and Chancery courts, it is not a wholly accurate story of what the real conceptual issue at stake is; that the trustee is the legal owner of the property, and thus deals with third parties as a legal owner does normally, but third party creditors can only access the trust assets to the extent that the trustee can, as their claim is against the trustee and thus dependent on the trustee's right. See discussion of *In Re Johnson* (1880) 15 Ch D 548, above in Chapter 2.

The familiar issues discovered in the English law chapter above follow. For example, if the liability is not *properly* incurred (or the trustee has acted outside his powers), the trustee is not entitled to an indemnity and consequently the creditor cannot access the trust estate using this right.[639] However, Scott's original reinterpretation that where the trustee has acted outside his powers or breached the trust but in doing so has enriched the trust estate, the creditor can reach the trust assets through an indemnity, but only to the extent of the benefit conferred.[640] The trustee's right of indemnity may also be similarly limited by settlor-imposed restrictions on what assets can be dedicated to trade.[641] This, in turn, limits the creditor's access, as it does in English law.

This theoretical underpinning of dependence on the trustee's right (if not on his personal liability) even imports one of the more striking problems of English asset partitioning law: that of unconnected liabilities. This is despite the efforts of Harlan Stone, whose 1922 paper appears to be aimed at solving this very problem.[642] The issue is that if a trustee has breached the trust and therefore owes money to it (i.e., is in default to the trust), the creditor cannot claim against trust assets using the trustee's right of indemnity because the trustee does not have one.[643] The

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[639] *See* Restatement (Second) of Trusts §268 cmt. d & illus. 1 (1959). See also: *Matter of Trust of Getty*, 252 Cal Rptr 342 (CA 1988); *Miller v. Tranakos*, 434 SE 2d 84 (Ga App 1993); *Bauerle v. Long*, 58 NE 458 (III 1900); *Kemer v. George*, 52 NE 2d 300 (III App 1943); *Donnelly v. Alden*, 118 NE 298 (Mass. 1918); *Marshall Field & Co. v. Himelstein*, 235 NW 181 (Mich 1931); *Clauson v. Stull*, 200 A 593 (Pa 1938).

[640] See *Dowse v Gorton* above in Chapter 2 for the English origins of this rule. American law as found in Restatement (Second) of Trusts §268 cmt. d & illus. 2 (1959).

[641] Restatement (Second) of Trusts (1959), *ibid.* For comparative English law, see discussion above in Chapter 2 of *Ex parte Garland* (1804) 10 Ves 110; *Ex parte Richardson*, (1818) 3 Madd 138; *Cutbush v Cutbush* (1839) 1 Beav 184.

[642] HF Stone 'A Theory of Liability of Trust Estates for the Contracts and Torts of the Trustee' (1922) 22 Colum LR 527, 528.

[643] Restatement (Second) of Trusts §268 cmt. e & illus. 3, 4 (1959); *Wilson v Fridenberg*, 21 Fla 386 (1885); *King v Stowell*, 98 NE 91 (Mass 1912); *Hewitt v. Phelps*, 105 U.S. 393 (1882); *Mason v Pomeroy*, 24 NE 202 (Mass 1890).

leading American case, *Mason v Pomeroy,*[644] echoes the key statements from *In Re Johnson* (discussed above in Chapter 2) with eerie similarity:

> If it should [be proved] finally that there was nothing to which [the trustee] was entitled, then the plaintiffs would fail (…), unless they should succeed in maintaining their case upon some ground independent of being substituted to the equity of the trustee who contracted the debt (…).[645]

Viewed from the side of the beneficiary, '[he] may continue to enjoy the full economic benefit of the trust property, including the benefit conferred upon it by the creditor of the trustee without the necessity of paying for it from the trust property or otherwise—the one authentic instance in the law where one may pay his debts with his losses.'[646]

However, the creditor is not left entirely without a remedy in American trust law. As we have seen above, many statutory instruments now abolish the trustees' personal liability, unless the contract specifically so provides. The contract may also specifically stipulate that the trust estate is to be bound, and not the trustee. This means that where the contract creditor brings a claim, it is against the trustee in a representative capacity only whereby liability is limited to the trust assets.[647] It also means that the right of the contract creditor does not clone the features of the trustee's indemnity, and therefore cannot be called a 'lien',[648] as it sometimes is in English and Australian law.[649]

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[644] *Mason v Pomeroy*, 24 NE 202 (Mass 1890).

[645] *Ibid*, 204.

[646] HF Stone 'A Theory of Liability of Trust Estates for the Contracts and Torts of the Trustee' (1922) 22 Colum LR 527, 529.

[647] See Restatement (Second) of Trusts §271 cmt. a, illus. 1 & 2.

[648] *Ibid*, cmt e.

[649] Thought this appears to be a mischaracterisation of the foundational cases, see above in Chapter 2.

A specific response to the issue of unconnected liabilities also seems to have been developed in American trust law jurisprudence. Because the trust estate can be claimed against directly (though not through the trustee's indemnity right), the door is opened to claims not based on obligations undertaken or incurred by the trustee, but on unjust enrichment of the trust estate itself.[650]

This principle appears to be based on the 19th century English authority of *Devaynes v Robinson*.[651] Essentially the case was one where trustees had mortgaged the trust property outside the proper administration of the trust (the testator's will had decreed that the trust property be sold and the proceeds distributed to beneficiaries). The case simply holds that 1) the trustees are liable for the depreciation of value of the trust estate which resulted from their breach,[652] 2) the mortgage is not binding as the lender had notice or should have made inquiries as to the breach,[653] and 3) that the mortgagee is 'entitled to stand as creditor against the purchase-money, for so much of his mortgage-money as was properly applied in administration'.[654] There is literally no reasoning or explanation for this last holding – Sir John Romilly MR simply responds,

[650] See Restatement (Second) of Trusts § 269 (1959). Ascher in ML Ascher (ed) *Scott and Ascher on Trusts* (4th ed Aspen Publishers 2007), 1902, describes this relief as preventing an inequity. In English law this would still be a claim that is derivative on the trustee's rights to the assets, as the trust estate has no separate existence from its legal owner, the trustee, and the trustee cannot give what he does not have. See *Clack v Holland* (1854) 19 Beav 262, 276-277; and *Re Evans* (1887) 34 Ch D 597, 601-602.

[651] *Devaynes v Robinson* (1857) 24 Beav 86, 53 ER 289.

[652] Also described as 'a suit to repair the breach', *ibid*, at 294-95.

[653] The mortgage transaction was entered into 31 years after the death of the testator, which set the lender on inquiry as to why they had not mortgaged the property before. *Ibid,* at 292.

[654] *Ibid,* 294.

'yes, he is entitled to that' when one of the counsel asks at the closing of the first hearing whether the mortgagee is so entitled. There is no argument on this, and no cases cited.[655]

Nonetheless, this claim is now reasonably well established in American law for both contracts and torts of the trustee,[656] possibly reflecting a more broadly applicable heading of preventing inequity,[657] akin to unconscionability in Australian restitution law.[658] In *Thomas v Provident Life & Trust Co,*[659] described as 'the leading case in this connection' in *Dixon v Davies,*[660] the trustees had entered into a mortgage agreement that was outside their authority, and used the mortgage money to pay off legacies and expenses. The mortgagee attempted to enforce, and the heirs brought a claim to set the mortgage aside. The court upheld the mortgagee's ability to claim against trust assets: 'even if the mortgage were not authorized by the terms of the will, the estate, having received the benefit of the money, ought, in equity, to repay it, with interest. Said the Supreme Court of Iowa in such a case: "The Estate has received the benefit of the money which was advanced by the defendant. It ought, in good conscience, to repay it, with legal interest."'[661]

655 The counsel, in a later hearing, do cite *Davis v Chanter* (1848) 2 Phil 545 and *Robinson v Bell* (1847) 1 De G & Sm 630; but both are procedural cases dealing with what kind of suit ought to be brought in the context.

656 Restatement (Second) of Trusts § 269, cmt. a & illus. 1-4 (1959).

657 See also Restatement (Second) of Trusts § 271A (1959): '[a creditor] of the trust may be permitted to obtain satisfaction of his claim out of the trust estate if it is equitable to permit him to do so'.

658 See *Roxborough v Rothmans of Pall Mall Australia Ltd* (2001) 208 CLR 516, at [70].

659 *Thomas v Provident Life & Trust Co.*, 138 F 348 (9th Cir 1905). The US Supreme Court has given it an indirect blessing by denying it *certiorari*, or an appeal to review the lower court's decision in 200 US 618, 26 S Ct 755.

660 *Dixon v Davies,* 31 F Supp 912 (WDSC 1940).

661 *Thomas v Provident Life, ibid*, 349; citing *Deery v Hamilton*, 41 Iowa 16 (Ia 1875).

Some conflicting decisions remain that touch on the conceptual difficulties of finding unjust enrichment of the trust estate without recognising personhood of that estate. In *Blair v Claflin*,[662] the beneficiary of a trust had mistakenly paid income tax on her life annuity that should have been paid by the trustees, and claimed restitution for money paid under a mutual mistake of the relevant tax law. The Massachusetts Supreme Judicial Court denied her claim on the basis that she had not acted on behalf of the trustees in paying the tax, and the trustees therefore did not owe her a debt. Similarly, in *Taliaferro v Taliaferro,*[663]an extremely costly and protracted case with multiple appeals, the claimant (the wife of the testator) had paid debts and taxes of an insolvent estate but could not recover as the trust deed did not authorise reimbursement. In both cases the trust estate is enriched, but the trustees' person is not bound to repay.

These decisions appear to put some limits on the creditor's ability to claim for restitution where the trust estate has been unjustly enriched, reflecting a more traditional view of the conceptual boundaries imposed by the trustee's legal ownership and the trust estate's lack of legal personality. While it appears that these issues are still within the collective consciousness of the American judiciary, it has nevertheless been held that a third party can claim for unjust enrichment of the trust estate regardless of the trustee's position towards the trust.

In *Newell v Hadley,*[664] an earlier tracing and subrogation decision of the same Massachusetts Supreme Judicial Court, a trustee ('Berry') for two separate trusts had stolen money from one trusts ('Pickett Trust') (and was therefore a 'defaulter', or indebted to the trust) and attempted to cover up his theft by stealing from the other ('Newell Trust') and applying the money to Pickett Trust. The money was partly used to pay taxes and mortgage interests on

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[662] *Blair v Claflin*, 37 NE 2d 501 (Mass 1941).

[663] *Taliaferro v Taliaferro*, 7 P 3d 1241 (Kan 2000).

[664] *Newell v Hadley,* 202 Mass 335, 92 NE 507 (Mass 1910).

buildings held by Pickett Trust, thus conferring a benefit on Pickett. It was held that Newell trust could recover regardless of Berry's indebtedness to Pickett. The court held that regardless of the fact that Berry had used the money taken from Newell Trust to pay off a debt he had to Pickett Trust, the title to the money remained with Newell,[665] as Berry was both the transferor from Newell and the recipient for Pickett, and therefore had knowledge of where the money came from and was not, as the Pickett trustee, a bona fide purchaser for value without notice.[666] Consequently Newell was subrogated to the position of Pickett's creditors, the tax authorities and mortgage lenders.

The case only establishes that a trustee's default towards his trust does not stop a third party from tracing to the trust where the trustee has knowledge of the money's origins – the claimant may still be subrogated to the position of the trust creditors as his money was used to pay off the trust liabilities. When read as being an unjust enrichment claim, however, the more general effect of this case becomes that a third party may claim against a trust estate regardless of whether the trustee is a defaulter, where the third party has conferred a benefit to the trust estate.[667] This is more clearly visible in the Pennsylvania case of *Manderson's Appeal,*[668] where a claim for the fees of a legal representative was allowed despite the trustee's default on the basis of the representative's beneficial service conferred to the trust estate.

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[665] *Ibid*, 346-47.

[666] *Ibid,* 346. The 'purchase for value' here is a little awkward – the only 'value' the Pickett Trust has given is the money Berry took from the trust. If we fictionalise this as being a debt that the trustee in his fictional due administration has undertaken, as we frequently do (see *Ex Parte Adamson; In Re Collie* (1878) 8 Ch D 807 at 819), it is still only that the trust estate has 'lent' money to Berry which he has now repaid, rather than the trust having 'purchased (the Newell money) for value'.

[667] Though, perhaps ironically, the decision actually depends on the *trustee*, not the trust estate, being the recipient of the money, which imported the all-important knowledge of breach of trust that decided the case.

[668] *Manderson's Appeal,* 6 A 893 (Pa 1886).

This is now the approach of the Restatement and *Scott on Trusts*,[669] and essentially makes it unnecessary to claim under the trustee's indemnity. The widespread availability of this claim opens an entirely new channel through which a creditor may gain access to trust assets without having to pilot upstream through the lock of the trustee's duty-engrafted legal rights to the assets.

3. Conclusion

American and English trust law regimes provide a fertile ground for meaningful comparisons, but only where the differences in their basic axioms are appreciated. While in England the conflict between the settlor's intent and the beneficiary's entitlement (or their competing interests, the settlor's pre-trust ownership and the beneficiary's post-trust entitlement) has never been conclusively resolved in favour of either, American law sides firmly with the settlor-oriented view. The starting point is therefore what limits, if any, are to be set on the settlor's freedom of disposition in carving out the trust from his own property.

The first Restatement gradually led to major legislative intervention in trust law all throughout the United States, continuing to this day. Personal liability of trustees is now abolished, along with other central features such as the doctrine of restraints on alienation. The third party brings a claim against the trustee in a representative capacity only, but can still gain access to the trust assets using the trustee's indemnity right, the existence of which depends on the trustee's personal liability. If the third party creditor has benefited the trust estate, he can claim against the trust estate in unjust enrichment regardless of whether the trustee owes money

[669] Restatement (Second) of Trusts §269 cmt a (1959); Ascher in ML Ascher (ed) *Scott and Ascher on Trusts* (4th ed Aspen Publishers 2007), 1904, also citing *Whiting v Hudson Trust Co.*, 138 NE 33 (NY 1923) which appears to be made on a similar basis as *Newell.*

to the trust, despite the fact that the trust estate is not a legal person,[670] and cannot be enriched in isolation of the trustee's personal patrimony (which of course includes his obligation to reconstitute the trust fund where he has misappropriated any of it).[671]

As a result, the contours of American trust law have fundamentally shifted. What remains to be seen is what effect these reshaped contours might have on the concept of the trust itself. Those questions will be discussed in Chapter 8, but first the access that a beneficiary's creditor has under US law must be discussed for a full picture and fruitful comparison to English law.

[670] Cardozo CJ in *Whiting v Hudson Trust Co,* 138 NE 33, 37 (NY 1923): '[the trustee] was not an agent identified with someone else, a principal, as the result of legal fiction. He was the principal himself. It is only a form of words when we speak of [the trustee] as the representative of an "estate". The "estate" had no separate existence. It was not a legal person. The only person was the trustee.'

[671] Learned Hand J stated in *Vass v Contron Bros Co*, 59 F 2d 969, 970 (2nd Cir 1932): 'no action may be maintained against the trustee as such (…); the law [of New York] does not apparently recognize multiple personalities.'

Chapter 7: Beneficiaries' Creditors in American Law

The topic of creditor access to a beneficiary's interest under a trust has received much academic attention in American trust law jurisprudence. In essence, as the main conceptual obstacles for restricting such access have been stripped away (as a result of the shift in basic trust law assumptions to more settlor-oriented forms outlined in the previous chapter), American trust law struggles to place *any* limitations on the settlor's powers to control the rights of the beneficiary and, by extension, those of the third party creditor. The result is a beneficial interest academically described as unquestionably proprietary, but that is protected from all external parties and that is now the preferred refuge for dynastic wealth.

It is this last point that academic comment focuses on – whether the 'dead hand' of settlor control should be allowed to redraw the lines of creditor access, how such control might be limited and what are the individual policy justifications for that limitation. The issue is broadly see as being divided into two main strands:[672] 1) to what extent is a settlor entitled to restrain alienation of the beneficial interest, given that such interests are viewed as an inherently limited proprietary rights akin to 'a gift projected on the plane of time and so subjected to a management regime',[673] carved out by the settlor from assets over which he commands supreme dominion; and 2) to what extent does the court have power to modify or terminate a trust against the express intentions of the settlor.

This chapter will first go through some of the basic conceptual and policy debates surrounding beneficiaries' creditors, building on the basic trust law assumptions and structures

[672] See, for example, J Dukeminier & R Sitkoff *Wills, Trusts, and Estates* (9th Ed, Wolters Kluwer Law & Business, New York 2013), 687.

[673] Bernard Rudden (review) 'John P. Dawson, Gifts and Promises (1981)' (1981) 44 MLR 610, 610.

introduced in the last chapter. The settlor's evanescent control interest and possible limitations on that interest will be discussed so as to give context to the doctrinal content in the latter half of this chapter. In the following chapter these principles and the doctrines they give rise to will be contrasted with those of English law in order to gain a deeper understanding of how asset partitioning rules are affected by central trust law principles, and what those rules might reveal about our own central principles.

1. Foundations of Creditor Access: Settlor's Intent and the Beneficial Interest

A succinct statement of the relationship of American trust law's basic assumptions and the law of beneficiaries' creditors is provided by Robert Sitkoff in the leading American student textbook on trusts: 'In the American tradition (…) the trust is regarded as a conditional gift, and a beneficiary takes his interest in the trust subject to any restrictions imposed by the settlor. Within American law, freedom of disposition includes the right to impose conditions on the beneficiary's enjoyment of the trust property, including a disabling restraint on voluntary and involuntary alienation of the beneficial interest'.[674] This statement is a culmination of over a century of academic and judicial development, emphasising the settlor's powers over his property and questioning the basic tenets of English trust law. The resultant trust device whereby the beneficiary enjoys a property right in the assets but cannot alienate his interest is known as a 'spendthrift trust'.[675] It is this strange form of the familiar trust device that serves as the test case in most academic discussions about the law of beneficiaries' creditors in the United States.

[674] J Dukeminier & R Sitkoff *Wills, Trusts, and Estates* (9th Ed, Wolters Kluwer Law & Business, New York 2013), 696.

[675] See generally EN Griswold *Spendthrift Trust* (1st Ed Matthew, Bender & Co, Albany 1936).

The rise of the spendthrift trust did not happen overnight, nor was it the result of a single judge, academic, case or treatise. However, most commentators trace the origins to the two foundational cases of *Nichols v Eaton*,[676] upholding the settlor's freedom of disposition at the expense of creditor access, and *Claflin v Claflin*,[677] denying the beneficiary's ability to terminate without the settlor's consent. These cases and their academic justifications and criticisms will now be considered in turn, as they form the axiomatic basis for the American law of beneficiaries' creditors and introduce some of its basic vocabulary.

i) Nichols v Eaton

Nichols v Eaton involved a question of construction and legal effect of a will by Mrs Sarah B Eaton. She had declared a testamentary trust in favour of her four children equally, with a residual interest going to potential grandchildren under certain conditions. The trust was primarily designed to pay dividends, rents and other income, but the trustees had an absolute discretion to pay half of the capital that each of the four children derived their income from, at which point the child's right to income under the trust would cease and it would be transformed into a discretionary trust for the remaining income. [678] The trust deed also included a provision

[676] *Nichols v Eaton* (1875) 91 US 716. See, for example, JC Gray *Restraints on Alienation of Property* (2nd Ed, Boston Book Co, Boston 1895), iii-iv ('When (…) the Supreme Court went out of its way [in *Nichols v Eaton*] to announce (…) that property *could* be so fenced about as to secure it from the characteristics of right and enjoyment to the beneficiary and immunity from his creditors, the words came to many persons with a shock'); Griswold, Ibid, §26 (calling the *Nichols v Eaton* 'the greatest single factor in the establishment of spendthrift trusts in the United States'); J Getzler 'Transplantation and Mutation in Anglo-American Trust Law' (2009) 10 Theoretical Inq 355, 375-8; LM Friedman 'The Dynastic Trust' (1964) 73 Yale LJ 547, 573; AS Emanuel 'Spendthrift Trusts: It's Time to Codify the Compromise' (1993) 72 Neb LR 173, 173 ('I date the controversy from the dictum of Justice Miller in *Nicholls v Eaton* (…)'); ML Ascher (ed) *Scott and Ascher on Trusts* (4th ed Aspen Publishers 2007), §15.2.1.

[677] *Claflin v Claflin* (1889) 20 NE 454 (Mass.); see, for example, Getzler, *ibid*, at 374 *et seq*.; Friedman, *ibid*, 586; J Dukeminier & R Sitkoff *Wills, Trusts, and Estates* (9th Ed, Wolters Kluwer Law & Business, New York 2013), 718; GS Alexander 'The Dead Hand and the Law of Trusts in the Nineteenth Century' (1985) 37 Stan LR 1189, 1202.

[678] *Nichols v Eaton* (1875) 91 US 716, 718-19.

stating that should any son alienate or dispose of their right to income or become bankrupt, their interest in the income would cease and the income would instead be paid to their wife and children. If no such objects exist, the income would accumulate into the capital. A son of the testator, Amasa M Eaton, had assigned his interest to his creditors, and declared bankrupt. He was unmarried and had no children. Charles Nichols was appointed his assignee in bankruptcy.

Nichols attempted to argue that the provision entitling a trustee to pay half of the capital to the beneficiary meant that the son had a right to receive such capital, although it was expressed as a discretionary power. His counsel relied on some of the English decisions cited in the Chapter 4 above,[679] and also mentions *Brandon v Robinson* but without elaboration.[680]

Justice Miller took *Brandon* as his starting point, stating that:

> The claim of the assignee is founded on the proposition (…) that a will which expresses a purpose to vest in a devisee either personal property, or the income of personal or real property, and secure to him its enjoyment free from liability for his debts, is void on grounds of public policy, as being in fraud of the rights of creditors; or as expressed by Lord Eldon in *Brandon v Robinson*, (…) "If property is given to a man for his life, the donor cannot take away the incidents of a life-estate."[681]

He then went on to say:

> If there had been no further provision in regard to the matter in this will than that on the bankruptcy or insolvency of the devisee, the trust as to him should cease and determine; or if there had been a simple provision, that, in such event, that part of the income of the estate should go to some specified person other than the bankrupt, there would be no difficulty in the case. But the first trust declared after the bankruptcy for this part of the income is in favor of the wife, child, or children of such bankrupt, and in such manner as said trustees in their discretion shall think proper. (…) It is strongly argued that these provisions are designed to evade the policy of the law already mentioned; that the discretion vested in the trustees is equivalent to a direction, and that it was well known it would be exercised in favor of the bankrupt.[682]

[679] *Davidson v Chalmers* (1864) 33 Beav 653; *Lord v Bunn* (1843) Y & CCC 98; *ibid,* at 720.

[680] *Brandon v Robinson* (1811) 18 Ves 429, *ibid*, at 720.

[681] *Nichols v Eaton* (1875) 91 US 716, 722.

[682] *Ibid.*, 722-23.

Justice Miller went on to argue, on the basis of *Twopeny v Peyton* and *Godden v Crowhurst*,[683] that English law is not settled,[684] and that the real doctrine in English law is that an assignee is entitled to whatever right the beneficiary had in the first place, and if the bankrupt beneficiary does not have any right under the trust his creditor cannot get anything either:

> [English decisions] are all founded on the proposition, that there is somewhere in the instrument which creates the trust a substantial right, a right which the appropriate court would enforce, left in the bankrupt after his insolvency, and after the cesser of the original and more absolute interest conferred by the earlier clauses of the will.[685]

On proper construction, this right is not one that the beneficiary can enforce after his bankruptcy, and therefore the creditor cannot either.[686]

As we have seen in Chapter 5, this account of the creditors' limited recourse is not quite accurate. It is true that the creditor gets only what the beneficiary can give him, and if the beneficiary has no right to demand the trust property then the creditor has no such right either. Any payments under a discretionary trust made to the beneficiary will, in English law, be attachable by the creditor. What Justice Miller's judgment on the English position failed to consider is the line of cases starting from *Younghusband v Gisborne*, disapproving the *Twopeny v Peyton* and *Godden v Crowhurst* line, and leading to the conceptual point that a trust that attempts to attack the *ability* of the beneficiary to assign his interest altogether is void.

[683] *Godden v Crowhurst* (1842) 10 Sim 642; 59 ER 765 and *Twopeny v Peyton* (1840) 10 Sim 487; 59 ER 704, two cases allowing trusts that restrict alienation in bankruptcy (see Chapter 5 above) that were disapproved of in *Younghusband v Gisborne* (1844) 1 Coll 400; 63 ER 473, at 402.

[684] *Nichols v Eaton* (1875) 91 US 716, 723-4.

[685] *Ibid*, 724.

[686] *Ibid.*

Justice Miller then went on to attack that very principle of beneficiary capacity, in an effort to place the settlor's freedom of disposition front and centre in American trust jurisprudence:

> [W]e do not wish to have it understood that we accept the limitations which [the English Chancery] court has placed upon the power of testamentary disposition of property by its owner. We do not see, (…) that the power of alienation is a *necessary* (emphasis in original) incident to a life-estate in real property, or that the rents and profits of real property and the interest and dividends of personal property may not be enjoyed by an individual without liability for his debts being attached as a necessary incident to such enjoyment. (…) We concede that there are limitations which public policy or general statutes impose upon all dispositions of property, such as those designed to prevent perpetuities (…). We also admit that there is a just and sound policy peculiarly appropriate to the jurisdiction of courts of equity to protect creditors against frauds upon their rights (…). But the doctrine, that the owner of property*, in the free exercise of his will in disposing of it, cannot so dispose of it* (emphasis added), but that the object of his bounty, who parts with nothing in return, must hold it subject to the debts due his creditors, though that may soon deprive him of all the benefits sought to be conferred by the testator's affection or generosity, is one which we are not prepared to announce as the doctrine of this court. (…) Why a parent, or one who loves another, and wishes to use his own property in securing the object of his affection, as far as property can do it, from the ills of life, the vicissitudes of fortune, and even his own improvidence, or incapacity for self-protection, should not be permitted to do so, is not readily perceived.[687]

This is an extraordinary departure from English doctrine and central principles, which, according to Justice Miller's analysis, was not even necessary. In his judgment he had already shown (warts and all) that English law under Justice Miller's interpretation would come to the same conclusion. The departure was justified by reference to statutory homestead exemptions and exemptions for a tradesman's tools,[688] that were designed to safeguard citizens from the harsh operation of English creditor rules at the time, including debtors' prison.[689]

The settlor's right to create a trust and determine the terms of that trust are not actively viewed as part and parcel of the settlor's original property right in English law, and once the

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[687] *Ibid*, 725-727.

[688] *Ibid*, 726

[689] See J Getzler 'Transplantation and Mutation in Anglo-American Trust Law' (2009) 10 Theoretical Inq 355, 378-380.

settlor sets up the trust his property right is transferred to the trustee. From that point it is the beneficiary's right that matters, at least insofar as claims against the trustee are concerned (and creditors' claims through the beneficial interest are, ultimately, claims against the trustee as assignee of the beneficiary's interest).[690]

First in line to sound criticisms of *Nichols* and the line of reasoning it represents was John Chipman Gray,[691] whose admirable book is aimed at exposing, analysing and classifying the doctrine regarding restraints on alienation, in an effort to develop and showcase a more coherent and accurate doctrinal picture than was presented in *Nichols*.[692] Gray did, however, include a vehement attack on the entire *Nichols* position in his preface to the second edition, implying that the emerging body of doctrine is a national failing,[693] and that '[if] there is one sentiment, therefore, which it would seem to be the part of all in authority, and particularly of all judges, to fortify, it is the duty of keeping one's promises and paying one's debts. (…) I still believe (…) that the old doctrine was a wholesome one, fit to produce a manly race, based on sound morality and wise philosophy; and that the new doctrine is contrary thereto.'[694] The *Nichols* doctrine, according to Gray, was apt to 'perpetuate a privileged class whose power and wealth should not be endangered by the weakness or folly of particular members',[695] or to produce 'a plutocracy, and to the accumulation of a great fortune in a single hand, through the power it affords to rich

[690] See chapter 5 for more detail.

[691] JC Gray *Restraints on Alienation of Property* (1st ed, Boston Book Co, Boston 1883); (2nd Ed, Boston Book Co, Boston 1895), all quotes from 2nd edition unless otherwise stated.

[692] *Ibid*, xiii, (preface to the first edition).

[693] *Ibid*, iii.

[694] *Ibid*, iii-v

[695] *ibid*, vi

men to assure the undisturbed possession of wealth to their children, however weak or wicked they may be.'[696]

Gray notes that the motive for these doctrinal developments was not to create a powerful ruling elite whose assets were invulnerable, but to protect those who are in weaker bargaining positions against those who would be in a position to impose oppressive debt regimes.[697] 'There is a strong and increasing feeling (…) that a main object of law is not to secure liberty of contract, but to restrain it, in the interest, or supposed interest, of the weaker, or supposed weaker, against the stronger, or supposed stronger, portion of the community. (…) To a frame of mind and a state of public sentiment like this, spendthrift trusts are most congenial.'[698]

In reaching for this motive, however, Gray argues the law has crafted exceptions that differentiate between the rich and the poor. As an example, Gray uses the law at the time in New York which gave the creditor rights in what Gray calls 'surplus of income given in trust beyond what is necessary for the education and support of the beneficiary'.[699] In practice, this has been interpreted to give a "gentleman of high social standing whose associations are chiefly with men of leisure and who is connected with a number of clubs" a larger protected income than a 'a man who has lived simply and plainly', effecting a 'descend to a depth of shameless snobbishness as any into which the justice of a country was ever plunged.'[700]

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[696] *ibid.*

[697] *ibid*, ix.

[698] *Ibid.*

[699] *ibid*, xi; This is still the law in New York: see New York Estate Powers and Trusts Law (2012) §7-3.4.

[700] *ibid*, xi.

These comments were proclaimed loudly in the introduction of the second edition, but were already written into the contents of the first. As Gray analysed *Nichols* in his main treatise, he stated that 'the general introduction of spendthrift trusts would be to form a privileged class, who could indulge in every speculation, could practice every fraud, and, provided they kept on the safe side of criminal law, could yet roll in wealth. They would be an aristocracy, though certainly the most contemptible aristocracy with which a country was ever cursed.'[701]

Gray's attack is unbridled and even contemptuous, but not without basis. The same theme (though usually in a different key) has been taken up by multitudes of academics, carrying the thread all the way to the 21st century. Writing in 1964, Lawrence Friedman argued, in line with Gray, that the American trust law rules produced the 'dynastic trust', and helped protect family wealth from free market pressures.[702] The 'dynastic trust' Friedman defines as 'a trust set up primarily to perpetuate the trust estate for as long a period as possible. Its furthest limit fixed by law—most notably the Rule against Perpertuities. (…) [The] dynastic impulse more usually springs from a desire to maintain the power and wealth of a family.'[703] The issue is also framed in terms of freedom of disposition, or the powers associated with ownership: 'Money is power; and principal more so than income. The settlor of the dynastic trust denies full power to his closest kin. But in so doing he extends his own power by projecting his wishes into a period that lasts long after his death (…).'[704]

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[701] JC Gray *Restraints on Alienation of Property* (1st ed, Boston Book Co, Boston 1883), §262 at 174, kept in the second edition at 247. Doctrinally Gray argues, at § 261a in the second edition, that the true answer is found in *In Re Coleman* (1888) 39 Ch 443, holding that the creditor cannot demand payment if the beneficiary cannot either, but anything the beneficiary gets is accountable to the creditor. See *Re Coleman* introduced and analysed in chapter 5 above.

[702] LM Friedman 'The Dynastic Trust' (1964) 73 Yale LJ 547.

[703] *Ibid*, 547-8.

[704] *Ibid*., 548.

But Friedman does not appear to be critical of the dynasticism given rise to by doctrinal developments of American trust law in the 19th century. In the way of the doctrinal lawyer, he has set his sights on explaining developments of existing trust law doctrine by reference to the seemingly unremarkable fact that US trusts are used for dynastic purposes. He goes on to argue,[705] that 'dynastic trusts must (…) remain relatively secure from the interference of current beneficiaries. Trust assets must not prematurely leak out of the trust; it should therefore be relatively indestructible.'[706] Friedman then proceeds to show, in the main thrust of the paper, how this impulse to create family dynasties protected from outside creditors using the trust device has led to a) flexible investing practices which give broad discretion to trustees to respond to long-term developments[707] ('the prudent investor rule' from *Harvard College v Amory*[708]), b) spendthrift trusts,[709] and c) the denial of the beneficiaries' ability to modify or terminate the trust without the settlor's consent[710] (the '*Claflin* doctrine', discussed below, from *Claflin v Claflin*).[711]

While Friedman notes Gray's writings with some detail, his tone is in marked contrast when he discusses the spendthrift trust's utility in preserving dynastic wealth: 'yet it is he [the unincorporated small businessman] who conformed most closely to the image of the sturdy individual entrepreneur so appealing to men like Gray. A spendthrift trust for his or his family's benefit protected virtue against undeserved misfortune'.[712] This change in tone might be a digest

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[705] *Ibid*, 551.

[706] *Ibid.*

[707] *ibid,* 554

[708] *Harvard College v Amory* (1830) 26 Mass (9 Pick) 446.

[709] LM Friedman 'The Dynastic Trust' (1964) 73 Yale LJ 547, 572 onwards.

[710] *Ibid,* from 586 onwards.

[711] *Claflin v Claflin* (1889) 20 NE 454 Mass. See Chapter 6 above.

[712] LM Friedman 'The Dynastic Trust' (1964) 73 Yale LJ 547, 578.

of the central arguments in relevant cases, but it certainly acts as a convenient justification for what Gray feared would be a privileged class – the spendthrift provision does not *threaten* the entrepreneurial impulse, it seeks to protect it by protecting the fruits of one's labour from 'internal and external attack'.[713]

This change in mood probably reflects a change in the prevailing winds of American political discourse.[714] Gregory Alexander has cast the debate expressly in terms of freedom of disposition, which he calls the 'basic paradox at the core of liberal property law. Individual freedom to dispose of consolidated bundles of rights cannot simultaneously be allowed and fully maintained. If the donor of a property interest tries to restrict the donee's freedom to dispose of that interest, the legal system, in deciding whether to enforce or void that restriction, must resolve whose freedom it will protect, that of the donor or that of the donee.'[715] He correctly notes that there is no objective basis to choose between which interest to protect,[716] a point which is particularly poignant given that Scott's *Restatements* have blithely declared that the beneficiary's interest is also a property right.[717] The question is, ultimately, one of ideology, with a

[713] *Ibid*, 580.

[714] Even Gray tied his criticisms to 'paternalism, which is the fundamental essence alike of spendthrift trusts and of socialism', [714] JC Gray *Restraints on Alienation of Property* (1st ed, Boston Book Co, Boston 1883); (2nd Ed, Boston Book Co, Boston 1895), at ix.

[715] GS Alexander 'The Dead Hand and the Law of Trusts in the Nineteenth Century' (1985) 37 Stan LR 1189, 1189.

[716] *Ibid*, 1193.

[717] Current edition: ML Ascher (ed) *Scott and Ascher on Trusts* (4th ed Aspen Publishers 2007, §13.1, at page 808: 'The beneficiary of a trust has a property interest in the subject matter of the trust, a form of ownership'.

strong emphasis on an individual's powers over their property as manifestations of their intentions.[718]

As in American discourse trust law was viewed as the liberal escape emphasising individual intentions from the rigid technicalities of feudal common law,[719] the doctrinal ground was fertile to the development of the trust device to emphasise the settlor's freedom of disposition. What stood in the way of upholding restraints on alienation was the idea that free alienability was conceptually bound to the very idea of property,[720] which is still the view (and methodology) in England today. The idea is included in Kent's *Commentaries* that the restraint on alienation is 'repugnant to the nature of the estate granted. (…) Such restraints were held by Lord Coke (*sic*) to be absurd,[721] and repugnant to reason, and to "the freedom and liberty of freemen"',[722] though Kent offers no further detail as to what, exactly, the conceptual absurdity is in upholding such restraints. This, Gregory Alexander argues, is the preserving ambiguity in the conceptual development model that English law still adheres to – English law never defined the 'sense in which "property" had to remain alienable, whether as title to some asset, or as all interest treated as property, including equitable interests.'[723]

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718 See J Kent *Commentaries on American Law* (William M Lacy Ed, The Blackstone Publishing Co, Philadelphia 1889), 303-304; GS Alexander 'The Dead Hand and the Law of Trusts in the Nineteenth Century' (1985) 37 Stan LR 1189, 1215.

719 *Ibid*, 1215-16.

720 See GS Alexander, *ibid*, 1225 onwards.

721 In *Sir Anthony Mildmay's Case*, (1606) 6 Co. 40a, 41b. Sir Edward Coke was never given peerage, though he is frequently referred to as 'Lord Coke' in American trust jurisprudence.

722 J Kent *Commentaries on American Law* (William M Lacy Ed, The Blackstone Publishing Co, Philadelphia 1889), 131

723 GS Alexander, n 735 above, 1227.

The great irony of the political choice to enforce restraints on alienation in America is therefore that English law and its followers in America perceived restraints on alienation to be a thing of the feudal past, and inherently in contradiction with the liberal individualist future. In the post-*Nichols* trust law doctrine it is precisely this ability of a private individual to tie the hands of any beneficiary of an equitable interests that reigns supreme.

At the same time, the *Nichols* judgment of the US Supreme Court cast off the methodological shackles of conceptual analysis and flatly denied that there was anything 'repugnant' about allowing a beneficiary the use of an asset but not the ability to assign the assets to his creditors. With this judgment went the central idea of the conceptual analysis method: 'that the law defines the exact nature of every estate in land, that each has certain incidents which are provided by law and cannot be changed by the individual grantor or testator (…)'.[724] Instead, the American methodology prefers to emphasise the utility of the interest created – 'if he creates a desirable interest, and then wishes to establish safeguards to protect it, the courts should lend their assistance.'[725] The effects of this way of thinking are evident in the legislative interventions in American trust law, ranging from abolishing of the rule against perpetuities to full limited liability, the chief utility of these measures being to attract trust money to a given state.

The fact that individual freedom was used to justify the imposition of restraints whose abolishment had been seen as central to dismantling a feudal land system was not the only irony in American trust law's development. Aside from the fact that the entire judgment in *Nichols* could now be described as unconstitutional,[726] Joshua Getzler has noted that the pro-creditor

[724] RE Manning 'The Development of Restraints on Alienation Since Gray' (1935) 48 Harv LR 373, 401.

[725] *Ibid,* 406.

[726] In that it involves a federal court deciding upon an issue of state private law jurisdiction contrary to *Erie Railroad Co v Tompkins* (1938) 304 US 64; 'Except in matters governed by the Federal Constitution or by acts of Congress, the law to be applied in any case is the law of the state. And whether the law of the state shall be declared by its Legislature in a statute or by its

tendencies of 19th century English law, that the American trust law movement starting with *Nichols v Eaton* defined itself against, represented a 'crude misapprehension':[727]

> In the early modern period, credit relations took place in a moral economy largely unregulated by law, with parties far more concerned with commercial reputation than the giving of collateral or the formal attachment of assets. Law was a tool of last resort, and often *ineffective in attaching debtors' assets unless reputational pressures were also at stake.* (Emphasis added.) (…) Creditor rights against individuals and firms were first clarified by rafts of legislation to reform procedures, and then in the latter part of the century creditor interests were regulated and reduced through bills of sale and notice legislation, concerned both with protecting vulnerable trade debtors and preventing clogs on title to personal property. Counterbalancing this push to protect debtor and third-party rights, there was also a pro-creditor enhancement of secured lending through doctrines of implicit notice binding third parties to respect charges in the commercial courts at the same time.[728]

The position in English law was therefore not as harsh to debtors as Justice Miller assumed, and far more subtle in its effects. Be that as it may, the result and approach in *Nichols* has been adopted and adhered to in several key cases, leading to a major shift in the basic vocabulary of American trust law. Justice Miller's strictly unnecessary foray into reorganising basic trust law principles was followed as doctrine in *Broadway National Bank v Adams,*[729] in which a creditor attempted to reach the income of a trust fund of one Charles W Adams. The trust deed stated that the income given to Charles Adams was to be 'free from the interference or

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highest court in a decision is not a matter of federal concern. There is no federal general common law. Congress has no power to declare substantive rules of common law applicable in a state whether they be local in their nature or 'general,' be they commercial law or a part of the law of torts. And no clause in the Constitution purports to confer such a power upon the federal courts,' at 78. At the time, however, the decision of *Swift v Tyson* (1842) 41 US 1, holding that 'the decisions of the local tribunals upon such subjects are entitled to, and will receive, the most deliberate attention and respect of this court; but they cannot furnish positive rules, or conclusive authority, by which our own judgments are to be bound up and governed,' (at 19) would have been the accepted view.

727 J Getzler 'Transplantation and Mutation in Anglo-American Trust Law' (2009) 10 Theoretical Inq 355, 383.

728 *Ibid.*

729 *Broadway National Bank v Adams* (1882) 133 Mass 170.

control of his creditors, my intention being that the use of said income shall not be anticipated by assignment'.[730]

The Supreme Judicial Court of Massachusetts placed a strong emphasis on the settlor's intentions and his powers of disposing of his property in any way he might wish: 'It is clear that, if the trustee was to pay the income to the plaintiff under an order of the court, it would be in direct violation of the intention of the testator and of the provisions of his will. The court will not compel the trustee thus to do what the will forbids him to do, unless the provisions and intention of the testator are unlawful.'[731] The court then shifted Sir Edward Coke's conceptual argument to policy grounds,[732] and stated that though the rule is good in the context of legal estates, it '[does] not apply in the case of a transfer of property in a trust. By the creation of a trust like the one before us, the trust property passes to the trustee with all its incidents and attributes unimpaired.'[733]

Before continuing, it is worth noting that this does not explain why the settlor-imposed restraints on the beneficial interest should continue to be in force, if the legal estate has been handed over to the trustee 'with all its incidents and attributes unimpaired'. The argument in fact seems to go against the view – if the settlor's property interest is no more and all that matters is the interests as they exist between the trustee and beneficiary, there is no reason to prefer the settlor's dominion over *his* property and *his* freedom of disposition as he has no interest in the trust property, over those of the beneficiary who has.[734]

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[730] *Ibid*, 170.

[731] *Ibid*, 171.

[732] *Ibid*, 171-2.

[733] *Ibid*, 172.

[734] At least in American law.

Nevertheless the Massachusetts court went on to mount a staunch defence of the principle of freedom of disposition of the settlor as determining trust law's content, and therefore inclined to deny Sir Edward Coke's conceptual argument:

> The founder of this trust was the absolute owner of his property. He had the entire right to dispose of it, either by an absolute gift to his brother, or by a gift with such restrictions or limitations, not repugnant to law, as he saw fit to impose. (…) His intentions ought to be carried out, unless they are against public policy. There is nothing in the nature or tenure of the estate given to the cestui que trust which should prevent this. The power of alienating in advance is not a necessary attribute or incident of such an estate or interest, so that the restraint of such alienation would introduce repugnant or inconsistent elements.
>
> We are not able to see that it would violate any principles of sound public policy to permit a testator to give to the object of his bounty such a qualified interest in the income of a trust fund, and thus provide against the improvidence or misfortune of the beneficiary. The only ground upon which it can be held to be against public policy is, that it defrauds the creditors of the beneficiary. (…)[the settlor] has the entire *jus disponendi*, which imports that he may give it absolutely, or may impose any restrictions or fetters not repugnant to the nature of the estate which he gives. Under our system, creditors may reach all the property of the debtor not exempted by law, but they cannot enlarge the gift of the founder of a trust, and take more than he has given.[735]

In short, Chief Justice Morton here relies on the basic position of English law, that a creditor of a beneficiary may only receive what the beneficiary himself was entitled to and has no greater right. Morton CJ denies, however, that there is any conceptual link between a beneficial interest and the ability to assign that interest, in stark contrast to the basic operation of English trust law. Instead, it is within the *settlor's* power to define the trust interest to his own satisfaction, and the creditor cannot complain if he is given no rights under that exercise.

In similar vein to Gray, Frederick Wait in 1884 called this case

> (…) probably the most advanced statement of the objectionable doctrine. (…) The creation of an aristocracy of prodigals, who can dwell in luxury and defy their creditors, brings the administration of justice into disrepute, and has a demoralizing influence upon honest people. The creditor is unjustly deprived of the power to compel his debtor to forego the comforts and luxuries of wealth, or to feel the privations incident to

[735] *Ibid*, 173-4.

> insolvency. The tendency of these cases must be checked by legislation, or the sober second thought of courts; the doctrine will never be tolerated by the American people.[736]

Nevertheless, the onslaught continued. In *Lampert v Haydel,*[737] the Supreme Court of Missouri adopted the rule with specific analysis the married women's cases in England,[738] stating: 'If a court of equity, as already seen, will guard such a trust in one case with jealous solicitude, why should it fail to do so in another, in circumstances equally meritorious?'[739] Sherwood J of the Missouri court also reasoned that trusts were equitable creations, and equity being malleable and responsive to needs of individual cases,[740] the content of equitable doctrine can change to circumvent the strict operation of limitations on legal estates to accommodate individual intention:

> Now, if a court of equity, in order to protect one class of trusts, (…), and by so doing to effectuate the intention of the author of the gift, exercises its own inherent power to model and qualify an interest in equitable property without regard to the rules which the law has established for regulating the enjoyment of property in other cases, it is difficult to see why, (…), such court may not lay down and declare a rule, in such a case as this, which shall be equally effectual in preventing the intention of the donor from being thwarted, — a rule which injures or defrauds no one, which violates no rule of public policy, and which gives stability and protection to a provision which, originating in the warmest ties of affection, seeks to afford to the beneficiary a sure and unfailing refuge against the vicissitudes of fortune.[741]

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[736] FS Wait *A Treatise on Fraudulent Conveyances and Creditors' Bills* (Beard Books, Washington DC, 1884 (reprint 2000)) §368, at 481.

[737] *Lampert v Haydel* (1888) 96 Mo 439; 9 SW 780.

[738] *Ibid*, 9 SW 780, 783 onwards. This included *Miss Watson's Case* and *Hulme v Tenant* (1778) 1 Brown Ch 16, the former specifically cited in *Brandon v Robinson* as being irrelevant (as discussed above in Chapter 5)

[739] *ibid*, 784.

[740] Here Sherwood J was relying on J Story *Commentaries on Equity Jurisprudence Vol 1* (4th ed, Little, Brown & Co Boston 1846), §439, at page 468: 'The beautiful character, pervading excellence, if one may so say, of equity jurisprudence, is that it varies its adjustments and proportions so as to meet the very form and pressure of each particular case, in all its complex habitudes.' Sherwood J omits to note that the section deals with 'conveyances or other instruments [that] are fraudulently or improperly obtained', relying instead on the vague notion that equity is flexible.

[741] *Lampert v Haydel* (1888) 96 Mo 439; 9 SW 780, 784.

In *Young v Snow,* The Supreme Judicial Court of Massachusetts, by then armed with *Claflin v Claflin*,[742] reiterated its own earlier *Broadway v Adams* decision in terms of settlor's powers to define the interest:

> [I]n creating an equitable estate a donor may carve out and *create such equitable rights in property as his fancy may dictate and his imagination devise, without regard to the rights appertaining to the several estates known to the law* (emphasis added.) This conclusion was stated to rest on the doctrine that in such a case the donor "does not give them an absolute estate and then impose restrictions and conditions repugnant to the estate, but gives an ownership qualified by the directions"[743] adopted by the donor.[744]

Similarly, the Supreme Court of Pennsylvania in *In Re Morgan's Estate*,[745] stated:

> The law rests its protection of what is known as a spendthrift trust fundamentally on the principle of cujus est dare, cujus est disponere.[746] It allows the donor to condition his bounty as suits himself so long as he violates no law in so doing. When a trust of this kind has been created, the law holds that the donor has an *individual right of property in the execution of the trust* (emphasis added); and to deprive him of it would be a fraud on his generosity. For the law to appropriate a gift to a person not intended would be an invasion of the donor's private dominion.[747] It is always to be remembered that consideration for the beneficiary does not even in the remotest way enter into the policy of the law. It has regard solely to the rights of the donor. Spendthrift trusts can have no other justification than is to be found in considerations affecting the donor alone. They allow the donor to so control his bounty, through the creation of the trust, that it may be exempt from liability for the donee's debts, not because the law is concerned to keep the

[742] *Claflin v Claflin* (1889) 149 Mass 19, of which further below.

[743] From *Young v Snow* (1897) 167 Mass 287, 288-9 (in turn citing *Claflin* without explanation).

[744] *Dunn v Dobson* (1908) 198 Mass 142, 146.

[745] *In Re Morgan's Estate* (Pa 1909) 72 A 498.

[746] 'Whose it is to give, his it is to dispose' in HC Black *A Dictionary of Law: Containing Definitions of the Terms and Phrases of American and English Jurisprudence, Ancient and Modern* (1st ed The Lawbook Exchange, New Jersey 1891 (reprint 1991)), 306.

[747] The Pennsylvania case cited in the report for this proposition, *Holdship v Patterson* (Pa 1838) 7 Watts 547, included the conceptual justification italised in the quotation for why the settlor's rights should still reign supreme when he no longer has any right in the trust property: 'A benefactor may certainly provide for a friend (and especially a child) without exposing his bounty to the debts and improvidence of the beneficiary. He has *an individual right of property in the execution of the trust*, and to deprive him of it would be a fraud on his generosity (parental duty). To appropriate a gift to a purpose or person not intended, would be an invasion of the donor's private dominion', at 551.

> donee from wasting it, but because it is concerned to protect the donor's right of property.[748]

This completes the modern vocabulary of American trust law, with a trust being treated as a conditional gift carved out of the settlor's estate, with the curious feature that the settlor no longer holds legal title upon which he could carve more limited property rights. Instead, what was in previous chapter called the settlor's 'evanescent interest' is identified as his 'individual right of property in the execution of the trust', which is an astonishing characterisation given the settlor's inability to enforce that execution. The rights of the beneficiary, in American trust law, are altogether irrelevant and do not determine the law's contents.

Of course, it is not surprising that the Pennsylvania case, *Holdship v Patterson*,[749] relied upon in *In Re Morgan* to import the vocabulary of gifts and individual intentions, conceptualised the trust as an interest carved out of a legal estate. The Pennsylvania jurisdiction was peculiar in that it had no courts of equity where equitable rights could be enforced, and thus in order for there to be a satisfactory remedy, such interests were equated with legal interests.[750] In passive trusts the legal estate was actually given to the beneficiary,[751] making the analogy to a gift more than a rhetorical device and turning it into actual doctrine. In *Holdship* itself, property was given to a daughter by her father's friends so that she may carry on business to support her father. Upon accepting the gift, she promised to give his father reasonable support. The father's creditors attempted to claim the gift, but were held unable to do so.

In this context, and noting that the Pennsylvania court at the time did not have a court of equity and was therefore unable to recognise the rights of the trust beneficiary in the due

[748] *In Re Morgan's Estate* (Pa 1909) 72 A 498, 499.

[749] *Holdship v Patterson* (Pa 1838) 7 Watts 547.

[750] JC Gray *Restraints on Alienation of Property* (2nd Ed, Boston Book Co, Boston 1895), §214 at 193.

[751] *ibid*, §215 at 193.

administration of the trust, the quotation from *Holdship v Patterson* in footnote 764 above has a very different meaning:

> A benefactor may certainly provide for a friend (and especially a child) without exposing his bounty to the debts and improvidence of the beneficiary. He has an individual right of property in the execution of the trust, and to deprive him of it would be a fraud on his generosity (parental duty). To appropriate a gift to a purpose or person not intended, would be an invasion of the donor's private dominion.[752]

The daughter was the recipient of the initial gift from her father's benefactors, and her role was simply to provide support for the father under a gratuitous promise to a third party. In law, there is no way the father's creditor could attach to what is now the daughter's property.

Only considerations of public policy can set limits to the settlor's freedom of disposition. One example of such an exception is claims by the beneficiaries' children,[753] discussed further below. Individual public policy exceptions aside, the effect of these decisions, and many more, is to give US trust law unrivalled 'dead hand control', meaning control of property that once belonged to someone who is now deceased. Even so pro-settlor a jurist as Austin Wakeman Scott noted the impulse and logic to control one's belongings, and spoke out against its dead hand effects:[754]

> Shall we not do as we wish with our own? But this world (…) is a world for the living and not for the dead. It would not be the part of wisdom to allow the living, in their enjoyment of property, to be unduly trammelled by the wishes of the dead. To allow to the owner of property the greatest power of directing its disposition on his death and after his death is not in truth the highest ideal of civilized society. The welfare of society demands that the law should set limits to the power of the hand of the dead to control human affairs.[755]

[752] *Holdship v Patterson* (Pa 1838) 7 Watts 547, 551.

[753] *Shelley v Shelley* (1960) 223 Ore 328, 335-337.

[754] Though he seemed to concentrate his efforts more towards disapproving of the seminal case of *Morice v Bishop of Durham* (1805) 10 Ves 522, see AW Scott 'Control of Property by the Dead' (1917) 65 U Pa LR 527, 537 onwards.

[755] *ibid*, 527.

Of course, there is no logical reason why the control of property by someone who is still alive but no longer has any interest in the property should be treated any differently. The same trust device under US law allows control of settlors who no longer hold title to reign supreme, indiscriminately of whether that settlor is alive or dead.

Austin's writings in 1917 notwithstanding, by the time he came to write his restatement in 1935, the spendthrift trust was well-established and so won its place in American trust law's most influential treatise, and it is now the position throughout the United States.[756] The position has also been enshrined in the Uniform Trust Code, §502: a spendthrift provision is valid if it restrains both voluntary and involuntary assignment (§502(a)), the words 'spendthrift trust' in the trust deed are sufficient to create it (§502(b)) and a beneficiary cannot assign, nor a creditor attach to, the interest under a such a trust (§502(c)). The protection is only subject to individual exceptions for e.g. spouses or children or state or US claims (enumerated in §503).

ii) Claflin v Claflin

In order to appreciate the modern US law of beneficiaries' creditors in its entirety, the accompanying provision for restraints on anticipation must also be considered. *Claflin v Claflin*,[757] the foundational case, involved a testamentary trust, whereby one Wilbur F Claflin directed one third of the proceeds of sale of his residual estate to his son, Clarence A Claflin in stages. He was to receive $10,000 when he was 21, another $10,000 when he was 25 and the rest when he turns 30. He received the first instalment, and before he turned 25 he brought the suit to claim the

[756] J Dukeminier & R Sitkoff *Wills, Trusts, and Estates* (9th Ed, Wolters Kluwer Law & Business, New York 2013), 697.

[757] *Claflin v Claflin* (1889) 149 Mass 19

rest. Clarence Claflin argued that the provisions postponing payment were void, as his interest in the trust fund was 'vested and absolute',[758] relying on *Saunders v Vautier* and subsequent cases.[759]

Field J for the Supreme Judicial Court of Massachusetts instead based his discussion on *Broadway Bank v Adams*, stating that it 'rests upon the doctrine that a testator has a right to dispose of his own property with such restrictions and limitations, not repugnant to law, as he sees fit, and that his intentions ought to be carried out, unless they contravene some positive rule of law, or are against public policy. (…) the grounds on which this court declined to follow the English rule in that case are applicable to this.'[760] He swiftly concluded that the restriction on anticipation until the plaintiff reaches 25 and 30 are not against public policy, and should therefore be upheld in order to carry out the intentions of the settlor.[761]

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758 *ibid*, 21.

759 *Ibid*, 22. Cases cited (but not discussed in detail) are *Josselyn v Josselyn* (1837) 9 Sim 63 (where Sir Lancelot Shadwell VC in one line simply interpreted the will as having actually vested the property in the beneficiary with directions to trustees being 'merely directory as to the future management', at 66); *Saunders v Vautier* (1841) 4 Beav 115; Cr & Ph 240, 41 ER 482 (see above in Chapter 5); *Rocke v Rocke* (1845) 9 Beav 66 (where Lord Langdale MR only stated: 'I will look at the terms of the will, and see if the order can be made. If I should be satisfied that there is an absolute gift, with a direction to pay at twenty-five, then, as he has an absolute right at twenty-one, and can sell and mortgage his interest, I shall order payment', at 66); *In re Young's Settlement* (1853) 18 Beav 199 (where, again, the case simply turns on the absolute interest given to the testator's daughter; see 201 per Sir John Romilly MR); *In re Jacob's Will* (1861) 29 Beav 402 (in which Sir John Romilly simply applies *Saunders* in a single-line judgment at 404) ; *Gosling v Gosling* (1859) John 265 (the most detailed of the cases here cited, in which Sir William Page-Wood MR approaches the *Saunders* principle as one of probate law: 'The principle of this Court has always been to recognise the right of all persons who attain the age of twenty-one to enter upon the absolute use and enjoyment of the property given to them by a will, notwithstanding any directions by the testator to the effect that they are not to enjoy it until a later age—unless, during the interval, the property is given for the benefit of another', at 272.); *Turnage v Greene*, (1854) 2 Jones Eq. 63 (a North Carolina case); *Battle v Petway* (1845) 5 Ired 576 (Also North Carolina).

760 *Ibid,* 23.

761 *Ibid*, 23-24.

The case has attracted extensive commentary as well, and *Claflin* and *Nichols* are often discussed concurrently. Friedman discussed *Claflin* from the viewpoint of the dynastic trust,[762] and noted its relationship to the doctrine in *Adams* (and therefore *Nichols*), stating:

> [T]he court borrowed from the dynastic trust cases the idea that the settlor's plan was sacred and the beneficiary's wishes irrelevant. (…) The *Claflin* rule therefore vests the power of termination, in trusts of this type, in the hands of the trustee rather than the beneficiary. The trustee wields that power as the earthly representative of the dead settlor. (…) The spread of the *Claflin* doctrine corresponds in time and feeling to the spread of the spendthrift doctrine and the national acceptance of the dynastic trust.[763]

The eponymous *Claflin* doctrine, denoting the US textbook version that a trust cannot be terminated or modified without the settlor's consent, unless 1) the modification or termination has the consent of all the beneficiaries and does not run counter to a material purpose of the trust, or 2) by equitable deviation in cases where a change in circumstances has frustrated the purposes of the trust,[764] is therefore conducive to dynastic wealth preservation. Friedman describes the material purpose doctrine as being difficult to fulfil in a dynastic trust, as the consent of the beneficiaries is difficult or impossible to obtain with multitudes of potential contingent beneficiaries and as the 'material purpose of the trust' is not expressly laid out. This latter point leads him to conclude that the 'purpose of the trust' is equated with the trust's structure, meaning the restraint on anticipation (or any other provision) is a purpose it itself: 'Under the *Claflin* doctrine trusts are presumed to be ends in themselves unless the contrary is shown'.[765]

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[762] LM Friedman 'The Dynastic Trust' (1964) 73 Yale LJ 547, 586 onwards.

[763] *Ibid*., 586-7.

[764] See, for example, J Dukeminier & R Sitkoff *Wills, Trusts, and Estates* (9th Ed, Wolters Kluwer Law & Business, New York 2013), 717; Restatement (Third) of Trusts §65(2) (2003); UTC §411(b); JH Langbein 'Burn the Rembrandt? Trust Law's Limits on the Settlor's Power to Direct Investments' (2010) 90 Boston U LR 375, 381.

[765] LM Friedman 'The Dynastic Trust' (1964) 73 Yale LJ 547, 587. This point has now been expressly denied in the UTC – see below.

Gregory Alexander has argued that English courts have conceptually tied the *Saunders* doctrine to the assignability of the beneficial interest,[766] relying on *Curtis v Lukin*.[767] The case may not justify as strong a point, but it is not wholly without merit. The question in that case was whether a testamentary bequest was invalidated by the rule against perpetuities (or if not, whether the trustees had acted in breach of trust), on which former point the plaintiff argued that '[w]here there is a gift which vests within the limited period, but which is not payable until afterwards, the gift is not void, but the Court directs payment immediately on the legatee attaining twenty-one,'[768] citing *Saunders* as support. The emphasis on assignability came at Lord Langdale's statement that the test for whether a gift is too remote is whether the beneficiaries of the gift are able to dispose of it: 'if, according to the intention of the testator, some person or persons must not necessarily be in existence, with legal power to dispose of the property, within the period limited by the rule of law, then, I apprehend, the gift is too remote.'[769] In light of that statement, it is likely that Lord Langdale MR was simply explaining how the rule in *Saunders v Vautier* operates in relation to perpetuities, vesting powers of free disposition on the beneficiary immediately as the will is executed and thus avoiding any perpetuity problems, rather than saying such powers are the part of the internal logic of that rule.

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[766] GS Alexander 'The Dead Hand and the Law of Trusts in the Nineteenth Century' (1985) 37 Stan LR 1189, 1201.

[767] *Curtis v Lukin* (1842) 5 Beav 147. The case itself was 'entirely different' from *Saunders* (at 155 per Lord Langdale MR), but a conforming statement is certainly there: '[the legatee] has everything but possession; he has the legal power of disposing of it, he may sell, charge, or assign it, for he has an absolute, indefeasible interest in a thing defined and certain; the Court, therefore, has thought fit (I don't know whether satisfactorily or not), to say, that since the legatee has such the legal right and power over the property, and can deal with it as he pleases, it will not subject him to the disadvantage of raising money by selling or charging his interest, when the thing is his own, at this very moment.' (at 156). Note again that this passage does not mention trusts specifically but describes the beneficiary simply as a 'legatee', placing the principle within probate and not trust law.

[768] *Ibid*, 150.

[769] *Ibid*, 155.

The effect of the *Claflin* decision is therefore to say that the beneficiary's right of alienation (which existed in *Claflin* – there was no restraint on it) simply means the creditor only gets whatever right the beneficiary has, and has no right to the trust capital if the beneficiary has no such right. This much is uncontroversially in line with English law. The decision only means that the right to demand accelerated payment, contemplated in English law at least since *Love v L'Estrange*[770] in 1727 and finally granted in *Saunders* in 1841, is not part of American trust law.

This does have corollary effects on the free assignability of the equitable interest. As Gregory Alexander notes, 'the restraint on anticipation practically had the same effect as a restraint on alienation of the equitable interest, since the beneficiary probably would not be able to find a willing purchaser of his interest, or at least not one who would pay a price commensurate with its value.'[771] This, of course, is not legal inalienability but simply lowers the value that a beneficiary might hope to obtain from selling his interest, resulting in a practical fetter on alienability.[772] No change is effected by *Claflin* in the central doctrines of creditor access.

It should be noted that such beneficiary is not in any worse a position than any other whose beneficial interest includes some limitation who wishes to sell the extent of his rights – the buyer will pay only for that extent, and not for anything more. *Claflin* alone does not make trusts indestructible or inalienable, but together with the abolition of the rule against perpetuities

[770] *Love v L'Estrange* (1727) 5 Bro PC 59; 2 ER 532. See Chapter 4 above.

[771] GS Alexander 'The Dead Hand and the Law of Trusts in the Nineteenth Century' (1985) 37 Stan LR 1189, 1204.

[772] EW Cleary 'Indestructible Testamentary Trusts' (1934) 43 Yale LJ 393, 400-01.

in several states[773] does add a lot to the settlor's ability to safeguard a family dynasty from 'internal and external attack'.[774]

Paul Matthews has conducted a comparative law study of the rule in *Saunders v Vautier*,[775] noting some of the developmental roots of that doctrine as found in chapter 5 above.[776] It should be noted that his defence of the pedigree of the rule is not particularly accurate. He states that 'similar decisions had been made for more than 150 years, including at least one, a century earlier, in the House of Lords, [referring to *Love v L'Estrange*] and at least one, 20 years before, permitting two beneficiaries to combine and claim the capital.'[777]

This last claim, while technically true, is misleadingly inaccurate as the operative law had nothing to do with trusts or even probate but coverture. *Barton v Briscoe*,[778] the case referred to by Matthews, was one where a trust settlement for a marriage contained a restraint on anticipation. The wife, Marian Barton, was to be paid income from consols (bonds) with the right to indicate who the money was to paid to, but without the right to sell, mortgage or charge the property itself. Her daughter, Marian Millicent Barton, was made a residuary beneficiary. The husband died, and the mother and daughter together argued that the mother now had an absolute interest

[773] Currently 29 states plus Washington DC – see RH Sitkoff & MM Schanzenbach 'Jurisdictional Competition for Trust Funds: An Empirical Analysis of Perpetuities and Taxes' (2005) 115 Yale LJ 356; MM Schanzenbach 'Perpetuities or Taxes? Explaining the Rise of the Perpetual Trust' (2005-2006) 27 Cardozo LR 2465.

[774] EW Cleary 'Indestructible Testamentary Trusts' (1934) 43 Yale LJ 393, 397.

[775] P Matthews 'The Comparative Importance of the Rule in *Saunders v Vautier*' (2006) 122 LQR 266.

[776] *Ibid*, 267.

[777] *Ibid*.

[778] *Barton v Briscoe* (1822) Jac 603, 37 ER 978.

in the property under the marriage settlement.[779] Sir Thomas Plumer MR noted that there was no relevant authority,[780] and stated that the question to be decided is 'whether a clause against anticipation, which is considered an obligatory and valid mode of preventing a married woman from depriving herself of the benefit of the property settled (for it is too late to argue that now),[781] becomes of no effect by the coverture being determined [by her husband's death].'[782]

The Master of the Rolls noted that there was nothing different about the case at hand and *Brandon v Robinson*, except gender and the laws of coverture,[783] 'and it cannot be said that the law will permit restraints upon the rights of property in the case of females which it will not permit in the case of males'.[784] With a crescendo finish, he noted:

> when the married woman becomes discovert, she has the same power over her property as other persons: the restraint, therefore, ought not to continue. The attempt to impose upon the power of alienation a fetter unknown to the common law of England may be permitted to the extent to which that power is created by equity, but not further; when the coverture is gone, the reason on which the restraint is founded no longer exists.[785]

It is true that the mother was transferred the property formerly held under the marriage settlement free of any restraints, but this was because 1) the marriage (and therefore coverture) had ended, thus ending the marriage settlement and 2) the coverture was the reason these restrictions were lawful in the first place. So while I agree that the rule in *Saunders v Vautier* has

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779 *Ibid*, 604.

780 *Ibid*, 605.

781 *Ibid,* 605. This appears to be a statement by the judge indicating disapproval of the then-current laws – such restraints were indeed valid and necessary to prevent the husband (or his creditors) taking ownership of the married woman's property until the Married Women's Property Acts of 1870 and 1882.

782 *Ibid,* 605.

783 *Ibid.*

784 *Ibid.*

785 *ibid*, 606.

long developmental roots whose appreciation should inform the doctrine itself, the broad brush claim that the doctrine had fully formed existence before *Saunders* has not been supported by any case uncovered in the research for this thesis.

Matthews' theoretical justification of the *Saunders* rule is more illuminating. He argues that property entails the power to make decisions,[786] in line with Sir Edward Coke's conceptual argument that property does not tolerate restraints on alienation as they clash logically with the concept. Since the property is no longer with the settlor, 'the decision whether to enjoy it or destroy it is no longer one for him. Instead, it is ultimately a decision for those who benefit from the trust.'[787]

But, on the basis of property rights and decision-making, there is no particular reason to prefer the beneficiary's property right over those of the settlor in locating exactly who commands this decision-making capacity and at what time. In line with this, John Langbein takes a different view to Paul Matthews. As already cited in the previous chapter, he states that

> The *Claflin* rule frames the relevant property rights at the time that the property is still in the hands of the donor, whereas the rule in *Saunders v Vautier* ignores rights claimed to have arisen at that time, waits for the transfer to have taken place, and then reckons the property in the hands of the donee as the sole source of property rights.[788]

If the basis of the rule in *Saunders* is in the beneficiary's property interest and concurrent decision-making powers, the challenge is to explain why the settlor's property interest should not command the same powers of decision, particularly as they are prior in time.

[786] P Matthews 'The Comparative Importance of the Rule in *Saunders v Vautier*' (2006) 122 LQR 266, 274.

[787] *Ibid*, 274-5.

[788] JH Langbein 'Why the Rule in *Saunders v Vautier* is Wrong' in PG Turner (ed) *Equity and Administration* (CUP Cambridge 2016) 189, 198.

Matthews' argument is that to prefer the settlor's property rights over those of the beneficiary is

> counter-intuitive. On the face of it, a person giving away property in trust ceases to that extent to have property rights, which have instead been transmitted to others (…). To allow a settlor to control property that he has given away would not be to favour his orthodox property rights, but—on the face of it—to create a new and different "property" right.[789]

It is unclear what is meant by this point. The point about 'favouring' the settlor's property right must clearly refer to the general structure of the law, and so that must be what the 'creation' of a new and different property right must refer to as well (as opposed to the settlor creating a new property right in the beneficiary). But no new property right is created in the settlor by the *Claflin* doctrine (as is evident from the settlor's lack of enforceable interests), it is simply a fact that only the settlor ever had an unrestricted property right in the first place and therefore only the settlor ever had unencumbered decision making powers related to that property. Even if we accept that the beneficiary has a right in the trust property beyond that of his right to have the trust duly administered, it cannot be said that that right is equal to an unrestricted legal title. Nor is the trustee's title equal – he holds legal title, but has no rights to use the property except insofar as the trust allows. The argument that denying *Saunders v Vautier* somehow leads to a logical contradiction in the basic concept of a trust does not seem to hold, at least if we accept that the rule is based on protection of the beneficiary's property right.

Matthews does accept that '[*Saunders v Vautier*] is not fundamental to the trust concept (…)'.[790] Instead, he argues that it is functionally useful in enhancing 'liquidity and efficiency of the market', and that the general direction of American trust law with its new-found tolerance

[789] P Matthews 'The Comparative Importance of the Rule in *Saunders v Vautier*' (2006) 122 LQR 266, 284.

[790] *Ibid*, 294.

for perpetuities together with the availability of restraints on anticipation may hamper those aims.[791]

It is nonentheless, as Matthews suggests, a plausible doctrinal choice that a trust jurisdiction may take. The argument, at its highest, therefore only appears to be that *Saunders* is one of the many functionally useful devices that operate within trust law's sphere and its removal is only problematic in creating inefficiencies when coupled with perpetuities or restraints on alienation. Indeed, as seen in Chapter 5 above, the roots of the doctrine lie in (Roman) probate law, and English law in practice can tolerate trusts that deny its operation. It is true that American trust law has taken the additional step of overruling the doctrine entirely, but nowhere is a trust that includes a residuary beneficiary denied existence on the basis that it offends *Saunders*.

2. Modern US Scholarship on Trust Asset Protection

The above developments of US law away from some of the central tenets (and incidental doctrines) of English law are now beyond serious debate. As a matter of positive law, the choice is made and it favours the inalienability of the beneficial interest and impossibility of court interference with the settlor's intent through *Saunders v Vautier,* while simultaneously insisting that the beneficiary has a property right. But as with the American law on trust creditors, the functional approach to the rights of beneficiaries' creditors as effected by legislative developments has meant that the time of American trust law's evolution is far from over. Both the thrust toward ever greater asset protection and the criticisms of such protection are matters

[791] *Ibid*, 292.

of great debate in modern American trust law scholarship, as the doctrinal grounds continue to shift.

In 1993, Anne Emanuel argued for a codification of the 'compromise' of allowing asset protection trusts (of the sort where alienation is restrained and early termination impossible) with individual exceptions for the wife or child, necessary services to the beneficiary or to preserve the interest of the beneficiary, or claims by the state.[792] She argues that 'two of the significant evils of restrains on alienation—perpetuating the dead hand's control of property and removing property interests from the stream of commerce—are substantially ameliorated by the rise of the modern trust in which the trustee has virtually all the power over the legal title to the property that an owner would have.'[793]

This point appears to be that the trust property is alienable, just not by the beneficiary, and it is therefore not removed from the general market. As such, it does not respond to the arguments put forward since John Chipman Gray first unleashed them, that the protection of the beneficiary's wealth from his creditors has the potential to create a class of people to whom liabilities do not attach and who can remain in fine claret and quails' eggs no matter how foolish their ventures. So long as the trustee is reasonably diligent, as trustees are required to be under US law or replenish the trust funds personally,[794] the trust property will remain protected from the usual free market pressures as concerns the beneficiary – bad management, bad luck or bad

[792] AS Emanuel 'Asset Protection Trusts: It's Time to Codify the Compromise' (1993) 72 Neb LR 179.

[793] *Ibid*, 188-9.

[794] Under the so-called 'prudent investor rule' - see Restatement (Third) of Trusts, §227.

character. The property itself may circulate in the market as it is exchanged for other property by the running of the trust business, but the value of the beneficiary's estate is preserved.[795]

The point has nevertheless been repeated and argued elsewhere. Adam Hirsch has argued,[796] that clogs on alienability of the beneficial interest do not hamper efficient reallocation of property through the free market system, because the trustee is free to alienate the property while preserving the value of the trust corpus.[797] '[T]his policy [of a general ban on restraints against alienation] has no bearing on a trust, which encumbers only the *beneficial* interest in property. (…) It is a revolving investment fund that [the trustee] can trade to whoever will pay top dollar. Only the fungible income that the corpus yields is subject to alienability restrictions.'[798] He also argues that by constraining hapless beneficiaries from spending away their fortunes all at once, spendthrift trusts keep beneficiaries 'off the welfare rolls [and] serve to hold down the cost of government'.[799] In other words, protecting dynastic descendants from the free market pressures everyone else is subject to, the spendthrift trust, according to Hirsch, actually produces more societal wealth than it locks away because it cuts down on government bureaucracy and welfare.

It is true that the individual pieces of property (say, shares or flats) within the trust corpus do continue to circulate in the free market in the normal management trust. What the argument fails to note, however, is that the accumulated value of those pieces of property remains locked inside the asset protection trust, slowly concentrating wealth to those who have

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[795] See further B Rudden 'Things as Things and Things as Wealth' (1994) 14 OJLS 81.

[796] AJ Hirsch 'Spendthrift Trusts and Public Policy: Economic and Cognitive Perspectives' (1995) 73 Wash U LQ 1.

[797] *Ibid*, 10-11.

[798] *Ibid*, 11.

[799] *Ibid*.

the means to rely on passive income (i.e., income that requires no work input, e.g. income from shares or flats, combined with capital appreciation) as opposed to those who must actually work for their sustenance and spend their savings. There being a finite amount of wealth (as well as finite property) in any economic system, such accumulation, if repeated by enough individuals, will eventually start to shape and hamper the economic development of that system as the locked away value does not get spent, or only gets spent on buying other protected assets from other asset protection vaults, and economic activity starts to concentrate on catering for those who still have the financial means to consume – the passive-income receivers with ever growing protected trust funds. The institutional effect over the long term is for manufacturing to move to specialized luxury products that few can afford, leading to a life of capital income leisure for the few, and a low-wage misery for the rest. In this way, even though the actual trust property may circulate from investor to investor with ever-increasing prices, the broad economy is not on a sound basis. The reallocation of wealth to the most efficient hands through the free market mechanisms is still hampered, because few products means few producers means low employment, which in turn means the most efficient hands may simply lack the means to acquire the right property. Even John Chipman Gray did not see the problem as being individual beneficiaries being protected, but a 'privileged *class*' (emphasis added).[800]

The modern law and economics –type free market justifications of the spendthrift trust leave something to be desired in their coherence. With no apparent sense of internal contradiction, Emanuel argues in the same breath that

> restraints are inconsistent with an entrepreneurial, free market society. Commerce cannot thrive if the critical property cannot be transferred. (…) What, then, accounts for the American approval of a classic restraint on alienation, the spendthrift provision? (…) the very interests which must invalidate restraints in order to thrive suddenly find that this particular restraint suits their personal interests (…). [T]he successful entrepreneur

[800] JC Gray *Restraints on Alienation of Property* (1st ed, Boston Book Co, Boston 1883); (2nd Ed, Boston Book Co, Boston 1895), vi.

> utilizes the free market concept to amass a fortune. Once he has amassed his fortune, the protection provided by a restraint on alienation suddenly becomes appealing.[801]

Admitting the defeat of logic, yielding to the American asset protection trust, Emanuel concludes:

> Spendthrift provisions may be theoretically suspect; they are, nonetheless, not only valid but also thriving. (…) Writing in the face of their all but universal acceptance, however, I counsel a pragmatic approach. Allow creditors to claim a percentage of each distribution—enough to be significant, but not so much as to frustrate the settlor's goal of taking care of the beneficiary.[802]

These recommendations have not led to legislative reform.

In the mid-1990s Lynn LoPucki argued that the various asset protection structures available to legal persons in the US, and the then-revolutionary developments in computer technology which made these structures more cost-effective and accessible, are beginning to lead to a regime where payment of liabilities is essentially optional.[803] Through strategic manipulation of systems designed to ensure that those who lack the capacity to pay judgments do not have to pay, individuals and businesses have developed methods of 'judgment-proofing'.[804] While the argument is not specifically aimed at trusts but includes asset securitisation[805] and other ownership structures (as well as multiple corporate form, practical bankruptcy protections and jurisdictional evasiveness), the paradigmatic example given by LoPucki is of an overseas

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[801] AS Emanuel 'Asset Protection Trusts: It's Time to Codify the Compromise' (1993) 72 Neb LR 179, 190.

[802] *Ibid*, 209.

[803] LM LoPucki 'The Death of Liability' (1996) 106 Yale LJ 1.

[804] *Ibid*, 4-5.

[805] Which the trust device is well suited to effect– see T Frankel *Securitization* (Ann Taylor Schwing ed, Fathom Publishing Co, 2nd ed 2005), T Frankel and M Fagan *Law and the Financial System* (Vandeplas Publishing 2009).

spendthrift trust,[806] overseas for additional jurisdictional protections.[807] He concludes that 'among individuals and small firms, [strategies for defeating liability] already protect the vast bulk of all assets (…),[808] sounding a cautionary note for the integrity of the whole system of private law in the United States.

LoPucki's argument has not gone without criticism. James White wrote a detailed response,[809] in which he describes LoPucki's vision of the death of individual and corporate liability as 'fictional'.[810] Noteworthy is, however, that White's article is based on empirical data – public financial information on corporate secured debt, asset-to-liability ratio, and insurance policies[811] – and he even (perhaps inadvertently) states that firms simply '*choose* not to judgment proof themselves' (emphasis added),[812] and that '[n]o single part of the American legal or economic structure explains why judgment proofing is not widespread.'[813]

A convincing logic for the spendthrift trust has eluded American trust law scholarship, and its existence therefore seems to be based on 'naked preference'.[814] This lacuna of a

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[806] LM LoPucki 'The Death of Liability' (1996) 106 Yale LJ 1, 33-38.

[807] *Ibid*, 38.

[808] *Ibid*, 89.

[809] JJ White 'Corporate Judgment Proofing: A Response to Lynn LoPucki's *The Death of Liability*' (1998) 107 Yale LJ 1363.

[810] *Ibid*, 1363.

[811] *Ibid*, 1369 onwards.

[812] *Ibid*, 1363.

[813] *Ibid*, 1394

[814] GS Alexander 'The Dead Hand and the Law of Trusts in the Nineteenth Century' (1985) 37 Stan LR 1189, 1193.

convincing response to Gray's concerns[815] now receives little attention, with most recent analyses concentrating on the continuing legislative and academic developments – such as the availability of self-settled asset protection trusts[816] and the completion of the Uniform Trust Code and Restatement (Third) of Trusts.[817]

The picture that emerges is one of judicial developments and legislative controls on those developments. For example, the Mississippi Supreme Court added tort claimants to the list of creditors against whom an asset protection trust could not shield in *Sligh v First National Bank* on public policy grounds,[818] only to be swiftly overruled by the Mississippi legislature.[819] The Uniform Trust Code with its limited exceptions in §504 could further nip such judicial developments in the bud in states that have adopted it.[820] These developments can only be seen

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[815] E.g. Anne Emanuel states that '[t]he current of history has swept away Gray's position without refuting it' at AS Emanuel 'Asset Protection Trusts: It's Time to Codify the Compromise' (1993) 72 Neb LR 179, 209.

[816] Whereby the settlor is the ultimate beneficiary of a spendthrift trust, first validated in Alaska in 1997 and quickly followed by Delaware in 1997, Nevada and Rhode Island in 1999, Utah in 2003, Oklahoma in 2004, South Dakota and Missouri in 2005, Tennessee and Wyoming in 2007, New Hampshire in 2009, Hawaii in 2010, Virginia in 2012, Ohio in 2013, Mississippi in 2014 and most recently, West Virginia in 2016. The current total is 16 states, with the remaining states' judiciaries resisting the validation of an out-of-state asset protection trust on grounds of public policy – see *Waldron v Huber (In re Huber),* 493 B.R. 798 (Bankr. W.D. Wash. 2013) and B Duffy 'In States we "Trust": Self-Settled Trusts, Public Policy and Interstate Federalism' (2016) 111 Northwestern U LR 205, (arguing the case was wrongly decided and that public policy grounds favour the view that an out-of-state asset protection trust should be valid). The closest English equivalent, the self-settled protective trust, is a 'fraud on the bankruptcy laws' – see *In Re Ashby, Ex Parte Wreford* [1892] 1 QB 872, 876.

[817] JK Eason 'Policy, Logic and Persuasion in the Evolving Realm of Trust Asset Protection' (2006) 27 Cardozo LR 2621, 2624.

[818] *Sligh v First National Bank* (1997) 704 So 2d 1020

[819] Family Trust Preservation Act 1998 at Miss Code Ann § 91-9-501 (2005). This act preserved the judgment only as regards self-settled trusts at § 91-9-509.

[820] See generally RT Danforth 'Article Five of the UTC and the Future of Creditors' Rights in Trusts' (2006) 27 Cardozo LR 2551 (arguing that Article 5 of the UTC strengthens rather than weakens the asset protection trusts).

in the context of competition for trust assets as mentioned in the last chapter, and the state legislatures tipping an ear to the local professional practitioners in drafting legislation.[821]

At the federal level, one significant amendment to the Bankruptcy Code affecting self-settled spendthrift trusts was passed by the Senate in 2005, extending time limits for fraudulent (with actual intent to defraud creditors) conveyances of property into self-settled trusts from one year to ten.[822] However, the amendment probably 'will have added little to the law in this area',[823] and rode on the coat tails of a more significant amendment calling for *all* transfers to such trusts within the last ten years before bankruptcy to be set aside to the extent that their aggregate value exceeded $125,000,[824] which amendment was defeated by strong Republican opposition on a purely partisan basis.[825]

Where the defence of the spendthrift trust aims to showcase its positive utility,[826] even the criticism of the spendthrift trust does not really attack its foundations but its economic effects. Kent Schenkel has argued that the spendthrift trust is nothing more than an 'elective externalization tool' with which those engaged in genuine economic activity (like manufacturing

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[821] JK Eason 'Policy, Logic and Persuasion in the Evolving Realm of Trust Asset Protection' (2006) 27 Cardozo LR 2621, 2654; AJ Hirsch 'Fear Not the Asset Protection Trust' (2006) 27 Cardozo LR 2685, 2687.

[822] 11 US Code § 548(e)(1) (2000).

[823] DG Shaftel and DH Bundy 'Impact of New Bankruptcy Provisions on Domestic Asset Protection Trusts' (2005) 32 Est Plan 28, 30.

[824] Known as the Schumer amendment, after its originator, Senator Charles Schumer, the current Senate minority leader.

[825] JK Eason 'Policy, Logic and Persuasion in the Evolving Realm of Trust Asset Protection' (2006) 27 Cardozo LR 2621, 2671. See also P Krugman 'The Debt-Peonage Society' in The New York Times, 8 March 2005, available at http://www.nytimes.com/2005/03/08/opinion/the-debtpeonage-society.html?mcubz=1 (accessed on 24 August 2017).

[826] AJ Hirsch 'Spendthrift Trusts and Public Policy: Economic and Cognitive Perspectives' (1995) 73 Wash U LQ 1; AJ Hirsch 'Fear Not the Asset Protection Trust' (2006) 27 Cardozo LR 2685.

or ranching) can avoid the costs of their activities by pushing them onto a third party.[827] The spendthrift trust is used to 'jettison the cost of debt-exposure so that it falls on those outside the trust deal', making a cost that would otherwise have been borne by the beneficiary an 'externality' or 'social cost'[828] that will instead be borne by his creditor, voluntary or not.[829]

In response, some suggest that the boots-on-the-ground view must be that asset protection trusts are not a significant problem, as evidenced by the lack of concentrated lobbying efforts by the consumer credit industry and dispute lawyers to outlaw them.[830] Nevertheless, Schenkel points out several specific inefficiencies, such as common pool problems in racking up information costs for creditors,[831] the unbargainable 'moralism'[832] that people loathe to see privileged beneficiaries protected from their follies[833] by a device that is only available for wealthy people,[834] and the simple distributional effect that those who must pay for credit in the market

[827] KD Schenkel 'Exposing the Hocus Pocus of Trusts' (2011) 45 Akron LR 63, especially 68-9.

[828] See RH Coase 'The Problem of Social Cost' (1960) 3 JL & Econ 1.

[829] KD Schenkel 'Exposing the Hocus Pocus of Trusts' (2011) 45 Akron LR 63, 70. This effect on involuntary creditors is loathed even by the asset protection trust's defenders, though they see it as a problem with judgment-proofing generally: see AJ Hirsch 'Fear Not the Asset Protection Trust' (2006) 27 Cardozo LR 2685, 2709 ('To be sure, the treatment of involuntary creditors under the doctrines that ground and surround this vehicle calls for rethinking (…) the use of asset protection trusts to defeat involuntary claims needs to be curtailed'.)

[830] AJ Hirsch 'Fear Not the Asset Protection Trust' (2006) 27 Cardozo LR 2685, 2711; WM McGovern Jr & SH Kurtz *Wills, Trusts and Estates* (3rd Ed West Publishing, 2004) §13.1.

[831] KD Schenkel 'Exposing the Hocus Pocus of Trusts' (2011) 45 Akron LR 63, 85.

[832] Essentially a result or state of affairs that does not lend itself to monetisation or bargaining, such as stern religious belief – see G Galabresi & AD Melamed 'Property Rules, Liability Rules and Inalienability: One View of the Cathedral' (1972) 85 Harv LR 1089, 1112.

[833] KD Schenkel 'Exposing the Hocus Pocus of Trusts' (2011) 45 Akron LR 63, 86.

[834] AJ Hirsch 'Fear Not the Asset Protection Trust' (2006) 27 Cardozo LR 2685, 2709-10, ('[t]hese vehicles are currently unaffordable by poorer individuals').

place will face higher credit charges because 'some debtors are protected by a spendthrift trust',[835] holding that such cost '[that] trusts can inflict on third parties are often unjustifiable.'[836]

As the grounds of US academic discourse have shifted toward a functional and economic analysis of central legal principles, it seems that the question of the basis of the spendthrift trust and its logic in the context of trust law's central framework will remain unanswered. This is partly because it is no longer seen as a particularly enlightening method of analysis, but also because a great deal of trust law in America has been effected by statute which, by definition, does not require any other logical defence than the legitimate representative democratic process. With the central aspects of a trust under legislative development, there is little point in attempting to find conceptual coherence in the device beyond its functional aspects. As seen above, however, there is little consensus on those aspects.

3. Creditor Rights against Beneficiaries under US Law

As with creditors of trustees, broadly speaking the basic structure of creditor rights against beneficiaries under US law follows the same logic as English law. The creditor's right depends on the beneficiary's ability to assign his rights under the trust, which ability the beneficiary has unless it has been specifically restricted. This continues to be upheld in various

[835] KD Schenkel 'Exposing the Hocus Pocus of Trusts' (2011) 45 Akron LR 63, 89.

[836] *Ibid*, 67.

state judiciaries,[837] as well as federally.[838] In US law, beneficiaries can even grant leases[839] and easements[840] where the trust property is land, in line with the idea that the beneficial interest is a property right. In 1937 the US Supreme Court reasoned, in a case concerning validity of assignments of beneficial interest for tax purposes, that

> [the beneficiary is] the owner of an equitable interest in the corpus of the property (...)By virtue of that interest, he was entitled to enforce the trust, to have a breach of trust enjoined, and to obtain redress in case of breach. The interest was present property alienable like any other, in the absence of a valid restraint upon alienation.[841]

The position then is only markedly different from English law where either a spendthrift trust is at issue, or the beneficiary otherwise attempts to go against the settlor's intent. The beneficiary's creditor can access his interest where the beneficiary has manifested an intention to transfer the interest presently,[842] the beneficiary has the legal capacity to make the transfer,[843] and the trustee has been notified.[844] Where the trustee has not been notified, the creditor only has rights against the beneficiary and the trustee is not liable should he continue to make distributions to the original beneficiary. Contrary to the English view, this logic does not extend

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[837] Arizona: *Dunlap Investors Ltd v Hogan* (1982) 650 P2d 432; California: *Walgren v Dolan* (1990) 276 Cal Rptr 554; Hawaii: *Matter of Lopez* (1981) 636 P2d 731; Illinois: *Paine/Wetzel Associates v Gitles* (1988) 528 NE2d 358; Maryland: *Rappold v Rappold* (1961) 166 A2d 897; Michigan: *Matter of Dodge Testamentary Trust* (1982) 330 NW2d 72; Missouri: *Bennett v Tower Grove Bank* (1968) 434 SW2d 560; New York: *In Re Gomez Trust* (1946) 59 NYS2d 519; North Dakota: *Hull v Rolfsrud* (1954) 65 NW2d 94; Pennsylvania: *Dravo Trust* (1951) 79 PaD&C 79.

[838] *Blair v Commissioner of Inland Revenue* (1937) 300 US 5.

[839] *R-Five Inc v Shadeco Inc* (Ill App 1999) 712 NE2d 913.

[840] *Granite State Electric Company v Gidley* (NH 1974) 318 A2d 486.

[841] *Blair v Commissioner of Inland Revenue* (1937) 300 US 5, 13.

[842] Restatement (Second) of Trusts §134(1) & cmt c (1959); Restatement (Third) of Trusts §52(1) & cmt a (2003).

[843] Restatement (Second) of Trusts §133(1) & cmt c & d (1959); Restatement (Third) of Trusts §51 cmt c (2003).

[844] Restatement (Second) of Trusts §136 (1959); Restatement (Third) of Trusts §52 & cmt d (2003).

to the idea that the first creditor to notify prevails except in some isolated states.[845] Instead, the first to procure their interest prevails over other assignments in the general case.[846] Where the interest is a future interest, the assignment takes effect as a contract requiring consideration.[847]

The methods by which the courts effect creditor access have been elaborated in US trust law, consistently with the idea that the beneficial interest is a property right. The basic position is that creditors can 'subject the interest of the beneficiary to the satisfaction of their claims, except insofar as a corresponding legal interest is exempt from creditors' claims'.[848] The court will give relief that is 'fair and reasonable in the circumstances'.[849] The court can order a sale of the beneficial interest and payment of the creditor's claim from the proceeds,[850] as well as payment out of the distributions made to the beneficiary.[851]

The major doctrinal differences therefore flow from the cases discussed at length above, *Nichols v Eaton* and *Claflin v Claflin*. These cases have led to significant doctrinal strands of their own, some aspects of which deserve specific mention.

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845 California: *Widenmann v Weniger* (1913) 130 P 421; Maryland: *Lambert v Morgan* (1909) 72 A 407; Pennsylvania: *Phillips's Estate* (1903) 55 A 213; Note also pre-*Nichols* USSC authority following the English position: *Judson v Corcoran* (1854) 54 US 612; *Spain v Hamilton's Administrator* (1864) 68 US 604.

846 Restatement (Third) of Trusts §54 (2003).

847 Restatement (Second) of Trusts §134(2) & cmt b (1959); Restatement (Third) of Trusts §52(1) & cmt d (2003).

848 Restatement (Third) of Trusts §56 (2003).

849 *Ibid*, cmt e.

850 e.g. where it 'appears unlikely that the debt can be satisfied from distributions within a reasonable time', *ibid*.

851 *ibid*.

i) Some Recent Developments in Restraints on Alienation

The foundational cases and their major conceptual and policy justifications having been discussed in detail above, what remains to be discussed is the incidence and interpretation of spendthrift provisions post-*Nichols*, and notable exceptions (or notable lack thereof) for certain types of claimants.

The spendthrift trust is recognised throughout the US, but its provisions differ from state to state. As much of this has been achieved by statute without rigorous judicial reasoning beyond what was said in *Nichols*, a complete survey of the differences between states would be of limited use in a work attempting to elaborate on trust law's central concepts. Some notable points are that while most states hold an assignment of a beneficial interest to be valid unless otherwise stated,[852] others make all trusts presumptively spendthrift unless the settlor's intention is clearly to the contrary.[853] In New York, the beneficial interest is nevertheless made subject to the beneficiary's creditors, except to the extent that is needed 'for the education and support of the beneficiary'.[854] This is quantified by reference to the kind of life the beneficiary is accustomed to: 'It is proper to consider his station in life, and the manner in which he has been reared and educated, his habits, and the means he may have to aid in his support.'[855] It is this principle, known as the Station-in-Life Rule, that released another broadside of scorn from John Chipman

[852] Uniform Trust Code §§501 to 503; California Probate Code §15300; Delaware Code Ann Title 12 §3536; Georgia Code Ann §53-12-28; Indiana Code 30-4-3-2; Iowa Code §633A.2301; Louisiana Revised Statutes §§9:1841, 9:2002; Nevada Revised Statutes §§166.010 to 166.160; North Dakota Century Code §59-03-18; Oklahoma Statutes Ann Title 60, §175.25; South Dakota Codified Laws Ann §§43-10-12, 55-1-16 to 55-1-18; Texas Probate Code Ann §112.035(a); Wisconsin Statutes §701.06.

[853] Michigan Compiled Laws §55.19; New York Estate Powers & Trusts Law §7-1.5(a)

[854] New York Estate Powers & Trusts Law §7-3.4.

[855] *Moulton v De Ma Carty* (1866) 29 NY Super Ct 533; cited with approval in *Wetmore v Wetmore* (1896) 149 NY 520, 531.

Gray, quoted above.[856] The rule has made the statutes permitting creditor access 'relatively useless to creditors of beneficiaries who are accustomed to luxury'.[857]

A budding distinction in American law has been that between voluntary and involuntary alienation.[858] It has already been discussed how legislative curtailments of judicial exceptions to tort creditors has weakened the hopes of a full-blown tort exception to spendthrift trusts' protections, and no such exception now exists in either the UTC or in the latest Restatement.[859]

These hopes have further dwindled with judicial development, perhaps heeding the lesson from the Mississippi legislature following *Sligh*. A striking example is *Scheffel v Krueger*.[860] In that case a judgment had been entered against Kyle Krueger for damages, Kyle Krueger having sexually assaulted the claimant's underage child, filmed the assault and posted it online. Kyle Krueger was the beneficiary of a trust with a spendthrift provision barring all anticipation and creditor claims. The trial judge had ruled that the trust assets cannot be attached by the claimant, and the New Hampshire Supreme Court eventually considered whether this was right in law.

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856 See n 717 above and accompanying text, JC Gray *Restraints on Alienation of Property* (1st ed, Boston Book Co, Boston 1883); (2nd Ed, Boston Book Co, Boston 1895), xi.

857 J Dukeminier & R Sitkoff *Wills, Trusts, and Estates* (9th Ed, Wolters Kluwer Law & Business, New York 2013), 702.

858 See AJ Hirsch 'Spendthrift Trusts and Public Policy: Economic and Cognitive Perspectives' (1995) 73 Wash U LQ 1, 7-8 ('[voluntary and involuntary alienation] are in fact both conceptually—and doctrinally—distinct.'); *Sligh v First National Bank* (1997) 704 So 2d 1020, 1026 ('The interest of a beneficiary of a spendthrift trust or a trust for support may be reached in cases other than [exceptions listed in the Restatement], if considerations of public policy so require. Thus it is possible that a person who has a claim in tort against the beneficiary of a spendthrift trust may be able to reach his interest under the trust.')

859 UTC §503 cmt ('The drafters also declined to create an exception for tort claimants.') See also RT Danforth 'Article Five of the UTC and the Future of Creditors' Rights in Trusts' (2006) 27 Cardozo LR 2551, 2560; Restatement (Third) of Trusts §59.

860 *Scheffel v Krueger* (NH 2001) 782 A2d 410; 146 NH 669.

The claimant argued that the New Hampshire spendthrift statute, Revised Statutes Annotated 564:23 I, was not intended to protect trust assets from tort creditors, and that public policy allowed the court to insert an exception, in line with *Sligh v First National* in the Mississippi Supreme Court four years earlier. The New Hampshire Supreme Court rejected the claim, stating simply that 'Nothing in this language suggests that the legislature intended that a tort creditor should be exempted from a spendthrift provision. (…) "It is axiomatic that courts do not question the wisdom or expediency of a statute."[861] Therefore, "[n]o rule of public policy is available to overcome [this] statutory rule.".'[862]

One notable exception to the protections of a spendthrift trust is the maintenance of the beneficiary's children, which exception is present in the majority of states and under the UTC §503(b)(1).[863] The reasoning in an early case struck the right chords in tying this exception back to the idea of individual power and responsibility.[864] In *Shelley v Shelley*, where the defendant argued that freedom of disposition includes the freedom to pass property free of claims for alimony, Justice O'Connoll for the Oregon Supreme Court stated:

> But the premise [that the testator has the privilege of disposing property as he pleases] is not sound. The privilege of disposing of property is not absolute; it is hedged with various restrictions where there are policy considerations warranting the limitation. (…) Certainly the defendant will accept the societal postulate that parents have the obligation to support their children. If we give effect to the spendthrift provision to bar the claims for support, we have the spectacle of a man enjoying the benefits of a trust immune from claims which are justly due, while the community pays for the support of his children. (…) We do not believe that it is sound policy to use the welfare funds of this state in support of the beneficiary's children, while he stands behind the shield of immunity created by a spendthrift trust provision. To endorse such a policy and to permit the

[861] Citing *Brahmey v Rollins* (1935) 87 NH 290, 298.

[862] *Scheffel v Krueger* (NH 2001) 782 A2d 410; 146 NH 669, 672-3.

[863] See TJ Vitollo 'Uniform Trust Code Section 503: Applying Hamilton Orders to Spendthrift Interests' (2008) 43 Real Prop Tr & Est LJ 169, 185-192.

[864] *Shelley v Shelley* (Or 1960) 354 P2d 282.

> spectacle which we have described above would be to invite disrespect for the administration of justice.[865]

It is not entirely clear whether this reasoning, particularly the issue of bringing the administration of justice to disrepute, applied in Justice O'Connoll's mind to other exceptions he listed in the judgment—including the rule against restraints on alienation—but it is nonetheless difficult to see how similar reasoning could not apply in the general case. The creditor's claims are justly due, and the rest of the community must bear the cost of the beneficiary's protected funds. Nevertheless, this exception has survived into the UTC, while a more general exception to tort creditors has been left out.[866]

ii) Modification and Termination of Trusts

The doctrinal landscape following *Claflin* also deserves a few points of clarification, beyond what has been said above. In essence, the ability to terminate or modify a trust against the will of the settlor depends on 1) the consent of all beneficiaries and 2) the material purpose of the trust. Because of the lack of specificity in defining 'material purpose' beyond the structure of the trust,[867] it is generally thought that a spendthrift trust, discretionary trust or a trust where

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865 *Ibid,* 285-6.

866 See See TJ Vitollo 'Uniform Trust Code Section 503: Applying Hamilton Orders to Spendthrift Interests' (2008) 43 Real Prop Tr & Est LJ 169, arguing that this represents inconsistent policy objectives and should be dealt with by removing all exceptions and instead allowing *Hamilton* orders for tort creditors and children. *Hamilton* orders, after *Hamilton v Drogo* (NY 1926) 250 NE 496, allow for a creditor to attach against future distributions of discretionary trusts, much as in English law the creditor is entitled to any distributions from a discretionary trust under *Re Coleman*. The *Hamilton* procedure is preserved in UTC §501.

867 LM Friedman 'The Dynastic Trust' (1964) 73 Yale LJ 547, 587. See n 782 above and accompanying text.

enjoyment is postponed cannot be terminated.[868] The UTC, however, has expressly stated that a spendthrift provision is not presumed to constitute a material purpose.[869]

The conditions under which a trust may be terminated have been interpreted very restrictively. In *Re Estate of Brown*,[870] the trust was set up to provide for the college education of the children of the testator's nephew, with the remainder to be used 'for the care, maintenance and welfare of my nephew Woolson S Brown and his wife Rosemary Brown, so that they may life in the style and manner to which they are accustomed (…)'.[871] The educational purpose having been achieved, the beneficiaries joined together to petition for termination. This was denied, on the basis that a material purpose of the trust was still to be achieved – namely the provision of income to the beneficiaries so that they may live in the style to which they are accustomed.[872]

Given that every trust involves some kind of restrictive arrangement whereby the beneficiary does not have the full liberty of dealing with the trust assets in every way they see fit (as they are by definition not the holder of legal title), this decision, if expansively followed, could well mean that *all* trusts have material purposes that put the trust assets beyond the beneficiaries' reach in American law. Interestingly, the trust was expressly held not to be a support trust or a spendthrift trust.[873] This means that the beneficieries would have been able to sell or otherwise assign their interest to a third party, but could not terminate. It is submitted that

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868 J Dukeminier & R Sitkoff *Wills, Trusts, and Estates* (9th Ed, Wolters Kluwer Law & Business, New York 2013), 719.

869 Uniform Trust Code §411(c).

870 *In Re Estate of Brown* (Vt 1987) 528 A2d 752.

871 *Ibid*, 754.

872 *Ibid,* 755.

873 *Ibid*, 754.

the position is the same in English law, as there are plenty of trusts to which *Saunders* is inapplicable but under which the beneficiary can still assign their interest.

Termination is therefore strongly tied with the settlor's intent with the material purpose doctrine. American trust law does not allow the beneficiaries to override what the settlor has deemed the purpose of the trust to be, either expressly or by implication from the trust's structure.

Modification of the trust under the doctrine of 'equitable deviation' is similarly tied to the settlor's intent occasionally with awkward results. In the leading case,[874] *In Re Pulitzer*,[875] Joseph Pulitzer created a testamentary trust for the benefit of his children, which expressly prohibited the sale of his interest in the publisher of the New York World newspaper. The paper later became unprofitable, and the trustees petitioned to the court to have the trust amended to allow the sale of the toxic asset. The amendment was granted, on the basis that '[t]he dominant purpose of Mr Pulitzer must have been the maintenance of a fair income for his children',[876] rather than to keep the newspaper alive no matter what the cost. The court reasoned that this could not have been the settlor's intent, because Mr Pulitzer was a man of 'sagacity and business ability' and such intent would have been 'mere vanity'.[877]

This imputation of intent has been described as a 'dubious finding',[878] and John Langbein has commented that '[r]elying on the sagacity that the court imputed to the settlor spared the

[874] JH Langbein 'Mandatory Rules in the Law of Trusts' (2004) 98 Northwestern U LR 1105, 1118.

[875] *In Re Pulitzer* (1931) 249 NYS 87, affirmed in (1932) 237 App Div 808.

[876] *Ibid*, 94.

[877] *Ibid*.

[878] Restatement (Third) of Trusts §27 Cmt b.

court from having to confront and invalidate the term that the settlor may have actually intended'.[879] Nonetheless, US trust law still sacrifices at the altar of settlor intent when it comes to modification of trusts.

The UTC makes the court's ability to modify a trust mandatory.[880] Langbein explains that this is because '[a]ttempting to prevent the court from modifying the trust in response to (…) worsened circumstances would offend the anti-dead-hand principle embodied in the rule that the trust must be for the benefit of the beneficiaries.'[881]

Finally, various states have been willing to relax the strict limits on trust termination and modification by modest reinterpretations of 'intent' versus 'material purpose',[882] or by recognition of the more substantial power of the court of 'equitable deviation', which allows the court to 'modify the administrative or *dispositive* terms of a trust or terminate the trust it, because of circumstances not anticipated by the settlor, modification or termination will further the purposes of the trust' (emphasis added).[883]Prior to the UTC, this doctrine of equitable deviation only applied to administrative provisions of the trust,[884] and the addition of modification of dispositive aspects adds plausibility to the view that American trust law is not entirely concerned with the settlor's dispositive powers, but also appears to consider the beneficiary's interests, however slight such considerations may be.

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879 JH Langbein 'Mandatory Rules in the Law of Trusts' (2004) 98 Northwestern U LR 1105, at 1118.

880 UTC §105(b)(4).

881 JH Langbein 'Mandatory Rules in the Law of Trusts' (2004) 98 Northwestern U LR 1105, 1118-9.

882 *Rust v Rust,* 176 F 2d 66, 67 (DC 1949).

883 UTC § 412(a).

884 Restatement (Second) of Trusts § 167 (1959).

4. Conclusion

The US law regarding beneficiaries' creditors represents a major point of divergence from its English law ancestry. While the basic mechanics are the same and even draw on some of the same decisions, the immensely important exception of allowing restraints on alienation has the potential to change the lineage entirely. While many commentators, spearheaded by John Chipman Gray, resisted the judicial push for allowing settlors to curtail creditors' access, the judiciaries of all states and all the way up to the US Supreme Court accepted the basic notion that a person may do with her property what she will, even if it means severely hampering the property rights of the beneficiary.

With these major doctrinal differences and their underlying principle and policy justifications in mind, we are now in a position to make comparisons between English and US trust law that inform some of the most enduring debates in trust law – why and how does the trust partition the assets of its members, and what are the basic conceptual implications of this for trust law as a whole. That is the topic of the next and final chapter of this thesis.

Chapter 8: Conclusions – Trust Law and Creditor Access

1. Outline

The trust is a peculiar form of group enterprise, vesting property and dispositive powers in the trustee, who contracts liabilities pertaining to the operation of the enterprise personally but with a strong priority right to be indemnified out of the enterprise assets. The beneficiary is equipped with a presumptive and unassailable power of assignment so long as his interest in the trust's administration persists, which power ensures the fluidity of group enterprise membership and creditor access. A separate pool of assets is created by the trustee's exclusion right against the rest of the world, and the assets partitioned from the trustee's personal assets by the duty owed to the beneficiary, a partition which in turn binds the trustee's personal creditors through the operation of equitable doctrine. So long as the beneficiary's interest persists, the liabilities incurred by the trustee can attach to the beneficiary's personal assets if the trust fund and trustee's personal assets are extinguished.

The internal operation of the trust is based on the partitioning of assets into distinct pools of the enterprise and its members on the one hand, and preventing debtor opportunism that asset partitioning gives rise to on the other. As regards asset partitioning on the trustee's side, we find that trust creditors of the trustee can access trust assets through subrogation to the trustee's indemnity, and the trustee is, to the extent of trust assets, shielded from the liabilities attaching to the trust. However, if the trust assets of the trustee are exhausted and the personal liability of beneficiaries does not cover the full amount of the trustee's indemnity, the trustee's personal assets become liable for execution of the creditors' claims.

The creditors of the beneficiary can be assigned the beneficiary's interest either by express donative transfer, or impliedly through execution or through the bankruptcy procedure. The creditor as an assignee of the beneficiary's interest becomes entitled to all distributions made by the trustee to the beneficiary, even where the beneficiary's interest has since terminated through forfeiture and has been reborn as a discretionary trust. The creditor does not, presumptively, become entitled to the trust property directly or even through *Saunders v Vautier*,[885] unless the conditions of that power are fulfilled.

The asset partitioning features of the trust give rise to the possibility of debtor opportunism. A member of the trust might raise credit using trust assets and then invest those same assets into another enterprise. This kind of opportunistic behaviour is limited in the trust through limiting access to trust assets in the case of the beneficiary's opportunism, and through the imposition of fiduciary duties in the case of the trustee's. It is suggested that these two features of trust law have developed with reference to each other, and both are needed to understand the whole picture of trusts as asset partitioning devices.

i) Trust Creditors' Access and Trustee Indemnities

A trust creditor cannot access trust assets directly, but must do so through subrogation to the trustee's indemnity. As such the creditor's claim is dependent on the trustee's right—where the trustee has lost his right of indemnity, as in the case where he is under a liability to the trust, the creditor has no access. This issue of unconnected liability is identified as one of the major problems in this area of law. This strand of case law is based on cases where the trustee

[885] *Saunders v Vautier* (1841) 4 Beav 115.

had become entitled to a beneficial share, such as *Jacubs v Rylance,*[886] *Doering v Doering*[887] and *In Re Dacre*.[888]

The trustee's indemnity gives him a right in an unascertained fund. Only after his indemnity is paid out, the trust fund becomes ascertained. There is conflicting case law as regards the question of whether the exercise of a trustee's indemnity can destroy the trust (*Darke v Williamson*,[889] *In Re Pumfrey*[890]), but it is suggested in this thesis that it should be possible. The nature of the trustee's right of indemnity is sometimes described as a lien, and its value is liable for execution of the trustee's debts under *Jennings v Mather*.[891] However, the later case of *In Re Richardson*[892] suggests that the indemnity is to be used to satisfy that liability which created the right of indemnity in priority to any other debt of the trustee.

The trustee may limit the extent of his liability to trust assets, where clear and unequivocal language is used in contracting the liability (*Muir v City of Glasgow Bank,*[893] *Re Robinson's Settlement,*[894] *Warborough Investments v Berry*[895]). It is also possible to limit the access of a

[886] *Jacubs v Rylance* (1873-74) LR 17 Eq 341.

[887] *Doering v Doering* (1889) 42 Ch D 203.

[888] *In Re Dacre* (1916) 1 Ch 344.

[889] *Darke v Williamson* (1858) 25 Beav 622; 53 ER 774.

[890] *In Re Pumfrey* (1882) 22 Ch D 255.

[891] *Jennings v Mather* [1901] 1 QB 108.

[892] *In Re Richardson* [1911] 2 KB 705.

[893] *Muir v City of Glasgow Bank* (1879) 4 AC 337.

[894] *In Re Robinson's Settlement* [1912] 1 Ch 717.

[895] *Warborough Investments Ltd v Berry and Others* [2003] EWHC 3152 (Ch).

creditor to a certain portion of the trust assets without giving notice to the creditor of the terms of the trust deed (*Ex Parte Garland*[896]).

In the context of trustee's indemnity and creditors' subrogation, by contrast to the usual operation of fiduciary duties, we inquire into the fraudulence or otherwise of the trustee to see whether his acting ultra vires denies the right of indemnity. It is found that where the trustee acts 'honestly and fairly, without any possibility of being a gainer' and benefits the trust, a mere exceeding of his authority does not deny his claim (*Balsh v Hyham,*[897] *Re German Mining Company,*[898] *Vyse v Foster*[899]). This has led to some regrettable decisions where pre-trust creditors of a business seek priority over the new trustee's indemnity. A creditor who has assented to a business being carried on under a trust (or a new trust) has no priority over the trustee's indemnity (*Dowse v Gorton*[900]). This otherwise unoffending notion has been reinterpreted in *In Re Oxley*[901] to the effect that the creditors of an insolvent business under a trust are in fact its beneficiaries, a conceptual problem for trust law.

Burdens associated with ownership are carried by the beneficiaries, and the liability to indemnify the trustee is personal. This is so even where the beneficiaries are no longer beneficiaries of the trust. (*Hardoon v Belilios*,[902] *Matthews v Ruggles-Brise*[903]).

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[896] *Ex parte Garland* (1804) 10 Ves 110.

[897] *Balsh v Hyham* (1728) 2 P Wms 453.

[898] *Ex Parte Chippendale, Re German Mining Company* (1854) 43 ER 415.

[899] *Vyse v Foster* (1872-73) 8 Ch App 309.

[900] *Dowse v Gorton* [1891] AC 190.

[901] *In Re Oxley* [1914] 1 Ch 604.

[902] *Hardoon v Belilios* [1901] AC 118.

[903] *Matthews v Ruggles-Brise* [1911] 1 Ch 194.

Of the three major problems identified, the issue of unconnected liabilities, entification and the idea of creditor-beneficiaries, the former two can be solved simply through doctrinal analysis. This is done by appreciating the relevant differences between an indemnity and a beneficial interest, as the case law establishing this rule actually involved trustee-beneficiaries. Additionally, the case of *In Re Richardson*, itself based on concurring logic, provides the judicial precedent to solve the problem—the trustee's indemnity is earmarked for the benefit of that unpaid creditor whose credit created the trustee's right of indemnity, otherwise the trustee's personal estate benefits from his misappropriation. This solution also rationalises the law as regards burdens associated with ownership: such burdens and trade liabilities no longer receive differential treatment as regards unconnected liabilities. It is submitted that the trustee's indemnity should also be able to destroy the trust—*In Re Pumfrey* is to be preferred over *Darke v Williamson*, the latter being confined to an equitable principle to be applied in exceptional cases only.

It is further submitted that the problem of entification of trusts is solved by giving due regard to the earmarking of trustee indemnity for the creditor who created it found in *Richardson*. *Jennings v Mather* describes the trustee's right as a lien, making it an assignable right and severing the dependence on the trustee's right, thus transforming the trust into an entity independent of the trustee. The case makes the value of the trustee's 'indemnity lien' available for distribution among the trustee's general creditors. *In Re Richardson* is higher authority than *Jennings*, and its appreciation effectively undoes the need to describe the indemnity as a lien: the original trust creditors' right survives the appointment of a new trustee, which, it is submitted, was the policy reason for describing the right as a lien in *Jennings v Mather*.

As regards theoretical solutions, it is first submitted that the ultra vires regime, notably relaxed, and the fiduciary duties regime, notably strict, are rightly kept separate. Though the asset partitioning function and fiduciary duties of the trust are interlinked, they are different legal regimes serving different functions. The ultra vires regime has implications on creditors, and thus their access ought not be limited by indoor management issues within the trust (in accordance with the modularity principle) in the absence of fraud. Fiduciary duties on the other hand ensure that the beneficiary's rights to trust assets are protected. In that context a strict no conflict requirement is appropriate.

The issue of creditor-beneficiaries is a conceptual problem for trust law as it gives the trustee a power to bring additional beneficiaries into the trust potentially going against the trust deed. It can be solved by reinterpreting *Dowse v Gorton.* That case, while holding simply that all trust assets are subject to the claims of trust creditors makes mention of the fact that the trust business is run for the benefit of creditors, is interpreted to mean simply that the continuation of the business is beneficial for the creditors. This could mean that *In Re Oxley*, where the creditor-beneficiary idea is established, is to be disapplied.

Lastly, the issue of limitation to trust assets is to be taken simply as a matter of contract law. The requirement of clear and unequivocal language gives both parties notice, and does not create any default law.

With these rationalisations the law regarding trustee's creditors becomes more coherent. The key solution to unconnected liabilities and the denial of the creditor-beneficiary idea support each other, as each is premised on the idea that there is a relevant difference between the trustee's right of indemnity and a beneficial interest in the trust. Thus difficult factual problems are erased along with awkward conceptual notions that do not sit well with our basic understanding of trust law.

ii) Beneficiaries' Creditors and the Beneficial Interest

In this thesis it is argued that *Brandon v Robinson*[904] is not the doctrinal origin of the beneficiary's liability to creditors or the impermissibility of restraints on alienation. The former had been quietly assumed since the Statute of Frauds, and the latter had not been settled for another few decades (*Godden v Crowhurst*[905] and *Twopeny v Peyton*[906]; disapproved of in *Younghusband v Gisborne*[907]). Taking *Brandon* as the analytical origin is probably a misconception of American origin, allowing the principle to be more easily attacked in light of the later cases coming to different conclusions.

The real common law test for the analytical maturity of central trust law notions came already in 1759, in *Burgess v Wheate*.[908] In that case, the judges carefully analysed the trust relationship to be one that acts as though it is proprietary between the trustee and beneficiary, ensuring the trust's survival independently of the trustee or beneficiary, but whose central feature is the trustee's holding of legal title and concurrent powers to deal with the assets as their legal owner. The beneficiary is not the 'true owner' of the property, unless the trustee has also become an agent of the beneficiary (*Smith v Anderson*[909]; *Baker v Archer-Shee*[910]). This is the true basis of creditor access to trust assets as we know it today.

Saunders v Vautier powers are not essential to creditor access in the same way, because *Saunders* has never been held to give the beneficiary an interest in the trust property that could

[904] *Brandon v Robinson* (1811) 18 Ves 429.

[905] *Godden v Crowhurst* (1842) 10 Sim 642.

[906] *Twopeny v Peyton* (1840) 10 Sim 487.

[907] *Younghusband v Gisborne* (1844) 1 Coll 400.

[908] *Burgess v Wheate* (1759) 1 WmBl 123, 1 Eden 177.

[909] *Smith v Anderson* (1880) 15 Ch D 247.

[910] *Baker v Archer-Shee* [1927] AC 844.

then form the basis of creditor access. The case has long developmental roots going all the way to Roman probate law,[911] and after it had crossed over to trusts in 1727 (in *Love v L'Estrange*[912]) it was of modest application—its proper application depends on 1) whether, as a matter of construction, the will (or trust deed) gives the beneficiary a vested interest as the ink dries on the settlement as opposed to an interest conditional on a contingent event (e.g. marriage or reaching a certain age) (*Booth v Booth*[913]) and if so, 2) that the delay in enjoyment does not benefit the beneficiary (*Hanson v Graham*[914] – approved in *Saunders v Vautier*). The beneficiary must also go to court to have the trust terminated, and have no interest in the property before that (*Thorpe v HMRC*;[915] *Stephenson v Barclays Bank Trust Co Ltd*[916]). *Saunders* does not make the beneficiary the true owner, nor the trustee the beneficiary's agent *(Thorpe v HMRC*).

A creditor's access to the beneficiary's interest is based on the beneficiary's power of assignment. As such, it is as dependent on the beneficiary's right as the trust creditor's access is to that of the trustee. The assignability of the beneficial interest, and therefore the survivability of the trust despite a change in beneficiaries, is one of the major logical implications of *Burgess v Wheate*, though it had been expressly confirmed over a century earlier (in *Warmstrey v Dominam Tanfield*,[917] in 1628). The beneficiary cannot assign the right to sue and recover for breach of trust

[911] Digest of Justinian, Book 36, Title 1, s. 46; see also Title 2, s. 22.

[912] *Love v L'Estrange* (1727) 5 Bro PC 59.

[913] *Booth v Booth* (1799) 3 Ves Jr 399.

[914] *Hanson v Graham* (1801) 6 Ves Jr 238.

[915] *Thorpe v HMRC* [2010] EWCA Civ 339.

[916] *Stephenson v Barclays Bank Trust Co Ltd* [1975] 1 WLR 882.

[917] *Warmstrey v Dominam Tanfield* (1628) 1 Ch Rep 29.

without assigning the whole beneficial interest (*Hill v Boyle*[918]). No particular form need be followed for an assignment of an equitable interest (*Harding v Harding*[919]).

An assignment of a beneficial interest can be made by the beneficiary alone, but it binds the trustee only when he is notified by the new assignee-beneficiary. This is because the identity of the beneficiary in part determines the content of the trustee's duties, as details of identity may well influence trustee's decisions of what is in the beneficiary's best interest (*Morice v Bishop of Durham*[920]). By notification, the assignee 'takes possession' of the equitable interest, making it enforceable against the trustee (*Dearle v Hall*[921]) and not just the beneficiary (*Kekewich v Manning*[922]; *Donaldson v Donaldson*[923]; *Re Way*[924]).

A beneficiary's interest is subject to the claims of his general creditors as well as specific assignees, and there can be no restraints on the beneficiary's power of alienation (*Davidson v Chalmers*[925]). The creditors become assignees of the beneficial interest (*Davidson*), and become entitled to whatever the beneficiary is entitled to—nothing more (*In Re Coleman*[926]; *In Re Ashby*[927]; *Chambers v Smith*[928]). The beneficiary's power of alienation cannot be altered or restrained (*Re*

918 *Hill v Boyle* (1867) LR 4 Eq 260.

919 *Harding v Harding* (1886) 17 QBD 442.

920 *Morice v Bishop of Durham* (1805) 10 Ves 522.

921 *Dearle v Hall; Loveridge v Cooper* (1828) 3 Russ 1.

922 *Kekewich v Manning* (1851) 1 De G M & G 176.

923 *Donaldson v Donaldson* (1854) Kay 711.

924 *Re Way's Trusts* (1864) 2 De G J & S 365.

925 *Davidson v Chalmers* (1864) 33 Beav 653.

926 *In Re Coleman* (1888) 39 Ch 443.

927 *In Re Ashby, Ex Parte Wreford* [1892] 1 QB 872.

928 *Chambers v Smith* (1878) 3 App Cas 795.

Burroghs-Fowler[929]; *Re Brown*[930]), but his beneficial interest may be terminated under a forfeiture provision *(Muschamp v Bluet*[931]). If done under a protective trust, the creditors still get the beneficiary's distributions from the trust (*In Re Ashby*).

iii) American Law

American trust law is based on the idea of freedom of disposition – the settlor's powers of disposing of his property in whatever way he pleases is unrestricted unless specific public policy justifications can be found, and this is what sets the content of the beneficiary's right. The beneficial interest is unequivocally described as a right in the trust property, and the trust is generally seen as a conditional gift. The trustee is seen more as a managerial agent (in a broad sense of the word) for the settlor. Much of the content of American trust law is determined by statute, driven by inter-state competition for asset management business. Some of the striking legislative interventions include permitting restraints on alienation, abolishing the personal liability of the trustee and abolishing the rule against perpetuities (in a majority of states).

American law followed English law in all major aspects until the publication of the first restatement, which sparked legislative interventions and codified AW Scott's view of trusts. Theoretically the creditor's access is still dependent on the trustee's right of indemnity (which in turn is dependent on personal liability, now abolished), which has limiting effects on creditor access as it does in English law. However, in America this procedure can be circumvented and the trust estate claimed against directly through unjust enrichment (*Thomas v Provident Life*[932]),

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[929] *In Re Burroughs-Fowler* [1916] 2 Ch 251.

[930] *Re Brown* [1954] Ch 39.

[931] *Muschamp v Bluet* (1617) J Bridg 132.

[932] *Thomas v Provident Life & Trust Co.* (1905) 138 Fed 348.

though this is still sometimes held to depend on the trustees' legal personality (*Blair v Claflin*[933]; *Taliaferro v Taliaferro*[934]; *Newell v Hadley*[935]). The trustee both is and is not the legal owner of the property, and case law struggles to fit these concepts together.

As the settlor's control interest of what was once his property is what determines the contours of the beneficiary's property right, American law of beneficiaries' creditors has markedly different doctrinal content as that of English law. Where the focus is on the settlor's powers over his property, there is no logical obstacle preventing the limitation of the beneficiary's ability to assign his interest (*Nichols v Eaton*[936]) or to terminate the trust (*Claflin v Claflin*[937]). The basis for both these major doctrinal strands is the individual control powers that a property owner has over his property, forever shifting the basic tenets of American trust law towards more and more settlor-oriented forms. Trust assets can consequently be shielded from early termination and assignment for the duration of the trust, which in a majority of states can now be in perpetuity.

Academic commentary has focused on the dead hand control exerted by the settlor, who of course has no further interest in the property. The ability to restrain alienation came under sustained attack from John Chipman Gray,[938] who was concerned that it would mark the formation of a privileged class of wealthy individuals who are shielded from liability. This has

[933] *Blair v Claflin* (1941) 37 NE 2d 501.

[934] *Taliaferro v Taliaferro* (2000) 7 P 3d 1241.

[935] *Newell v Hadley* (1910) 202 Mass 335, 92 NE 507.

[936] *Nichols v Eaton* (1875) 91 US 716.

[937] *Claflin v Claflin* (1889) 20 NE 454.

[938] JC Gray *Restraints on Alienation of Property* (2nd Ed, Boston Book Co, Boston 1895).

subsequently been described as the 'dynastic trust',[939] though not always in as disapproving terms as Gray did. Kent Schenkel has argued that the trust is nothing more than a device to make the costs of carrying out a group activity external to the group enterprise,[940] and Lynn LoPucki has used the spendthrift trust to indicate the death knell to the whole concept of liability,[941] reviving the Gray critique of the trust.

Together with the conceptual restrains on the settlor's ability to create the kind of trust he desires (*Nichols v Eaton*; *Broadway National Bank v Adams*[942]; as interpreted in *Young v Snow*[943]) the US Supreme Court cast off the entire methodology of attempting to adhere to conceptual reasoning. The emphasis in both academia and in practice is on policy justifications, with scholarship concentrating more and more on economic arguments for the utility of the spendthrift trust, and case law attempting to find policy exceptions to it (*In Re Morgan*[944]). The discrepancies in results in this methodology are readily apparent—even Adam Hirsch, a proponent of the spendthrift trust because of its supposedly positive economic impact in keeping beneficiaries away from the welfare system,[945] proposes an exception for tort creditors, while the legislature, trust law reformers and judiciary have, after initial wavering (*Sligh v First*

[939] LM Friedman 'The Dynastic Trust' (1964) 73 Yale LJ 547.

[940] KD Schenkel 'Exposing the Hocus Pocus of Trusts' (2011) 45 Akron LR 63.

[941] LM LoPucki 'The Death of Liability' (1996) 106 Yale LJ 1.

[942] *Broadway National Bank v Adams* (1882) 133 Mass 170.

[943] *Young v Snow* (1897) 167 Mass 287.

[944] *In Re Morgan's Estate* (Pa 1909) 72 A 498.

[945] AJ Hirsch 'Spendthrift Trusts and Public Policy: Economic and Cognitive Perspectives' (1995) 73 Wash U LQ 1; AJ Hirsch 'Fear Not the Asset Protection Trust' (2006) 27 Cardozo LR 2685.

National[946]), decided against such exceptions (e.g. *Scheffel v Krueger*[947]; UTC §503). One exception that is widely recognised is alimony and child support—the community should not have to support a man's children while the man is immune from liabilities.

Again, the basic doctrinal position is the same or very similar to English law; the creditor can sue as an assignee of the beneficiary's interest, either expressly or impliedly, and the court gives effect to that finding in a fair and reasonable way. However, many trusts are presumptively spendthrift, and their existence is so ubiquitous that the basic method of creditor access hardly bears mentioning.

Termination could provide a way around a spendthrift clause, as these two features are not logically dependent on each other (*In Re Estate of Brown*[948]). However, termination is also tied to the settlor's probable intent, being only allowed where 1) consent of all beneficiaries has been obtained, and 2) where it does not go against a material purpose of the trust. The material purpose of the trust is to be found in its structure, if not expressly mentioned, though a spendthrift provision is no longer presumed to be a material purpose under the UTC.

In contrast with the ability to terminate the trust, modification of trust terms under the doctrine of equitable deviation cannot be excluded (UTC §105(b)(4)). Under the UTC, equitable deviation can also affect dispositive provisions (UTC §412(a)) and not just administrative, as was the position previously under the second restatement. These moderate developments show that US trust law does spare a thought for the beneficiary's interest, slight as that thought might be.

946 *Sligh v First National Bank* (1997) 704 So 2d 1020.

947 *Scheffel v Krueger* (NH 2001) 782 A2d 410.

948 *In Re Estate of Brown* (Vt 1987) 528 A2d 752.

2. Analysis

The exposition and brief analysis of the body of case law regarding creditor claims against trustees and trust assets offers some informative points on central trust law debates. As the creditors' rights through both trustees and beneficiaries depends on the rights of the trustee/beneficiary, the way in which a creditor actually gets their hands on the trust assets can enlighten us about the nature of that relationship, the nature of their rights to the assets and the way in which the trust device partitions group enterprise assets from the general assets of the members. In the discussion below, it will be assumed that the doctrinal position is as suggested in chapter 3, where a more coherent picture of trust creditors' access was developed.

i) The Trust as a Vehicle for Group Enterprise

As we have now seen, the common claim that a trust separates the assets of its members from those of the group enterprise[949] hides a far more subtle regime. While it is true that a personal creditor of the trustee has no right to the trust assets, this is only true because the trustee has no such right. The trustee may only dip into the trust assets where he has incurred a liability in the proper exercise of his duties, through his indemnity right. The case law conflicts,

[949] Versions of this argument include the notion that a trust creates a 'dual patrimony' without creditor access from one patrimony to another; see KGC Reid 'Patrimony Not Equity: the Trust in Scotland' (2000) 8 European Review of Private Law 427; GL Gretton 'Trusts Without Equity' (2000) 49 ICLQ 599; for a thoughtful discussion of this idea, see L Smith 'Trust and Patrimony' (2008) 38 Rev Générale de Droit 379. In the civilian (e.g. Scottish) context this idea is consistent with basic axioms but it entails jettisoning much of the basic doctrinal content of common law trusts (at least insofar as creditor access is concerned) and leads to a much more rigidly impermeable asset partitioning between the trustee's different patrimonies than is present in the common law trust. For the view that that something akin to the Scottish dual patrimony theory is present in the common law doctrine of a deceased person's estate, see L Smith 'Scottish Trusts in the Common Law' (2013) 17 Edinburgh L Rev 283.

but *Jennings v Mather*[950] suggests that once the trustee has a right of indemnity, that indemnity is available to his personal creditors as well, meaning personal creditors of the trustee *can* levy execution against the trust assets as much as the trustee can (though they have no powers to deal with the property with outsiders by entering into contracts etc – which the trustee has as the legal title holder).

However, on the view presented in this thesis preferring *In Re Richardson*[951] over *Jennings*, the benefit of the indemnity should only be available to the creditor whose interaction with the trustee created the liability—otherwise the trustee's estate in bankruptcy can be enriched by an indeterminate amount, as the liability of the trust creditor is only extinguished once he is paid all he is owed and thus the indeminity persists until all personal creditors are paid from the trust assets. This argument has the effect of strengthening the asset partitioning wall between the trustee's general creditors and trust creditors, but fundamentally the trustee is still personally liable and may well have paid the creditor from his personal assets before claiming the indemnity. Indeed, the trustee's ability to skip the step of paying upfront personally required litigation to settle.[952] The trustee's personal assets are also at stake if the trust assets are completely depleted.

Nor is the beneficiary completely insulated from creditors of trustees—the beneficiary's liability to indemnify the trustee is personal.[953] This means that the beneficiary could come under a duty to pay the trust creditor, where the trustee's personal estate and the trust assets have both

[950] *Jennings v Mather* [1901] 1 QB 108

[951] *In Re Richardson* [1911] 2 KB 705.

[952] *Blundell v Blundell* (1889) 40 Ch D 370.

[953] *Hardoon v Belilios* [1901] AC 118.

been exhausted. It is therefore simply not true to say that a trust separates the assets of its members from the group enterprise, though it does place an order of priority over them.

The beneficiary can only ever have personal creditors—they have no right in the trust property under English law, and their creditors only get their right to have the trust duly administered under an express or implied assignment. This can in some limited contexts include a *Saunders v Vautier* power, but the exercise of it destroys the trust and by definition, all asset partitioning features. In a case where *Saunders* is applicable, there is practically no asset partitioning wall between the beneficiary and the trust assets, as the creditor can also terminate the trust.[954]

Where *Saunders* is inapplicable, however, the trust assets are protected from the beneficiary's personal creditors—the beneficiary is not. This means that the trust remains in place until its purposes have been achieved, but the beneficiary may cause another person to take his place as his assignee-beneficiary. The trustee does not, and should not, have such powers of determining who might be added on as a beneficiary, unless specifically mentioned in the trust deed (as was in *Re Manisty's Settlement*[955]). This means that creditors do not become beneficiaries, as was erroneously suggested in *In Re Oxley*.[956]

It is therefore false to claim that the trust assets are available to the beneficiary's creditors. The beneficial interest is, but only to the extent of the individual beneficiary's right and with the same conditions attached. The assignee gets the same benefit of an obligation as the beneficiary enjoyed.

[954] *Re Smith* [1928] Ch 915.

[955] *Re Manisty's Settlement* [1974] Ch 17.

[956] *In Re Oxley* [1914] 1 Ch 604.

The comparison to US law is fruitful here. On the trustee side, US law struggles to reconcile the fact that a trustee is not personally liable but is only a manager of a settlor-imposed property regime, with the fact the trust itself is still not a legal person (other than through specific statutory schemes). The basic creditor claim of unjust enrichment of the trust estate is problematic in cases where the performance of a trustee's duty is undertaken by another person (in *Blair v Claflin*[957] and *Taliaferro*[958] it was by a beneficiary) and that performance saves the trust estate costs or incurs a benefit. In the leading case, *Newell v Hadley*,[959] the leading US treatise skips over the logical inconsistency of the trustee having knowledge of the fact that trust money was paid from one trust to another (which is the foundation of the claim), while simultaneously characterising the claim as one of unjust enrichment of the estate (which does not depend on knowledge of the money's origins, nor could the trust estate alone even have any such knowledge). Under that interpretation of *Newell*, both the trustee and the estate are the recipients of the money simultaneously.

So where legislative or academic reform tampers with the basic structures of trust law, the result is judicial confusion. The asset partitioning features of trusts grounded on personal liability of the trustee, together with 1) his legal ownership of the trust assets and 2) his inability to access those assets, are not only fundamental to the trust concept but also elegant means of achieving a surrogate legal personality without strong asset partitioning or a specific statutory incorporation scheme. The issues that US law (and AW Scott) set to resolve by enhancing the personality features of the trust,[960] chief among them the issue of trustee's unconnected default destroying the creditor's right, can be solved doctrinally with the ruling in *In Re Richardson*

[957] *Blair v Claflin* (1941) 37 NE 2d 501.

[958] *Taliaferro v Taliaferro* (2000) 7 P 3d 1241.

[959] *Newell v Hadley* (1910) 202 Mass 335, 92 NE 507.

[960] AW Scott 'Liabilities Incurred in the Administration of Trusts' (1915) 28 Harv LR 725.

(earmarking the indemnity to the use of the creditor whose dealings with the trustee gave rise to it in the first place)—as indeed was attempted by Harlan Stone.[961]

ii) How the Trust Behaves with Outsiders

The effects of the trust on unauthorised transferees of the trust assets are well known and much studied.[962] While it may be accurate to say these effects are best explained as exhibiting proprietary features,[963] the broader conclusion that a beneficial interest is proprietary cannot be supported by the other main way in which third parties can interact with the trust assets—namely as creditors who have not received the assets.

As already seen above, the beneficiary's creditor does not get a right to the assets. They only get what the beneficiary is entitled to, which may well be nothing. The right of the beneficiary is to the due administration of the trust, a right which is 'quite as good and often better than any legal right but it is not in any case one, which for all purposes makes the trust fund "belong" to the beneficiary'.[964] This principle is strongly adhered to in the law of creditor access to the beneficiary's interest, which is based on assignment.

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961 HF Stone 'A Theory of Liability of Trust Estates for the Contracts and Torts of the Trustee' (1922) 22 Colum LR 527, 540.

962 See e.g. *Barnes v Addy* (1874) 9 Ch App 244; *Re Barney* [1892] 2 Ch 265 (trusteeship *de son tort*); *Williams v Central Bank of Nigeria* [2014] 2 WLR 355; *BCCI v Akindele* [2001] Ch 437 ('unconscionable receipt'); *Re Hallett* (1880) 13 Ch D 696; *Foskett v McKeown* [2001] 1 AC 102 (Tracing); LD Smith, 'Tracing, "Swollen Assets" and the Lowest Intermediate Balance Rule' (1994) 8 TLI 102; LD Smith *The Law of Tracing* (Clarendon Press, Oxford 1997); PS Davies *Accessory Liability* (Hart Publishing, Oxford 2015), Chapter 4.

963 RC Nolan 'Equitable Property' (2006) 122 LQR 232.

964 *Baker v Archer-Shee* [1927] AC 844, 850.

Only where *Saunders v Vautier* is available can it be said with any confidence and credibility that the trust interacts with a non-recipient in a proprietary fashion, provided the actual petition is brought to the court and the trust actually terminated. Until that happens, the usual trust rules are in place. In the view suggested in this thesis, that *Saunders* is not a conceptual feature of trusts but a probate law principle, distantly derived from Roman law, namely that a right to enjoyment subjected to a delaying clause counts as a vested interest. Granted that this principle has jumped over to the law of trusts, it maybe maintained that *Saunders v Vautier* represents a special case, and not a general rule or principle about the intrinsic proprietary qualities of a beneficial interest..

This means that the basic description of the *Saunders* claim as yielding an unconditional right *ad rem*[965] is not supported by a close reading of the relevant case law. It is more accurate to say that where such a right has been created by the trust deed, as a matter of construction, it can be exercised where the delay in enjoyment does not specifically benefit the beneficiary. Rare must be the trust that creates an unconditional right to receive trust property but which seeks to delay payment unwisely, and consequently *Saunders* is probably not as important a principle to trust law's basic structure as is sometimes suggested. It does not confer powers to direct the trustees,[966] and until the petition is actually made the trust persists.[967] In fact, if *Saunders* had created a general and unconditional right *ad rem* in the beneficiary, it would have rewritten the judgment in *Burgess v Wheate* which expressly denied this possibility and therefore upheld the existence of the very concept of a trust as separate from a legal estate.[968]

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[965] T Cutts 'The Nature of "Equitable Property": A Functional Analysis' (2012) 6 J Eq 44.

[966] *Thorpe v HMRC* [2010] EWCA Civ 339; *In Re Brockbank* [1948] Ch 206.

[967] *Stephenson v Barclays Bank Trust Co Ltd* [1975] 1 WLR 882.

[968] *Burgess v Wheate* (1759) 1 Eden 177, 248-49.

In light of this, the US law decision to disallow termination unless it is agreed upon by all beneficiaries and does not offend a material purpose of the trust does not seem too far removed from the doctrinal operation of *Saunders v Vautier* in English law, though admittedly the requirement in English law that the delay in payment be an unwise provision that does not benefit the beneficiary may well have been lost along the way on the pages of obscure law reports. However, the basis upon which *Claflin v Claflin*[969] was decided is very different, emphasising the settlor's right to carve out bespoke interests from his assets.

This, and the origin of this line of thinking in *Nichols v Eaton*,[970] represent a tectonic shift in basic trust law structures and showcase just how much doctrine can change when its theoretical basis is shaken. Most of American trust law as we know it is a consequence of these central asset partitioning rules and their theoretical exposition in *Nichols*, including the well-known example of remedial constructive trusts.[971] So while the *Saunders-Claflin* debate itself may not be as foundational as sometimes imagined, the doctrinal ideology that it represents certainly is.

Outside the termination/modification issue, the most important change in US law affecting how a third party can claim against trust assets through the beneficiary is obviously the permissibility of the spendthrift trust. The line of cases following *Nichols v Eaton* and *Broadway National Bank v Adams*[972] represents the severest limitation of creditor access, admitting only claims based on specific and limited public policy exceptions. This means that in American law,

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[969] *Claflin v Claflin* (1889) 20 NE 454 Mass.

[970] *Nichols v Eaton* (1875) 91 US 716.

[971] It can now be seen that there is simply no theoretical space in US trust law for a constructive trust other than as a remedy—where a trust is an expression of the settlor's power to carve out conditional gifts from his property, a trust without express donative intent is an oxymoron. It is therefore reinterpreted to be a remedy that is only analogous to a donative trust in its effects.

[972] *Broadway National Bank v Adams* (1882) 133 Mass 170.

so far as spendthrift trusts are concerned, the trust assets are almost completely protected from outside access and can only be reached through the trustee route.

In light of these points, particularly the *Nichols* line, it is difficult to see how American law can unquestioningly maintain that the beneficiary's interest is a property right, other than to achieve false coherency with the notion that the trust is a gift carved out of the settlor's estate. Even in the case of a non-spendthrift trust where alienation is permitted, the alienation does not concern the trust property unless the court specifically finds it just and reasonable to impose a charge on it in response to a particularly pressing claim by a creditor. In US law, like in England, the beneficiary assigns his interest in the due administration of the trust, and nothing more. Of course, even this limited assignability is rendered moot where spendthrift trusts are concerned, and the beneficiary has absolutely no power to affect the trust property even where the court would otherwise deem it just and reasonable, unless limited public policy exceptions apply.

It is therefore difficult or impossible to hold that a beneficiary has an interest in the trust property, but the settlor's property interest is allowed to curtail that interest below what would normally pass as proprietary or even contractual. At most, American law appears in truth to be consistent with an extreme version of the idea that a beneficiary only has a power to demand due administration of the trust. This is not entirely inconsistent with the view that a trust is carved out of a settlor's property right in the subject matter, but when taken together with the cases where a beneficiary grants leases or easements over his interest in land held on trust, these notions approach logical inconsistencies.

In light of the above, it cannot be said that any of the law concerning creditor access to trust assets supports the notion that a beneficiary has a property right in the trust assets, and attempting to force this notion into the law will lead to inconsistencies. If the beneficiary has a property right, then the settlor must have given him a property right, which idea in turn goes a long way towards making the trust a gift carved out of the settlor's estate and subjecting that gift to whatever conditions the settlor wants to impose on it. In this way American law is quite consistent and follows these notions to all their conclusions, even the paradox that the beneficiary of a spendthrift trust has a property right in the trust assets.

Far from supporting such a view, we find in the law of creditor access to trust funds 1) that the pool of trust assets is not even ascertained until the trustee's prior right to indemnity is satisfied;[973] 2) that the beneficiary's liability to indemnify the trustee does not transfer automatically with an assignment of the beneficiary's interest;[974] 3) that the creditor of a beneficiary has the same right as the beneficiary had to simply demand due administration; 4) that even the mechanism of creditor access to the beneficial interest follows assignments of debts and 'future possibilities';[975] and 5) that making a trustee aware that a new duty owed to a new person fully completes a transfer of a beneficial interest and makes it enforceable against other transferees.[976] All this is evidence that the beneficial interest is really an obligation, albeit transmissible in the same way that a debt is transmissible.

The fact that the law on creditor access cannot be said to support a proprietary view of the beneficial interest does not diminish the simple point that tracing rules and recipient liability could still be described as exhibiting proprietary features. But it would be premature to conclude that the beneficiary's right is proprietary in the general case, as the other main way in which an outsider may interact with the trust assets in no way provides evidence for it, and provides plenty against.

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[973] *Dodds v Tuke* (1884) 25 Ch D 617, 619 (see n 90 and accompanying text).

[974] *Matthews v Ruggles-Brise* [1911] 1 Ch 194, 203-4.

[975] *Warmstrey v Dominam Tanfield* (1628) 1 Ch Rep 29.

[976] *Dearle v Hall; Loveridge v Cooper* (1828) 3 Russ 1; 38 ER 475.

As regards the trustee side, the general effect of the trust is broadly speaking in conformity to the principle of modularity introduced in chapter 1. The trustee is the only legal person who has powers to deal with the assets of the trust as their legal title holder, and duties to outsiders will generally attach to the person of the trustee (unless he is an agent of the beneficiary). The trustee, if authorised to do so, may sell parts of the trust assets and use the proceeds to buy replacement assets.

However, what distinguishes the trust's behaviour with outsiders from all other property regimes is that even the trustee lacks the general power to attach claims to the actual trust property. Where an outsider deals with the trustee, the trustee contracts a liability which then entitles him to an indemnity out of the trust assets. If the trustee is not authorised to deal with an asset in a certain way, say to sell it to a third party, he will be sued personally and the claim never attaches to the trust corpus, though the judgment may still under certain conditions be satisfied by subrogation to the trustee's indemnity right. This right is not lost by ultra vires actions that benefit the trust, unless an element of fraud, personal gain or bad faith was present in the trustee's actions. Where such elements are present, there is absolutely no way to gain access to the trust assets as no claim attached to them – the creditors' claims never do, and the trustee's claims are barred.

This thesis seeks to reinforce the court's ability to direct payment out of the trust assets through use of the trustee's indemnity right even where the trustee is indebted to the trust because of a prior default. This, however, does not change the central landscape of trust law—the claim is still against the trustee personally, and does not attach to the trust assets directly. This is because the trustee's indemnity is not a property right in the assets.

The trustee's indemnity allows ascertainment the trust property by subtraction. Only once the trustee's own claim has been satisfied, the extent of the beneficiary's interest can be determined. That is, the trustee has a strong priority claim to cover the costs incurred in the administration of the trust, but this interest is not, and should not be, available to his general creditors if the original creditor remains unpaid. If the trustee goes bankrupt, his trustee in bankruptcy cannot, in the view of this thesis, sell the indemnity right to realise its value and then distribute this money to general creditors. Instead, so long as the original creditor remains unpaid, the money is to be used to satisfy this claim.

This does not mean the trustee's indemnity is a property right as it can be destroyed by improper motives. In fact, the trust's operation with outsiders is peculiar to the device. The trust property is held legally by the trustee, and the beneficiary has a right to demand due administration of the trust's terms from the trustee, but nobody has the direct ability to attach obligations to the trust property to levy execution (unless allowed by the trust deed). The trustee can only attach his claim under the conditions that he has dealt with an outsider and incurred a liaibility in the proper administration of the trust, or benefitted the trust without bad motives or any possibility of personal gain. The beneficiary, by comparison, can only force the trustee to act in accordance with the terms of a trust. If a third party deals with the trustee, he must go through the trustee's right of indemnity to gain access. If they deal with the beneficiary, they only receive the beneficiary's right to demand due administration of the trust terms and nothing more.

Access to the trust corpus is therefore governed by the trust's purposes, and not the enforceability of rights against the trust's members. A beneficiary cannot demand the benefit of the trust assets other than in accordance with the trust's usual administration (or by termination where applicable). A trustee can only empower creditors with an enforceable claim if he has acted properly for the trust's benefit. The fact that access to a pool of assets can legally be limited not by what rights an individual has against whom but how the purposes of a privately imposed governance regime have been met could have the potential to force a rethink of the basic structure of private law as exhibiting definable correlative rights.

Any attempted description of the trust in purely Hohfeldian terms will always require qualification by reference to the trust's purposes. A trustee may have a duty, and the beneficiary may have a claim to enforce that duty—but the duty is only to act in accordance with the trust's purposes and the claim could lead to no legally relevant event if exercised. Another way to say this is that the beneficiary has a claim, but only when the trustee has come under a duty to perform some action concerning the trust corpus under the trust's terms. The beneficiary could have a power, and the trustee a corresponding liability, whereby the beneficiary can change the nature of her legal relation with the trustee—but again, the trustee is only liable to act in accordance with the trust's purposes and nothing might happen as a result. Again, the description reduces to the notion that the beneficiary has a power when the trust deed says so. The beneficiary might have an immunity, and the trustee a corresponding disability—but these are only against actions not in accordance with the trust's purposes. The beneficiary has a liberty to use, but only that trust property that has been transferred to her in accordance with the trust. The trustee has a liberty to deal with the trust property, but can only effect changes in legal relations concerning the property when acting for the trust's purposes.[977]

These analytical problems in a Hohfeldian approach to trusts are reflected dealings with outsiders. While a trustee has the exclusory right as regards the trust property against third parties as the holder of legal title, there is no power to waive that right by granting access unless acting in due administration of the trust. As regards the beneficiary, a third party may enforce against the beneficial interest but only as the assignee of that interest—the trust's terms still govern access to the trust corpus.

[977] In fact, we know Hohfeld struggled to fit trusts into his classification of jural relations; see WN Hohfeld 'The Relations Between Equity and Law' (1913) 11 Mich LR 537, 569. See also JW Harris 'Trust, Power and Duty' (1971) 87 LQR 31, who argued that the trust does not exhibit a Hohfeldian correlative or 'relational' duty but the 'rule-conception of duty', after HLA Hart *The Concept of Law* (3rd Ed OUP, Oxford 2012), 55-56 and 83-86.

None of these rights are directly against specific persons, or concern specific things, before they pass through the additional analytical prism of the trust's purposes—they consequently cannot exist without reference to the specific management regime of the specific trust. It is proposed that the trust, and its asset partitioning features, are best conceived as two transmissible positions. Both the trustee's and the beneficiary's identity can change, but so long as the positions remain, the trust will persist.[978] The precise nature of the two positions is determined by the trust's purposes and general law, and only after these positions are defined can any talk of rights, powers, liberties or immunities have any substantive colour.

iii) Nature of the Beneficial Interest

The extent to which the beneficial interest is proprietary is another well-known debate that has been raging at least since *Burgess v Wheate*. Armed with the exposition of central case law and theoretical structures on creditor access from both England and the US, it is the view of this thesis that the debate is not particularly meaningful unless the specific aspects of a proprietary right at issue are defined.

Honoré identified 11 incidents of ownership,[979] which are scattered across the trustee and beneficiary seemingly almost at random. Of these, the trustee has the right to possess (in Honoré's sense of a right to be put in exclusive control and to remain in control); the right to

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[978] AM Honoré 'Rights of Exclusion and Immunities against Divesting' (1959-60) 34 Tul LR 453, who argued for the continental wisdom that rights can be against things and not just persons (at 463) and that some 'rights' are relations which survive past the divesting of the subject matter of the right, implying they do not primarily concern the individuals who happen to hold them at a given time (at 464 to 467).

[979] AM Honoré 'Ownership' in *Making law bind*: Essays Legal and Philosophical (Clarendon Press, Oxford 1986) 161–92, (Originally published in Guest AG (ed) *Oxford Essays in Jurisprudence* (Oxford University Press, Oxford 1961) 107–147.

manage (i.e. to decide how and by whom the thing is to be used, to the extent permitted by the trust deed); the right to alienate the capital (if the trust deed allows); and the right to remain the owner (within the perpetuity period). Moreover, the trustee is subject to the prohibition of harmful use; his interest is transmissible from one trustee to another; and he is the residuary owner should the beneficiary disappear. However, he has no right to use the thing, no liberty to consume or waste, and no right to its income, his interest is for a term and it is not liable for execution of his debts.

The beneficiary has a right to use the trust property (to the extent allowed in the trust deed); a right to its income; a power to alienate *his* interest (but not the actual trust property); the liberty to consume or waste what he is distributed; his interest is transmissible, subject to a prohibition of harmful use and liable for execution. He does not have a residuary interest (other than by reference to other beneficiaries if such priorities have been drawn out in the trust deed), his interest is for a term, he has no right to the capital (unless specifically allowed), no right to manage, or possess, or to remain a beneficiary.

With this in mind, it is impossible to say who 'owns' the trust property in light of the law discussed in this thesis. The notion in *Burgess v Wheate* that as between the trustee and beneficiary the trust interest is proprietary probably refers to the transmissibility of both interests or positions—both the identity of the trustee and beneficiary may change without the trust being dismantled. As is evident from the doctrines discussed in this thesis, transmissibility of position alone does not imply proprietary rights in the assets.

This transmissibility is also reflected in some of the central cases on creditor access to the beneficiary's interest. Recall that in *Dearle v Hall* it was stated that 'the act of giving the trustee notice is, in a certain degree, taking possession of the fund: it is going as far towards equitable possession as it is possible to go'.[980] With notice, the assignee-beneficiary makes the interest enforceable against the trustee, which preserves the trust and makes him 'take possession' of the fund. The beneficiary's right then becomes proprietary as against the trustee, 'and all claiming by and under them',[981] highlighting the transmissibility of their respective rights.

But it does not mean that a beneficiary has any right in the assets themselves. Even a transfer of the trust assets to a third party under circumstances where that party becomes a constructive trustee can be said to be an instance of the transmissibility of the trustee's interest, preserving the trust. The beneficiary now simply has a right to demand due administration from the constructive trustee, and to petition the court to appoint new trustees instead.

In light of the law on beneficiaries' creditors, it is more accurate to say that not only is the beneficial interest obligational (though transmissible), the specific contours of the obligation of the trustee are personal to that specific beneficiary. As we know, the notice to the trustee is 'not necessary for there to be a perfected equitable assignment as between the assignee and assignor'.[982] The notice to the trustee only makes the *trustee* bound, and all other assignees inferior (even if prior in time). This is because, as argued above,[983] the beneficial interest is more than just the right to sue and recover,[984] and directly related to what the content of the trustee's duty actually is. Where the transmissible position of the beneficiary is filled by Alan, the trustee might justifiably make different decisions than if it is filled by Belinda. The identity of the

[980] *Dearle v Hall; Loveridge v Cooper* (1828) 3 Russ 1, 58-59.

[981] *Burgess v Wheate* (1759) 1 Eden 177, 251.

[982] *Technocrats International Inc v Fredic Ltd (no 1)* [2004] EWHC, para 57.

[983] See n 364 *et seq.,* and accompanying text.

[984] *Hill v Boyle* (1867) LR 4 Eq 260, n 358 *et seq*, and accompanying text.

beneficiary determines the content of the trustees' duties, and whoever notifies the trustee first will set that content in stone.

Finally, an interesting aspect of the beneficial interest debate is the characterisation of burdens attaching to ownership, such as rents or taxes. These, according to *Hardoon v Belilios*[985] and *Matthews v Ruggles-Brice*,[986] are ultimately carried personally by the beneficiary with priority against the beneficial interest, suggesting that the beneficiary is in some sense to be considered the owner of the property and ultimately responsible for the liabilities attaching to it. This is certainly the case where the trustee is the beneficiary's agent.[987]

It may, however, merely be the case that the court views rents and tax liabilities as part of the interest in the benefit or use of the property—whoever has the right to the actual benefit must also bear the burdens. This is certainly reflected in what the courts are actually saying: 'the plainest principles of justice require that the [beneficiary] who gets all the benefit of the property should bear its burden unless he can show borrower reason why his trustee should bear them himself'.[988] A lent bicycle will invest the borrower with the right to use it within a period, but this does not mean that the borrower is the true owner.

3. Conclusion

[985] *Hardoon v Belilios* [1901] AC 118.

[986] *Matthews v Ruggles-Brise* [1911] 1 Ch 194.

[987] *Baker v Archer-Shee* [1927] AC 844

[988] *Hardoon v Belilios* [1901] AC 118, 123.

The trust as a trading vehicle has a long history of subtle development by some of our history's greatest legal minds. It lies at the heart of the law of trusts that a trust effects a segregation of assets. The fact that the precise doctrinal operation of this segregation is so obscure and conflicted is an embarrassment to our basic understanding of the law of trusts. This thesis attempts to shed light on this obscure doctrine, both in terms of English law and through comparative common law from the US. It also seeks to align the law doctrinally as well as with central principles of trust law, ensuring it is as workable and flexible now, in the world of vast investment vehicles and pension trusts, as it has proved itself to be in the past where its natural terrain was the family settlement or the modest joint stock enterprise.

The law of creditor access has not received due attention from English trust law scholarship. Very basic notions of unavailability of the trustee's personal assets, or availability of the beneficiary's property in trust assets, to meet claims of their respective creditors, turn out to be murky and usually described inaccurately. The trustee's personal assets *are* available to trust creditors, and the beneficiary's interest only allows the creditor to receive what the trustee is duty-bound to distribute in acting for his existing or present beneficiary.

This thesis has sought to explain the terrain of trustee and beneficiary liabilities by focusing outward on wider trust debates, and inwards on the proper characterisation of key case law. It is argued here, among other things, 1) that *Saunders v Vautier* is not of prime conceptual importance to trusts but an errant exception; 2) that the beneficiary's interest cannot be proprietary and its limited or simulated proprietary effects are best explained by the transmissibility features of both the trustee's and beneficiary's interests; 3) that the law of trust creditors is in dire need of clarification with suggested solutions; 4) that American trust law represents a fruitful comparison in its treatment of creditors' claims against trustees and beneficiaries; and 5) that the comparison shows us the effect and importance this obscure area of trust law can have on its core concepts.

It is important for the future of trust law to clarify claims made on the basis of this obscure law. Bad things grow in the dark, and obscurity of central principles breeds bad law. I have here attempted to investigate the majority of central cases at a level of detail that does justice to their analytical complexity, in the hopes that this might spark an interest in the law of trust creditors that matches the enthusiasm of our US counterparts in this area. It is also hoped that it may serve as a starting point for discoveries beyond our present horizon.

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