Trusts

Legal Formality and Fraud

[University of Greenwich Logo]

Mark Pawlowski*

[Aston University Logo]

James Brown**

*Barrister and professor emeritus of property law, School of Law, University of Greenwich.

** Barrister and reader in law, School of Law, Aston University.

This article seeks to examine the current scope of the equitable principle that "equity will not allow a statute to be used as an instrument of fraud". In particular, it examines the meaning of fraud in the context of oral trusts of land and the question whether the so-called rule in Rochefoucauld v Boustead [1897] 1 Ch. 196 can be applied legitimately in the enforcement of informal rights under a trust for the benefit of third parties.

Most lawyers will, of course, be familiar with the equitable principle that "equity will not permit a statute to be used as an instrument of fraud".[1] The principle dates back to the early days of equity and to a series of cases decided shortly after the enactment of the Statue of Frauds 1677. Put simply, if property is transferred from A to B on the basis of a verbal arrangement with B that B is to hold the land on trust for A, equity will not permit the lack of legal formality to defeat the trust. In these circumstances, equity intervenes so as to prevent B, who knows he has acquired the property as trustee, from acting fraudulently in seeking to deny the trust and keep the property for himself. This is the traditional formulation of the principle which, as we shall see, has been applied in a number of modern cases.

Fraud and the transferee

The element of fraud

As already mentioned, the element of fraud which triggers equity's intervention is the reliance by the transferee of the lack of writing in order to deny the trust and claim the land for his own

[1] *Heard v Pilley* L.R. 4 Ch. 548, at 553, *per* Giffard L.J. The expression "an instrument of fraud" probably originates with Lord Eldon in *Mestaer v Gillespie* (1805) 11 Ves. Jun. 622.

benefit. The principle was enunciated by Lindley L.J. in *Rochefoucauld v Boustead*[2] and has been applied and followed in several modern decisions, most notably in *Bannister v Bannister*[3] and *Hodgson v Marks.*[4] In *Rochefoucauld* itself, the claimant, the Comtesse de la Rochefoucauld, was the owner of certain lands in Ceylon subject to a mortgage. The mortgagees sold the lands to the defendant as trustee for the claimant but the trust was not evidenced by any writing signed by the defendant as required by s.7 of the Statute of Frauds.[5] The Court of Appeal held that parol evidence was admissible to prove the existence of the trust despite non-compliance with the statute. In the words of Lindley L.J:[6]

> . . . notwithstanding the statute, it is competent for a person claiming land conveyed to another to prove by parol evidence that it was so conveyed upon trust for the claimant, and that the grantee, knowing the facts, is denying the trust and relying upon the form of conveyance and the statute in order to keep the land himself.

There is, clearly, no need for the claimant to prove any actual fraud (i.e., fraudulent intent) on the part of the transferee at the time of the original transaction. The element of fraud in this context is simply the setting up of the conveyance (or transfer) in order to defeat the transferor's equitable interest. However, it seems fundamental to the operation of the rule that the transferee should have knowledge of the informal trust when the property is transferred to him. The obvious analogy here is with the doctrine of secret trusts, which requires that the terms of the secret trust should be communicated to the secret trustee in order to render the trust binding on him.

Express or constructive trust?

Interestingly, Lindley L.J. considered that the trust created by virtue of the operation of the rule was an express trust in the sense of being one which both parties had intended to create from the start. In other words, it was the original trust manifested by the parties intentions and not a trust in the constructive sense arising by operation of law. On this basis, the rule in *Rochefoucauld* does not attempt to avoid s.53(1)(b) of the Law of Property Act 1925 by raising a resulting or constructive trust, but simply gives effect to the original trust in the face of the statutory provision in order to prevent what would otherwise be an obvious fraud on the part of the trustee. This approach is also consistent with the accepted notion that s.53(1)(b) does not render the declaration of trust void for lack of writing[7] but simply unenforceable. In other words, the express trust is valid despite non-compliance with the statutory provision. However, the alternative view, namely that the trust which is given effect under the rule is a constructive trust falling within the statutory exception contained in s.53(2)[8] of the 1925 Act, has also had judicial

[2] [1897] 1 Ch. 196, at 206.
[3] [1948] 2 All E.R. 133, (C.A.).
[4] [1971] Ch. 892, (C.A.).
[5] See now, s.53(1)(b) of the Law of Property Act 1925.
[6] [1897] 1 Ch. 196, at 206.
[7] The writing required for s.53(1)(b) may be contained in one document or across several (e.g., by a series of letters or exchange of emails or text messages).
[8] Section 53(2) provides that the requirements of legal formality do not affect the creation or operation of resulting, implied or constructive trusts.

support. In *Bannister*, mentioned earlier, a case involving a transfer of land on the express verbal undertaking by the transferee that the transferor should retain a right to live in the property (a cottage) rent free for life, the Court of Appeal classified the trust as being constructive, arising as soon as the transferee set up his own title in disregard of the rights to which he has agreed to take subject. Most recently, in *Banner Homes Group plc v Luff Developments Ltd*,[9] Millett L.J. also viewed the *Rochefoucauld* rule as a sub-category of constructive trust doctrine.

The distinction between the enforcement of an express or constructive trust under the *Rochefoucauld* rule may be significant in cases where A transfers property to B on terms of an oral trust for C. As we shall see later, if the trust enforced is the original express trust, it is likely that C can claim the benefit of the trust despite the lack of writing. On the other hand, if the trust is characterised as constructive, the position is less clear cut since it is arguable that it should be used simply to effect a return of the property to A. The latter outcome is, of course, unavoidable if the trust under the rule is treated as being a resulting trust. Interestingly, in *Hodgson*, referred to above, involving a voluntary transfer of the claimant's house to the defendant's predecessor in title on the express verbal understanding that the beneficial ownership was to remain with the claimant, the Court of Appeal favoured the imposition of a resulting trust so as to debar the defendant's predecessor from relying on s.53(1)(b) under the *Rochefoucauld* rule. The effect was that, as with a constructive trust, reliance could be placed on the statutory exception contained in s.53(2), so that the claimant's equitable interest was protected as an overriding interest which, in turn, bound the defendant as a subsequent purchaser of the property.

Fraud and the transferor

Where there is no basis for finding fraud

So far, we have assumed that it is the transferee who has sought to renege from his oral promise to hold the land on trust for the transferor by relying on the absence of writing. What, however, is the position of the transferor? In the first place, it is apparent that the *Rochefoucauld* principle will not come into play where a person simply declares himself a trustee of property prior to acquiring legal title to it. In these circumstances, the trust will fail simply because there is no subject-matter at the time of the declaration. The rule will also not operate where A orally declares himself a trustee of property which he already owns in favour of B.[10] In such a case, there is no basis for finding that a fraud has been perpetrated against the purported beneficiary and so the basic rationale underlying the statutory requirement for writing (i.e., to safeguard against the possibility of false or mistaken allegations of trust) will prevail. The position will be different, however, if A and B have made mutual wills whereby it is agreed that each shall make a will in favour of the other and the survivor shall leave his estate to a third party (C). If the survivor seeks to revoke, equity will impose a constructive trust on him for the benefit of C. A constructive trust will also be imposed in similar circumstances where A transfers property to B on the basis that B may enjoy the property during her lifetime but is obliged to leave it to C on

[9] [2000] 2 W.L.R. 772, at 780, (C.A.). See also, *Neale v Willis* (1968) 19 P. & C.R. 836, at 839, (C.A.); *Binions v Evans* [1972] 1 Ch. 359, at 368, (C.A.); and *Re Densham* [1975] 1 W.L.R. 1519, at 1525.

[10] See, *Rowe v Prance* [1999] 2 F.L.R. 787; *Paul v Constance* [1977] 1 W.L.R. 527, (C.A.) and *Jones v Lock* (1865) 1 Ch. App. 25, (C.A.).

her death. B's executors will hold the property on a constructive trust for C in order to give effect to the parties' oral arrangement.[11] In each case, equity intervenes to prevent B acting inconsistently with the understanding or arrangement made with A.

Where property is held on trust for a third party

What, however, is the position if A executes a voluntary transfer of land to B upon an oral undertaking by B that he (B) will hold it on trust for a third party, C? Is the transferor (A) entitled to rely on s.53(1)(b) in order to defeat C's entitlement under the oral trust? On one view, the transferor, in these circumstances, is free to resile from his intention to benefit C because his failure to comply with the statutory provision means that there is no completely constituted trust for the benefit of C. In the absence of any successful claim based on proprietary estoppel, the transferee (B) would hold the property on a resulting trust for the transferor (A). This reasoning accords with the decision in *Hodgson v Marks* where the argument that such a resulting trust is based on presumed intention and that, where there is an express trust intended and declared by B (albeit ineffectively) there is no room for such an implication, was expressly rejected. In the words of Russell L.J,[12] giving the judgment of the Court:

> If an attempted trust fails, that seems to me just the occasion for implication of a resulting trust, whether the failure be due to uncertainty, or perpetuity, or lack of form.

An analogy can be made here with fully secret trusts. If the testator (A) bequeaths property to the secret trustee (B) on the oral understanding that he (B) is to hold the property on trust for C, then B (assuming the terms of the trust have been properly communicated and accepted) will be bound to give effect to A's intentions despite the lack of testamentary writing required by the Wills Act 1837. B's conscience is affected as soon as he accepts the terms of the trust even though the trust itself is not fully constituted until A's death when the property will vest in B. If B was permitted to deny the trust, because of the lack of testamentary formalities, and to assert a personal entitlement to the property, he would be using the Wills Act 1837 as an instrument of fraud. As has been cogently argued elsewhere,[13] the fraud element here is the attempt by the secret trustee to defeat a beneficial interest which he had led the deceased to believe would belong to the secret beneficiary. The fraud is perpetrated not only against the testator (whose wishes are frustrated) but also against the secret beneficiary who is deprived of his benefit under the secret trust. Equity, therefore, will allow parol evidence of the existence of the trust in order not only to prevent the secret trustee from benefitting from the property himself but also to compel actual performance of the trust in favour of the secret beneficiary.[14] Whilst, however, the trust is enforceable against the secret trustee, there is nothing to prevent the testator from changing his mind and revoking the will; if this happens, there will be no property vesting in the

[11] *Re Pearson Fund Trusts*, (unreported), 21 October 1977, Slade J.
[12] [1971] Ch. 892, at 933.
[13] D.R. Hodge, "Secret Trusts: The Fraud Theory Revisited", *Conveyancer and Property Lawyer*, (1980), at 341-350.
[14] The mechanism of a resulting trust in favour of the testator's estate would be sufficient to prevent the secret trustee taking beneficially, but would not be enough to prevent the fraud of betraying the testator's confidence and defeating the expectations of the secret beneficiary.

secret trustee to which the trust can attach.[15] The secret beneficiary's expectations will, of course, be frustrated but, in the absence of any detrimental reliance supporting a proprietary estoppel claim,[16] he cannot complain.

Similarly, in respect of an oral trust of land, C has no claim against A if the latter revokes B's authority to declare the trust in C's favour. Since C, as we have seen, would be precluded from adducing oral evidence to support an oral declaration of trust by A himself in his favour, there seems no reason why he should be entitled to do so if A transfers the land to B and he (B) orally declares the trust for C. In either case, the admission of the *Rochefoucauld* principle would result in the effective abrogation of the rule regarding legal formalities and render s.53(1)(b) virtually redundant. This is not, however, to deny C's remedy against B. By analogy with the secret trust and mutual will cases, C can enforce the trust against B because otherwise B would be perpetrating a fraud on C by relying on the absence of writing to defeat the trust. It is, perhaps, significant in this context that Nourse J. in *Re Cleaver*[17] sought to assimilate the doctrine of secret trusts, mutual wills and the *Rochefoucauld* rule under one general principle under which equity will intervene to impose a constructive trust. His Lordship identified[18] this principle as being that:

> . . . a court of equity will not permit a person to whom property is transferred by way of gift, but on the faith of an agreement or clear understanding that it is to be dealt with in a particular way for the benefit of a third person, to deal with that property inconsistently with that agreement or understanding.

The case of *Neale v Willis*[19] provides a good illustration. Here, the husband borrowed a sum of money from his mother-in-law on the understanding that it would be used to purchase a house in the joint names of himself and his wife. In fact, the house was conveyed into the husband's sole name. The Court of Appeal held that, although the agreement between the husband and his mother-in-law was for the benefit of his wife (who was a third party), equity would enforce the agreement on her behalf so that the husband held the house on a constructive trust for both himself and his wife. The rationale, applying the decision in *Bannister*, was that "if a person who takes a conveyance to himself, which is absolute in form, nevertheless has made a bargain that he will give a beneficial interest to another, he will be held to be a constructive trustee for it for the other".[20] The significance of this case for present purposes is that it clearly admits C's claim against B in enforcing the agreement made between A and B.

Constituting the trust in favour of the third party

During the period whilst the informal trust in favour of C remains incompletely constituted for lack of writing, it is open to the transferor (A) to provide written evidence of the trust thereby

[15] *Gold v Hill* [1999] 1 F.L.R. 54, but see *Re Gardner (No. 2)* [1923] 2 Ch. 230 which has been heavily criticised.
[16] *Gillett v Holt* [2000] 1 W.L.R. 195, (C.A.).
[17] [1981] 1 W.L.R. 939, at 947.
[18] [1981] 1 W.L.R. 939, at 947.
[19] (1968) 19 P & C.R. 836, (C.A.).
[20] (1968) 19 P & C.R. 836, at 839, Lord Denning M.R.

constituting the trust in favour of C. In *Tierney v Wood*,[21] Sir John Romilly M.R. concluded that A was the person who could declare the trust so that A's signed writing complied with the Statute of Frauds despite being presented *after* the conveyance of the land to B. In that case, B held the land on an informal express trust for A, but there is no reason why the principle should not apply to a case where B holds on a resulting trust for A during the period when the informal trust remains ineffective (for lack of writing) to pass the equitable interest to C, the intended beneficiary. On this reasoning, the trust would become enforceable by C both against A and B as soon as the trust was formally constituted by written evidence.

Can the transferor change his mind?

But what if B himself is minded to perform the informal trust in favour of C? Can he do so despite the wishes of A? After all, as we have seen, the trust is not void under s.53(1)(b) but merely unenforceable for lack of writing.[22] Clearly, if A is entitled to revoke his instructions to B, the latter can no longer carry out the trust in favour of C once his mandate has been effectively terminated. Thus, in the context of secret trusts, if the testator revokes the trust before his death, the secret trustee will not be permitted to set up any trust contrary to the testator's changed intentions. In this context, the secret trust is not constituted until the death of the testator and, hence, A is free to resile from his original intentions regardless of the arrangements made with the secret trustee. If A, however, transfers land to B on an oral understanding that B is to hold for the benefit of C, the legal estate will pass to B, but the exact location of the equitable interest is not as clear. On one view, as we have seen, it results back to A pending compliance with the statutory formalities. On this basis, A is free to change his mind and recall the property relying on s.53(1)(b). Alternatively, if B holds the equitable interest by virtue of a valid (albeit unenforceable) express trust in favour of C, A has no power to revoke his instructions and there is no reason why B, if he so minded, may not carry out the trust in favour of C despite A's wishes to the contrary. Indeed, there is some English authority[23] for the proposition that B can himself provide the necessary writing so as to constitute the trust in favour of C, without the concurrence of A, since the trust is valid despite non-compliance with the statutory formalities.

Which view is correct depends largely on the question of whether A should be allowed (as a matter of policy) to rely on the statute so as to defeat C's beneficial claim. Put another way, should the *Rochefoucauld* principle be extended so as to allow C to recover the trust property against A notwithstanding non-compliance with the statutory formalities? We have already seen that the rule has no application where A simply declares himself a trustee of land in favour of a volunteer beneficiary. In this scenario, the declaration must be unenforceable for lack of writing simply because there is no fraud (in the sense already described) perpetrated by A and, more importantly, if enforcement in favour of the beneficiary was allowed, there would be no circumstances at all which would come within the scope of s.53(1)(b). On this reasoning, the interposition of B's trusteeship should not affect the position so that, despite the validity of the informal trust, the equitable interest lies with A who is free to revoke B's mandate at any time until the requirements of s.53(1)(b) are satisfied.

[21] (1854) 19 Beav. 330.
[22] See, *Gardner v Rowe* (1828) 5 Russ. 258.
[23] *Gardner v Rowe* (1828) 5 Russ. 258.

Conclusion

As we have seen, the basic rationale underlying the *Rochefoucauld* rule is that a statute passed to prevent fraud should not be allowed to be made an instrument of fraud. Inevitably, there are two competing interests at work here. On the one hand, there is the notion that the formality of writing is needed in respect of certain transactions in order to limit the possibility of fraudulent and mistaken allegations of trust. On the other hand, strict adherence to the concept of formality may lead to injustice where the absence of writing is itself used to perpetrate a fraud. Some relaxation of the formality requirement is, therefore, inevitable where the usefulness of form is outweighed by the desire to produce fairness between the parties. This balance between a strict adherence to form and doing justice between the parties is readily apparent from the case law which has sought to apply the *Rochefoucauld* rule. Clearly, the rule will have no application in the simple case where A orally declares himself a trustee of property for B. Here, the purpose underlying s.53(1)(b) prevails over A's ability to deny the trust for lack of writing. As we have seen, no fraud (in equity's sense) is perpetrated against B so B cannot complain if the gratuitous promise in his favour is not carried out. But if A transfers property to B to hold on trust for A, B cannot set up the absence of writing so as to defeat the trust in favour of A.

What, however, remains controversial is the extent to which the rule can apply to a situation where A transfers property to B upon trust for C. It has been argued, in this context, that whilst C may be entitled to enforce the trust against B, he has no such right against A. This is because, unlike B, A commits no fraud against C in relying on the strict formalities of writing. Moreover, to allow C to enforce the trust against A would result in the virtual abrogation of s.53(1)(b) since there is nothing to significantly distinguish this scenario from that where A simply holds on trust for B.