The Modern Application of the Rule in Keech v Sandford

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Abstract

The article examines the current law on the application of the rule in Keech v Sandford with a view to identifying its scope and ambit, and to argue that, despite earlier caselaw, it should be viewed today as an application of the broad principle of equity that a trustee or fiduciary must not make a profit out of the trust or his fiduciary position.

It is a general principle of equity that a person in a fiduciary position must not put himself in a position where his interest conflicts with his duty. In simple terms, duty prevails over interest. The rule is illustrated by the celebrated case of *Keech v Sandford*,[1] where a trustee, who held a lease on behalf of an infant beneficiary, made use of his influence in order to obtain a renewal of the lease for himself. In equity, it was held that he held the lease on trust for the beneficiary as an accretion to or graft upon the original term. Lord King LC explained the outcome in this way:[2]

> "This may seem hard, that the trustee is the only person of all mankind who might not have the lease; but it is very proper that the rule should be strictly pursued, and not in the least relaxed; for it is very obvious what would be the consequences of letting trustees have the lease on refusal to renew to *cestui que trust*."

The historical rationale for the rule has been explained in the following terms:[3]

> "If a trustee on the refusal of a lessor to renew a lease to the trust were permitted to take a lease for himself, few leases would ever be renewed in favour of trusts. This prohibition was wholly understandable at that time. Many ecclesiastical , charitable and public bodies were by law restricted as to the length of leases which they were able to grant and leases were therefore renewed more or less as a matter of right. By taking a renewal of a lease for himself, a trustee was therefore in practice depriving the trust of a grant which it had a right to expect."

[1] (1726) Sel Cas Ch 61.
[2] ibid, at 62.
[3] See, Parker and Mellows, *The Modern Law of Trusts*, (7th ed., 1998), Sweet & Maxwell, at p. 307.

As we shall see, the rule has been extended to apply to other persons in a fiduciary position. In the absence, however, of this special feature, a person is free to take the benefit of the transaction for himself. In *Savage v Dunningham*,[4] for example, the defendant rented an unfurnished flat which was occupied by the claimants and himself. All three occupants contributed equally to towards the rent and outgoings. The landlords subsequently offered the opportunity of purchasing a long lease of the property to the defendant who, without informing the claimants, accepted. The claimants argued that the lease was held by the defendant on trust for all of them. The claim was rejected, however, on the ground, inter alia, that the defendant owed no fiduciary duty to the claimants and was, therefore, entitled to purchase the long lease for his own benefit.

It will be observed that the rule was held to apply in *Keech v Sandford* despite express proof of the landlord's refusal to renew the lease in favour of the beneficiary, the court apparently taking the view that to relax the rule would give the trustees too great an opportunity to defraud the beneficiaries. However, even where the trustee has renewed the lease for himself, this will not give rise to a breach of fiduciary duty if the rule has been expressly excluded. Thus, a will may provide that the trustee may keep the retained lease for himself.[5] Moreover, the beneficiary under the trust cannot be compelled to accept and pay for the renewal. If he refuses to do so, either before or after the acquisition by the trustee, the latter is entitled to acquire and retain the renewal for his own use, but if the beneficiary does require that the renewal be brought into the trust estate, then the trustee must deal with it accordingly, subject to recoupment out of the trust estate.[6] Similarly, where the rule applies and the trustee holds the property on trust, he will be entitled to a lien on the property for the expenses of renewal.[7]

The requirement of a fiduciary relationship

The rule applies not only to trustees but also to mortgagees, agents, directors and partners. In *Don King Productions Inc v Warren*,[8] the rule was applied to the renewal of a contract held on trust for a partnership established between boxing promoters Don King and and Frank Warren in 1994. The partnership was later dissolved in 1997. On the basis that the partners stood in a fiduciary relationship, the Court of Appeal held that the benefit of any management or promotion agreements concluded by a partner after the date of dissolution but prior to the conclusion of the winding up of the partnership affairs with a boxer with whom he already had such an agreement would be held on trust for the partnership.

The rule, however, will have no application where the person renewing a lease does not clearly occupy a fiduciary position. In *Re Biss*,[9] the landlord granted a lease of a house in which the tenant carried on a business. On expiry of the lease, the landlord refused to renew it, but allowed the tenant to remain in occupation as a yearly tenant. The tenant later died

[4] [1974] Ch 181.
[5] See, *Re Knowles' Will Trusts* [1948] 1 All ER 866, at 871.
[6] See, *Thompson's Trustee in Bankruptcy v Heaton* [1974] 1 WLR 605, at 612, referring to the acquisition of a reversionary interest by the trustee.
[7] *Isaac v Wall* (1877) 6 Ch D 706.
[8] [2000] Ch 291.
[9] {1903] 2 Ch 40.

intestate leaving a widow and three children. She and two of the children continued to run the business and each applied for a new lease for the benefit of the tenant's estate which was refused. The landlord subsequently terminated the yearly tenancy and granted the other child (a son, who had never become an administrator of his father's estate) personally a new lease of the house. The widow then sought to have the lease treated as having been taken by her son for the benefit of the tenant's estate. It was held that the son owed no fiduciary duty towards the estate and, hence, was entitled to the lease in his own name. Romer LJ stated that, in the absence of a fiduciary relationship, a person:[10]

> ". . . is only held to be a constructive trustee of the renewed lease if, in respect of the old lease, he occupied some special position and owed, by virtue of that position, a duty towards the other persons interested."

Interestingly, it was also suggested that, where a lease has been obtained by a partner, the presumption of exploitation of a fiduciary position is rebuttable – the effect of this is that it will be presumed that the lease is held for the benefit of the partnership unless the partner can rebut this presumption. A rebuttable presumption would appear to apply also to mortgagors,[11] mortgagees,[12] and tenants for life. By contrast, where the fiduciary is a trustee, personal representative, agent, joint tenant and tenant in common, there is an irrebuttable presumption that he cannot obtain the benefit of the transaction entered into in his personal capacity. The distinction has been critcised academically and it has been suggested that there is no good reason why partners, who are quite clearly fiduciaries for all other purposes, should be in the former category.[13]

Other requirements?

In the early cases,[14] it was suggested that the rule would only be imposed where the lease was renewable by custom or contract (the purchase thus cutting off the right of renewal) or where the trustee obtained the reversion by virtue of his position as leaseholder (i.e., a landlord offering enfranchisement to all his leaseholders). The distinction between renewals and reversions was explained by Wilberforce J in *Boardman v Phipps*[15] in this way:

> " . . . whereas in the case of a renewal the trustee is in effect buying a part of the trust property, in the case of a reversion this is not so; it is a separate item altogether, and therefore the trustee may purchase it unless, in so doing, he is in effect

[10] Ibid, at 61.
[11] *Leigh v Burnett* (1885) 29 Ch D 231.
[12] *Nelson v Hannam and Smith* [1943] Ch 59.
[13] See, Parker & Mellows, *The Modern Law of Trusts*, (7th ed., 1998), Sweet & Maxwell, at p. 308, where it is suggested that the subsequent cases of *Thompson's Trustee in Bankruptcy v Heaton* [1974] 1 WLR 605 and *Popat v Shonchatra* [1995] 1 WLR 908 , which concerned purchases of the freehold reversions, may well have changed the law in this respect, "although the question cannot yet be regarded as finally settled".
[14] See, *Re Lord Ranelagh's Will* [1884] 26 Ch D 590; *Phillips v Phillips* [1885] 29 Ch D 673; *Longton v Wilsby* [1897] 76 LT 770; *Bevin v Webb* [1905] 1 Ch 620: *Griffith v Owen* [1907] 1Ch 195.
[15] [1964] 1 WLR 993, at 1009.

> destroying part of the trust property; or . . . he intercepts and cuts off the chance of further renewals."

Significantly, *Keech v Sandford* was not a case concerning the acquisition of *other* property for the benefit of the trust, but instead about preserving the *existing* trust property. As a result, later decisions[16] held that, in cases where the acquisition of the reversion by the trustee had nothing to do with the trust itself, in that it did not damage the trust lease or any incident of it, and the opportunity did not come to the trustee as lessee, the rule in *Keech v Sandford* did not apply to the acquisition of the reversion.[17] As we shall see, the Court of Appeal[18] has since taken a different view which must now be taken to represent the modern law.[19]

Purchase of the freehold

The principle in *Keech* has been extended to the purchase by a trustee of the freehold reversion expectant on the lease. In *Protheroe v Protheroe*,[20] a husband and wife acquired a lease of a house as their family home. The leasehold estate was transferred into the name of the husband alone, but it was not in dispute that that the lease was held by the husband on trust for himself and his wife in equal shares. The husband later purchased the freehold reversion for £200. The Court of Appeal held that the wife was entitled equally with the husband to the net proceeds of sale of the freehold of the family home since, as the husband had held the lease as a trustee, the freehold reversion was regarded in equity as having been acquired on the same trust as the leasehold estate. The husband was, however, entitled to be reimbursed the purchase price and the expenses connected with its acquisition. Lord Denning MR put the matter in this way:[21]

> "Being a trustee, he had an especial advantage in getting the freehold. There is a long established rule of equity from *Keech v Sandford* downwards that if a trustee, who owns the leasehold, gets in the freehold, that freehold belongs to the trust and he cannot take the property for himself. On that principle when the husband got in the freehold, it attached to and became part of the trust property."

Interestingly, his Lordship characterised the rule as applying to a trustee purchasing the reversion upon a lease as holding it *automatically* upon the same trusts as the lease. This, of course, does not accord with the earlier authorities where, as we have seen, the rule would only apply if the lease was renewable to the trust by custom or contract or where the trustee obtained the reversion by virtue of his position qua leaseholder. Most commentators, however, have justified the decision on the basis that a purchaser of the reversion falls foul of the strict principles established in *Boardman v Phipps*,[22] especially since the trustee would

[16] Notably, *Bevin v Webb* [1905] 1 Ch 620.
[17] See, *Re Capital Investment Centre Ltd* [2021] 4 WLUK 498, at [26]-[28], (County Court, Bristol), per HH Judge Paul Matthews.
[18] See, *Protheroe v Protheroe* [1968] 1 WLR 519.
[19] For a full discussion of the earlier cases, see S Cretney, (1969) 33 Conv 161.
[20] [1968] 1 WLR 519.
[21] Ibid, at 521.
[22] [1967] 2 AC 46.

personally become the landlord of the trust tenancy. In *Boardman* itself, the majority of the House of Lords held that a solicitor was accountable as constructive trustee to the beneficiaries of an express trust for shares he had purchased, without the authority of all the beneficiaries, whilst acting as solicitor to the trust.

Significantly, the principle in *Protheroe* has since been extended to apply to a situation where a person has undertaken to act for another in a particular matter in circumstances giving rise to a relationship of trust and confidence. In *Hooper v Gorvin,*[23] the tenants of different units on an industrial estate learnt that the freehold was up for sale. They authorised the defendant (one of the tenants) to negotiate the purchase with the freeholder on their behalf. The defendant went ahead and bought the freehold for his own account. Mr Kevin Garnett QC (sitting as a deputy judge of the High Court) held that the categories of fiduciary relationship were not closed and that the other tenants had expected and trusted the defendant to act in their collective interests, and not his own. As such, the defendant had assumed fiduciary duties towards the other tenants in negotiating for the acquisition of the freehold reversion. In acquiring the reversion for himself, therefore, the defendant was in breach of those duties and, consequently, held the reversion on trust for himself and the other tenants.

The deputy judge also alluded to the principle that, when assessing whether the relationship was a fiduciary one, it was relevant to consider, particularly in a commercial context, whether the alleged fiduciary knew that the principal would act to his detriment in reliance upon the agreement reached. In *Hooper*, it was clear that someone else would have been nominated to negotiate on behalf of the tenants had the defendant been unwilling to act. Moreover, it was also clear that, had the defendant told the other tenants that he intended to try to buy the freehold for himself, they would have attempted to buy it for themselves. To that extent, therefore, they had acted to their detriment. In the result, the deputy judge made a declaration that the defendant held the freehold reversion on trust for himself and the other tenants, subject to being paid the appropriate portion of the purchase price.

The decision in *Protheroe* was also applied in the earlier case of *Thompson's Trustee in Bankruptcy v Heaton*,[24] where a partner had purchased the freehold reversion of a farm that was a partnership asset. Pennycuick V-C held that, since the duty of good faith between partners still subsisted where the assets of a dissolved partnership remained undistributed, the partner could not acquire the reversion of the leasehold interest for himself without giving the other partner an opportunity to share equally in the acquisition. He was, therefore, accountable to the other partner for a half interest in the freehold reversion. In the course of his judgment, his Lordship stated the relevant principles in the following terms:[25]

> "It is well established that where someone holding a leasehold interest in a fiduciary capacity acquires a renewal of the leasehold interest, he must hold the renewed interest as part of the trust estate . . . It is also, I think, well established that where someone holding a leasehold interest in a fiduciary capacity acquires the freehold reversion, he must hold that reversion as part of the trust estate."

[23] [2001] WTLR 575.
[24] [1974] 1 WLR 605.
[25] ibid, at 612.

Interestingly, his Lordship was prepared to accept the correctness of the decision in *Protheroe* on the basis that it was really "in modern terms an application of the broad principle that a trustee must not make a profit out of the trust estate".[26] In his view, however, the distinction between the purchase of a reversion and the renewal of an existing lease continued to be an important one. On this point, his Lordship stated:[27]

> ". . . the reversion upon a lease stands in quite a different position from a renewal of a lease. The latter is treated as being a continuation of a lease whereas the former is treated as being a separate and extraneous interest . . . It would be a wide extension of the principle to hold that someone who is not in a fiduciary capacity is not entitled to acquire a freehold reversion upon a lease for his own benefit."

Most recently, in *Fairclough v Salmon*,[28] Mummery LJ had occasion to echo the principle laid down in *Protheroe* that, if a person who holds a leasehold as a trustee obtains the freehold reversion, then the freehold reversion belongs to the trust and cannot be taken by the trustee as property for himself.

Conclusion

The rule in *Keech v Sandford* prevents a trustee from keeping for his own benefit a renewal of a lease which he was able to obtain for himself as a result of being the trustee of the original lease. The rule has since been extended to apply to the renewal of contracts held on trust and the purchase of the reversion expectant on a lease. In earlier cases, however, the courts limited the rule to situations where the lease was renewable by law or custom. The rationale for this limitation is explained in Hanbury & Martin, *Modern Equity*, in the following terms:[29]

> ". . . if the lease were normally renewed in practice, the lessee would suffer if the lease passed to a third party who might not follow the custom (particularly if the lease, as was commonly the case with church leases, was generally renewed at less than the market rent). Thus, it was wrong to allow the trustee, who ought to be protecting his beneficiary's interests, to damage them."

Much of this reasoning, however, is no longer apposite in modern leasehold law where, as Hanbury & Martin point out,[30] many leases are given extensive statutory rights of renewal or enfranchisement. It is submitted, therefore, that the correct approach today is to ask simply whether the trustee or fiduciary has taken advantage of his position to obtain a personal benefit. This accords with the views expressed in the *Don King*, *Hooper v Gorvin* and

[26] Ibid, at 612. See also, *Popat v Shonchhatra* [1995] 1 WLR 908, at 917: "the decision in *Thompson's* case is treated as an extension, or, perhaps more accurately, an application, of the rule in *Keech v. Sandford*, which has, of course, a broad ambit", per Mr David Neuberger QC, (sitting as a deputy High Court judge).
[27] [1974] 1 WLR 605, at 614.
[28] [2006] EWCA Civ 320, at [28].
[29] Hanbury & Martin. *Modern Equity*, (10th ed., 2012), Sweet & Maxwell, at p. 646.
[30] Ibid, at p. 646.

Thompson's Trustee line of cases, favouring the *Protheroe* approach that, essentially, the rule in *Keech v Sandford* is no more than an application of the broad principle of equity that a trustee or fiduciary must not make a profit out of the trust or his fiduciary position.