

Conflicts of Interest and Trustees

The essential principles

Introduction

1. A person in a fiduciary capacity is not allowed to put himself in a position where his interest and duty conflict. This includes a situation where a reasonable person looking at the circumstances concludes that there is a real possibility of conflict.
2. A good starting point ~~is are~~ the classic statement~~s~~ of the equitable principle to be found in such judgments as that of Lord Cranworth L.C. in **Aberdeen Railway Company v. Blakey** (1854) 1 Macq. 461 at 471 and of Lord Herschell in **Bray v. Ford** (1896) A.C. 44, 51 to 52 which, with other, more modern, citations to the same effect, are conveniently collected in the judgment of Lindsay J. in the **In re Drexel Burnham Lambert Pension Plan** case.
3. As put by Lord Herschell, the principle is that:

“It is an inflexible rule of a Court of Equity that a person in a fiduciary position...is not allowed to put himself in a position where his interest and duty conflict. It does not appear to me that this rule is, as has been said, founded upon principles of morality. I regard it rather as based on the consideration that, human nature being what it is, there is danger, in such circumstances, of the person holding a fiduciary position being swayed by interest rather than by duty, and thus prejudicing those whom he is bound to protect.”
(L. Herschell in *Bray v. Ford* at 51)

4. This equitable principle is closely aligned if not connected to the allied principle that a trustee, like other fiduciaries, is not in general allowed to retain a benefit acquired or a profit made by him for the use of trust property or in the course of or by virtue of his trusteeship.
5. There is much academic debate as to whether theses~~s~~ two principles are in actual fact distinct with some suggesting (in my opinion correctly) that the profit principle may in

fact be no more than a subset of the conflict principle. Certainly this appeared to be the view of Lord Upjohn in **Boardman v. Phipps** who stated that “the fundamental rule of equity that a person must not make a profit out of a trust which is part of the wider rule that a trustee must not place himself in a position where his duty and interest may conflict.”

6. Similarly in **Swain v The Law Society** [1982] 1 WLR 17, 29 Stephenson L.J. regarded the “profit rule” as but one aspect of the wider “conflict rule”, but this has not found universal acceptance. The High Court of Australia (**Chan v. Zacharia** (1984) 154 CLR 178) for instance found that ~~the~~the two principles, while overlapping, were distinct.

Certain well-known sub-rules

7. This central underlying conflict principle has of course given rise to certain well known rules applicable to specific commonly encountered situations.
8. A non exhaustive list of examples of such rules recognised by Hart J in **The Public Trustee v. Paul Cooper** are:
 - a. a professional trustee may not charge for his services unless expressly authorised to do so by the trust instrument;
 - b. A director trustee must account for remuneration earned as a director unless expressly authorised to retain it.
 - c. A beneficiary is entitled ex debito justitiae, that is to say, without having to prove actual unfairness or impropriety, to set aside any transaction entered into by the trustee in his personal capacity in respect of the trust assets unless that personal transaction is expressly authorised by the trust instrument.
 - d. A trustee is not generally speaking, able to exercise a power of appointment in his own favour unless expressly or implicitly authorised to do so.
9. However despite the existence of a number of hard and fast rules attaching to certain black and white areas of conflicted interest, there is in fact as recognised by Hart J. in the Paul Cooper case “a surprising lack of English authority on the consequences of trustees

acting or purporting to act in situations to which the developed rules do not in terms apply, but where actual or potential conflicts are alleged to exist.”

10. What then is the consequence of the trustees acting in conflict of interest situations not within the currently established black and white areas? As Hart J states:

“The relative absence of authority certainly suggests that there is no iron rule that, where such action has taken place, a beneficiary is entitled ex debito justitiae to have it set aside. Equally one would expect to find, in the absence of such an iron rule, that, where such action is challenged on such grounds, the onus would be thrown upon the trustees to demonstrate that the conflicting interest or duty has not in fact operated in a vitiating way.”

Strategy when a conflict arises

11. Hart J. outlines the three possible modes of conduct available to trustees if they find themselves in a situation where a conflict of interest either potential or actual might arise:
- a. Resignation;
 - b. Surrendering their discretion to the Court; and
 - c. Thirdly, where tThe trustees may honestly and reasonably feel able to make the decision an application to and may wish for the Court for it to approve such a decision in advance of it being implemented made.

Resignation

12. As Hart J. recognises : “This will not always provide a practical or sensible solution. The trustee concerned may represent an important source of information or advice to his co-trustees or have a significant relationship to some or all of the beneficiaries such that his or her departure as a trustee will be potentially harmful to the interests of the trust estate or its beneficiaries”.

13. However, as a matter of caution, it should be remembered that, although resignation in advance may be a viable option where what is proposed falls outside the black and white

areas subject to already-established hard and fast rules, it is unlikely to be of assistance where the intended transaction does fall within such a black and white area. Thus, a trustee intending to purchase trust property will not be able successfully to effect such a purchase by the simple expedient of resigning as a trustee just before the purchase goes through.

~~13~~.14. Although not expressly considered by Hart J., it should be remembered that section 37 of the Trustee Act 1925 allows in certain circumstance for new Trustees to be appointed over separate Trust funds. Sometimes difficulties can be dealt with by way of appointment of new trustees thereby allowing different trustees to validly represent differing beneficial interests in the overall assets.

Surrender of Discretion

~~14~~.15. In an extreme case, the trustee may surrender his discretion to the court (**Thrells Ltd v. Lomas** [1993] 1 WLR 456), such as where the conflict is so pervasive throughout the trustee body that they feel they have no other option (**Public Trustee v. Cooper** [2001] WTLR 901). However, only rarely is it advisable to do this, as it means abandoning all control over the outcome.

Seek approval of a proposed course of action

~~15~~.16. Instead, it is generally preferable to seek the court's approval of a proposed course of action in advance of it being implemented. The burden will then be on the beneficiaries to demonstrate that the proposed action is improper (**Public Trustee v. Cooper**, which also contains an explanation of the difference between surrendering discretion and seeking the courts approval).

~~16~~.17. The Court is the most useful tool in a Trustee's armoury. It has the power to approve and protect. An unreported judgment of Robert Walker J., as he then was, given in chambers in 1995 dealt with what he saw as four distinct situations where a court would have to adjudicate on a course of action proposed or actually taken by Trustees. He highlighted:

- (1) *The first category is where the issue is whether some proposed action is within the trustees' powers. That is ultimately a question of construction of the trust instrument or a statute or both. The practice of the Chancery Division is that a question of that sort must be decided in open court and only after hearing argument from both sides;*
- (2) *The second category is where the issue is whether the proposed course of action is a proper exercise of the trustees' powers where there is no real doubt as to the nature of the trustees' powers and the trustees have decided to exercise them but, because the decision is particularly momentous, the trustees wish to obtain the blessing of the court for the action on which they have resolved and which is within their powers. Obvious examples of that, which are very familiar in the Chancery Division, are a decision by trustees to sell a family estate or to sell a controlling holding in a family company. In such circumstances there is no doubt at all as to the extent of the trustees' powers nor is there any doubt as to what the trustees want to do but they think it prudent, and the court will give them their costs of doing so, to obtain the court's blessing on such a momentous decision. In a case like that there is no question of surrender of discretion and indeed it is most unlikely that the court will be persuaded in the absence of special circumstances to accept the surrender of discretion on a question of that sort, where the trustees are prima facie in a much better position than the court to know what is in the best interests of the beneficiaries.*
- (3) *The third category is that of surrender of discretion properly so called. There the court will only accept a surrender of discretion for a good reason, the most obvious good reasons being either that the trustees are deadlocked (but honestly deadlocked, so that the question cannot be resolved by removing one trustee rather than another) or because the trustees are disabled as a result of a conflict of interest. Cases within categories (2) and (3) are similar in that they are both domestic proceedings traditionally heard in Chambers in which adversarial argument is not essential although it sometimes occurs. It may be that ultimately all will agree on some particular course of action or, at any rate, will not violently oppose some particular course of action. The*

difference between category (2) and category (3) is simply as to whether the court is (under category (2)) approving the exercise of discretion by trustees or (under category (3)) exercising its own discretion.

(4) The fourth category is where the trustees have actually taken action, and that action is attacked as being either outside their powers or an improper exercise of their powers. Cases of that sort are hostile litigation to be heard and decided in open court.”

Why is it better to be proactive early?

~~17~~18. If the trustees choose not to seek the approval of the court, they run the risk of hostile litigation at a later ~~stage~~^{tab}. In this situation, the trustees are at risk of finding themselves personally liable for the costs of all parties (**Breadner v. Granville-Grossman** (No. 2) Unreported July 17 2000) (above para: (2005) P.C.B. 4 219-230 at 229) as opposed to the ~~scenario situation~~ where, if seeking one of the court remedies highlighted by Robert Walker above, ~~they will have~~^{ing} their costs met from the Trust Fund (often on the indemnity basis).

19. Further, as a practical matter, the proposed scheme will be likely to have a much better chance of getting the blessing of the Court if approval is sought in advance of implementation, rather than being the subject-matter after the event of hostile litigation.

Self-Dealing Rule

~~18~~20. A purchase of trust property by a trustee not expressly authorised by the trust instrument is voidable at the instance of any beneficiary. However honest and fair the sale may have been and even if at higher than an open market value, a beneficiary has an absolute right to have the sale set aside within a reasonable time after he discovers the circumstances. It is the possibility of conflict that matters and must be guarded against (**Ex p Lacey** (1802) 6 Ves 625)- “the criterion..is not what was done, but what might be done.” (Viscount Dunedin in **Wright v. Morgan** [1926] AC 788). Doesn’t matter whether purchase was by a trustee who is a sole trustee or from co-trustees.

~~19~~21. Three ways of circumventing this rigid rule:

- (i) Apply in advance to the court to sanction the purchase. Would have to prove that transaction at full value etc.
- (ii) Ensure that the trust instrument includes provisions authorising sanctioning such a purchase.
- (iii) Obtain consent of all beneficiaries, if they are all of full age and sui juris, having ensured that each fully understand the proposal and have had the opportunity to receive their own advice.

~~20~~22. _____ Cannot be avoided by indirect methods (e.g. appointment of a nominee). However, in very exceptional circumstances the rule is not totally inflexible and where they exist the court will not necessarily hold a purchase to be voidable (most famously in **Holder v. Holder** and also see **Public Trustee v. Cooper** [2001] WTLR 901).

~~21~~23. _____ In cases where trustee sells to wife, family company or partnership of which he is a member, the transaction will be viewed with suspicion (**Burrell v. Burrell's Trustees** 1915 SC 333) and if questioned by the beneficiaries, the burden will be on the trustee to show that the sale was proper, in good faith and at the best price available (**Farrar v. Farrars Ltd** (1880) 40 Ch D 395; *Thomas & Hudson, 'The Law of Trusts' p. 346*).

Trustees exercising dispositive powers in favour of themselves

~~22~~24. _____ In cases where a trustee has a discretion to prefer some beneficiaries over others and yet is also a beneficiary himself, the problem of conflicts of interests is acute. The Court of Appeal (**Edge v. Pensions Ombudsman** [1999] 4 All ER 546) have held that in such a situation a trustee may benefit over other beneficiaries, even though the dispositive power is a fully fiduciary power vested in the trustees as such. Moreover, the burden rests with those who raise a challenge to the exercise of his powers. (**Lewin**, 20-117) This exception to the self-dealing rule will apply where the settlor has placed the trustee in such a position by the terms of the trust (e.g. by making him both one of the

appointors, as an original trustee, and also an object of the power) or where the rule itself is excluded by the terms of the trust (Lewin, 20-121).

Fair Dealing

~~23~~25. _____ Whereas the self-dealing rule deals with the trustee's purchase of trust property, the fair dealing rule is concerned with purchases by the trustee of his beneficiary's beneficial interest in the trust property. Such a transaction is not automatically voidable and in determining whether such a purchase is permissible, the question is whether the beneficiary is sui juris and gave fully informed consent to a fair and honest transaction (Snell, 7-43-46; Tito v. Waddell (No. 2) [1977] Ch 106). The rule has been described as 'regulatory' as opposed to 'prohibitory' (Hon. Mr Justice McPherson, '*Self-dealing Trustees*' in *Trends in Contemporary Trusts Law* cited in *G. Watt on Trusts and Equity* p.331).

~~24~~26. _____ A purchase by a trustee from his beneficiary is at all times a transaction of great nicety, and one which the courts will watch with the utmost jealousy (Ex parte Lacey (1802) 6 Ves. Jr. 625; Lewin 20-127)

~~25~~27. _____ If beneficiary raises an objection, burden will be on the trustee. Although the trustee is required to give full disclosure of the facts, he is not required ~~to~~ actually to advise the beneficiary.

Profiting from the trust

~~26~~28. _____ The general rule is that a trustee is entitled to no allowance whatsoever for his care and trouble (Re Thorpe [1891] 2 Ch 360).

~~27~~29. _____ This rule is circumvented if:

- (i) the trust instrument expressly authorises the fiduciary to receive remuneration. (By virtue of s. 28(4) TA 2000 such remuneration is now treated as remuneration for services and not as a gift/legacy);
- (ii) [s. 29 TA 2000 applies, allowing a A](#) professional trustee or a trust corporation is entitled to receive reasonable remuneration under [that section -s. 29 TA 2000](#). This applies regardless of when the trust was created, although not in relation to any death before 1 February 2001.
- (iii) The agreement of all the beneficiaries (provided they are sui juris) is obtained.
- (iv) The court authorises [the payment of](#) remuneration under its inherent jurisdiction. (Balance the general rule of non-remuneration against the aim of achieving a well administered trust)

~~28-30.~~ Furthermore, the trustee cannot receive any other incidental profits or financial benefits without authority (e.g. directorship remuneration, competing with trust business). The basic rule is always the same: “that which is the fruit of trust property or of the trusteeship is itself trust property.” (**Swain v. Law Society** [1981] 3 All ER 797; **Thomas & Hudson, ‘The Law of Trusts’ p. 349**).

Remedies

~~29-31.~~ Where there is a breach of fiduciary duties the remedies are an account of profits, the imposition of a constructive trust (or equitable compensation at the beneficiary’s election).

~~30-32.~~ If the trustee makes an unauthorised profit from the trust, then he will hold the cash or other assets constituting the profit (subject to a lien in respect of any costs reasonably incurred by him in making the profit) upon a constructive trust for the beneficiaries (**Cook v. Deeks** [1916] 1 AC 554). The beneficiaries therefore have both a personal and proprietary remedy against the trustee and the trust funds. If a trustee sets up a business in competition with a business carried on by the trust, he can be restrained from doing so by injunction (**Re Thompson** [1930] 1 Ch 203, **Lewin 20-40**).

31.33._____ If a beneficiary obtains an order setting aside a purchase by a trustee, he is then entitled to have the property put up for sale again (**Holder v. Holder; Lewin 20-97**).

32.34._____ The available remedies (rescission, profit stripping, compensation) all focus on removing from the trustee any benefit that he received from entering into the transaction while he had a conflict between duty and interest. The purpose is to remove any attraction which such a transaction might hold for the trustee, in order to deter him from entering into the transaction. It is arguable that removing the fruits of temptation is designed to neutralise the temptation itself by rendering it pointless (**Harris v. Digital Pulse Pty Ltd (2003) 56 NSWLR 298; (2005) 121 LQR 452 at 463**).

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